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Adobe Inc. (NASDAQ: ADBE)

Price: $263.08 | **Market Cap:** $105.9bn | **Enterprise Value:** $106.9bn | **Diluted Shares:** 402.5m

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The business Adobe sells software subscriptions to people who make things for a living, and to the marketing organisations. FY25 revenue was $23.8bn, of which 96% was subscription. Gross margin is 89%. Capex is $179m, under 1% of revenue. It is incredibly asset light, and customers pay before the service period.

Two very different businesses

Digital Media, $17.6bn, growing 11%.
This is Adobe's core business. Creative Cloud includes Photoshop, Illustrator, Premiere Pro, After Effects, InDesign and Lightroom, sold together for roughly $70 per month. Document Cloud includes Acrobat and Acrobat Sign, built around the PDF format. Together, Digital Media has roughly **95% gross margins**.

Digital Experiencem $5.9bn, growing 9%.
This is Adobe's enterprise marketing business. It includes tools for managing content, customer data, analytics and marketing campaigns. It has lower gross margins of around **70–72%**, which brings down Adobe's overall margin. The business was originally built through acquisitions, including Omniture, Magento and Marketo. Adobe also acquired Semrush for **$1.9bn in April 2026**.

Publishing and Advertising, $256m.
This is a small declining business. It is not important to the investment case and can largely be ignored.

Who pays Adobe?

Most of Adobe's revenue comes from professionals. More than 70% of subscription revenue comes from creative and marketing professionals such as agencies, in-house design teams, studios and enterprise marketing departments.

The remaining revenue comes mainly from business users and consumers, particularly through Acrobat and Express. Adobe changed its reporting system in FY26 to focus on these customer groups rather than individual products. This makes older comparisons between products less reliable.

How Adobe makes money and generates cash

Adobe's business model is attractive because customers often sign multi-year contracts and pay upfront. This gives Adobe strong visibility into future revenue, reflected in its $22.3bn of remaining performance obligations. Total ARR was $27.1bn in Q2 FY26, growing 12.5%. Once Adobe has built its software, serving an additional customer costs relatively little, so a large portion of additional revenue can turn into cash.

The biggest cost is employees: Adobe has 34,328 employees, with headcount rising by almost 3,000 in two quarters. Another important cost is stock-based compensation, which equals about 8.2% of revenue. This is important because it can make Adobe's cash generation look stronger than its true economic profitability.

Why Adobe is interesting now

There are two main reasons to pay attention to Adobe.

1. AI is creating a new revenue stream.
Adobe is adding generative AI products such as Firefly, Firefly Foundry and Acrobat AI Assistant. Unlike traditional software, some of these are sold based on usage rather than the number of seats. AI-first ARR has passed $500m, roughly tripling year over year.

2. The stock has become much cheaper.
Adobe's share price is around 65% below its 2021 peak, and its price-to-sales multiple is at levels last seen around 14 years ago. In other words, the market has largely reversed the premium valuation Adobe gained during the shift to subscription software. The investment question is therefore whether AI can create a new growth opportunity while Adobe's existing business remains strong enough to support the much lower valuation.

Why Adobe is controversial

The **bear case** is that AI eventually becomes good enough to create finished designs on its own, making tools like Photoshop less necessary. Adobe's own numbers give both sides of the argument, AI usage is growing quickly, but generative AI is also hurting parts of Adobe's traditional business.

There is also leadership uncertainty. Shantanu Narayen announced in March that he would step down as CEO after 18 years, and CFO Dan Durn left in June to become CFO of Marvell. Adobe has since appointed Anil Chakravarthy as CEO, so the CEO position is no longer vacant, but the market is wary of the transition.

The key question is whether AI makes Adobe's existing tools less valuable faster than Adobe can adapt them into the new AI-driven creative workflow.

T**he debate**

The key question is whether Adobe remains the "toll road" for creative work, regardless of which AI tools people use, or whether AI becomes good enough to bypass Adobe's software entirely. If Adobe keeps generating large amounts of cash and uses that cash to reduce its share count, shareholders can still earn attractive returns even with limited business growth. Adobe has historically used buybacks heavily.

