



Adobe Inc.

ADBE

EQUITY RESEARCH REPORT

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ADBE — Adobe Inc.

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EXECUTIVE SUMMARY

Metric	Value
Recommendation	**BUY**
Current Price	\$223.01 / €195.04
Fair Value (Base Case)	~\$310 / €271
Margin of Safety	~28%
Target Entry (if HOLD)	N/A — already below fair value

Return Profile	Value
Dividend Yield	0.0% (no dividend)
Expected Dividend Growth	N/A
Expected Price Appreciation	~9.5% CAGR
Total Expected Return (Base)	~9.5% CAGR
Bear Case Total Return	~+1.5% CAGR
Bull Case Total Return	~16% CAGR
Probability-Weighted Return	~9.1% CAGR

Risk Assessment	Value
Wealth Preservation Score	71 / 100
Downside Protection Score	70 / 100
Quality Score	68 / 100
Risk Level	MODERATE
Probability of >50% Loss	~7%
Recession Profile	RESILIENT

One-Line Thesis:

Adobe is a fortress-balance-sheet software monopoly generating 30%+ net margins and ~63% ROIC, now trading at roughly 11x forward earnings because the market fears generative AI will hollow out its moat — a fear

that the numbers do not yet support.

INVESTMENT THESIS

You are buying a business that converts nearly a third of every revenue dollar into net income, earns a return on invested capital north of 60%, and carries almost no net debt. Adobe grew revenue 13% year-over-year in Q2 FY2026 to \$6.62B, reached \$27.1B in annualized recurring revenue, and management raised full-year guidance to \$26.5–26.6B in revenue and \$24.35–24.45 in non-GAAP EPS. This is not a deteriorating business. The stock fell roughly 43% over the trailing year on a narrative — that AI-native tools will commoditize creative software — rather than on reported results.

The gap between narrative and numbers is the opportunity. At \$223, you pay about 11x forward earnings and roughly 10x free cash flow for a company that has compounded revenue at 11%+ for five straight years while expanding operating margins to 46%. The market is pricing in structural decline. The filings show the opposite: subscription revenue accelerating, Document Cloud up 17%, and AI products (Firefly) already exceeding \$250M ARR. Adobe owns the workflow, the file formats, the enterprise contracts, and — critically — a licensed, IP-safe training dataset that lets it sell AI to legal and compliance-sensitive enterprises that cannot touch scraped-data competitors.

What could go wrong is real but manageable. If AI genuinely erodes seat-based creative revenue over a decade, the multiple stays compressed and your return comes only from earnings growth. That is the bear case, and it still leaves you roughly flat to modestly positive because you entered at a trough valuation. The downside is capped by the valuation itself: you are not paying for growth, so you cannot lose much when growth disappoints. The absence of a dividend means all return depends on price and buybacks — a genuine limitation for a preservation mandate, offset here by the \$25B repurchase authorization and the fortress balance sheet. Against a 4% HYSA, this position offers materially higher expected return with limited permanent-loss risk. **Exit triggers:** organic ARR growth falling below 6%, gross margin dropping below 82%, or Firefly/AI ARR failing to reach \$1B by FY2028.

1. BUSINESS QUALITY ASSESSMENT

Adobe runs three segments. Digital Media (Creative Cloud + Document Cloud) generated \$4.84B in Q1 FY2026 and represents roughly three-quarters of revenue and a higher share of profit. Digital Experience (enterprise CXM) added \$1.41B. Publishing & Advertising is a small, declining legacy unit that took a non-cash goodwill impairment in Q2 FY2026.

Over 90% of revenue is recurring subscription. Adding a user costs almost nothing, so margins scale with the base. This is the economic model you want for preservation: predictable, high-margin, sticky.

Understandable: Yes. You know what Photoshop and Acrobat are and why professionals cannot easily leave.

Secular decline: No. Digital content creation and document workflows are growing.

Defensive vs cyclical: Moderately cyclical. Creative Cloud individual subscriptions are resilient; enterprise Digital Experience budgets are discretionary and would compress in a recession.

2. FINANCIAL FORTRESS ANALYSIS

Adobe carries near-zero net debt and an Altman Z-Score of 8.92 (bankruptcy risk effectively nil). FY2025 revenue was \$23.77B with operating income of \$10.99B (46% operating margin) and net income of \$7.13B (30% net margin).

Solvency Stress Test — 30% revenue drop for 2 years:

- Remain solvent? Comfortably. Interest coverage is enormous; net debt is negligible.
- Maintain dividend? N/A — no dividend to defend.
- Avoid dilutive raise? Yes. Operating cash flow of \$7–9B per year with modest capex leaves large surplus even under severe stress.

Metric	Value	Assessment
Debt-to-Equity	Low (near-zero net)	PASS
Interest Coverage	>20x	PASS
FCF positive 5/5 years	Yes	PASS
Cash vs total debt	High	PASS
ROIC	63.3%	Exceptional

Solvency Assessment: FORTRESS

3. DIVIDEND ANALYSIS

Adobe pays no dividend. Capital return runs entirely through buybacks — a fresh \$25B authorization was approved April 2026, following ~8.5M shares repurchased in a recent quarter. For a strict preservation mandate this is a weakness: you receive no income cushion and must rely on management repurchasing shares intelligently. At today's ~11x forward earnings, buybacks are accretive; the risk was buybacks at the peak multiples of prior years.

