



Adobe Inc.

ADBE

EQUITY RESEARCH REPORT

June 12, 2026

ADBE — Adobe Inc.

Report Date: 2026-06-12

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EXECUTIVE SUMMARY

Metric	Value
Recommendation	BUY
Current Price	see current market quote
Fair Value (Base Case)	EUR 295-310 equivalent (~USD 320-335)
Margin of Safety	~20-25% (estimated from recent ~USD 259 quote)
Target Entry (if HOLD)	n/a — current valuation already attractive

Return Profile	Value
Dividend Yield	0.0% (no dividend)
Expected Dividend Growth	n/a
Expected Price Appreciation	~9-11% CAGR (base)
Total Expected Return (Base)	~10.0% CAGR
Bear Case Total Return	~+1.5% CAGR
Bull Case Total Return	~16% CAGR
Probability-Weighted Return	~9.4% CAGR

Risk Assessment	Value
Wealth Preservation Score	72 / 100
Downside Protection Score	70 / 100
Quality Score	74 / 100
Risk Level	MODERATE
Probability of >50% Loss	~6%
Recession Profile	RESILIENT

One-Line Thesis:

Adobe converts an industry-standard creative and document franchise into 80%+ gross margins and a 40% free-cash-flow margin, and you can buy that cash machine at roughly 10-11x earnings — a level that historically marked the bottom of its valuation range — with the AI-disruption fear already priced in.

INVESTMENT THESIS

Adobe sells software that professionals cannot easily abandon. Photoshop, Illustrator, Premiere, and Acrobat sit at the center of creative and document workflows, and the switching costs run deep: trained skills, file formats, plug-ins, and team-wide standards. That moat shows up in the numbers. Gross margin holds near 82%, operating margin near 39%, and free-cash-flow margin near 40%. A business converting 40 cents of every revenue dollar into free cash, growing the top line at low-double-digits, qualifies as a quality compounder by any standard you apply.

The reason you can buy it now is fear. The stock fell about 32% from September 2025 to mid-2026, and it sits at roughly 10-15x trailing earnings and ~10x forward earnings against a 5-year average forward P/E near 26x and a 10-year median P/E near 48x. The market is pricing a thesis that generative AI tools (Canva, OpenAI, Google, lower-cost models) commoditize creative software and that Adobe cannot monetize its own AI fast enough. That risk is real and I treat it as the central variable. But two facts cut against the bear: Adobe still grew Q1 FY2026 revenue 12% to \$6.40 billion, with Document Cloud up 17%, and the company guided to exceed \$250 million in annual AI revenue. The franchise is not eroding in the reported numbers. You are paying a melting-ice-cube multiple for a business still growing double-digits.

What can go wrong, and why it stays manageable: the worst credible outcome is a multi-year deceleration where AI competition caps seat growth and pricing, growth slows to mid-single digits, and the multiple stays compressed. Even in that bear case, a business at 10x earnings generating \$9 billion of free cash, buying back stock under a fresh \$25 billion authorization (through April 2030), does not lose you capital permanently — it grinds out a low-single-digit return. The balance sheet carries no going-concern risk, a clean audit, no material weakness, and ample cash generation to fund buybacks without leverage. The downside is a disappointing return, not a permanent impairment. That asymmetry — limited permanent-loss risk against a re-rating optionality if AI monetization proves out — is what earns a BUY under this mandate. Adobe pays no dividend, so total return depends entirely on earnings growth plus multiple change plus buyback-driven EPS accretion, which I have modeled conservatively below.

Exit triggers (also in monitoring table): (1) Two consecutive quarters of Digital Media ARR growth below 6% — re-review thesis. (2) Operating margin contraction below 35% sustained over a year — sell. (3) Semrush or future M&A pushing net leverage above 1.5x EBITDA — re-review. (4) Multiple re-rates above 22x forward P/E without commensurate growth acceleration — trim into strength.

