

Q2 2019 Earnings Call

Company Participants

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

Other Participants

- Brad Zelnick
- Brent Thill
- Jay Vleeschhouwer
- Jennifer Lowe
- Kash Rangan
- Keith Weiss
- Kirk Materne
- Mark Moerdler
- Saket Kalia
- Sterling Auty
- Tom Roderick
- Walter H Pritchard

Presentation

Operator

Good afternoon. I would like to welcome you to the Adobe Second Quarter Fiscal Year 2019 Earnings Conference Call. Today's conference is being recorded. During today's presentation, all lines will be muted and we will take questions following the prepared remarks.

At this time, I would like to turn the call over to Mike Saviage, Vice President of Investor Relations. Please go ahead, sir.

Mike Saviage {BIO 3176226 <GO>}

Good afternoon, and thank you for joining us today. Joining me on the call are Adobe's President and CEO, Shantanu Narayen; and John Murphy, Executive Vice President and CFO. In our call today, we will discuss Adobe's second quarter fiscal year 2019 financial results.

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By now, you should have a copy of our earnings press release, which crossed the wire approximately one hour ago. We've also posted PDFs of our earnings call prepared remarks and slides, and an updated investor data sheet on adobe.com. If you would like a copy of these documents, you can go to Adobe's Investor Relations page and find them listed under Quick Links.

Before we get started, we want to emphasize that some of the information discussed in this call, particularly our revenue and our operating model targets, and forward-looking product plans is based on information as of today June 18, 2019 and contains forward-looking statements that involve risk and uncertainty. Actual results may differ materially from those set forth in such statements. For discussion of these risks and uncertainties, you should review the forward-looking statements disclosure in the earnings press release we issued today, as well as Adobe's SEC filings.

On this call, we'll discuss GAAP and non-GAAP financial measures. Reconciliation between the two is 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 and is the property of Adobe. The call audio and the webcast archive may not be re-recorded or otherwise reproduced or distributed without prior written permission from Adobe.

I'll now turn the call over to Shantanu

Shantanu Narayan {BIO 3332391 <GO>}

Thanks, Mike, and good afternoon. Q2 was another strong quarter for Adobe with record revenue and continued growth across Adobe Creative Cloud, Adobe Document Cloud and Adobe Experience Cloud. We delivered \$2.74 billion in revenue in Q2, representing 25% year-over-year growth. GAAP earnings per share for the quarter was \$1.29, and non-GAAP earnings per share was \$1.83. Adobe's solutions have become the standard for creating and managing the world's digital experiences.

Millions of consumers depend on brands like Photoshop and PDF for their personal and professional pursuits. Thousands of enterprises the world over are turning to Adobe every day to help them transform their businesses. The power of our brand, the continuous innovation in our products and services, the deep investment we're making in our technology platforms and a robust ecosystem of partners are enabling us to serve millions of customers around the globe. We are creating large, addressable markets in the creativity, document and customer experience management categories. Our opportunity has never been greater. In our Digital Media business, we drove strong revenue growth in both Creative Cloud and Document Cloud in Q2. Net new Digital Media Annualized Recurring Revenue or ARR was \$406 million, and total Digital Media ARR exiting Q2 grew to \$7.47 billion. Q2 Creative revenue was \$1.59 billion, which represents 22% year-over-year growth. Mobile is a tailwind in our Digital Media business and we are driving significant increases in mobile traffic and member sign-ups for our offerings.

This is the golden age of creativity and our vision for Creative Cloud is to be the creativity platform for all. Whether you're a student, an experience designer, a YouTuber, or a marketer, storytelling is central to the way you communicate and connect.

A key part of our Creative Cloud growth strategy is appealing to new segments of users. Adobe Spark, our offering for easily turning ideas into compelling stories, graphics and web pages is rapidly gaining popularity among creators from the classroom to the boardroom.

Spark traffic on web and mobile has more than doubled year-over-year. In Q2, we expanded Spark's global footprint with support for five new languages. Brazilian, Portuguese, French, German, Italian and Spanish. We've expanded our vision of platforms to include social media channels like Facebook, Instagram and YouTube. Premiere Rush is rapidly becoming the solution of choice for YouTubers and social video creators. Premiere Rush is now available on Android, in addition to iOS, Mac, and Windows.

Experience design is one of the most explosive creative categories and we continue to innovate in this space with Adobe XD, our design system for UX and UI. We released a major update to Adobe XD in May, enabling teams to create and share designs, to enhance both productivity and collaboration. In Q2, we drove strong subscription growth across our flagship photography and digital video offerings.

