

ADOBE SYSTEMS INC  
Form 10-Q  
September 25, 2014

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

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FORM 10-Q  
(Mark One)

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

For the quarterly period ended August 29, 2014

or  
 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)

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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  No   
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  No

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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller

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reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
The number of shares outstanding of the registrant's common stock as of September 19, 2014 was 498,738,874.

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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)

	August 29, 2014 (Unaudited)	November 29, 2013 (*)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$903,329	\$834,556
Short-term investments	2,616,868	2,339,196
Trade receivables, net of allowances for doubtful accounts of \$7,879 and \$10,228, respectively	528,331	599,820
Deferred income taxes	79,713	102,247
Prepaid expenses and other current assets	151,227	170,110
Total current assets	4,279,468	4,045,929
Property and equipment, net	785,856	659,774
Goodwill	4,746,781	4,771,981
Purchased and other intangibles, net	490,839	605,254
Investment in lease receivable	80,439	207,239
Other assets	110,297	90,121
Total assets	\$10,493,680	\$10,380,298
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Trade payables	\$53,791	\$62,096
Accrued expenses	630,679	656,939
Debt and capital lease obligations	606,426	14,676
Accrued restructuring	2,351	6,171
Income taxes payable	4,438	10,222
Deferred revenue	947,563	775,544
Total current liabilities	2,245,248	1,525,648
Long-term liabilities:		
Debt and capital lease obligations	901,830	1,499,297
Deferred revenue	48,975	53,268
Accrued restructuring	5,776	7,717
Income taxes payable	141,473	132,545
Deferred income taxes	344,715	375,634
Other liabilities	74,403	61,555
Total liabilities	3,762,420	3,655,664
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; 498,599 and 496,261 shares outstanding, respectively	61	61
Additional paid-in-capital	3,675,629	3,392,696

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Retained earnings	6,850,790	6,928,964
Accumulated other comprehensive income	20,067	46,103
Treasury stock, at cost (102,235 and 104,573 shares, respectively), net of reissuances	(3,815,287 )	(3,643,190 )
Total stockholders' equity	6,731,260	6,724,634
Total liabilities and stockholders' equity	\$ 10,493,680	\$ 10,380,298

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The Condensed Consolidated Balance Sheet as of November 29, 2013 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.

Table of ContentsADOBE SYSTEMS INCORPORATED  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	August 29, 2014	August 30, 2013	August 29, 2014	August 30, 2013
Revenue:				
Products	\$349,151	\$582,178	\$1,299,852	\$1,902,866
Subscription	547,373	299,346	1,447,630	778,133
Services and support	108,885	113,595	326,255	332,542
Total revenue	1,005,409	995,119	3,073,737	3,013,541
Cost of revenue:				
Products	23,172	32,564	75,169	111,351
Subscription	86,670	71,656	247,549	200,763
Services and support	47,882	42,856	138,419	126,927
Total cost of revenue	157,724	147,076	461,137	439,041
Gross profit	847,685	848,043	2,612,600	2,574,500
Operating expenses:				
Research and development	212,049	208,700	630,666	621,435
Sales and marketing	406,475	388,673	1,243,446	1,188,914
General and administrative	141,676	128,043	409,798	381,766
Restructuring and other charges	201	(791)	) 498	24,203
Amortization of purchased intangibles	13,108	13,064	40,012	38,295
Total operating expenses	773,509	737,689	2,324,420	2,254,613
Operating income	74,176	110,354	288,180	319,887
Non-operating income (expense):				
Interest and other income (expense), net	1,454	1,732	7,162	4,246
Interest expense	(13,361)	) (16,747)	) (47,054)	) (50,786)
Investment gains (losses), net	669	(2,079)	) 813	(5,476)
Total non-operating income (expense), net	(11,238)	) (17,094)	) (39,079)	) (52,016)
Income before income taxes	62,938	93,260	249,101	267,871
Provision for income taxes	18,252	10,258	68,842	43,206
Net income	\$44,686	\$83,002	\$180,259	\$224,665
Basic net income per share	\$0.09	\$0.16	\$0.36	\$0.45
Shares used to compute basic net income per share	498,468	504,116	497,782	502,039
Diluted net income per share	\$0.09	\$0.16	\$0.35	\$0.44
Shares used to compute diluted net income per share	507,811	514,058	508,575	513,155