1. BUSINESS QUALITY ASSESSMENT

Adobe runs a subscription-first software model across three clouds: Creative Cloud and Document Cloud (Digital Media segment) and Experience Cloud (Digital Experience segment). Digital Media drives the franchise. In Q1 FY2026 it generated \$4.84 billion, up roughly 10%+ year over year, with Document Cloud at \$843 million growing 17%. Digital Experience added \$1.41 billion. The recurring revenue base produces predictable cash flow and funds heavy R&D.

The business is understandable, not in secular decline, and sits in a stable-to-growing software sector. It is moderately cyclical — enterprise IT budgets tighten in downturns and Experience Cloud deals can stretch — but the creative and document subscriptions for individuals and SMBs prove sticky through cycles.

Sector tailwinds: continued digitization of content workflows, growth in document/e-signature automation, and AI-assisted creation expanding the addressable market. The countervailing force is AI-driven competition, which I address directly in the risk section. Tailwinds are a bonus here, not the thesis.

Business Quality: HIGH

2. FINANCIAL FORTRESS ANALYSIS

Solvency check against a severe recession.

Metric	Adobe	Threshold	Assessment
Free Cash Flow (5Y)	Positive every year (\$6.7B → \$9.25B)	Positive 4/5	Pass
FCF Margin	~40% (FY25), ~46% (FY21)	High	Fortress
Operating Margin	~39% (FY25)	Stable high	Pass
Gross Margin	~82% (FY25)	High	Pass
Cash generation vs debt	Strong; no leverage spike flagged	Conservative	Pass

The filings disclose no new long-term debt issuance, no leverage spike, a clean unqualified audit, no material weakness, and no going-concern language across FY24 and FY25 10-Ks and recent 10-Qs. The provided data does not give a precise debt-to-equity figure, so I rate solvency on cash generation and the absence of any leverage red flags.

Stress test: if revenue dropped 30% for two years, Adobe would remain solvent with room to spare. A company generating ~\$9.25 billion of FCF at ~\$23 billion revenue could absorb a deep revenue decline and stay strongly free-cash-flow positive. No dividend exists to defend. No dilutive equity raise would be needed.

Earnings quality: operating cash flow (~\$9.70 billion FY25) exceeds net income (~\$7.18 billion), confirming high-quality earnings — cash conversion above 100% of net income. One watch item: a third-party note flags projected declining cash conversion, which I monitor but do not treat as a present concern given current ratios.

Dilution: the new \$25 billion repurchase authorization (through April 2030) against a ~\$111 billion market cap signals aggressive net share reduction. Insider ownership is low (0.18%), typical for a mature large-cap; insider selling appears routine tax/estate-driven, not a distress signal. Heavy buybacks at ~10x earnings are accretive and value-creating at this multiple.

Solvency Assessment: FORTRESS

Earnings Quality: HIGH

Dilution Assessment: EXCELLENT (large buyback, low net dilution)

Dividend Sustainability: n/a (no dividend)

ROIC: Not precisely disclosed in inputs; given ~\$9B operating income on a high-margin, asset-light base, ROIC comfortably exceeds 15%. Verdict: Value Creating.

3. DIVIDEND ANALYSIS

Adobe pays no dividend. Capital return runs through buybacks. Under this framework, the absence of a dividend is permitted; total return must clear the ~7% hurdle on price appreciation alone, which the base case does. The \$25 billion authorization provides a buyback-driven EPS tailwind in place of a yield.

4. VALUATION ANALYSIS

Metric	Current	5Y Avg	10Y Median	vs. History	Assessment
Forward P/E	~10.1-10.8x	26.3x	—	~62% below	Attractive
Trailing P/E	~12.7-15.1x	—	48.5x	~74% below 10Y median	Attractive
EV/EBITDA	~9.5-11.2x	—	—	Low end of large-cap software	Attractive
P/FCF	~10.3x	—	—	FCF yield ~10.7% vs. peer avg	Attractive
P/B	~8.4-9.2x	14.3x	—	~40% below	Attractive
P/S (fwd)	~3.37x	peer avg 8.71x	—	~60% below peers	Attractive

Against the US software industry P/E of ~27.9x, Adobe trades at roughly half. Across forward P/E, P/B, P/FCF, and P/S, multiple independent sources mark Adobe as undervalued versus its own 3-10 year history and versus peers.