At NAB in Las Vegas, we unveiled new innovations across Premiere Pro, Audition, Character Animator and After Effects. One exciting announcement was the availability of the Content-Aware Fill feature in After Effects, powered by Adobe Sensei, which magically enables editors to seamlessly remove unwanted objects from video, saving hours of tedious manual work. It won five awards at the show, including the NAB Show Product of the Year Award.

We continue to expand Creative Cloud with value-added services. Adobe Stock, our fast-growing service for stock images, videos, and millions of additional creative assets grew greater than 25% year-over-year. We're proud of the role of our solutions play in inspiring the global creative community and shaping popular culture. This quarter we launched a creative campaign with 17 year old music sensation Billie Eilish, which inspired significant participation among our important student segment.

With Adobe Document Cloud, we're reinventing how people scan, edit, collaborate, sign and share documents in the cloud and mobile era. Document Cloud revenue in Q2 was a record \$296 million and we grew Document Cloud ARR to \$921 million driven by continued strength in Acrobat subscription adoption.

Mobile is the next frontier for digital documents and our flagship apps. Adobe Reader for mobile and Adobe Scan continue to gain traction. Adobe Scan, which allows you to capture everything from documents to forms, whiteboard sketches or business cards and turn them into picture perfect high-quality PDFs is now the leading scanning app on iOS and Android.

We're driving adoption for Adobe Sign, our cloud-based electronic signature solution, with customers including Merck, Hitachi, and Iowa State University. They're using Adobe Sign to provide a better customer experience, close contracts, and win business.

In our Digital Experience business, we achieved record Experience Cloud revenue of \$784 million for the quarter, which represents 34% year-over-year growth. To win in today's competitive landscape, businesses must become more customer-centric and data-driven. Our vision for Adobe Experience Cloud is to enable businesses to reimagine the entire customer journey using data to understand and drive their business from discovery through trial, purchase, use and renewal. At the core of Adobe's own transformation has been our use of Adobe Experience Cloud.

B2B and B2C companies across every country and industry are choosing Adobe Experience Cloud, the only end-to-end solution for marketing, advertising, analytics and commerce to master the art and science of Customer Experience Management. Key Experience Cloud customer wins in Q2 include Amazon, Rite Aid, Vodafone and Wyndham Hotels. The acquisitions of Magento and Marketo have significantly increased our value to existing customers, helped us attract new logos, and expanded Adobe's addressable opportunity.

Magento adds to our Experience Cloud vision by allowing us to make every moment personal, and every experience shoppable in addition to attracting a large and vibrant developer community to Adobe. This quarter we announced the availability of Adobe Commerce Cloud, built on the Magento Commerce platform, with deep integrations across Adobe Analytics Cloud, Marketing Cloud and Advertising Cloud.

We announced a new partnership with Amazon, creating Magento Commerce branded stores for Amazon sellers, which will give merchants a more seamless way to manage their business across both Amazon.com and their own storefront. With the addition of Marketo, Adobe provides the leading marketing engagement platform for both B2B and B2C customers. We've deepened the integration between Adobe Marketing Cloud and Marketo Engage.

We are leveraging Adobe Sensei so companies can deliver the right experiences to the right people at the right time. This quarter we announced our partnership with LinkedIn, empowering B2B marketers and sellers to easily identify, understand and engage B2B customer buying teams. At Summit, we announced the global availability of Adobe Experience Platform, the industry's first real-time platform for Customer Experience Management. Adobe Experience Platform provides real-time CDP and DMP capabilities, and stitches together data from across the enterprise creating real-time customer profiles and enabling the activation and delivery of hyper-personalized experiences. Some of the world's leading brands are already using Adobe Experience Platform in beta, including Best Buy, Sony Interactive Entertainment, The Home Depot and Verizon Wireless.

We've built a strong ecosystem of global partners. Recently we announced new partnerships with ServiceNow and Software AG. We will deliver integration between Adobe Experience Platform and the ServiceNow Platform as well as with Software AG's

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webMethods platform. Adobe and Marketo were both positioned as Leaders by Gartner in the Magic Quadrant for Multichannel Marketing Hubs. Among the 21 companies evaluated, Adobe achieved the strongest position for 'Completeness of Vision'. Adobe Experience Cloud was recently named a leader in the Gartner Magic Quadrant for Digital Experience Platforms. Adobe Marketing Cloud, Advertising Cloud and Analytics Cloud were reviewed and successfully validated by TrustArc, making Adobe the first company in the digital experience space to receive TRUSTe GDPR Privacy Practices Compliance Validation.

