ADOBE SYSTEMS INC
Form 10-Q
March 28, 2013

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 March 1, 2013

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 (State or other jurisdiction of incorporation or organization)	77-0019522 (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" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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 March 22, 2013 was 501,936,172.

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)

	March 1, 2013 (Unaudited)	November 30, 2012 (*)
ASSETS		
Current assets:		
Cash and cash equivalents	$1,306,382	$1,425,052
Short-term investments	2,354,307	2,113,301
Trade receivables, net of allowances for doubtful accounts of $12,715 and $12,643, respectively	485,801	617,233
Deferred income taxes	64,930	59,537
Prepaid expenses and other current assets	161,663	116,237
Total current assets	4,373,083	4,331,360
Property and equipment, net	686,014	664,302
Goodwill	4,221,487	4,133,259
Purchased and other intangibles, net	580,568	545,036
Investment in lease receivable	207,239	207,239
Other assets	97,320	93,327
Total assets	$10,165,711	$9,974,523
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade payables	$72,725	$49,759
Accrued expenses	505,465	590,140
Capital lease obligations	22,406	11,217
Accrued restructuring	6,767	9,287
Income taxes payable	11,126	49,886
Deferred revenue	645,834	561,463
Total current liabilities	1,264,323	1,271,752
Long-term liabilities:		
Debt and capital lease obligations	1,509,003	1,496,938
Deferred revenue	54,197	58,102
Accrued restructuring	10,053	12,263
Income taxes payable	159,859	155,096
Deferred income taxes	292,770	265,106
Other liabilities	70,168	50,084
Total liabilities	3,360,373	3,309,341
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; 501,045 and 494,132 shares outstanding, respectively	61	61
Additional paid-in-capital	3,116,471	3,038,665

Retained earnings	6,808,489	7,003,003
Accumulated other comprehensive income	40,110	30,712
Treasury stock, at cost (99,789 and 106,702 shares, respectively), net of reissuances	(3,159,793)	(3,407,259)
Total stockholders' equity	6,805,338	6,665,182
Total liabilities and stockholders' equity	$10,165,711	$9,974,523

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(*) The Condensed Consolidated Balance Sheet as of November 30, 2012 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	
	March 1, 2013	March 2, 2012
Revenue:		
Products	$675,789	$808,521
Subscription	224,266	146,230
Services and support	107,818	90,469
Total revenue	1,007,873	1,045,220
Cost of revenue:		
Products	51,982	25,668
Subscription	62,580	48,780
Services and support	42,122	33,817
Total cost of revenue	156,684	108,265
Gross profit	851,189	936,955
Operating expenses:		
Research and development	209,638	177,728
Sales and marketing	398,033	358,963
General and administrative	132,853	102,681
Restructuring charges	2	(2,825)
Amortization of purchased intangibles	12,439	11,429
Total operating expenses	752,965	647,976
Operating income	98,224	288,979
Non-operating income (expense):		
Interest and other income (expense), net	1,246	(2,785)
Interest expense	(16,834)	(16,838)
Investment gains (losses), net	848	1,021
Total non-operating income (expense), net	(14,740)	(18,602)
Income before income taxes	83,484	270,377
Provision for income taxes	18,367	85,168
Net income	$65,117	$185,209
Basic net income per share	$0.13	$0.37
Shares used to compute basic net income per share	498,607	494,016
Diluted net income per share	$0.13	$0.37
Shares used to compute diluted net income per share	507,840	500,378

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	
	March 1, 2013	March 2, 2012
	Increase/(Decrease)	
Net income	$65,117	$185,209
Other comprehensive income, net of taxes:		
Available-for-sale securities:		
Unrealized gains / losses on available-for-sale securities	702	12,864
Reclassification adjustment for gains on available-for-sale securities recognized during the period	(1,584)	(497)
Net increase (decrease) from available-for-sale securities	(882)	12,367
Derivatives designated as hedging instruments:		
Unrealized gains on derivative instruments	21,776	12,581
Reclassification adjustment for gains on derivative instruments recognized during the period	(7,094)	(10,348)
Net increase from derivatives designated as hedging instruments	14,682	2,233
Foreign currency translation adjustments	(4,402)	2,198
Other comprehensive income	9,398	16,798
Total comprehensive income, net of taxes	$74,515	$202,007

