ADOBE SYSTEMS INC
Form 10-Q
September 27, 2017

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

FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 1, 2017

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

For the transition period from to

Commission File Number: 0-15175

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

Delaware	77-0019522
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

345 Park Avenue, San Jose, California 95110-2704
(Address of principal executive offices and zip code)

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

Indicate by 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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The number of shares outstanding of the registrant's common stock as of September 22, 2017 was 492,943,014.

ADOBE SYSTEMS INCORPORATED
FORM 10-Q

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PART I—FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	September 1, 2017 (Unaudited)	December 2, 2016 (*)
ASSETS		
Current assets:		
Cash and cash equivalents	$1,774,550	$1,011,315
Short-term investments	3,593,936	3,749,985
Trade receivables, net of allowances for doubtful accounts of $9,112 and $6,214, respectively	1,006,187	833,033
Prepaid expenses and other current assets	206,384	245,441
Total current assets	6,581,057	5,839,774
Property and equipment, net	939,809	816,264
Goodwill	5,820,656	5,406,474
Purchased and other intangibles, net	420,667	414,405
Investment in lease receivable	—	80,439
Other assets	144,626	139,890
Total assets	$13,906,815	$12,697,246
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade payables	$90,327	$88,024
Accrued expenses	932,292	739,630
Income taxes payable	56,754	38,362
Deferred revenue	2,136,771	1,945,619
Total current liabilities	3,216,144	2,811,635
Long-term liabilities:		
Debt	1,889,218	1,892,200
Deferred revenue	68,093	69,131
Income taxes payable	173,023	184,381
Deferred income taxes	276,271	217,660
Other liabilities	113,632	97,404
Total liabilities	5,736,381	5,272,411
Stockholders' equity:		
Preferred stock, $0.0001 par value; 2,000 shares authorized, none issued	—	—
Common stock, $0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 492,874 and 494,254 shares outstanding, respectively	61	61
Additional paid-in-capital	4,988,491	4,616,331
Retained earnings	9,072,321	8,114,517
Accumulated other comprehensive income (loss)	(98,630)	(173,602)
Treasury stock, at cost (107,960 and 106,580 shares, respectively), net of reissuances	(5,791,809)	(5,132,472)
Total stockholders' equity	8,170,434	7,424,835
Total liabilities and stockholders' equity	$13,906,815	$12,697,246

(*) The condensed consolidated balance sheet as of December 2, 2016 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 1, 2017	September 2, 2016	September 1, 2017	September 2, 2016
Revenue:				
Subscription	$1,570,336	$1,168,602	$4,437,882	$3,322,560
Product	158,961	180,960	513,891	578,572
Services and support	111,777	114,405	343,137	344,879
Total revenue	1,841,074	1,463,967	5,294,910	4,246,011
Cost of revenue:				
Subscription	168,915	116,990	452,830	339,664
Product	11,709	15,435	41,530	51,490
Services and support	82,298	70,276	245,259	212,198
Total cost of revenue	262,922	202,701	739,619	603,352
Gross profit	1,578,152	1,261,266	4,555,291	3,642,659
Operating expenses:				
Research and development	315,555	248,450	900,033	718,138
Sales and marketing	550,093	477,475	1,623,488	1,415,155
General and administrative	147,402	143,364	455,139	428,010
Amortization of purchased intangibles	19,428	22,652	57,876	60,034
Total operating expenses	1,032,478	891,941	3,036,536	2,621,337
Operating income	545,674	369,325	1,518,755	1,021,322
Non-operating income (expense):				
Interest and other income (expense), net	13,539	2,725	25,899	12,995
Interest expense	(18,809)	(17,281)	(55,286)	(52,924)
Investment gains (losses), net	975	1,532	5,261	(2,955)
Total non-operating income (expense), net	(4,295)	(13,024)	(24,126)	(42,884)
Income before income taxes	541,379	356,301	1,494,629	978,438
Provision for income taxes	121,810	85,513	302,224	209,269
Net income	$419,569	$270,788	$1,192,405	$769,169
Basic net income per share	$0.85	$0.54	$2.41	$1.54
Shares used to compute basic net income per share	493,426	498,584	494,138	499,224
Diluted net income per share	$0.84	$0.54	$2.38	$1.52
Shares used to compute diluted net income per share	500,398	503,669	501,060	505,135

See accompanying notes to condensed consolidated financial statements.