1. Thesis

Most bull cases on Adobe start from the observation that it trades at roughly 13x after-SBC free cash flow against a five-year average in the mid-thirties, and conclude that a re-rating is owed.

The argument I do want to make is narrower. Adobe generates about $7.9bn of after-SBC free cash flow. At $263 it can retire something like 5% of its shares a year out of that cash flow without borrowing. Reported cash flow grew 8.0% a year over FY21–FY25. Per share it grew 11.3%, because the diluted count went from 481m to 427m to 402m today.

My thesis is assuming that revenue doesn't decline, operating margin doesn't fall more than about 400bp, and management keeps buying stock and not companies.

My thesis is **not assuming** that Firefly wins, Adobe out-innovates OpenAI, seat counts grow, or the **multiple recovers.**

What you're actually underwriting is about a 9% return without the multiple recovering, low teens if the multiple partially recovers, and roughly a 30% loss if revenue falls and margins compress at the same time.

2. What you are paying

FY2025 ($m)	Value	Multiple	Yield
Operating cash flow − capex	9,852	10.7x	9.3%
...less stock-based compensation	7,910	13.4x	7.5%
...less deferred-revenue build	7,139	14.8x	6.7%

Adobe spent $11.3bn on repurchases in FY25 partly to offset SBC.

The third line strips out the $771m deferred-revenue inflow inside FY25 operating cash flow. Deferred revenue moves with billings growth. In a seat-contraction scenario, that inflow reverses. I use $7.1bn as the conservative base and $7.9bn as the working one.

Balance sheet at Q2 FY26: cash of $4,919m and short-term investments of $707m against $6,645m of debt, so about $1.0bn net debt. Adobe stopped being a net-cash company some time ago and has funded buybacks partly with issuance, $2.0bn in each of FY24 and FY25.

Five-year record, consistently defined (all $m):

	FY21	FY22	FY23	FY24	FY25
Revenue	15,785	17,606	19,409	21,505	23,769
OCF	7,230	7,838	7,302	8,056	10,031
FCF ex-SBC	5,813	5,956	5,224	6,040	7,910
Diluted shares	481	471	459	450	427
FCF ex-SBC / share	**$12.09**	**$12.65**	**$11.38**	**$13.42**	**$18.52**
Buybacks	3,950	6,550	4,400	9,500	11,281

One caveat on FY25. FY24 operating cash flow was held down by the roughly $1bn Figma termination fee, so the FY24-to-FY25 jump is exaggerated.

3. durability

The bear case is that a capable enough agent produces a finished campaign without going near Adobe software. I think this is wrong.

Control of the final details. Generative AI is good at creating something that looks right, but not necessarily exactly what you want. Creative work, especially in the commercial industry, requires precision such as exact colours, crops, fonts, spacing, and layouts. Adobe's products let users turn AI-generated ideas into precise work. So as AI creates more content, people still need Adobe to refine and finish it.

Control of the brand. This is one of Adobe's biggest advantages. Large companies have their own logos, images and brand guidelines. Adobe already has access to much of this through its existing customer relationships and contracts. Competitors would need to get permission to access this proprietary content, which is a legal and business moat. **Firefly Foundry** lets companies train AI models on their own brand assets, making this advantage even stronger.

Legal protection and transparency. Adobe has an advantage because Firefly is trained on licensed and public-domain content, allowing Adobe to provide legal protection against copyright claims. Adobe also helps lead the C2PA standard, which tracks where AI-generated content comes from. For large companies, this makes Adobe safer to use because they face less legal risk. Competitors like Midjourney, Canva and Figma have not matched this level of protection.

Distribution. Monthly active users passed 850m in Q2 FY26, up from above 700m, with Adobe.com traffic growing over 40%. Its apps are also being built into other platforms, including ChatGPT. At the same time, Adobe lets users access competing AI models through Firefly. This means Adobe can benefit from the growth of AI regardless of which model ultimately wins.

AI strategy. Adobe lets users access many different AI models instead of relying only on its own.. Adobe is betting that the real long-term value will be in the software and workflow around AI and not the AI models themselves. If that is wrong, the investment thesis is much weaker.

