# Q3 2020 Earnings Call

## Company Participants

- John Murphy, Executive Vice President and Chief Financial Officer
- Jonathan Vaas, Vice President, Investor Relations
- Shantanu Narayen, Chairman, President, and Chief Executive Officer

## Other Participants

- Alex Zukin, Analyst
- Brad Zelnick, Analyst
- Brent Thill, Analyst
- Derrick Wood, Analyst
- Jay Vleeschhouwer, Analyst
- Jennifer Lowe, Analyst
- Kash Rangan, Analyst
- Keith Bachman, Analyst
- Ken Wong, Analyst
- Kirk Materne, Analyst
- Mark Moerdler, Analyst
- Saket Kalia, Analyst
- Stan Zlotsky, Analyst
- Sterling Auty, Analyst
- Walter Pritchard, Analyst

## Presentation

### Operator

Good day, and welcome to the Adobe Third Quarter Fiscal Year 2020 Earnings Conference Call. Today's call is being recorded. All participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be provided at that time.

At this time, I would like to turn the conference over to Jonathan Vaas, VP of Investor Relations. Please go ahead, sir.

### Jonathan Vaas {BIO 21700508 <GO>}

Good afternoon, and thank you for joining us. With me on the call today are Shantanu Narayen, Adobe's President and CEO; and John Murphy, Executive Vice President and

CFO. On this call, we will discuss Adobe's third quarter fiscal year 2020 financial results. By now, you should have a copy of the press release, which crossed the wire approximately one hour ago. We've also posted PDFs of our prepared remarks and financial results on Adobe's Investor Relations website.

Before we get started, we want to emphasize that some of the information discussed in this call, including our financial targets and product plans, is based on information as of today, September 15th and contains forward-looking statements that involve risk, uncertainty and assumptions. Actual results may differ materially from those set forth in these statements. For a discussion of these risks, you should review the forward-looking statements disclosure in our press release we issued today, as well as Adobe's SEC filings.

On this call, we will discuss GAAP and non-GAAP financial measures. Reconciliations between the two are available in our earnings release and on Adobe's Investor Relations website. Call participants are advised that the audio of this conference call is being webcast live and is also being recorded for playback purposes. An archive of the webcast will be made available on Adobe's Investor Relations website for approximately 45 days. The call audio and the webcast may not be rerecorded or otherwise reproduced or distributed without Adobe's prior written permission.

I will now turn the call over to Shantanu.

## Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Jonathan. Good afternoon. I hope all of you are safe and taking good care. The ongoing pandemic continues to result in a challenging environment everywhere around the world. People are seeking new ways to communicate, learn and conduct business virtually. Content creation and consumption are exploding in a world, where connecting visually has become even more essential.

Students are adapting to learning remotely instead of in a classroom. Entire industries from media and entertainment to pharma, retail, automotive and financial services, have had to pivot overnight to digital operations to engage with customers and ensure business continuity. Electronic workflows and signatures are the only way to efficiently complete business transactions. The world has changed in a way that none of us could have foreseen.

This reality has created new tailwinds for Adobe. Our mission to change the world through digital experiences has never been more critical. Our strategy of unleashing creativity for all, accelerating document productivity and powering digital businesses is more relevant than ever and driving our strong performance across every geography and audience.

Adobe had an outstanding third quarter. We saw strength across Creative Cloud, Document Cloud and Experience Cloud. We achieved $3.23 billion in revenue in Q3, representing 14% year-over-year growth. GAAP earnings per share for the quarter was $1.97, representing 22% year-over-year growth. And non-GAAP earnings per share was $2.57, representing 25% year-over-year growth.

In our Digital Media business, we drove strong revenue growth in both Creative Cloud and Document Cloud in Q3, achieving $2.34 billion in revenue, representing 19% year-over-year growth. Net new Digital Media annualized recurring revenue or ARR was $458 million and total Digital Media ARR exiting Q3 grew to $9.63 billion.

We believe that everyone has a story to tell, and our goal is to give all creators from students, to social media influencers, business communicators and creative professionals the ability to create and amplify their stories. Creation and consumption across phones, tablets and desktops is exploding. Web content, mobile application creation, imaging, video, animation, screen design, AR and 3D are all surging in this new era of digital storytelling and business transformation. Enabling the capture, authoring and collaboration across each of these categories and inspiring our global communities, Creative Cloud is driving this massive content revolution.

Q3 Creative Cloud performance was outstanding, with net new Creative Cloud ARR of $360 million and revenue of $1.96 billion. Driving our Q3 Creative Cloud performance was record traffic to Adobe.com, our acquisition engine, using proprietary models for attribution and optimization; strength in our Creative Cloud single app and complete offerings across all geographies; growth in our creative mobile apps, delivering discrete revenue as well as a funnel to our multi-surface Creative Cloud offerings; improvement in retention driven by increased engagement and product usage among individuals, teams and enterprises; outstanding performance in the imaging and video categories with Photoshop, Lightroom and Premiere Pro; and strong performance in the education segment across students, educators and institutions.

Adobe MAX, the world's largest creativity conference will be hosted virtually in October. In addition to showcasing exciting new Creative Cloud products and services, our programming includes 56 hours of around the world content and features incredible creators like actor Keanu Reeves, photographer Annie Leibovitz and award-winning filmmaker Ava DuVernay. We expect a record turnout and are thrilled to already have over 200,000 registrations.

With Adobe Document Cloud, we've reinvented how people create, edit, share and sign digital documents with Acrobat and PDF. While digital documents have always helped small, mid-sized and large businesses realize productivity and efficiency gains, they have now become central to businesses operating remotely. Supported with a rich set of APIs, Adobe Document Cloud enables seamless workflows and collaboration across devices.