Our mission to change the world through digital experiences gives purpose to the work we do. We're proud, Adobe was honored with a Hope Award from the National Center for Missing and Exploited Children. For more than a decade, Adobe has been partnering with NCMEC through software contributions and technical expertise - in service of its important mission: to find missing children and prevent child exploitation and victimization.

At Adobe, our employees are our greatest asset and we continue to invest in our future talent. This summer, we're pleased to welcome more than a thousand interns in and new Grads to Adobe from more than a 150 schools around the world. Our strategy of empowering people to create and transforming how businesses compete offers a unique value proposition in the market and large addressable opportunities to grow our business.

FY '19 is expected to be another record year. We expect the first-half momentum to continue in the second half. Our revenue growth, cash flow and operating profit differentiates us among SaaS companies at scale. John?

John Murphy {BIO 16018871 <GO>}

Thanks, Shantanu. As with last quarter, we are reporting results based on our adoption of ASC 606 this fiscal year. As a reminder, our results in the year ago fiscal period were reported based on ASC 605. We have not adjusted our prior fiscal year reported numbers for comparison purposes under ASC 606.

In Q2 FY19, Adobe achieved record revenue of \$2.74 billion, which represents 25% year-over-year growth. GAAP diluted earnings per share in Q2 was \$1.29 and non-GAAP diluted earnings per share was \$1.83.

Business and financial highlights in Q2 included record Digital Media revenue of \$1.89 billion, including Creative revenue of \$1.59 billion and Adobe Document Cloud revenue of \$296 million, strong net new Digital Media ARR of \$406 million, record Digital Experience revenue of \$784 million. Remaining Performance Obligation or RPO grew to \$8.37 billion. Cash flow from operations of \$1.11 billion, Repurchasing 2.5 million shares of our stock through stock buyback and approximately 91% of our revenue in Q2 was from recurring sources.

In our Digital Media segment, we achieved record revenue of 22% year-over-year growth. The addition of \$406 million net new Digital Media ARR during the quarter grew the total to \$7.47 billion. Within Digital Media, we achieved another strong quarter with our Creative

business. Creative revenue grew 22% year-over-year in Q2 and we increased Creative ARR by \$341 million.

Notable growth drivers in Q2 across conversion upsell and retention included new user growth driven by numerous global initiatives to generate demand, including targeted campaigns and promotions, leveraging the funnel of users coming to Creative Cloud through mobile apps and online engagement; and continued focus on new categories including immersive media and new segments such as social media creators.

Creative Cloud Photography plan subscriptions; Adobe Premiere Pro single app subscriptions in the video category; Creative Cloud enterprise, including customer acquisition, seat expansion and services adoption; and adoption of Adobe Stock, where revenue and subscription growth rates remain strong

We achieved record Document Cloud revenue of \$296 million in Q2, which represents 22% year-over-year growth, and we added \$65 million of net new Document Cloud ARR during the quarter. The growth in the Document Cloud business was driven by strong demand on Adobe.com, the continued migration of Acrobat perpetual customers to subscriptions, enterprise services adoption, and monetization of mobile app use. In addition, Adobe Sign achieved another strong quarter of growth.

In our Digital Experience segment, we achieved record quarterly Experience Cloud revenue of \$784 million, which represents 34% year-over-year growth. Experience Cloud subscription revenue was a record \$654 million. Business performance in Digital Experience during the quarter was driven by strength in, Adobe Marketing Cloud, including Adobe Experience Manager, Adobe Target and Adobe Campaign. Multi-solution digital transformation engagements and traction with cross-selling Magento and Marketo in the enterprise.

During Q2, we continue to focus on driving Magento and Marketo synergies, including organizational products and go-to-market alignment. Both Magento and Marketo were prominently featured at some of the events in the US and Europe, and we also held Magento Imagine and Marketo Marketing Nation events during Q2. The depth and breadth of our enterprise partner ecosystem remains a competitive advantage, contributing to pipeline generation, customer success, as well as financial performance.

We had another successful quarter of selling alongside Microsoft, where our combined value proposition is resonating with Enterprise customers. Our overall financial results were negatively affected by currency rate movements. Total Adobe Q2 year-over-year revenue growth would have been 27% if measured in constant currency and year-to-date total first half FY19 year-over-year revenue growth would have been 26% if measured in constant currency.