Dividend Sustainability: N/A (non-payer — treated as neutral, not disqualifying)

4. VALUATION ANALYSIS

Metric	Current	5Y/Recent Norm	vs History	Assessment
P/E (trailing)	~15x	20–30x	Well below	Attractive
Forward P/E	~10.8x	mid-teens–low-20s	Well below	Attractive
EV/EBITDA	11.2x	~18–22x	Below	Attractive
P/FCF	~10.3x	high-teens	Below	Attractive

Metric	Current	5Y/Recent Norm	vs History	Assessment
P/B	9.2x	~14x	Below	Attractive
PEG (fwd)	0.83	—	<1 = cheap growth	Attractive

Margin of Safety Calculation:

Applying a conservative 14x multiple (well below Adobe's historical norm) to forward EPS of ~\$24.40 (non-GAAP guidance midpoint) yields a fair value near \$340. Using GAAP EPS of ~\$16.50 at 18x yields ~\$300. Blending to a conservative base fair value of ~\$310 against \$223 gives a margin of safety of roughly **28%**.

Valuation: ATTRACTIVE | Margin of Safety: ~28%

5. SCENARIO ANALYSIS

BEAR CASE (25% weight): AI erodes seat growth, organic ARR decelerates to low single digits, multiple stays at 10–11x. EPS grows ~3–4% annually. Terminal multiple 10x.

- 10-Year Total Return CAGR: **~+1.5%**
- Capital preserved, return below hurdle but positive.

BASE CASE (50% weight): Revenue compounds ~9–10%, margins stable, AI products offset seat pressure, multiple re-rates modestly from trough toward ~14–15x.

- 10-Year Total Return CAGR: **~9.5%**

BULL CASE (25% weight): Firefly and AI monetization drive ARR reacceleration, multiple re-rates toward historical 20x.

- 10-Year Total Return CAGR: **~16%**

Scenario	Total CAGR	Weight	Contribution
Bear	+1.5%	25%	+0.4%
Base	+9.5%	50%	+4.75%
Bull	+16%	25%	+4.0%
Expected			**~9.1%**

Downside Protection: Historical peak-to-trough drawdown was ~43% (already largely realized). Bear case shows a modestly positive 10-year return because the entry multiple is already at cyclical lows. Probability of >50% permanent loss (not recovered in 5 years): ~7%, below the 10% preservation threshold.

Key Question — Is bear case return positive? Yes (~+1.5%). Downside protection is adequate.

6. RISK ASSESSMENT

The dominant risk is **generative AI commoditizing creative software**. This is a genuine long-duration threat, not a fabrication. The counterweights: switching costs, file-format lock-in, enterprise contracts (~\$22.3B RPO), and Adobe's licensed IP-safe dataset that competitors using scraped data cannot match for compliance-sensitive customers.

Secondary risks:

- **CFO transition** (Durn out June 2026, Steven Day interim) — no accounting concern flagged, but continuity risk around the \$25B buyback.
- **CEO transition** (Narayan departure signaled) — execution risk during an AI-heavy pivot.
- **Reliance on M&A** (Semrush) to sustain growth optics as organic ARR decelerates to ~8–9%.
- **Enterprise cyclical**ity in Digital Experience.
- **Goodwill impairment** in Publishing & Advertising (non-cash, non-core).

Auditor opinion is clean and unqualified. No going-concern, no material weakness, no restatement.

Risk Level: MODERATE

7. MANAGEMENT & GOVERNANCE

Management executed the boxed-software-to-SaaS pivot and built enterprise CXM through disciplined acquisitions. Track record on value-per-share creation is strong. The current watch items are the twin leadership transitions (CEO and CFO) and the question of whether M&A is masking organic deceleration. Insider selling in the filings is routine RSU vesting, not a red flag.

Management Quality: GOOD | **Capital Allocation: ACCEPTABLE** (buybacks now accretive at trough valuations; historical buybacks at peak prices were less efficient)

8. PEER COMPARISON

Adobe screens cheaper than most application-software peers on P/E, EV/EBITDA, P/FCF, and P/B while posting best-in-class profitability (ROE 58.8%, ROIC 63.3%). Against the software cohort it ranks top-tier on balance sheet strength, margin, and capital efficiency, and top on valuation discount. The absence of a dividend places it below preservation peers like utilities or staples on income reliability.