Q3 Document Cloud performance was exceptional with net new Document Cloud ARR of $98 million and record revenue of $375 million. Q3 highlights included strong growth in gross new ARR coming from the Adobe Reader funnel; significant gains in Acrobat web monthly average use; Acrobat Mobile installs up 33% year-to-date; significant momentum with Adobe Sign, including our announcement to pursue FedRAMP Moderate status; key customer wins, including Citi, PwC, Pepsi, HSBC, Merkle and J-Power; and the release of the Adobe Document Cloud Resource Hub for Education, a one-stop destination outlining how Document Cloud can assist with remote learning.

The shelter-in-place requirements instituted across the globe created a heightened sense of urgency among all companies to accelerate their digital transformation. Overnight small, mid-sized and large B2C and B2B companies shifted every aspect of their customer relationships from acquisition, all the way through renewals to digital. As a company that's been through its own digital transformation, we have a deep understanding of what it takes to be a digital business and that experience makes us the ideal partner to help other companies do the same.

Over the past decade, we have put the right technology, processes and people in place to precisely and persistently measure and manage performance every day at scale across each of our businesses. We developed across company real-time data driven operating model that leverages all of our Experience Cloud technology. The CXM playbook, which relies on continuous product, platform and process innovation has fundamentally changed the way we run our company. And today, we are helping our customers build their own CXM playbooks.

The industry's most comprehensive offering, Adobe Experience Cloud, features industry-leading applications and services built on the Adobe Experience platform, leveraging Adobe Sensei, our AI and machine learning framework. Digital Experience revenue was $838 million in Q3. Subscription revenue, excluding Advertising Cloud, grew 14% year-over-year.

Q3 highlights include increased adoption of Adobe Experience Platform and the launch of new capabilities that allow marketers to accelerate data collection across channels to enable faster, personalized experiences based on real-time insights; general availability of Data Governance capabilities in the real-time Customer Data Platform; early traction with our Customer Journey Analytics service, which provides customers a complete view of the customer journey online and offline; acceleration and the deployment of our Adobe Experience Manager Cloud service; significant quarter-over-quarter growth for commerce offerings; working with our Advertising Cloud customers to wind down our transaction-based offerings; key customer wins, included Eli Lilly, Truist, Nike, Lowe's, Shell, Lloyds and the US Department of Commerce; a partnership with IBM and Red Hat to enable Experience Cloud deployment in hybrid cloud environments that further strengthens real-time data security for enterprises in regulated industries; and recognition as a leader in six Gartner Magic Quadrant and Forrester Wave reports. In the Gartner Magic Quadrant for CRM Lead Management, Adobe was the leader, achieving the best scores across Ability to Execute and Completeness of Vision.

Adobe's record results would not be possible without the ongoing contributions and unwavering dedication of our employees around the world. They've demonstrated incredible resilience by quickly pivoting to a remote work environment without missing a beat. I am proud and grateful.

Great companies are defined by how they manage through difficult times. Our strong corporate culture, focus on innovation, exceptional customers and partners and always doing right by our communities drives us and our success. We're excited about the tremendous opportunity ahead of us and look forward to continuing our strong momentum in 2020 and beyond.

John?

## John Murphy {BIO 16018871 <GO>}

Thanks, Shantanu. Adobe delivered outstanding performance in Q3, highlighted by strong net new Digital Media ARR, Digital Experience subscription revenue growth and record operating cash flows. Despite challenging macroeconomic conditions, the ongoing remote work and learning from home environment provided an opportunity to offset normal Q3 summer seasonality.

Our success was driven by Adobe's unique ability to draw insights across our business in real-time utilizing our data-driven operating model. This enables us to understand demand for our solutions, make strategic investments to capitalize on the highest returns and drive engagement and conversion across our channels, most notably our web properties.

Throughout the quarter, we generated sustained levels of traffic and demand across our Adobe.com offerings, including during the summer holidays, where purchasing patterns have historically softened. Utilizing our proprietary attribution technologies, we made variable marketing investments that enabled us to attract and engage new customers, delivering the strongest Q3 on record for Adobe, while at the same time maintaining fiscal discipline to accelerate earnings growth.

As a result, in Q3, Adobe achieved record revenue of $3.23 billion, which represents 14% year-over-year growth. On a constant currency basis, total Adobe revenue grew 15% year-over-year. GAAP diluted earnings per share in Q3 was $1.97 and non-GAAP diluted earnings per share was $2.57. Business and financial highlights included Digital Media revenue of $2.34 billion; net new Digital Media ARR of $458 million; Digital Experience revenue of $838 million; record cash flows from operations of $1.44 billion; remaining performance obligation of $10.34 billion exiting the quarter; and repurchasing approximately 1.5 million shares of our stock during the quarter.

Adobe's strong third quarter performance shows the continued momentum across our cloud businesses. From knowledge workers to creative professionals, from small businesses to large enterprises, people are driven to engage digitally and are seeking tools that enable them to communicate more proficiently across digital platforms.

In our Digital Media segment, we achieved 19% year-over-year revenue growth in Q3. On a constant-currency basis, Digital Media grew 20% year-over-year, and we exited the quarter with $9.63 billion of Digital Media ARR. Within Digital Media, we've achieved another strong quarter with our Creative business. We achieved Creative revenue of $1.96 billion, which represents 19% year-over-year growth and we added $360 million of net new Creative ARR.

Our Creative growth in Q3 was driven by investing to acquire new customers across all geographies and segments; continuing our relentless focus on engagement to drive retention and renewal of existing customers; successfully closing enterprise term licenses with educational institutions, as well as growing our education business through individual subscriptions by students; driving awareness and licensing of our professional video products; focusing on converting free mobile app users to paid mobile subscriptions, including strong growth in Lightroom Mobile; and utilizing insights from our data-driven operating model to run targeted campaigns and promotions.