Margin of safety: applying a conservative normalized multiple of ~16-18x to FY25 GAAP diluted EPS of ~\$15.35 produces a fair value near USD 245-275 on earnings alone; applying a still-conservative 20x to forward earnings reaching ~\$16-17 yields ~USD 320-340. Against a recent ~USD 259 quote, the margin of safety runs roughly 20-25%. Analyst consensus average target sits near USD 327, implying ~19% upside, though the consensus rating is Hold.

Valuation: ATTRACTIVE | Margin of Safety: ~20-25%

5. SCENARIO ANALYSIS (10-Year Horizon)

No dividend, so total return = earnings growth + multiple change + buyback accretion.

BEAR CASE (25% weight): AI competition caps growth, revenue CAGR slows to ~3-4%, margins drift toward 35%, multiple stays compressed near 10x. Buybacks add ~2-3% annual EPS accretion. Net total return roughly +1.5% CAGR. Critically, the bear case stays positive — capital is preserved, the outcome is a poor return, not a loss.

BASE CASE (50% weight): Revenue compounds ~8-10%, margins hold near 39%, AI monetization grows steadily, multiple normalizes modestly from ~11x toward ~14-16x over the decade with buyback support. Total return ~10% CAGR.

BULL CASE (25% weight): AI features drive durable ARPU and retention, revenue CAGR ~11-12%, margins expand, multiple re-rates toward 20x. Total return ~16% CAGR.

Scenario	Total CAGR	Weight	Contribution
Bear	+1.5%	25%	+0.4%
Base	+10.0%	50%	+5.0%
Bull	+16.0%	25%	+4.0%

Scenario	Total CAGR	Weight	Contribution
Expected	~9.4%		

Downside protection: historical max drawdown was sharp (~32% peak-to-trough in 2025-26), but the franchise generated record revenue throughout. Probability of permanent >50% loss not recovered in five years: ~6%, below the 10% mandate ceiling. The combination of a fortress balance sheet, 40% FCF margin, and a trough-level multiple limits permanent-impairment risk.

6. RISK ASSESSMENT

Primary risks, ranked by importance to the thesis:

AI disruption and pricing pressure. The central risk. Cheaper AI tools (Canva, OpenAI, Google, low-cost models) could erode pricing power in creative software. Adobe must convert AI usage into durable revenue; it guided to exceed \$250 million in annual AI revenue, a start but small relative to a \$23 billion base. Mitigant: deep workflow lock-in and Adobe's own AI integration. Monitor: Digital Media ARR growth and ARPU.

Growth deceleration. Estimates point to ~8.5% forward sales growth, a slowdown from prior years. Operating margin reportedly flat over the past year, signaling limited near-term operating leverage.

Regulatory / M&A execution. The Semrush acquisition remains pending regulatory approval and is excluded from guidance. The blocked Figma deal (\$1 billion breakup fee) shows antitrust scrutiny is live. Monitor net leverage on any closed deal.

Management transition. CEO Shantanu Narayen's planned transition rattled the stock. Succession and strategic continuity are watch items, though the bench and governance show no crisis signals.

Macro sensitivity. Enterprise IT budget tightening can stretch Experience Cloud deal cycles and slow seat expansion.

Earnings-quality watch items. Year-over-year comparisons are noisy (Figma fee distortion); a third party flags projected declining cash conversion. Present cash conversion exceeds 100% of net income, so this is a monitor, not a current flag.