9. KEY METRICS SUMMARY

Metric	Value
Revenue (FY25)	\$23.77B
Net Income (FY25)	\$7.13B
Net Margin	30%

Metric	Value
Operating Margin	46%
ROIC	63.3%
ARR	\$27.1B
Net Debt	~Zero
Forward P/E	~10.8x
PEG (fwd)	0.83

10. MONITORING CHECKLIST

Item	Threshold	Action
Organic ARR growth	<6%	Re-review thesis
Gross margin	<82%	Investigate AI compute cost
Firefly/AI ARR	<\$1B by FY2028	Reassess AI monetization
CFO/CEO transition	Strategy shift	Monitor capital allocation
Buyback pace	Slowdown	Check cash generation

11. MARKET EXPECTATIONS & CONSENSUS

The current ~11x forward multiple implies the market expects roughly flat-to-low-single-digit long-term earnings growth — a structural-decline scenario. Consensus bull case: AI monetization reaccelerates ARR and the multiple normalizes toward 18–20x. Consensus bear case: seat-based creative revenue erodes as AI-native tools capture casual and SMB users.

Analyst targets imply high-teens upside from recent levels. The trailing ~43% drawdown reflects sentiment, not fundamentals — revenue grew 11–13% throughout.

What would validate consensus recovery: ARR reacceleration, Firefly ARR crossing \$1B, stable gross margin.

What would disappoint: organic ARR below 6%, gross margin compression from AI compute, enterprise Digital Experience weakness.

Forward Valuation (from research data):

Metric	Value	Assessment
Fwd P/E	~10.8x	Well below history — cheap

Metric	Value	Assessment
PEG	0.83	Growth undervalued
EV/EBITDA	11.2x	Below sector
Beta	~1.2 (est.)	Growth/moderately cyclical exposure

12. KEY BUSINESS DRIVERS

Driver 1: Annualized Recurring Revenue (ARR)

Why it matters: Measures durable subscription base and offsets AI-commoditization fear.

Current level: \$27.1B.

Bull threshold: reacceleration above 12% growth.

Bear threshold: below 6% growth.

Next data point: Q3 FY2026 earnings.

Driver 2: AI / Firefly ARR

Why it matters: Proves Adobe monetizes AI rather than being displaced by it.

Current level: >\$250M.

Bull threshold: >\$1B by FY2028.

Bear threshold: stalling below \$500M.

Next data point: quarterly disclosures.

Driver 3: Gross Margin

Why it matters: AI compute cost could erode Adobe's ~88% gross margin.

Current level: ~88%.

Bull threshold: stable >86%.

Bear threshold: below 82%.

Next data point: quarterly filings.

Driver 4: Organic ARR growth (ex-M&A)

Why it matters: Distinguishes genuine momentum from acquisition-driven optics.

Current level: ~8–9%.

Bull threshold: >10% organic.

Bear threshold: <6% organic.

Next data point: earnings commentary / 10-Q.

13. PROXY TRACKERS & LEADING INDICATORS

Proxy	Ticker/Symbol	Relationship	Signal
Application software ETF	IGV	correlates with	Bullish if IGV trends above 50-day MA; bearish if it breaks below
AI-native design peers	Figma/Canva (private/sentiment)	leads narrative	Bearish if they capture SMB share rapidly
Broad software	XLK	correlates with	Bearish if XLK breaks 50-day MA
Enterprise IT spend	Nasdaq-100 (QQQ)	correlates	Confirms enterprise budget health

Monitoring rule: If IGV breaks below its 50-day moving average while ADBE underperforms the index by more than 10%, re-evaluate the thesis within 5 trading days.

EXIT TRIGGERS (BUY recommendation):

- Organic ARR growth falls below 6%: reduce position by half.
- Gross margin drops below 82%: full re-review.
- Firefly/AI ARR fails to reach \$1B by FY2028: reassess AI thesis.
- Buyback program materially slowed without explanation: re-review capital allocation.

FINAL RECOMMENDATION

RECOMMENDATION: BUY at \$223.01 / €195.04

Position Size: €75 (standard). WP Score of 71 and expected CAGR of ~9.1% place this in the "solid candidate" band. The single deduction from a full position is the absence of a dividend income cushion, which matters for a preservation mandate.

Expected Total Return: ~9.1% CAGR (all price appreciation and buyback-driven; no dividend).

Downside Protection: Bear case ~+1.5% CAGR — capital preserved.

Absolute Requirements Check:

- [x] Bear case total return $\geq 0\%$ (~+1.5%)
- [x] Base case total return $\geq 7\%$ (~9.5%)
- [x] Solvency: FORTRESS
- [x] Dividend sustainability: N/A (non-disqualifying)
- [x] Probability of >50% permanent loss: ~7% (<10%)

ANALYST NOTES

Key Assumptions:

- Revenue compounds ~9–10% in base case.
- Multiple partially re-rates from trough toward ~14–15x over the horizon.
- AI monetization at least offsets seat-based erosion.
- Buybacks continue at accretive prices under the \$25B authorization.

Limitations:

- No dividend removes income floor typical of preservation holdings.
- Twin leadership transitions (CEO, CFO) create execution uncertainty.
- Generative-AI disruption is a genuine multi-year uncertainty that cannot be fully quantified.
- EBITDA/FCF figures rely partly on third-party estimates; Adobe does not report these directly.
- Beta and sector-average comparisons are estimates, not from a verified live feed.

Confidence Level: MEDIUM — The balance sheet and valuation case are strong and well-documented.

Confidence is capped at medium by the AI-disruption uncertainty and the leadership transitions, both of which are unresolved.

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

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