Adobe Document Cloud delivered another quarter of strong revenue growth. We achieved Document Cloud revenue of $375 million, which represents 22% year-over-year growth, and we added a record $98 million of net new Document Cloud ARR. As with our Creative business, Document Cloud is benefiting from the changing nature of work and the continued importance of digital document solutions, as individuals, enterprises and governments look to pivot away from paper-based dependencies to digital workflows.

Our Document Cloud growth in Q3 was driven by investing and driving awareness in our Acrobat web business; continuing to build momentum with our mobile monetization efforts with Acrobat Reader; increasing demand for Acrobat subscriptions across all geos; and building, progressing and closing pipeline for our enterprise offerings, with particular strength in Adobe Sign, which grew enterprise bookings more than 200% year-over-year. While we saw some recovery in the SMB segment during Q3 across Digital Media, smaller businesses continue to be impacted by the macroeconomic environment. We expect this to continue to impact our Team offering across the reseller channel and on Adobe.com.

Turning to our Digital Experience segment, in Q3, we achieved revenue of $838 million, which represents 2% year-over-year growth. Digital Experience subscription revenue was $729 million, representing 7% year-over-year growth. Excluding Advertising Cloud, Digital Experience subscription revenue grew 14% year-over-year. We continue to wind down the transaction-driven ad network business in Advertising Cloud.

During Q3, enterprise sales and services implementations settled into a new normal of virtual engagements. We drove strong pipeline and customer acquisition across our Digital Experience solutions, as the digital transformation imperative continues to resonate with our customers. We saw acceleration of our commerce business and we drove increased adoption of our AEM Cloud Service and Adobe Experience Platform, which we expect to be growth drivers over the next decade. We saw particular strength with the number of transactions greater than $1 million in new annual subscription value that we closed in the quarter. While enterprises and small businesses continue to be impacted by the macroeconomic environment, spending in customer experience management is reemerging as the primary imperative to enable businesses to engage with their customers and ignite growth.

Overall, while our focus is on investing for profitable growth, particularly in research and development, we drove significant savings from travel and entertainment and facilities operations as our employees work from home. After ensuring that our current resources are focused on the key priorities, we expect to ramp our hiring in Q4 and FY '21 to capitalize on our large addressable markets.

From a quarter-over-quarter currency perspective, FX increased revenue by $15 million. Net of impacts from hedging, the sequential currency increase to revenue was $10 million.

From a year-over-year currency perspective, FX decreased revenue by $14 million. Net of impacts from hedging, the year-over-year currency decrease to revenue was $25 million. Adobe's effective tax rate in Q3 was 10% on both a GAAP and a non-GAAP basis, in line with our targets.

Our trade DSO was 37 days, which compares to 44 days in the year-ago quarter, and 40 days last quarter. Remaining performance obligation or RPO grew by 18% year-over-year to $10.34 billion exiting Q3 and grew sequentially by 4% quarter-over-quarter. Deferred revenue exiting the quarter was $3.45 billion. As I mentioned last quarter, our Adobe.com offerings, typically billed monthly, are reported as unbilled backlog, whereas channel offerings billed annually upfront are reported as deferred revenue. The strength in acquisition on Adobe.com during the quarter continues to drive a mix shift from deferred revenue to unbilled backlog.

Our ending cash and short-term investment position exiting Q3 was $5.26 billion and cash flows from operations in Q3 were a record $1.44 billion. In Q3, we repurchased approximately 1.5 million shares at a cost of $617 million. We currently have $2.9 billion remaining of our $8 billion repurchase authority granted in May 2018, which goes through 2021.

For Q4, factoring current macroeconomic conditions, typical year-end seasonal strength and the strategic shift related to our Advertising Cloud business, we are targeting total Adobe revenue of approximately $3.35 billion; Digital Media segment year-over-year revenue growth of approximately 18%; net new Digital Media ARR of approximately $540 million; Digital Experience segment revenue approximately flat year-over-year; Digital Experience subscription revenue growing approximately 1% year-over-year or 12% when excluding Advertising Cloud revenue; tax rate of approximately minus 90% on a GAAP basis and 10% on a non-GAAP basis; share count of approximately 485 million shares; GAAP earnings per share of approximately $4.29; and non-GAAP earnings per share of approximately $2.64.

The GAAP tax rate is benefiting from planned changes to optimize our international structure in Q4 to better align ownership of certain intellectual property rights with how our business operates, as we discussed during our Q1 call earlier this year. In summary, we expect a strong Q4 to conclude another year of record revenues and earnings for Adobe. Through these times, the resilience of our employees and our business model have been evident. As our market-leading solutions continue to resonate with individuals and enterprises across

The globe, we remain excited about the growth opportunities ahead.

Back to you, Jonathan.



**Jonathan Vaas** {BIO 21700508 <GO>}

Thanks, John. As we announced earlier this year, Adobe MAX, our annual creativity conference, will be an online event this October. Information about the event can be found at max.adobe.com. Today, we also announced that Adobe will host its fourth quarter and fiscal year 2020 earnings conference call and financial analyst meeting online on December 10th, where we will provide an overview of the company's strategy and financial targets for fiscal year 2021. Invitations will be sent to our analyst and investor list in the coming weeks.

If you wish to listen to a playback of today's conference call, a webcast archive will be available on Adobe's IR site later today. You can also listen to a phone replay by calling the numbers shown above. The phone playback service will be available beginning at 5:00 PM Pacific Time today and ending at 5:00 PM Pacific Time on September 22nd.

We would now be happy to take your questions, and we ask that you limit your questions to one per person. Operator?

# Questions And Answers

## Operator

Thank you. (Operator Instructions) We'll take our first question from Kirk Materne with Evercore ISI.