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended	
	March 1, 2013	March 2, 2012
Cash flows from operating activities:		
Net income	$65,117	$185,209
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	76,752	69,861
Stock-based compensation	84,196	71,582
Deferred income taxes	15,176	63,377
Unrealized (gains) losses on investments	(418)	(3,168)
Other non-cash items	(4,647)	(6,650)
Excess tax benefits from stock-based compensation	—	(2,670)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	131,511	152,721
Prepaid expenses and other current assets	(35,447)	(15,080)
Trade payables	22,477	(42,542)
Accrued expenses	(78,966)	(116,908)
Accrued restructuring	(4,047)	(39,057)
Income taxes payable	(29,187)	(19,051)
Deferred revenue	79,514	16,739
Net cash provided by operating activities	322,031	314,363
Cash flows from investing activities:		
Purchases of short-term investments	(723,541)	(352,179)
Maturities of short-term investments	110,958	112,089
Proceeds from sales of short-term investments	366,808	207,672
Acquisitions, net of cash acquired	(96,356)	(353,184)
Purchases of property and equipment	(60,190)	(51,088)
Purchases of long-term investments and other assets	(46,633)	(5,203)
Proceeds from sale of long-term investments	2,840	4,186
Net cash used for investing activities	(446,114)	(437,707)
Cash flows from financing activities:		
Purchases of treasury stock	(100,000)	(80,000)
Proceeds from issuance of treasury stock	88,566	13,366
Excess tax benefits from stock-based compensation	—	2,670
Proceeds from debt and capital lease obligations	25,703	—
Repayment of debt and capital lease obligations	(2,507)	(2,264)
Debt issuance costs	(357)	(2,297)
Net cash provided by (used for) financing activities	11,405	(68,525)
Effect of foreign currency exchange rates on cash and cash equivalents	(5,992)	3,632
Net decrease in cash and cash equivalents	(118,670)	(188,237)
Cash and cash equivalents at beginning of period	1,425,052	989,500
Cash and cash equivalents at end of period	$1,306,382	$801,263
Supplemental disclosures:		
Cash paid for income taxes, net of refunds	$49,863	$51,397

Cash paid for interest	$31,960	$33,883
Non-cash investing activities:		
Issuance of common stock and stock awards assumed in business acquisitions	$661	$4,265

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 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 November 30, 2012 on file with the SEC (our “Annual Report”).

With the exception of the discussion below, there have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report.

Recent Accounting Pronouncements

In December 2011, the FASB amended the accounting standards to increase the prominence of other comprehensive income (“OCI”) by eliminating the option to present components of OCI as part of the statement of changes in shareholders’ equity and requires the components of OCI to be presented either in a single continuous statement of comprehensive income or in two consecutive statements. We adopted the amended accounting standards at the beginning of our first quarter of fiscal 2013 by electing to present separate consolidated statements of comprehensive income from the consolidated statements of income. The amended accounting standards only impact the financial statement presentation of OCI and do not change the components that are recognized in net income or OCI. The adoption had no impact on the Company’s financial position or results of operations.

NOTE 2. ACQUISITIONS

On December 20, 2012, we completed our acquisition of privately held Behance, an online social media platform to showcase and discover creative work. During the first quarter of fiscal 2013, we began integrating Behance into our Digital Media reportable segment. Behance’s community and portfolio capabilities will accelerate our strategy to bring additional community features to the Creative Cloud. We have included the financial results of Behance in our condensed consolidated financial statements beginning on the acquisition date.