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ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 1, 2017	September 2, 2016	September 1, 2017	September 2, 2016
	Increase/(Decrease)		Increase/(Decrease)	
Net income	$419,569	$ 270,788	$1,192,405	$ 769,169
Other comprehensive income (loss), net of taxes:				
Available-for-sale securities:				
Unrealized gains / losses on available-for-sale securities	3,545	3,055	13,234	21,677
Reclassification adjustment for recognized gains / losses on available-for-sale securities	(488)	(869)	(894)	(1,982)
Net increase (decrease) from available-for-sale securities	3,057	2,186	12,340	19,695
Derivatives designated as hedging instruments:				
Unrealized gains / losses on derivative instruments	1,483	13,233	3,613	9,089
Reclassification adjustment for recognized gains / losses on derivative instruments	30	(3,656)	(31,219)	(9,964)
Net increase (decrease) from derivatives designated as hedging instruments	1,513	9,577	(27,606)	(875)
Foreign currency translation adjustments	43,552	(12,828)	90,238	16,149
Other comprehensive income (loss), net of taxes	48,122	(1,065)	74,972	34,969
Total comprehensive income, net of taxes	$467,691	$ 269,723	$1,267,377	$ 804,138

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended	
	September 1, 2017	September 2, 2016
Cash flows from operating activities:		
Net income	$1,192,405	$ 769,169
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	244,763	249,675
Stock-based compensation	331,401	262,382
Deferred income taxes	47,859	44,164
Unrealized losses (gains) on investments, net	(3,243)	3,916
Excess tax benefits from stock-based compensation	—	(69,269)
Other non-cash items	2,606	(124)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	26,461	(57,033)
Prepaid expenses and other current assets	31,824	(86,350)
Trade payables	(68,397)	(10,861)
Accrued expenses	81,624	(5,540)
Income taxes payable	6,880	95,923
Deferred revenue	185,450	308,075
Net cash provided by operating activities	2,079,633	1,504,127
Cash flows from investing activities:		
Purchases of short-term investments	(1,419,411)	(1,813,509)
Maturities of short-term investments	601,130	557,769
Proceeds from sales of short-term investments	978,737	698,486
Acquisitions, net of cash acquired	(459,626)	(48,427)
Purchases of property and equipment	(140,438)	(155,172)
Purchases of long-term investments and other assets	(25,669)	(56,413)
Proceeds from sale of long-term investments and other assets	2,034	331
Net cash used for investing activities	(463,243)	(816,935)
Cash flows from financing activities:		
Purchases of treasury stock	(800,000)	(775,000)
Proceeds from reissuance of treasury stock	157,682	139,823
Taxes paid related to net share settlement of equity awards	(220,580)	(224,243)
Excess tax benefits from stock-based compensation	—	69,269
Repayment of capital lease obligations	(1,328)	(86)
Net cash used for financing activities	(864,226)	(790,237)
Effect of foreign currency exchange rates on cash and cash equivalents	11,071	(5,843)
Net increase (decrease) in cash and cash equivalents	763,235	(108,888)
Cash and cash equivalents at beginning of period	1,011,315	876,560
Cash and cash equivalents at end of period	$1,774,550	$ 767,672
Supplemental disclosures:		
Cash paid for income taxes, net of refunds	$211,343	$ 108,508
Cash paid for interest	$59,769	$ 58,182
Non-cash investing activities:		
Investment in lease receivable applied to building purchase	$80,439	$ —

Issuance of common stock and stock awards assumed in business acquisitions	$10,348	$ —

See accompanying notes to condensed consolidated financial statements.

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ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

We have prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, we have condensed or omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended December 2, 2016 on file with the SEC (our “Annual Report”).

Reclassifications

Certain immaterial prior year amounts have been reclassified to conform to current year presentation in the condensed consolidated balance sheets, condensed consolidated statements of income and condensed consolidated statements of cash flows.

Recently Adopted Accounting Guidance

On March 30, 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies various aspects related to the accounting and presentation of share-based payments. The amendments require entities to record all tax effects related to share-based payments at settlement or expiration through the income statement and the windfall tax benefit to be recorded when it arises, subject to normal valuation allowance considerations. Tax-related cash flows resulting from share-based payments are required to be reported as operating activities in the statement of cash flows. The updates relating to the income tax effects of the share-based payments including the cash flow presentation must be adopted either prospectively or retrospectively. Further, the amendments allow the entities to make an accounting policy election to either estimate forfeitures or recognize forfeitures as they occur. If an election is made, the change to recognize forfeitures as they occur must be adopted using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. Early adoption is permitted.