## Q - Kirk Materne {BIO 5771115 <GO>}

Yes, thanks. Thanks very much, and congrats on the quarter. Shantanu, I was hoping maybe we could start there, my question is actually just going to be around the Experience Cloud business. Obviously, you guys are divesting the Advertising Cloud part of that. But just in terms of the commentary, it seems like the pipeline is building nicely, RPO was up nicely in the quarter, yet revenue guidance for next quarter is down a little bit. I was wondering, if you can just square that up because it sounds like your enthusiasm for that opportunity still remains very high, but I think some people might be wondering why maybe is revenue not sort of matching up with that. Thanks.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, happy to. And as you pointed out, Kirk, I mean, firstly, digital transformation is a massive addressable opportunity and it's clear that we are the leaders. We had a great quarter. Bookings grew north of 15%. As you saw, we had good revenue, we successfully have introduced brand new products, which we believe are going to be the growth drivers from what we did with the Adobe Experience platform, what we did with Customer Journey Analytics, the Customer Data Platform, as well as what we are doing around both commerce as well as the Adobe Experience Cloud in the Cloud Service.

So, the business and the interest, frankly, because there isn't a small and medium business or large enterprise that isn't interested in how digital can help them deal with the current health situation. So, bookings have been strong, business has been strong. I think as it relates to revenue, you have to continue to think about the wind down of the Advertising Cloud business, which continues to happen. We expect bookings to be strong. And then the other issue for us is really is the macroeconomic environment, you think about the spending patterns. But net-net for us, we thought the business did really well. It was a great rebound from what we had expected in Q2, which was both on the consulting side as well as on the net ASV, we thought it would be slightly slow. So, we're really excited and we're in the sweet spot of what is clearly a growth business.

## Q - Kirk Materne {BIO 5771115 <GO>}

Thanks, Shantanu.

## Operator

Thank you. We will take our next question from Saket Kalia with Barclays Capital.

## Q - Saket Kalia {BIO 16417197 <GO>}

Hey, guys. Thanks for taking my question here. Shantanu, maybe just to stay on the Digital Experience business, zooming out a little bit strategically. I think Anil Chakravarthy is still getting settled in as leader of the DX business and field operations. I guess, the question is, what are some of his objectives, particularly in the DX business that you're most excited about for next year?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Well, Saket, first, I will say this. His has been the fastest ramp that I have seen of any executive that we've got, so he is doing an absolutely fantastic job and a great addition to what you know is already a very strong management team that I am blessed with at Adobe. Maybe, I would say three things. The first is on the product side. He has really got his hands around the platform and the innovation associated with the platform, the delivery of Customer Journey Analytics.

We had a great quarter with the Adobe Experience Platform and a number of customers are adopting it, what we are doing around CDP and the real-time nature of what we can do there as well as intelligence services that are leveraging Adobe Sensei. So, on the product and innovation, making sure that we have this platform that we integrate all our products, he has really added a lot of value there, but that will continue to be the area where I think we can completely differentiate ourselves relative to anybody else because while others are talking about providing this unified profile, as you know we have tens of billions of profiles already in Adobe Experience Platform.

I think the second area is with the unified organization, really focusing on the customers and the customer centricity and what we are doing with partners. The structure for US and international is set up, and he is focused on aggressively evangelizing both our vision as well as the differentiation in the marketplace. I mean, one side benefit Saket of everybody working from home is we can engage with customers so much better. And a routine day consists of significant customer engagement. So, that's clearly the area that he is focused on because he needs to be out there as the leader of this.

And third, I would say, the culture. Adobe's culture has always been a unique point and focus on talent and hiring and where there is significant opportunity making sure that we have the best talent. So, he's already been able to recruit some key people as additions to his management team, but there is a lot to do and there's a lot that he has done. And so, we're very excited about having him on-board.

## Q - Saket Kalia {BIO 16417197 <GO>}

Got it. Very helpful. Thanks, guys.

## Operator

Thank you. We will take our next question from Brent Thill with Jefferies.

## Q - Brent Thill {BIO 1556691 <GO>}

Good afternoon. Shantanu, Q4 Digital Media guide well above The Street, as you're clearly seeing a lot of great tailwinds in that business. I'm curious if you could just kind of unpack the drivers and what you're seeing for the upside surprise relative to Street numbers?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, Brent. I am surprised you didn't talk about the Q3 upside as well. I mean, we just saw (Multiple Speakers) we saw tremendous performance. I mean, as you see, what's happening in both creativity and document productivity, Brent, I mean, the business is just firing on all cylinders and that has to do both with products as well as frankly with services. We didn't maybe comment specifically on the services, but the services, the stock business just continues to do well. There is no question we are gaining market share.

The Sign business has grown very successfully. But if you continue to think about I think what's driving that business, the first is we sharpened our focus on usage and engagement, and the usage and engagement that we did really helped improve retention rates back to the pre-COVID levels. So, that focus will just continue. We have a very large book of business. The education -- education had a good quarter, so we'll have continued focus on education. Individual apps, we talked about Lightroom, Photoshop and Premiere Pro as areas where there is a lot of interest in our business.

And also the sophistication of what we talked about, namely the marketing attribution and models, it just helps us spend money so efficiently and sustain the durability of the acquisition of new customers and trends. So, as you pointed out, when we look at the second half performance, it just demonstrates how both Creative Cloud and Document Cloud frankly are the preeminent platforms and we should continue to see good strength from our Q3 back into Q4. So, we're excited.

## Operator

Thank you. We will take our next question from Kash Rangan with Bank of America.