More specifically in Q2 from a quarter-over-quarter currency perspective, FX decreased revenue by \$4.9 million. We had \$9 million in hedge gains in Q2 FY19, versus \$8.5 million in hedge gains in Q1 FY19 thus, the net sequential currency decrease to revenue considering hedging gains was \$4.4 million. From a year-over-year currency perspective,

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FX decreased revenue by \$45.3 million. The \$9 million in hedge gains in Q2 FY19 versus \$0.3 million in hedge gains in Q2 FY18 resulted in a net year-over-year currency decrease to revenue considering hedging gains of \$36.6 million.

In Q2, Adobe's effective tax rate was 11% on a GAAP and non-GAAP basis. Our trade DSO was 42 days, which compares to 44 days in the year-ago quarter, and 46 days last quarter. Remaining Performance Obligation or "RPO" was approximately \$8.37 billion exiting Q2, which compares to \$8.13 billion exiting Q1. Deferred revenue exiting Q2 was \$3.13 billion. The sequential decline in deferred revenue was a result of timing rather than business performance due to fewer billing cycles in our second quarter. The impact was more than offset by an increase in unbilled backlog. Our ending cash and short-term investment position exiting Q2 was \$3.48 billion, and cash flow from operations was \$1.11 billion in the quarter. In Q2, we repurchased approximately 2.5 million shares at a cost of \$659 million. We currently have \$6.6 billion remaining of our \$8 billion repurchase authority granted in May 2018 which goes through 2021.

Now I will discuss our financial targets. As a reminder, our Q3 includes the summer months of June, July and August and we expect normal seasonality to influence our results during the quarter.

In Q3 FY '19, we are targeting revenue of approximately \$2,800 million. Digital Media segment year-over-year revenue growth of approximately 20%. Net new Digital Media ARR of approximately \$360 million. Digital Experience segment year-over-year revenue growth of approximately 34%.

Other Expense of approximately \$22 million. Tax rate of approximately 11% on a GAAP and non-GAAP basis. Share count of approximately 491 million shares. GAAP earnings per share of approximately \$1.40 and non-GAAP earnings per share of approximately \$1.95.

As usual, we are not updating annual targets at this time of the year. We are pleased with our first half performance and we expect our first half momentum to continue in the second half, with typical seasonality in Q3 and strength in Q4. We continue to expect sequential operating margin growth as we move through the second half of the year.

I'll now turn the call back over to Mike.

Mike Saviage {BIO 3176226 <GO>}

Thanks, John. Adobe MAX, our user conference focused on our Digital Media solutions, will occur during the first week of November this year in Los Angeles. On day one at MAX on Monday, November 4th, we plan to host a financial analyst meeting. Invitations, including discounted registration information, will be sent to our analyst and investor email list later this summer. More information about the event can be found online at max.adobe.com. If you wish to listen to a playback of today's conference call, a webcast archive of the call will be available on our IR site later today. Alternatively, you can listen to a phone replay by calling 888-203-1112; use conference ID number 2843011. International callers should dial 719-457-0820. The phone playback service will be available beginning at 5pm Pacific Time today and ending at 5pm Pacific Time on June 25, 2019.

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

(Question And Answer)

Thank you. (Operator Instructions) We'll take our first question from Brent Thill with Jeffries. Please go ahead.

Q - Brent Thill {BIO 1556691 <GO>}

Thanks, Tiffany. Shan just on Magento and Marketo, just curious if you could give us your updated thoughts on the integration, how you're doing in the field, and some of the customer traction on both those acquisitions that'll be helpful. Thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Brent. Both of them are actually big picture going really well. We have as you saw started to integrate the products, the delivery of the Adobe Commerce Cloud that was based on Magento Commerce, we announced some good partnerships there as well, as it relates to what we're doing with Amazon to allow multiple, small and medium businesses, to be able to deliver their storefronts, based on this combined technology.

We did some good work, as it related to integration between the Adobe Experience manager, as well as the Adobe Commerce Cloud. So, you can now have in a single digital foundation, the ability to do web content management, analytics, as well as commerce. So, product integration with Magento is going well. I think on the go-to-market efforts, the Enterprise motion that we have which was clearly a strength of Adobe, we are putting the Magento Solutions through that Enterprise go-to-market motion.

We've also done a good job I think of integrating the mid-market, small and medium business whatever you want to call it Magento and Marketo, because the combination of both of them give us a little bit more heft in the marketplace. And on Marketo, as well I mean it's clearly fabulous SaaS platform for engagement as it relates to B2B marketing, the focus there has been on both integration with Adobe Analytics, as well as making sure that the combination of Campaign and Marketo will be the best B2E, which is what we call the sort of the business to everyone engagement platform. So pleased with it, results are good, continued focus. And I think that's one of the reasons why we are aligning the organizations more rapidly to make sure that we get the appropriate alignment.