Under the acquisition method of accounting, the total preliminary purchase price was allocated to Behance’s net tangible and intangible assets based upon their estimated fair values as of December 20, 2012. The total adjusted preliminary purchase price for Behance was approximately $111.1 million of which approximately $90.5 million was allocated to goodwill, $28.5 million to identifiable intangible assets and $7.9 million to net liabilities assumed. The impact of this acquisition was not material to our condensed consolidated financial statements.

On January 13, 2012, we completed our acquisition of privately held Efficient Frontier, a multi-channel digital ad buying and optimization company. During the first quarter of fiscal 2012, we began integrating Efficient Frontier into our Digital Marketing reportable segment. The Efficient Frontier business adds cross-channel digital ad campaign forecasting, execution and optimization capabilities to our Adobe Marketing Cloud, along with a social marketing engagement platform and social ad buying capabilities. We have included the financial results of Efficient Frontier in our condensed consolidated financial statements beginning on the acquisition date.

Under the acquisition method of accounting, the total purchase price was allocated to Efficient Frontier’s net tangible and intangible assets based upon their estimated fair values as of January 13, 2012. The total final purchase price for Efficient Frontier was approximately $374.7 million of which approximately $291.4 million was allocated to goodwill, $122.7 million to identifiable intangible assets and $39.4 million to net liabilities assumed. The impact of this acquisition was not material to our condensed consolidated financial statements.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 March 1, 2013 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	$247,671	$—	$—	$247,671
Cash equivalents:				
Corporate bonds and commercial paper	9,514	1	(2)	9,513
Money market mutual funds	895,845	—	—	895,845
Municipal securities	1,498	—	(1)	1,497
Time deposits	63,956	—	—	63,956
U.S. Treasury securities	87,900	1	(1)	87,900
Total cash equivalents	1,058,713	2	(4)	1,058,711
Total cash and cash equivalents	1,306,384	2	(4)	1,306,382
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,195,722	10,379	(165)	1,205,936
Foreign government securities	12,492	64	(1)	12,555
Municipal securities	185,907	386	(11)	186,282
U.S. agency securities	506,699	2,024	(20)	508,703
U.S. Treasury securities	439,712	926	(1)	440,637
Subtotal	2,340,532	13,779	(198)	2,354,113
Marketable equity securities	194	—	—	194
Total short-term investments	2,340,726	13,779	(198)	2,354,307
Total cash, cash equivalents and short-term investments	$3,647,110	$13,781	$(202)	$3,660,689

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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 November 30, 2012 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	$200,771	$—	$—	$200,771
Cash equivalents:				
Corporate bonds and commercial paper	3,998	—	—	3,998
Money market mutual funds and repurchase agreements	1,171,270	—	—	1,171,270
Municipal securities	3,895	—	—	3,895
Time deposits	45,118	—	—	45,118
Total cash equivalents	1,224,281	—	—	1,224,281
Total cash and cash equivalents	1,425,052	—	—	1,425,052
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,059,158	11,415	(133)	1,070,440
Foreign government securities	6,919	45	(12)	6,952
Municipal securities	180,488	97	(60)	180,525
Time deposits	20,113	—	—	20,113
U.S. agency securities	501,863	2,346	(18)	504,191
U.S. Treasury securities	330,072	801	(37)	330,836
Subtotal	2,098,613	14,704	(260)	2,113,057
Marketable equity securities	237	7	—	244
Total short-term investments	2,098,850	14,711	(260)	2,113,301
Total cash, cash equivalents and short-term investments	$3,523,902	$14,711	$(260)	$3,538,353

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 March 1, 2013 and November 30, 2012 (in thousands):

	2013		2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	$191,986	$(167)	$95,489	$(132)
Foreign government securities	3,599	(1)	2,105	(12)
Municipal securities	14,950	(12)	40,524	(60)
U.S. Treasury and agency securities	102,862	(19)	48,203	(55)
Total	$313,397	$(199)	$186,321	$(259)

There were 153 securities and 65 securities that were in an unrealized loss position for less than twelve months at March 1, 2013 and at November 30, 2012, 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 have been in a continuous unrealized loss position for more than twelve months, as of March 1, 2013 and November 30, 2012 (in thousands):

	2013		2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	$—	$—	$2,999	$(1)
U.S. Treasury and agency securities	8,209	(3)	—	—
Total	$8,209	$(3)	$2,999	$(1)

There was one security in an unrealized loss position for more than twelve months at March 1, 2013 and November 30, 2012.