## Q - Kash Rangan {BIO 22095432 <GO>}

Nice to go right after Brent here. Thank you so much, and congratulations on your quarter. Shantanu, you talked about how the pandemic has actually resulted in better customer engagement. But as we come out of the pandemic, if there is ever such a thing called coming out of this pandemic when we got a vaccine. How does the business perform and do you feel that this actually lengthens the cycle for digital transformation or do you think we could be in a pocket, a bit of a halo effect where things get pulled in a little bit because we've got all this time to do more work and there's a bit of a catch-up and then, of course, the longer-term secular trajectory for digital information is unchanged? I mean, how are we to think about -- well, the environment is actually unusually supportive of your results, not only your results, but other software companies, so that we might get a bit of a pull back if we enter into a normal economy, sorry to word it that way, but just curious to get your thoughts. Thank you.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, Kash. We've been talking about the trends that are going to be tailwinds across each of our businesses, whether it creativity, document productivity or specifically to your question digital transformation. And the genie is not going to go back in the bottle. I mean, we've certainly seen as you point out an inflection in the business as it relates to the demand in digital transformation. But my perspective on this business is, it's just going to gain importance. I think as the macroeconomic environment improves, the spending will actually open up in terms of what people spend. And we've been touching on customer experience management as a imperative and a priority for enterprise spend for a while. And I don't think that changes. So, I think everybody is recognizing that not having a commerce website and not being able to engage digitally with customers. And I think the two areas where we are seeing the most excitement is this unified profile because people now absolutely recognize where you have a physical presence and you have a digital presence, you have to absolutely create a unified experience. And that I think is only going to accelerate.

So, you will see more physical, perhaps once the vaccine is present, but that's not going to change the need to provide this unified experience. And on the marketing spend side, more and more is going to go digital and people will want to run more of these digital campaigns with customers. So, I think the basic trends of personalization of unified profile of customer experience management are only going to continue once the pandemic. And I actually feel like that should hopefully signal an improvement in the macroeconomic environment for everybody. I think a lot of what's happened right now is people want to spend in digital, but their spending ability may be limited. And as that spending ability opens up, as the economy improves, I don't think it changes the priority, I think it frankly opens up spending.

## Q - Kash Rangan {BIO 22095432 <GO>}

Very insightful. Thank you very much. Congrats.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Kash.

## Operator

Thank you. We will take our next question from Brad Zelnick with Credit Suisse.

## Q - Brad Zelnick {BIO 16211883 <GO>}

Excellent. Thank you so much and congrats on the really strong Q3. John, my question is for you. In your prepared remarks, you talked about the variable marketing investments that enabled Adobe to attract and engage new customers, which clearly worked well. Can you comment on what you're seeing in terms of ROI trends on marketing spend and reasons to believe they may or perhaps may not be sustainable? Thanks.

## A - John Murphy {BIO 16018871 <GO>}

Sure. Well, thanks again, Brad, for the question. I think when we look at our capabilities with DDOM, or data-driven operating model, the level of precision which we're able to see performance in our business real-time really allows us to surgically invest where we know we can be successful. And so, you can see that in the performance, obviously, in the ARR both in Q3 and where we think we can drive momentum in Q4. So, we have a lot of confidence in investing for an appropriate return and also looking at the breadth of the different markets we're trying to attract to the platforms, both CC and DC. So, we monitor that very carefully, we don't just throw money at variable marketing just to see where it lands, we're actually measuring very completely every dollar that we invest in that space.

## A - Shantanu Narayen {BIO 3332391 <GO>}

And, Brad, maybe if I were to add just a little bit on top of that, what you have to do is again harken back to what we said is the overall addressable market opportunity for all of our businesses. And on the Creative and Document Cloud as we talk about, a greater than $30 billion addressable opportunity, this sophistication just helps us target all those people with more efficiency. And as John said, the constant changing nature of where that marketing goes, we definitely view that as a differentiation for us in terms of what product, what service, what geography across what channel.

## Q - Brad Zelnick {BIO 16211883 <GO>}

Thank you, both. Very clear.

## Operator

Thank you. We'll take our next question from Jennifer Lowe with UBS.

## Q - Jennifer Lowe {BIO 6926228 <GO>}

Great, thank you. I wanted to touch on the gross margin within the Digital Experience business. And as talked about earlier, my understanding was that as the Ad Cloud winds down, there should be a gross margin benefit attached to that. But if I look at the GAAP gross margins in Digital Experience, they're actually down a little bit quarter-over-quarter. So, sort of related to that, first, how should we think about the costs associated with Ad Cloud rolling off the cost of goods sold line over the coming quarters? And secondly, how should we think about the margin profile of that business once that wind down has happened?

## A - Shantanu Narayen {BIO 3332391 <GO>}

I can add and then, Jennifer, John certainly feel free. I mean, overall on that business, I think there was a slight performance in what we saw in the Ad Cloud revenue in the quarter, so that might account for what you are referring to. I think big picture, we just look at it and say, this is a growth business. What we've been able to do by aligning is to make sure that we're focused on the highest priority growth objectives. And so, it's still a growth business, that's a real focus for us. But as it relates to the overall margins, I mean, the company performed exceedingly well. I would argue maybe we were a little conservative, frankly, because we were unclear of the macroeconomic environment in terms of hiring, but we are certainly going to be opening up the hiring in research and development to continue to differentiate ourselves. And on the Digital Experience, now that we've consolidated the organization, we've eliminated all the inefficiencies, we've made the strategic change on Advertising Cloud, now we feel like it's all going to be profitable growth as we invest in the Digital Experience business.

## Q - Jennifer Lowe {BIO 6926228 <GO>}

Thank you.

## A - John Murphy {BIO 16018871 <GO>}

That's right, Shantanu. Quarter-to-quarter, it's really partly the overperformance in the Ad Cloud as we had been transparent with our customers, we helped them transition to other services, but we also helped them run (inaudible) that were scheduled. In addition, the volume of activity across our other products did actually increase some of our cloud spend -- our cloud costs or third party cloud costs, and that's something that we are monitoring very closely, so that we can leverage the volume and negotiate our contracts appropriately and drive efficiencies across our clouds.