Risk Level: MODERATE

7. MANAGEMENT & GOVERNANCE

Management executed a best-in-class transition from perpetual licenses to subscriptions starting 2013, growing revenue nearly fivefold since 2015 while holding ~40% operating-class margins. Capital allocation favors R&D, AI build-out, and buybacks; the fresh \$25 billion authorization at a trough multiple is shareholder-friendly. The Figma episode shows a willingness to make large strategic bets that now run into antitrust limits — a calibration question, not a competence failure. Governance is clean: institutional base ~83%, unqualified audits, no material weakness, routine board refreshment. Insider ownership is low (0.18%), reducing alignment, offset by performance pay tied to relative TSR and net-new-sales goals.

Management Quality: GOOD

Capital Allocation Track Record: STRONG

8. PEER COMPARISON

Adobe trades at roughly half the US software industry P/E (13.1x vs 27.9x) and at ~3.37x forward P/S against a peer average of ~8.71x. On EV/EBITDA (~9.5-11x) it sits at the low end of the large-cap software range. Among quality software franchises, few combine 80%+ gross margins, 40% FCF margins, and a sub-12x earnings multiple. On wealth-preservation criteria — cash generation, balance-sheet strength, valuation discount — Adobe ranks well, with the open question being growth durability rather than financial quality.

9. KEY METRICS SUMMARY

Metric	Value
FY25 Revenue	~\$22.98B (+11%)
FY25 Operating Margin	~39%
FY25 Net Income	~\$7.18B
FY25 Diluted EPS	~\$15.35
FY25 FCF	~\$9.25B (~40% margin)
Gross Margin	~82%
Forward P/E	~10-11x
EV/EBITDA	~9.5-11x
FCF Yield	~10.7%
Buyback Authorization	\$25B through Apr 2030
Dividend	None
Institutional Ownership	~83%

10. MONITORING CHECKLIST

Item	Threshold / Trigger	Action
Digital Media ARR growth	Below 6% for 2 consecutive quarters	Re-review thesis
Operating margin	Sustained below 35% over a year	Sell
AI revenue trajectory	Misses \$250M run-rate or stalls	Reduce conviction
Net leverage post-M&A	Above 1.5x EBITDA	Re-review
Forward P/E	Re-rates above 22x without growth acceleration	Transition into strength
Cash conversion	Falls materially below 100% of net income	Investigate quality
CEO transition execution	Strategic discontinuity or further departures	Re-review governance

Item	Threshold / Trigger	Action
Semrush deal	Blocked, or closes with poor integration ROIC	Reassess capital allocation

FINAL RECOMMENDATION

RECOMMENDATION: BUY

Adobe clears every absolute requirement: bear case total return positive (~+1.5%), base case above the ~7% hurdle (~10%), solvency FORTRESS, no dividend to defend, and probability of >50% permanent loss ~6%. WP Score of 72 supports a standard-to-full position. You are buying a high-quality, cash-rich franchise at the low end of its decade-long valuation range, with the dominant risk — AI disruption — already heavily discounted by a 32% drawdown and a sub-12x multiple. Position sizing: standard to full (EUR 75-100 scale), accumulating on weakness.

ANALYST NOTES

Key Assumptions:

- Live price unavailable; analysis anchored to a recent ~USD 259 quote (May 29, 2026) for margin-of-safety context. Verify against current market quote before acting.
- Base case assumes 8-10% revenue CAGR and ~39% operating margins hold despite AI competition.
- Buybacks under the \$25B authorization add ~2-3% annual EPS accretion at current multiples.

Limitations:

- Inputs do not provide a precise debt-to-equity ratio, interest coverage, current ratio, or ROIC; solvency and capital-efficiency ratings inferred from strong FCF, margins, and absence of leverage flags.
- AI monetization pace is the key uncertainty and is not yet provable from reported revenue mix.
- FY26 figures are partial (Q1) and forward estimates carry standard error.

Confidence Level: MEDIUM — High confidence in financial quality and valuation discount; medium confidence in growth durability given the unresolved AI-competition question.

Report prepared for Moschovakis Capital. This analysis is for informational purposes only.

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