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsADOBE SYSTEMS INCORPORATED  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	August 29, 2014	August 30, 2013	August 29, 2014	August 30, 2013
Net income	\$44,686	\$83,002	\$180,259	\$224,665
Other comprehensive income, net of taxes:				
Available-for-sale securities:				
Unrealized gains / losses on available-for-sale securities	(1,822	) (7,757	) 1,666	(12,310
Reclassification adjustment for gains / losses on available-for-sale securities recognized	(1,592	) 46	(3,480	) (2,326
Net increase (decrease) from available-for-sale securities	(3,414	) (7,711	) (1,814	) (14,636
Derivatives designated as hedging instruments:				
Unrealized gains / losses on derivative instruments	10,003	(2,947	) 11,976	29,713
Reclassification adjustment for gains / losses on derivative instruments recognized	(1,075	) (10,487	) (6,490	) (32,880
Net increase (decrease) from derivatives designated as hedging instruments	8,928	(13,434	) 5,486	(3,167
Foreign currency translation adjustments	(32,090	) 6,651	(29,708	) 57
Other comprehensive income, net of taxes	(26,576	) (14,494	) (26,036	) (17,746
Total comprehensive income, net of taxes	\$18,110	\$68,508	\$154,223	\$206,919

See accompanying Notes to Condensed Consolidated Financial Statements.



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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	August 29, 2014	August 30, 2013
Cash flows from operating activities:		
Net income	\$ 180,259	\$ 224,665
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	235,443	239,877
Stock-based compensation	248,811	244,090
Deferred income taxes	(7,912)	) 41,002
Write down of assets held for sale	—	23,838
Unrealized (gains) losses on investments	47	6,719
Tax benefit (shortfall) from employee stock option plans	31,883	(17,186)
Other non-cash items	829	2,972
Excess tax benefits from stock-based compensation	(31,953)	) —
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	71,973	112,015
Prepaid expenses and other current assets	13,352	(13,669)
Trade payables	(8,305)	) 16,106
Accrued expenses	(13,749)	) (65,992)
Accrued restructuring	(5,627)	) (8,454)
Income taxes payable	4,952	(75,908)
Deferred revenue	167,726	106,629
Net cash provided by operating activities	887,729	836,704
Cash flows from investing activities:		
Purchases of short-term investments	(1,412,539)	) (1,635,999)
Maturities of short-term investments	913,308	292,374
Proceeds from sales of short-term investments	209,172	1,084,873
Acquisitions, net of cash acquired	—	(704,375)
Purchases of property and equipment	(111,557)	) (153,237)
Purchases of long-term investments and other assets	(12,496)	) (64,820)
Proceeds from sale of long-term investments	1,364	3,396
Net cash used for investing activities	(412,748)	) (1,177,788)
Cash flows from financing activities:		
Purchases of treasury stock	(475,000)	) (700,000)
Proceeds from issuance of treasury stock	213,841	526,240
Cost of issuance of treasury stock	(163,293)	) (90,356)
Excess tax benefits from stock-based compensation	31,953	—
Proceeds from debt and capital lease obligations	—	25,703
Repayment of debt and capital lease obligations	(11,431)	) (19,838)
Debt issuance costs	—	(357)
Net cash used for financing activities	(403,930)	) (258,608)
Effect of foreign currency exchange rates on cash and cash equivalents	(2,278)	) (6,275)
Net decrease in cash and cash equivalents	68,773	(605,967)
Cash and cash equivalents at beginning of period	834,556	1,425,052

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Cash and cash equivalents at end of period	\$903,329	\$819,085
Supplemental disclosures:		
Cash paid for income taxes, net of refunds	\$7,114	\$110,697
Cash paid for interest	\$61,562	\$64,334
Non-cash investing activities:		
Investment in lease receivable applied to building purchase	\$126,800	\$—
Issuance of common stock and stock awards assumed in business acquisitions	\$—	\$1,160

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 29, 2013 on file with the SEC (our “Annual Report”).

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 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 retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for us in the first quarter of fiscal 2018. We have not yet selected a transition method and 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 revenue standard discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the nine months ended August 29, 2014, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended November 29, 2013, that are of significance or potential significance to us.

NOTE 2. ACQUISITIONS

On July 22, 2013, we completed our acquisition of privately held Neolane, a leader in cross-channel campaign management technology. During the third quarter of fiscal 2013, we began integrating Neolane into our Digital Marketing reportable segment. Neolane brings a platform for automation and execution of marketing campaigns across the web, e-mail, social, mobile, call center, direct mail, point of sale and other emerging channels which will drive consistent brand experiences and personalized campaigns for our customers.