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 March 1, 2013 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$549,442	$550,707
Due between one and two years	701,820	706,425
Due between two and three years	728,813	732,718
Due after three years	360,457	364,263
Total	$2,340,532	$2,354,113

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 three months ended March 1, 2013, 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 three months ended March 1, 2013.

The fair value of our financial assets and liabilities at March 1, 2013 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:				
Corporate bonds and commercial paper	$9,513	$—	$9,513	$—
Money market mutual funds	895,845	895,845	—	—
Municipal securities	1,497	—	1,497	—
Time deposits	63,956	63,956	—	—
U.S. Treasury securities	87,900	—	87,900	—
Short-term investments:				
Corporate bonds and commercial paper	1,205,936	—	1,205,936	—
Foreign government securities	12,555	—	12,555	—
Marketable equity securities	194	194	—	—
Municipal securities	186,282	—	186,282	—
U.S. agency securities	508,703	—	508,703	—
U.S. Treasury securities	440,637	—	440,637	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	32,466	—	32,466	—
Other assets:				
Deferred compensation plan assets	17,456	506	16,950	—
Total assets	$3,462,940	$960,501	$2,502,439	$—
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	$3,251	$—	$3,251	$—
Total liabilities	$3,251	$—	$3,251	$—

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of our financial assets and liabilities at November 30, 2012 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:				
Corporate bonds and commercial paper	$3,998	$—	$3,998	$—
Money market mutual funds and repurchase agreements	1,171,270	1,171,270	—	—
Municipal securities	3,895	—	3,895	—
Time deposits	45,118	45,118	—	—
Short-term investments:				
Corporate bonds and commercial paper	1,070,440	—	1,070,440	—
Foreign government securities	6,952	—	6,952	—
Marketable equity securities	244	244	—	—
Municipal securities	180,525	—	180,525	—
Time deposits	20,113	—	20,113	—
U.S. agency securities	504,191	—	504,191	—
U.S. Treasury securities	330,836	—	330,836	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	13,513	—	13,513	—
Other assets:				
Deferred compensation plan assets	15,094	436	14,658	—
Total assets	$3,366,189	$1,217,068	$2,149,121	$—
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	$998	$—	$998	$—
Total liabilities	$998	$—	$998	$—

See Note 3 for further information regarding the fair value of our financial instruments.

Our fixed income available-for-sale securities consist of high quality, investment grade securities from diverse issuers with a minimum credit rating of BBB and a weighted average credit rating of AA-. We value these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, we classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. Our procedures include controls to ensure that appropriate fair values are recorded such as comparing prices obtained from multiple independent sources.

Our deferred compensation plan assets consist of prime money market funds and mutual funds.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We also have direct investments in privately held companies accounted for under the cost method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write down the investment to its fair value. We estimate fair value of our cost method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. For the three months ended March 1, 2013, we determined there were no material other-than-temporary impairments on our cost method investments.

As of March 1, 2013, the carrying value of our lease receivables approximated fair value, based on Level 2 valuation inputs which include Treasury rates, LIBOR rates and applicable credit spreads. See Note 12 for further details regarding our investment in lease receivables. The fair value of our long-term debt was approximately $1.6 billion as of March 1, 2013, based on Level 2 quoted prices in inactive markets. See Note 13 for further details regarding our debt.