Where the moat is getting worse

Canva is a growing threat. It reached roughly $4bn ARR at end-2025 on 265m monthly active users and 31m paid subscribers, with a B2B business around $500m ARR growing at 100%. In October 2025 it made the acquired Affinity suite (a direct Photoshop, Illustrator and InDesign substitute) completely free, and got a **million signups in four days**. Adobe charges $70 a month for this tier. Adobe Express is designed to combat this threat but im not entirely sure how effective it will be.

Figma is expanding into Adobe's surfaces. Q2 FY26 revenue of $370m grew 48%, the third straight quarter of acceleration, with net dollar retention at 136%. It it moving into Make, Sites, Draw, Buzz and Motion, which is brand and marketing territory.

On the Q1 FY26 call management said the decline was "steeper than we expected" and "playing out more quickly than we had planned for,". Q1 net-new Digital Media ARR came in around $400m against $450–460m expected. This is the first Adobe revenue line destroyed by generative AI, and Adobe is destroying it itself with Firefly if its not able to monetise it fast enough.

Adobe no longer dominates video. Premiere holds roughly 35% of video editing against DaVinci Resolve's 15% and rising, with Resolve free at the entry tier. I should note that i found these figures online and im not sure how reliable they are.

4. AI monetisation

Digital Media gross margin runs around 95%. A credit-funded generation calls a model, at a marginal cost. Working back from published API pricing and Adobe's credit consumption tables puts credit gross margin somewhere in the 25–50% range. Lets say 35%.

If AI consumption revenue substitutes for subscription revenue instead of adding to it:

AI revenue as % of Digital Media	Blended gross margin	Change
2%	93.8%	−1.2pts
5%	92.0%	−3.0pts
10%	89.0%	−6.0pts
20%	83.0%	−12.0pts
30%	77.0%	−18.0pts

Adobe's own numbers already look like the early stage of this. Non-GAAP operating margin was 44.5% in Q2 FY26, the lowest of the last nine quarters, against 45.5% a year earlier and 47.4% in Q1. AI-first ARR crossed $500m, tripling year over year. Headcount went from 31,360 to 34,328 in two quarters.

I'm still long, for a few reasons.

AI is adding revenue, instead of replacing Adobe's business. Most AI revenue comes from extra purchases, such as Firefly subscriptions and credit packs, rather than customers cancelling Creative Cloud. Firefly is approaching $300m in annual recurring revenue, compared with Adobe's $23.8bn total revenue. So any major replacement of Adobe's existing business is likely still many years away.

Total profit matters more than the profit margin percentage. AI revenue may have a lower gross margin, which can reduce Adobe's overall margin percentage. But it still generates additional profit. For example, $1 of revenue at a 35% margin generates 35 cents of gross profit. That extra cash can still be used for share buybacks, even if the overall margin percentage falls.

Topaz reduces Adobe's AI costs. Adobe's acquisition of Topaz Labs helps move some AI processing from Adobe's servers onto customers' own devices. This means Adobe spends less money running AI models in the cloud. Topaz is relatively small, with around $48m in revenue, so it is more of a potential long-term solution.

On-device AI could improve margins. If AI generation happens directly on users' devices, Adobe would have to spend less on running AI in the cloud. This could make AI products much more profitable and reduce the pressure on Adobe's margins. Although this is speculative,

Adobe does not need to win the AI model race. Firefly is generally behind leading models like Midjourney and Flux in image quality, particularly for realistic people and more creative outputs. Adobe's solution is to let users access competing AI models through Firefly.

The stronger investment argument is that Adobe can remain the platform people use to manage content even if other companies build the best AI models.

5. What you get paid

Constraining repurchase to after-SBC free cash flow less acquisitions, at a 90% payout and 2% gross annual dilution:

FCF growth	**No M&A**	**$1bn/yr M&A**
0%	5.8%	4.6%
3%	9.9%	**8.6%**
5%	12.8%	11.4%

Base case is 3% cash flow growth with $1bn a year of acquisitions, which returns about 9% with no multiple recovery. Share count goes from 402m to roughly 308m.