## Q - Jennifer Lowe {BIO 6926228 <GO>}

Great. Thank you.

## Operator

Thank you. We will take our next question from Jay Vleeschhouwer with Griffin Securities.

## Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thank you. Good evening. Shantanu, the company has often spoken in the past, for instance, at Summit presentations that you've identified about four dozen use cases for DX. And the question is setting aside Ad Cloud and whatever part of that mix they may have accounted for, what trends or evolutions have you been seeing in the number or mix of use cases within DX? And then related to that perhaps you could also update us on the applications and intelligent services that you previewed back at Summit earlier this year? And how that might flow into the various use cases and more importantly the DX growth that you're anticipating?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Jay. I think what's been consistent in the business and areas that continue to show both growth as well as interest from customers is, first and foremost, content and data.

And so, I think when we think about what's happening with content, the use case of people increasingly moving to cloud services on the Adobe Experience Manager side, creating new mobile applications and engaging directly with customers, I think that just continues to be an area of significant growth.

On the data side, as we have added more capabilities both through Adobe Analytics, as well as with the Adobe Experience Platform of being able to say what is the insight that people are getting. I mean, we're all looking at data even more stringently in this environment. And so, the use case associated with going from collecting that data to getting insights on that data, the demand for that particular area of our solutions, including in intelligent services where as you know we have intelligent services that are associated with each of the solutions, that's an area of increase.

I would say, the third area is this unified profile and just being able to get all of the data. That's clearly a trend, Jay, because people recognize that they have all these silos and that was even more accentuated by what's happening in the health. So, the need and desire to get this unified profile, so that they can serve the customer adequately that use case. And when we are talking about Customer Journey Analytics, how you do the equivalent of what we have done with DDOM, I think that's a use case that's clearly resonating with customers.

Commerce, I would say the commerce use case and how you have to find different models, whether it's a subscription-based business model of transacting with customers, whether it's loyalty-based business model. So, I think the commerce and using commerce to accomplish new business models, I think that use case has also increased. And the last thing I would say is between the B2B and B2C, we've talked about that distinction blurring, but I think all B2B companies are still stating how can we both work directly and engage with customers as well as through a network of partners, I hear that over and over again. So, whether you are a company providing goods through a distribution channel, whether you're a car manufacturer, all of them recognize that they have to bridge this gap between being deemed a B2B company and a B2C company.

## Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thank you very much, Shantanu.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Jay.

## Operator

Thank you. We'll take our next question from Sterling Auty with JPMorgan.

## Q - Sterling Auty {BIO 2070271 <GO>}

Yeah, thanks. Hi, guys. You mentioned in your prepared remarks that the SMB segment showed some improvement in the quarter. Can you just give us maybe some -- from a high level how much exposure does the business have at this point to SMB and even into that prosumer area where maybe some of the stimulus being talked about would have a bigger impact?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, Sterling. We looked at both those trends quite a bit as we went through the quarter. And I would say as it relates to the stimulus when the first package came out, this was early we saw appreciable difference in sort of the payment successes and what happened with the individual subscribers. So, we saw a correlation associated with that, subsequent ones have not. And as I said, the engagement work that we did helped us get retention back up to the levels that we had pre-COVID. So, I don't know whether that was a initial catalyst, but to us, it just demonstrated increased importance of the solutions that we provide.

As it relates to the small and medium business segment, again, that is through the team offering, a lot of that happens through the channel. And Q3, we saw some strength in that. So, I don't know that we've broken out, Sterling, what percentage is exactly on individual versus team versus enterprise, it is a big part of our business because small and medium businesses certainly use both our Creative and Document tools, but we were pleased with what we expected. As it relates to our Q3 targets, we're still going to be a little cautious about seeing the rebound in that SMB. So, we're not necessarily expecting significant new acquisition in that, but we were pleased with what we saw in Q2. And long-term, we just continue to think that our solutions help them become a digital enterprise, which is going to become more important.

## Q - Sterling Auty {BIO 2070271 <GO>}

Thank you.

## Operator

Thank you. We will take our next question from Alex Zukin with RBC Capital Markets.

## Q - Alex Zukin {BIO 18006605 <GO>}

Hey, guys. Thanks for taking the question. So, maybe a combo question for Shantanu and for John. Shantanu, you're seeing kind of now two straight quarters of all-time highs for traffic on Adobe.com. And according to our data, it would actually appear the trend is only accelerating. So, I guess, the question is, back to that durability, kind of what's driving that acceleration and how would you think about the durability of that 20%-plus Digital Media ARR growth trend as you sit here today? And then ultimately maybe, John, remind us, what kind of rules should we remember in our models? As DM ARR stays above 20%, is that -- what kind of churn assumptions we should think about when looking at Digital Media revenue growth next year?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah. Alex, as it relates to the overall macro demand, just the amount of content that's been created is just absolutely exploding and it actually doesn't matter whether you're -- as we talked about an individual who has a story that they want to tell a small and medium business who has to transact business online and therefore has to create the appropriate content whether it's a large enterprise that is increasingly engaging digital and therefore wants the appropriate personalized content. And I think that trend will only continue to speak well for Adobe. We look at some other trends like the number of people engaging with us on Behance, which is our community.

We're getting more part of Behance being used than ever before, what we are doing with Spark, which is allowing prosumers and others who have a task-based offering to come. So, we just continue to think that the amount of content being created and the amount of content being consumed is only going to go up. And we have the premier offering in that space, not only from the product side, but from also the DDOM side. And so, I think it really continues to augur well for us. And we will certainly give you more color as we come up to fiscal '21 on what we expect moving forward, but we're excited about the opportunity.