Under the acquisition method of accounting, the total final purchase price was allocated to Neolane's net tangible and intangible assets based upon their estimated fair values as of July 22, 2013. The total final purchase price for Neolane was \$616.7 million of which \$515.2 million was allocated to goodwill that was non-deductible for tax purposes, \$115.0 million to identifiable intangible assets and \$13.5 million to net liabilities assumed. The impact of this acquisition was not material to our Condensed Consolidated Financial Statements.

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 has brought additional community features to Creative Cloud since its acquisition. 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 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 final purchase price for Behance was \$111.1 million of which \$91.4 million was allocated to goodwill, \$28.5 million to identifiable intangible assets and \$8.8 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 August 29, 2014 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$274,463	\$—	\$—	\$274,463
Cash equivalents:				
Money market mutual funds	565,996	—	—	565,996
Time deposits	62,870	—	—	62,870
Total cash equivalents	628,866	—	—	628,866
Total cash and cash equivalents	903,329	—	—	903,329
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,456,706	5,955	(425)	) 1,462,236
Foreign government securities	23,128	40	(3)	) 23,165
Municipal securities	185,634	543	(5)	) 186,172
U.S. agency securities	506,227	881	(260)	) 506,848
U.S. Treasury securities	437,362	580	(122)	) 437,820
Subtotal	2,609,057	7,999	(815)	) 2,616,241
Marketable equity securities	174	453	—	627
Total short-term investments	2,609,231	8,452	(815)	) 2,616,868
Total cash, cash equivalents and short-term investments	\$3,512,560	\$8,452	\$(815)	) \$3,520,197

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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 29, 2013 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$286,221	\$—	\$—	\$286,221
Cash equivalents:				
Money market mutual funds	429,373	—	—	429,373
Time deposits	104,711	—	—	104,711
U.S. Treasury securities	14,251	—	—	14,251
Total cash equivalents	548,335	—	—	548,335
Total cash and cash equivalents	834,556	—	—	834,556
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,261,375	7,116	(631	) 1,267,860
Foreign government securities	11,213	56	—	11,269
Municipal securities	186,320	328	(24	) 186,624
U.S. agency securities	446,615	1,516	(186	) 447,945
U.S. Treasury securities	424,076	799	(97	) 424,778
Subtotal	2,329,599	9,815	(938	) 2,338,476
Marketable equity securities	177	543	—	720
Total short-term investments	2,329,776	10,358	(938	) 2,339,196
Total cash, cash equivalents and short-term investments	\$3,164,332	\$10,358	\$(938	) \$3,173,752

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 August 29, 2014 and November 29, 2013 (in thousands):

	2014		2013	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	\$256,849	\$(289	) \$225,759	\$(631
Foreign government securities	7,595	(3	) —	—
Municipal securities	9,837	(5	) 13,522	(24
U.S. Treasury and agency securities	169,621	(232	) 105,278	(283
Total	\$443,902	\$(529	) \$344,559	\$(938

There were 208 securities and 177 securities in an unrealized loss position for less than twelve months at August 29, 2014 and at November 29, 2013, 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 August 29, 2014 (in thousands):

	2014	
	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	\$18,577	\$(136 )
U.S. Treasury and agency securities	29,416	(150 )
Total	\$47,993	\$(286 )

As of August 29, 2014, there were 16 securities in an unrealized loss position for more than twelve months. As of November 29, 2013, there were no securities in an unrealized loss position for more than twelve months.

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 August 29, 2014 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	\$629,477	\$630,712
Due between one and two years	808,082	810,830
Due between two and three years	915,643	918,119
Due after three years	255,855	256,580
Total	\$2,609,057	\$2,616,241

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 August 29, 2014, 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 August 29, 2014.

The fair value of our financial assets and liabilities at August 29, 2014 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	\$565,996	\$565,996	\$—	\$—
Time deposits	62,870	62,870	—	—
Short-term investments:				
Corporate bonds and commercial paper	1,462,236	—	1,462,236	—
Foreign government securities	23,165	—	23,165	—
Marketable equity securities	627	627	—	—
Municipal securities	186,172	—	186,172	—
U.S. agency securities	506,848	—	506,848	—
U.S. Treasury securities	437,820	—	437,820	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	14,384	—	14,384	—
Other assets:				
Deferred compensation plan assets	24,821	536	24,285	—
Interest rate swap derivatives	5,146	—	5,146	—
Total assets	\$3,290,085	\$630,029	\$2,660,056	\$—