NOTE 5. DERIVATIVES AND HEDGING ACTIVITIES

In countries outside the U.S., we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge certain cash flow exposures resulting from changes in these foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities up to twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

We recognize these contracts as derivative instruments and they are classified as either assets or liabilities on the balance sheet and measured at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income in our Condensed Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income to interest and other income, net in our Condensed Consolidated Statements of Income at that time. If we do not elect hedge accounting, or the derivative does not qualify for hedge accounting, the changes in fair market value from period to period are recorded in interest and other income (expense), net in our Condensed Consolidated Statements of Income.

We also hedge our net recognized foreign currency denominated assets and liabilities with foreign exchange forward contracts to reduce the risk that the value of these assets and liabilities will be adversely affected by changes in exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded to interest and other income (expense), net in our Condensed Consolidated Statements of Income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged.

The bank counterparties to these contracts expose us to credit-related losses in the event of their nonperformance. However, to mitigate that risk, we only contract with counterparties who meet our minimum requirements as determined by our counterparty risk assessment process. We monitor ratings, credit spreads and potential downgrades on at least a quarterly basis. Based on our ongoing assessment of counterparty risk, we may adjust our exposure to various counterparties. In addition, our hedging policy establishes maximum limits for each counterparty to mitigate any concentration of risk.

The aggregate fair value of derivative instruments in net asset positions as of March 1, 2013 and November 30, 2012 was $32.5 million and $13.5 million, respectively. These amounts represent the maximum exposure to loss at the reporting date as a result of all of the counterparties failing to perform as contracted. This exposure could be reduced by up to $3.3 million and $1.0 million, respectively, of liabilities included in master netting arrangements with those same counterparties.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of derivative instruments on our Condensed Consolidated Balance Sheets as of March 1, 2013 and November 30, 2012 were as follows (in thousands):

	2013		2012	
	Fair Value Asset Derivatives[1]	Fair Value Liability Derivatives[2]	Fair Value Asset Derivatives[1]	Fair Value Liability Derivatives[2]
Derivatives designated as hedging instruments:				
Foreign exchange option contracts[3]	$25,521	$—	$10,897	$—
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	6,945	3,251	2,616	998
Total derivatives	$32,466	$3,251	$13,513	$998

(1) Included in prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets.
(2) Included in accrued expenses on our Condensed Consolidated Balance Sheets.
(3) Hedging effectiveness expected to be recognized into income within the next twelve months.

The effect of derivative instruments designated as cash flow hedges and of derivative instruments not designated as hedges in our Condensed Consolidated Statements of Income for three months ended March 1, 2013 and March 2, 2012 was as follows (in thousands):

	2013		2012	
	Foreign Exchange Option Contracts	Foreign Exchange Forward Contracts	Foreign Exchange Option Contracts	Foreign Exchange Forward Contracts
Derivatives in cash flow hedging relationships:				
Net gain (loss) recognized in OCI, net of tax[1]	$21,776	$—	$12,581	$—
Net gain (loss) reclassified from accumulated OCI into income, net of tax[2]	$7,094	$—	$10,348	$—
Net gain (loss) recognized in income[3]	$(4,668)	$—	$(8,245)	$—
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income[4]	$—	$1,478	$—	$8,150

(1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").
(2) Effective portion classified as revenue.
(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income (expense), net.
(4) Classified in interest and other income (expense), net.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill as of March 1, 2013 and November 30, 2012 was $4.221 billion and $4.133 billion, respectively. The increase was primarily due to our acquisition of Behance.

Purchased and other intangible assets subject to amortization as of March 1, 2013 and November 30, 2012 were as follows (in thousands):

	2013			2012		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Purchased technology	$358,612	$(162,882)	$195,730	$366,574	$(161,538)	$205,036
Customer contracts and relationships	$324,221	$(82,802)	$241,419	$318,027	$(74,214)	$243,813
Trademarks	66,551	(21,249)	45,302	53,293	(19,171)	34,122
Acquired rights to use technology	147,397	(61,222)	86,175	104,402	(56,782)	47,620
Localization	8,423	(5,369)	3,054	8,586	(4,654)	