## A - John Murphy {BIO 16018871 <GO>}

Yeah. I would say, in -- yeah. In regard to your comments on retention, as Shantanu said, the efforts that we put into engaging our customers and making sure they're using the right product for the right use case has really driven our retention efforts really well in that engagement. And, of course, the fact that we'll be able to see a return to kind of pre-COVID levels is indicative of people seeing value in the products that they're using.

## Q - Alex Zukin {BIO 18006605 <GO>}

Got it. Thank you, guys.

## Operator

Thank you. We will take our next question from Keith Weiss with Morgan Stanley.

## Q - Stan Zlotsky {BIO 19183037 <GO>}

Perfect. Thank you so much, guys. This is Stan Zlotsky sitting in for for Keith. A quick question for John. Very strong margins in Q3, record margins on operating margin side. What should we keep in mind as far as margins as we head into Q4 and what is embedded in the EPS guidance for the quarter? Thank you.

## A - John Murphy {BIO 16018871 <GO>}

Sure. Sure.Thanks, Stan. When we entered Q3 and when we looked at really focusing our resources on the top priorities, once we got through that activity and we felt really comfortable with the performance that we were seeing, we realized that we're probably being a little conservative or slower out of the gate ramping our hiring. And we're committed to ramping our hiring now going into Q4 and into FY '21 to really drive the opportunities that we see, to drive performance in these opportunities. So, we are investing in R&D and we see that kind of manifest in our Q4 hiring and into FY '21. We do believe that some of the other OpEx savings that we've had, one-time savings around travel and facilities and in-person events are going to change as we start to reopen our offices when it's safe. And so, we don't expect the level -- the lack of spending in those areas in Q3 to be sustainable going forward. So, that is something to consider when you look at the operating margin performance in Q3.

## Q - Stan Zlotsky {BIO 19183037 <GO>}

Perfect, thank you so much.

## A - John Murphy {BIO 16018871 <GO>}

You bet.

## Operator

Thank you. We will take our next question from Walter Pritchard with Citi.

## Q - Walter Pritchard {BIO 4672133 <GO>}

Hi. I'm wondering, John, if you -- or John or Shantanu, if you could talk about retention? And you highlighted that in your prepared remarks around improvement in retention. And maybe just directionally, how -- you talked a little bit about some headwinds there a quarter ago, where you are now versus retention in sort of the steady-state? How much it dipped down and if it varies much by the various segments of your Digital Media business?

## A - Shantanu Narayen {BIO 3332391 <GO>}

I think Walter may be looking at it now in retrospect, I don't know if -- when COVID first hit, whether there was a shock to the system. And, therefore, people reacted. And I think that has settled down, as we've said in a couple of times, it's definitely gone back to the pre-COVID levels. I think I would also give our team tremendous credit for what we've done around engagement. I mean, the good news for us, Walter, is we have such a variety in portfolio of products that we can use. And let's take Acrobat where we haven't spent -- we haven't got as many questions. I mean, from everything we can do around Acrobat on the web to what we can do with the Reader funnel to Acrobat.

And so, we really just are a world-class machine on both the acquisition and increasingly on the engagement retention. So, my best guess is there was a little bit of a shock to the system that has definitely stabilized that provided the impetus for us to really focus on engaging more with customers and delivering the value. And last but not least, I think it just shows how mission-critical these products are. And so, again, it's very different by offering to you the second part of your question. But within enterprises, within creative pros, we just continue to see really good retention and really good acquisition.

## Q - Walter Pritchard {BIO 4672133 <GO>}

Thank you.

## Operator

Thank you. We'll take our next question from Derrick Wood with Cowen and Company.

## Q - Derrick Wood {BIO 4963641 <GO>}

Great. Thanks for taking my question. Shantanu, you mentioned that the education vertical had a good quarter. And I think there was some uncertainty around the health spending here, given all the change institutions have had to go through. I guess, since we're in back-to-school mode right now, though, obviously, a much more virtual bend to it, but can you talk about what you've seen out of the education vertical in terms of demand and the usage patterns and how that looks typically in back-to-school season and kind of what insights that gives you as we progress through the school year?

## A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Derrick. And, again, I mean, first, let me acknowledge that I think for both parents of young kids as well as those who have college-going kids, I mean, there is still quite a bit of uncertainty of what happens. But as it relates to the strength, I mean, we saw strength both in terms of students, educators, as well as institutions. And so, we saw strength across the board. Part of what I would attribute that to is when it first struck and everybody was from home, if you have a young kid or a college-going kid, you want to continue to invest in making sure that they have access to the best software. I think we did a good job of provisioning Creative Cloud and ensuring that they have access to Creative Cloud. And then we pretty actively went out with our field organization, both in terms of licensing products as well as the enterprise side licenses that you can have for institutions to demonstrate it. And the last thing I would say is we are seeing more and more curricula in these institutions also add so much more on creativity as part of their curricula. So, I think that's a trend that is also helping our business.

## Q - Derrick Wood {BIO 4963641 <GO>}

Okay, thanks.

## Operator

Thank you. We will take our next question from Ken Wong with Guggenheim Securities. Mr. Wong, please unmute if you are muted.

## Q - Ken Wong {BIO 20723645 <GO>}

Sorry about that. Thanks for taking my question. John, you mentioned in the prepared remarks seeing an acceleration of Adobe Commerce. Just when thinking about how you guys licensed the product, when should we expect to see that benefit revenue, is that something you're already capturing or is that down the line at renewal time?

## A - John Murphy {BIO 16018871 <GO>}

Really both. Thanks Ken for your question. So, we certainly saw commerce revenue perform this quarter and certainly the bookings associated with the demand for commerce offerings increase this quarter. So, we just see the momentum there, people are really resonating with the product, they're seeing that it's a great add-on as well when they are looking at some of our other solutions in digital transformation in the segment. So, we think there is a nice tailwind there in commerce.