Q - Brent Thill {BIO 1556691 <GO>}

Thank you.

Operator

And we'll take our next question from Jennifer Lowe with UBS Please go ahead.

Q - Jennifer Lowe {BIO 6926228 <GO>}

Great. Thank you. It was nice to see the net new ARR out performance this quarter, so it sounds like it was a few different things there, but just any more color on what drove the upside would be great, in particular I know last quarter there were some unusual items. And I just want to check was there anything unusual this quarter, or may be just around it out? As we think about seasonality into Q3, it looks like the guide implies a bit more seasonality, than what we saw last year, anything to keep in mind there as well. Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, I think big picture Jennifer. Digital Media, we continue to do really well, we had as you point out a great Q2 achieving, I think \$406 million in net new ARR which is a record for Q2. Certainly, I think in terms of the different offerings, as John mentioned in his prepared remarks, we are seeing traction on the video offerings, we're seeing traction with Enterprise adoption. Services, both stock and sign are continuing to perform quite well. International expansion continues to be an area of opportunity, as well as new customer acquisition through the through the marketing campaigns that we have. And if you think about as you pointed out again, the 360 million target that we're putting for Q3, which would be a record for a Q3. And then you add to that what the \$750 million plus in ARR for the first half. I mean, it's clear that the momentum continues in the business. I think to your question around seasonality and color, I think it's our expectation that net new DM ARR and Q4 would be similar to what we had last year in Q4 and so if you add that all up it implies that we will have record new ARR again in 2019. And I think underlying all of that as we've outlined to you is the DDOM model that we have it allows us to optimize our marketing spend, it allows us to engage better with customers and MAX should be another great show for that business. One thing I should also mention sorry, is that Acrobat continues to as you clearly saw from the results, do really well.

Q - Jennifer Lowe {BIO 6926228 <GO>}

Great, thank you.

Operator

And we'll take our next question from Keith Weiss with Morgan Stanley, please go ahead. Hi Keith, your line is open you may be on mute.

Q - Keith Weiss {BIO 6993337 <GO>}

Sorry about that I was on mute. Thank you for taking the question and very nice quarter, I wanted to touch base on kind of leadership on the digital experience side of the equation. I'm kind of -- what the current thought process is, I'm sure Shantanu, you are doing a great job sort of with leadership there but are we planning on replacing Brad and kind of what's the sort of game plan for rolling out new leadership and how sort of the new assets are going to sit under that new leadership plan.

A - Shantanu Narayen {BIO 3332391 <GO>}

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Thanks, Keith for the question. It's such a large opportunity that we're completely convinced I am that the focus on the aligned organization was the right choice. It's been great our focus a lot of time on the customers, just I think over the last 10 days three Fortune 100 CEOs have come in to talk to us about our view and our vision for digital transformation, spent a lot of time on the product to make sure that we get great alignment, you've seen. The general availability of the Adobe experience platform, the Artificial Intelligence features that we're now in Beta attribution and customer journey. We've signed some great partnerships with its Software AG and ServiceNow. And really I have been trying to focus also the organization on a lot more, with respect to customer centricity.

I think as we've aligned the two acquisitions in Magento and Marketo, which we've outlined to you Keith, was a priority. We brought the same rigor that we have in DDOM for creating that cadence and customer-centricity, for pipeline progression, for marketing demand generation, as well as for the software delivery lifecycle. And so, I'm really also pleased with how the current management team which is extremely strong and has stepped up. And is executing an alignment. So, while the search continues we haven't missed a beat and I've been spending a lot of time, which just continues to give me a lot of faith in the long-term opportunity associated with the business and it's not hampering the progress at all in terms of what we need to do.

Q - Keith Weiss {BIO 6993337 <GO>}

Thank you so much. Sounds great.

A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks.

Operator

And we'll take our next question from Brad Zelnick with Credit Suisse. Please go ahead.

Q - Brad Zelnick {BIO 16211883 <GO>}

Excellent. Thanks so much, and congrats as well and a great quarter. Shantanu, on customer data platforms, there's been a lot of recent news from Adobe as well as some of your competitors launching their own CDP offerings. How will Adobe experience platform differentiate from peers? And why is your product going to be better and win in the market?