With no M&A the same case returns 9.9%. Sustaining $9bn a year of repurchase, roughly the FY25 pace, needs about $1.7bn of incremental debt over five years on top of $1.0bn of existing net debt.

Adding a re-rating to the base case:

Exit multiple	**Implied price**	**5y IRR**
10.0x	$298	2.5%
12.0x	$357	6.3%
13.4x (today)	$399	8.7%
16.0x	$476	12.6%
18.0x	$536	15.3%

Adobe's five-year average multiple is in the mid-thirties.

Downside

Here's what happens if revenue declines.

Scenario	FY30 FCF	Shares	Price	Return
Flat revenue, −450bp margin, 12x exit	$6.8bn	282m	$291	+11%
Flat revenue, −450bp margin, 10x exit	$6.8bn	282m	$243	−8%
Revenue −5%, −800bp margin, 10x exit	$5.7bn	309m	$185	**−30%**

The buyback cushions the decline. Even with revenue flat and 450bp of margin compression, continued repurchase at depressed prices roughly holds the outcome flat over five years. You need actual revenue decline together with severe margin compression to get a bad result.
The board authorised a $25bn repurchase on 21 April 2026 running to April 2030, about 24% of the market cap. So the capacity is there.

6. What breaks the thesis

The biggest vulnerability is that the buyback, which the entire per-share argument rests on, slows down when the price makes it most valuable.

That's already happening. Q2 FY26 repurchases were down 40%, with the stock near seven-year lows. Operating cash flow was $2,165m against $2,191m, basically flat on 13% revenue growth.

Management has already shown it prefers acquisitions at the margin. In November 2025 Adobe agreed to buy Semrush for $1.9bn in cash at a 78% premium, closing in April 2026. Topaz followed in June. This is $2 billion not spent on bybacks when the stock was at multi year lows.

Semrush could give Adobe a strong position in a growing market, while Topaz could help reduce AI costs. But both require Adobe to spend cash instead of buying back shares. That’s why the base case assumes Adobe spends around **$1bn a year on acquisitions**, reducing the amount

of cash available for buybacks.

The freemium strategy could be hiding weaker demand. Adobe delayed planned price increases and is giving more users access to Firefly for free. Management says this will reduce short-term revenue, costing roughly $500m of FY26 annual recurring revenue.

The concern is that Adobe may be doing this because customers are becoming less willing to pay higher prices. The strategy could be smart long term because it brings more users into Adobe's AI products. There are **two possible explanations**: Adobe is deliberately sacrificing short-term revenue to build its AI business, or its pricing power is weakening. T

Less transparency for investors. Adobe changed how it reports its business, moving from reporting individual product clouds to reporting by customer group. This makes it harder to see exactly how products like Document Cloud and Adobe Stock are performing. Investors now have to rely more on management's explanations rather than being able to verify performance from detailed financial figures.

The market is more cautious than I am. Mizuho downgraded Adobe to Neutral and cut its price target to $245, despite previously believing the valuation was attractive. Other analysts also argue that Adobe's competitive advantage is becoming narrower as it shifts from dominating creative software to providing enterprise governance and workflow tools.

I think that is a reasonable concern. My view is only slightly more bullish: if Adobe can generate around a 9% return while keeping the downside manageable, the stock is worth owning.

Monitorables:

Metric	**Current**	**Thesis intact**	**Thesis broken**
Quarterly repurchase	$2.1bn	>$2.5bn/qtr	<$2.0bn for 2 consecutive quarters
Diluted share count	402m	<390m by Q4 FY26	flat or rising
Non-GAAP op margin	44.5%	>43%	<42%
Total ARR growth	12.5%	>8%	<6%
RPO	$22.27bn	resumes growth by Q4 FY26	third consecutive flat/down quarter
Firefly ending ARR	~$300m	>$600m by FY27	below $400m

Metric	Current	Thesis intact	Thesis broken
Net-new Digital Media ARR	~$400m (Q1)	≥$450m/qtr	second consecutive quarter below $420m

If two consecutive quarters come in below $2.0bn of repurchase without agood reason or if a new CEO announces a large acquisition without a clear benefit; or if non-GAAP operating margin drops below 42% while ARR growth is simultaneously below 8%, than a sell must be seriously considered