We early adopted this standard during the first quarter of fiscal 2017. As required by the standard, excess tax benefits recognized on stock-based compensation expense were reflected in our condensed consolidated statements of income as a component of the provision for income taxes rather than paid-in capital on a prospective basis. Accordingly, we recorded excess tax benefits within our provision for income taxes, rather than additional paid-in capital upon adoption. The cumulative effect to retained earnings from previously unrecognized excess tax benefits, after offset by the related valuation allowance, was not significant to our condensed consolidated balance sheets.

We also elected to prospectively apply the change in presentation of excess tax benefits wherein excess tax benefits recognized on stock-based compensation expense were classified as operating activities in our condensed consolidated statements of cash flows for the nine months ended September 1, 2017. Prior period classification of cash flows related to excess tax benefits were not adjusted in our condensed consolidated statements of cash flows.

Presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to all periods presented as such cash flows have historically been presented as financing activities. Further, we did not elect an accounting policy change to record forfeitures as they occur and thus we continue to estimate forfeitures at each period.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Significant Accounting Policies

There have been no other material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report.

Recent Accounting Pronouncements Not Yet Effective

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the full retrospective or modified retrospective transition method. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. Accordingly, the updated standard is effective for us in the first quarter of fiscal 2019. We expect to adopt this updated standard in the first quarter of fiscal 2019 on a modified retrospective basis. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

While we are continuing to assess all potential impacts of the new standard, we currently believe the most significant impact relates to our accounting for arrangements that include term-based software licenses bundled with maintenance and support. Under current GAAP, the revenue attributable to these software licenses is recognized ratably over the term of the arrangement because VSOE does not exist for the undelivered maintenance and support element as it is not sold separately. The requirement to have VSOE for undelivered elements to enable the separation of revenue for the delivered software licenses is eliminated under the new standard. Accordingly, under the new standard we will be required to recognize as revenue a portion of the arrangement fee upon delivery of the software license. We expect revenue related to our professional services and cloud offerings for business enterprises, individuals and teams to remain substantially unchanged. Due to the complexity of certain of our contracts, the actual revenue recognition treatment required under the new standard for these arrangements may be dependent on contract-specific terms and, therefore, may vary in some instances.

On February 24, 2016, the FASB issued ASU No. 2016-02, Leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition and requires application of the new guidance at the beginning of the earliest comparative period presented. The updated standard is effective for us beginning in the first quarter of fiscal 2020 and we do not plan to early adopt. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

On August 28, 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging, requiring expanded hedge accounting for both non-financial and financial risk components and refining the measurement of hedge results to better reflect an entity's hedging strategies. The updated standard also amends the presentation and disclosure requirements and changes how entities assess hedge effectiveness. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative effect adjustment recorded to opening retained earnings as of the initial adoption date. The updated standard is effective for us beginning in the first quarter of fiscal 2020 and we do not plan to early adopt. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

With the exception of the new standards discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 1, 2017, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended December 2, 2016, that are of significance or potential significance to us.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2. ACQUISITIONS

On December 19, 2016, we completed our acquisition of TubeMogul, a publicly held video advertising platform company. During the first quarter of fiscal 2017, we began integrating TubeMogul into our Digital Marketing reportable segment.

Under the acquisition method of accounting, the total purchase price was preliminarily allocated to TubeMogul's net tangible and intangible assets based upon their estimated fair values as of December 19, 2016. During the third quarter of fiscal 2017, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to goodwill and liabilities assumed. The total purchase price for TubeMogul was $560.8 million which was preliminarily allocated to goodwill, that is non-deductible for tax purposes, for $349.0 million, to identifiable intangible assets for $113.1 million and to net assets acquired for $98.7 million. The fair values assigned to assets acquired and liabilities assumed are based on management's best estimates and assumptions as of the reporting date and are considered preliminary pending finalization of valuation analyses pertaining to intangible assets acquired and tax liabilities assumed including calculation of deferred tax assets and liabilities.

Pro forma financial information has not been presented for this acquisition as the impact to our condensed consolidated financial statements was not material.

NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as "available-for-sale." In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our condensed consolidated balance sheets. Gains and losses are recognized when realized in our condensed consolidated statements of income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

Cash, cash equivalents and short-term investments consisted of the following as of September 1, 2017 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	$413,411	$ —	$ —	$413,411
Cash equivalents:				
Money market mutual funds	1,344,350	—	—	1,344,350
Time deposits	16,789	—	—	16,789
Total cash equivalents	1,361,139	—	—	1,361,139
Total cash and cash equivalents	1,774,550	—	—	1,774,550
Short-term fixed income securities:				
Asset-backed securities	99,295	51	(162)	99,184
Corporate bonds and commercial paper	2,427,062	8,962	(3,000)	2,433,024
Municipal securities	145,850	162	(51)	145,961
U.S. Treasury securities	917,426	14	(1,673)	915,767
Total short-term investments	3,589,633	9,189	(4,886)	3,593,936
Total cash, cash equivalents and short-term investments	$5,364,183	$ 9,189	$ (4,886)	$5,368,486

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of December 2, 2016 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	$208,635	$ —	$—	$208,635
Cash equivalents:				
Corporate bonds and commercial paper	1,249	—	—	1,249
Money market mutual funds	782,210	—	—	782,210
Municipal securities	1,301	—	—	1,301
Time deposits	17,920	—	—	17,920
Total cash equivalents	802,680	—	—	802,680
Total cash and cash equivalents	1,011,315	—	—	1,011,315
Short-term fixed income securities:				
Asset-backed securities	111,009	95	(190)	110,914
Corporate bonds and commercial paper	2,464,769	3,135	(9,554)	2,458,350
Municipal securities	134,710	37	(525)	134,222
U.S. agency securities	39,538	42	—	39,580
U.S. Treasury securities	1,008,195	194	(1,470)	1,006,919
Total short-term investments	3,758,221	3,503	(11,739)	3,749,985
Total cash, cash equivalents and short-term investments	$4,769,536	$ 3,503	$(11,739)	$4,761,300

See Note 4 for further information regarding the fair value of our financial instruments.
The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in an unrealized loss position for less than twelve months, as of September 1, 2017 and December 2, 2016 (in thousands):

	2017		2016	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	$710,735	$ (2,497)	$1,282,076	$(9,474)
Asset-backed securities	62,235	(150)	54,063	(189)
Municipal securities	6,387	(23)	114,810	(525)
U.S. Treasury and agency securities	808,221	(1,400)	580,529	(1,470)
Total	$1,587,578	$ (4,070)	$2,031,478	$(11,658)

There were 570 securities and 1,052 securities in an unrealized loss position for less than twelve months at September 1, 2017 and at December 2, 2016, respectively.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that were in a continuous unrealized loss position for more than twelve months, as of September 1, 2017 and December 2, 2016 (in thousands):

	2017		2016	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	$94,397	$ (503)	$39,162	$ (80)
Asset-backed securities	1,495	(12)	1,331	(1)
Municipal securities	10,077	(28)	—	—
U.S. Treasury and agency securities	47,636	(273)	—	—
Total	$153,605	$ (816)	$40,493	$ (81)

There were 90 securities and 23 securities in an unrealized loss position for more than twelve months at September 1, 2017 and at December 2, 2016, respectively.

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated effective maturities as of September 1, 2017 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$1,079,772	$1,079,092
Due between one and two years	1,353,653	1,353,378
Due between two and three years	776,048	778,726
Due after three years	380,160	382,740
Total	$3,589,633	$3,593,936

We review our debt and marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment’s amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to interest and other income, net in our condensed consolidated statements of income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income, which is reflected as a separate component of stockholders’ equity in our condensed consolidated balance sheets. For equity securities, the write-down would be recorded to investment gains (losses), net in our condensed consolidated statements of income. During the nine months ended September 1, 2017 and September 2, 2016, we did not consider any of our investments to be other-than-temporarily impaired.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 4. FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the nine months ended September 1, 2017.

The fair value of our financial assets and liabilities at September 1, 2017 was determined using the following inputs (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market mutual funds	$1,344,350	$1,344,350	$—	$ —
Time deposits	16,789	16,789	—	—
Short-term investments:				
Asset-backed securities	99,184	—	99,184	—
Corporate bonds and commercial paper	2,433,024	—	2,433,024	—
Municipal securities	145,961	—	145,961	—
U.S. Treasury securities	915,767	—	915,767	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	11,559	—	11,559	—
Other assets:				
Deferred compensation plan assets	52,554	1,622	50,932	—
Interest rate swap derivatives	7,564	—	7,564	—
Total assets	$5,026,752	$1,362,761	$3,663,991	$ —
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	$1,410	$—	$	