A - Shantanu Narayen {BIO 3332391 <GO>}

It's a good question, Brad. And I think fundamentally, it stems from the fact that when you have the leading content management platform, we have the data and I think that continues to differentiate us, in terms of the customer interaction across different channel points. we've been talking to you for a couple of years of the investment that we have made in the Adobe Experience platform, the vision there has always been not only to integrate all of our existing solutions, so we have a platform across content and data to win it. But to frankly stitch together all that customer profile in real time. And when you have all that customer interaction that's happening, as a result of mobile access to the

website or web site access or as customers are giving us access to the other channel data, that's just as unique differentiator, that no other company has. So we start off from that being a huge advantage.

I think the effort that we have put into an ecosystem of partnerships there, in terms of ingesting that data, the common taxonomy that we've agreed to the partnership with SAP and Microsoft on ODI And frankly, the credibility that we just continue to get, associated with the fact that when you're processing these hundreds of trillions of transactions on an annual basis, that we have more insight to be able to activate it. I think all of that gives us hope.

I think with the whole Experience Cloud, I will continue to reinforce that when we talk about it being north of \$70 billion addressable market, you should look at this as it's not a win-loss kind of situation. There's just so much opportunity, but starting with what we had with Audience Manager and DMP that we had with Demdex, combined with what we are doing in CDP, and making sure that all operates in real time. I think that is just a unique combination for Adobe.

Q - Brad Zelnick {BIO 16211883 <GO>}

Very helpful. Thank you.

Operator

We'll take our next question from Saket Kalia with Barclays Capital. Please go ahead.

Q - Saket Kalia {BIO 16417197 <GO>}

Hey, thanks for taking my question here. Maybe for you Shantanu, just to dig into one of the prior questions on Creative. Adobe Spark seems to be doing very well. So can you just talk a little bit about why you think that's doing so well? And maybe more specifically, talk about what you've seen in the last couple of years that Spark has been available. What you've seen in terms of lifetime value and customer acquisition cost qualitatively?

A - Shantanu Narayen {BIO 3332391 <GO>}

Saket, I mean I think it stems from this fundamental assertion and hypothesis that we have belief that we have. That everyone has a story to tell, and when you have K through 12 student all the way to the largest enterprise in the world, wanting to use social media, wanting a quick template based approach to start to be able to express themselves, and then grow that expertise into using our products. It's just a fantastic on-ramp, and so the millions of customers that we have the penetration in the education segment is both an opportunity in itself.

But frankly, great brand building and awareness of what the Adobe Solutions can do across the spectrum. And so, I think it really -- we've been talking about this for a while, but it's the golden age of creativity and design and it doesn't matter whether you're studying history or geography, I mean the ability to express yourself visually and graphically and to do that across social channels, is just such an intrinsic part of what it is and I think we've really struck a chord with a great product across both mobile.

I think the fact that we're exploring different platforms and previously we used to look at print and web as a platform, now we look at even channels like YouTube as a platform. It's just a great in addition to mobile, a way to attract new customers. So, I think that's why it really resonates with customers and why it will continue to be both from an ARR perspective of growth, as well as from overall brand and awareness, just a significant ability for us to continue to keep digital media ARR momentum going.

Q - Saket Kalia {BIO 16417197 <GO>}

Thank you.

Operator

We will take our next question from Sterling Auty with JP Morgan. Please go ahead.

Q - Sterling Auty {BIO 2070271 <GO>}

Yeah, thanks. Hi guys. Maybe I can bring John into the conversation here. Kind of curious as you look at the growth in Creative Cloud for the quarter is there a way to disaggregate, how much of that growth is actually come from, the price changes that you've made over X number of quarters versus how much that growth is actually coming from pure volume.

A - John Murphy {BIO 16018871 <GO>}

Yes, sure. It's really coming from both and when you think about the North America price increased that we did last year in Q2, that as we said it was going to be accretive and certainly through the year as we now anniversary that price increase. And then earlier this year in February, we did price increased for Doc Cloud and also in EMEA for Creative. So all these things are accretive, but one of the things that we've talked about for a long-time now is attracting new users to the platform is really our biggest growth opportunity. And we're able to do that through the various new products that are attracting folks to our platform because some of these newer products are easier to use and then as they get comfortable with those they end up -- we're able to upsell them into full Suite products from multiple applications. So we have this opportunity to really kind of tackle it from many different ways and we've been successful now and growing the number of users across the platform and also leveraging the mobile app on ramp.