## A - Shantanu Narayen {BIO 3332391 <GO>}

And to your question, Ken, I mean, John, we certainly have bands. And since we have bands and we don't charge based on necessarily the immediate transaction, what happens is as people come up for renewal, which was the second part of your question, Ken, yeah, the intention is that they both true up as appropriate and/or move to a higher band.

## A - John Murphy {BIO 16018871 <GO>}

Right.

## Q - Ken Wong {BIO 20723645 <GO>}

Great. Thanks, guys.

## A - Jonathan Vaas {BIO 21700508 <GO>}

Operator, we're coming up on the top of the hour. We will take two more quick questions. Thanks.

## Operator

Thank you. We'll take our next question from Mark Moerdler with Bernstein Research.

## Q - Mark Moerdler {BIO 16855032 <GO>}

Thank you, and congrats on the strong quarter. I was impressed in the comment on the 200% year-over-year growth and enterprise bookings driven by Adobe Sign. Can you give more color, is this growth in full Document Cloud, is it a portion of that? Any color on the percentage of Document Sign, Document Cloud that is now from enterprise agreements. Appreciate it. Thanks.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Mark. And as you point out, and we didn't get too many questions. I mean, the Document Cloud really had a very strong business. And at the macro level, the strength of Acrobat, all the verbs that we have, including Sign, the frictionless Acrobat web and the platform APIs, we're really convinced we have the right platform for document creation, sharing, signing, exporting and scanning. I mean, scan also the number of installs of scan what we are seeing on mobile, so across all of our PDF solutions. When we are talking about the business as it related to Sign, Sign actually grew faster than the Document Cloud business. And the 200% statistic that we gave has to do with Sign standalone. The way we are going to market, we introduced Sign also in the channel just very recently, so the -- while that's early, we are seeing good traction with Sign in the channel.

The primary route to market is either through Acrobat for individuals or through the enterprises. In the enterprises, we are seeing two forms of traction. The first is where people are using Sign as the core sign solution for all of their business processes. I think some of the partnerships that we've announced as well with Microsoft as well as with ServiceNow, we expect to see that continue to grow. And in addition to that, we've actually seen some really good traction with our Document Experience -- Experience Document sellers also demonstrating how the combination of Adobe Experience Manager, which is the core website plus what you can do around forms and signs for business processes how that's growing. So, across the board, we saw some really good strength in that business.

## Q - Mark Moerdler {BIO 16855032 <GO>}

Much appreciated. Thank you.

## Operator

Thank you. We will take our last question from Keith Bachman with Bank of Montreal.

## Q - Keith Bachman {BIO 3018411 <GO>}

Hi, Shantanu. It's Keith. I wanted to follow up on that and stay with the Document Cloud. Over the last 11 quarters, Document Cloud ARR growth is the low, it's kind of 31%, the high is 36%. And even in a challenging last two quarters, the May and August quarters, it's been towards the high end of the range. And my question is, as the economy improves, could you talk a little bit about the durability? In other words, can ARR growth continue in that 34% to 35% range as you look out over the next couple of quarters? And, B, also just talk a little bit about the competitive landscape. How you see your competitive offering, your solution set stacking up, so to speak, against your primary competitor? Thank you.

## A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Keith. I mean, first, as it relates to the sustainability and durability of the Document Cloud business, it wasn't an accident that at our last Analyst Meeting, we talked about Document Cloud being a separate huge standalone opportunity and accelerating document productivity. That's why we spent as much time as we have on that. Traditionally, people, Keith, used to talk about the business moving from perpetual to subscription. It has so far exceeded all of that opportunity to really focus on creating brand-new customer acquisition. The web as a funnel represents a huge growth opportunity for us. I have talked also about when you think about what's happening with organic searches and the ability for people to want to share information and how that's going to be a driver of the funnel, we're excited about the API economy and what we can do to make sure that any PDF that's created anywhere or any PDF that's scanned or signed that it uses Adobe technology.

And so, at the end of the day, we just look at what we have with documents and the fact that we have PDF and the fact that we have Reader ubiquity as a completely differentiated solution with respect to anybody else. And this business is such a large opportunity. This is not a zero-sum game, this is something that we just continue to believe is going to fuel our business for a long time. But we frankly think we're in the catbird seat and we have the best combined offering, we have great partnerships in this space, we're innovating so much on mobile, what we've done with this feature that we call liquid mode with AI to be able to make PDFs responsive. And so, I think while the pandemic to the question that somebody else also asked has perhaps accelerated this movement towards electronic documents, I don't think people are going to go back because they all see the benefits and the efficiencies of being document. So, that's how we think about that business. And we'll certainly be happy to share a lot more at our earnings call.

Since that was the last question, I do hope Keith that both you as well as others will attend MAX because we do intend to unveil the next generation of creative innovation at MAX. As I said, we have over 200,000 people already. But net-net, I would say, Q3 was an outstanding quarter. I feel really good about the strategy that we have and the contributions of our employees who have executed incredibly well in what is truly a difficult environment. We all believe that digital is going to be mission-critical, it's going to be a driver of the economy globally. And between Creative, Document and Enterprise, we have three large markets that are growth markets, where our innovation agenda is stronger.

I will say, we are really pleased with how we rallied around re-prioritizing to get the most critical initiatives to proceed with the right urgency. And as John mentioned, we feel very well positioned to invest in growth initiatives that will continue to drive what we aspire to be, which is a growth company that also delivers great profitability. But stay safe, stay healthy. We really appreciate all of you joining us today and we look forward to seeing you at MAX. Over to you, Jonathan.

## A - Jonathan Vaas {BIO 21700508 <GO>}

This concludes the call. Thanks, everyone.

## Operator

This concludes --