A - Shantanu Narayan {BIO 3332391 <GO>}

But if you think of it in terms of material, it's primarily new user growth and new subscriptions, Sterling, is how you should think about it. I think the value that we're providing enables us to keep driving at the anniversary of people moving over to the new pricing keep them as loyal customers and improve their engagement. But, as it relates to the photography and video, it's primarily new user growth that's driving the digital media ARR.

Q - Sterling Auty {BIO 2070271 <GO>}

Sounds good, thank you.

Operator

And we'll take our next question from Kash Rangan with Bank of America. Please go ahead.

Q - Kash Rangan {BIO 22095432 <GO>}

Hi, thank you very much. Congratulations. I'm curious, given the strength of the quarter. You had a very nice quarter on net new ARR and on the experience cloud, you said, you had very good bookings as well. But when I look at the guidance, you didn't change the guidance for the year but Q3 numbers look a little bit like relative to the Street, at least it's just a function of conservatism given maybe a questionable macro-environment or is it just that the seasonality of the business we've had the firsthand chance to model the seasonality of the business including the acquisitions and that we may have been little off relative to what is the new seasonality of Adobe. Just wondering what your thoughts are there. Thank you so much, and congrats.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yes, I think Kash, thanks first. I mean big picture it's clear we're having another record year in great execution against both growth opportunities across all of the three marketing clouds creative, document and experience. And as you point out, the results in a revenue growth of 25%, the significant cash flow as well as the strong EPS, while we're increasing margins. I think on Digital Media, I gave some color as it related to what will certainly be a record Digital Media ARR year, and I think we factor in seasonality and so that's I think part of how you should be thinking about Q3 versus Q4.

And in DX as well, I mean the subscription revenue growth if you look at that, when you see the revenue growth of 34% the subscription revenue growth certainly is exceeded that, and it's closer to 39% and so I think that also reflects the success that we continue to have. And the fact that we have the leading SaaS enterprise platform for enterprises to engage digitally with their customers. And so I think big picture, the two opportunities continue to be significant tailwinds, we're executing well against it, I think we'll give you more color as it relates to Q4 in September as well as 2020 at max, but continue to be really optimistic. And I think where we are in the quarter just updating annual numbers for a year is tend to be giving Q3 and Q4 targets, and that's why as typically we don't do that, but that should not change the fact that we have momentum in the business and optimism for the future.

Q - Kash Rangan {BIO 22095432 <GO>}

Congrats Shantanu, and team. Thank you

A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks.

Operator

We'll take our next question from Mark Moerdler with Bernstein Research. Please go ahead.

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Q - Mark Moerdler {BIO 16855032 <GO>}

Thank you so much. I really appreciate and congrats also on the quarter. So you've guided to 34% digital marketing growth for the back half of the year, what's more difficult set of compares as you lap Magento's acquisition and lap a bit of the Marketo. Can you give us a bit more color on what's driving that strength? I appreciate.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yes. I think as it relates to the digital experience business, we've always outlined, Mark, that the focus has been on driving subscription bookings. I think as the deferred revenue also starts to taper-off, that certainly going to factor into what happens, but it's just a large addressable opportunity. We have the market-leading products and we continue to be excited about how we execute against that. So that's how I would think about that particular business.

Q - Mark Moerdler {BIO 16855032 <GO>}

Appreciate. Thank you.

Operator

And we'll take our next question from Jay Vleeschhouwer with Griffin Securities. Please go ahead.

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thank you. Good evening. Shantanu, a technology strategy question. I was hoping we could parse through the plethora of three letter acronyms that Adobe has been sharing with us at Summit and at other occasions, we now have CDP, CXM, CXP, XDM and so forth. The question is ultimately, does Adobe have a single underlying data model, that is the Adobe data model or could you foresee two or more principal data models, particularly in DX?

I ask in part because at Summit EMEA, last month, there was some mention in one of the sessions about, you're having a new purpose built B2B data model. And so, maybe you could put this in the context of the complexity of the architecture or the technology as it might relate to any implications for R&D and sales efficiency?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yes. You forgot ODI and maybe a couple of other TLAs Jay, but it's a good question. And I think as it relates to how we think about the technology underpinnings, we think about it from two strategic points of view.

The first is, are we able in our own products to have a common way in which people can really provide integration for our existing applications better than any other individual point product vendor can provide? And I think our track record is as you know better than most in terms of what we've done on the digital media side of having colors and types and font faces work well. That is the reason why the underlying data model allows us to

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have things like campaigns or segments, or audiences work better across our applications than anybody else.

And so we did that heavy lifting, associated with having a common way to define the taxonomy, the customer journey across our products. We clearly saw that, that was not going to be adequate in terms of the aspirations we had to actually being the underlying sort of infrastructure for how all companies deal with digital transformation. And the reasons for the partnership with both Microsoft as well as with SAP is to actually through ODI, make that true not just for customer behavioral data, where we clearly have access to all of that data, but also to extend that to financial data, to transactional data, overtime to IoT data.

And so, the way I would think about it, it's a common taxonomy, it's a common way for people to extend it. But we don't have to do the heavy lifting of defining everything, the beauty of the model is that actually we define the framework, we define the API, we define the services, and other people can actually extend and augment that. And so it enables the entire ecosystem to partner.

So it's exciting, we're delivered that through the Adobe experience platform. I talked in the prepared remarks about how we have early beta customers who are starting to see it certainly Adobe is using it in our own offering, but I think it's really going to be the underlying infrastructure for a next generation enterprise, who wants to engage with their customers, so we're excited about that.

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thanks, Shantanu.

Operator

We will take our next question from Kirk Materne with Evercore ISI Please go ahead.

Q - Kirk Materne {BIO 5771115 <GO>}

Thanks very much. Shantanu, I want to ask a little bit about Sensei in the context of this. Is that coming up at all and some of your conversations on the Experience Cloud side, I know there's a lot of factors that go into those decisions from a product portfolio perspective, I was just kind of curious if Sensei's adding to the conversation, if you view that as sort of a needle mover for you all at this point. Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

I'm really glad you asked that question, because we talked a lot about the Adobe magic that we've had in the digital media products. And we certainly touched on what we've done with content-aware fill which is magic, as it relates to being able to do that across frames and reduce a whole bunch of complexity for the video products.

We are investing very heavily in the same technology Sensei in the Experience Cloud. Let me maybe give you a couple of examples to make it more tangible. I mean the first is,

when you're doing search, the way you do search, when you're doing it in digital media, trying to find an object in stock, where we have the best technology, is still substantially different from the way you would do search.

In Commerce, where you're looking for an object may be based on a color or based on a type of preference. So, I think, in Commerce, that's one area with Sensei and the ability to do search and find the right shopping good that you're interested in, that's a game-changer, in targeting and in what we can do around, how we can optimize targets, and recommendations, that's another area where AI is certainly beneficial.

When you're talking about a subscription model and customer preference and our prediction score of who's likely to churn and what are the best way to engage with them across channels, that's another area where we have AI technology. But in addition to that as part of the Experience platform, we actually now have modules. I talked a little bit about attribution. AI, and things like that which are AI modules and frameworks for people to actually augment the Experience Cloud. So, I think unlike other companies, we believe that the AI is best built into each of the existing solutions and through frameworks. But our track record of delivering against that has been strong and it's only getting better.

Q - Kirk Materne {BIO 5771115 <GO>}

Great. Thanks very much.

Operator

And we'll take our next question from Tom Roderick with Stifel. Please go ahead.

Q - Tom Roderick {BIO 6678063 <GO>}

Hi. Good afternoon. Thanks for taking my question. John, let me throw this one of you, just looking at the digital experience segment itself, we saw a nice bounce back in the segment, gross margins and part of that of course came into scale and some of the deferred revenue write downs rolling off. But the other part of course is realizing some of the integrations between the components. And thus hoping you could speak to what you're seeing with some of the leverage between the properties of Magento and Marketo in the core of Digital Experience. In particular on the COGS side you, are there elements of architectural leverage that are starting to show up and then even below that line? Are you seeing much sales leverage between the acquired properties? Thank you.

A - John Murphy {BIO 16018871 <GO>}

Yeah. No, absolutely. For sure, we're seeing the ability in both properties that we acquired for us to be able to unify development across the platform, and that in and of itself will provide some efficiencies. In addition from the go-to-market perspective, as we've talked about we've unified and aligned our go-to-market strategy, with the existing Adobe Enterprise sales organization under Matt.

And so, that's been able to bring a lot more efficiency, as we cross sell not only the existing Digital Experience products but also Magento and Marketo. Not to mention then our partner ecosystem, where we are selling alongside Microsoft for example and being

successful in having multi solution sales with them as well. So, it's been something that through scale and through continued focus on integration that we're able to get some leverage out of that.

Q - Tom Roderick {BIO 6678063 <GO>}

Excellent, thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

But one thing maybe I'd like to add to that I know there was some question around seasonality, and while this question was specifically around operating margins, I think Kash had asked. So maybe we give you color on how we think about our investment as well as what's happening as it relates to margins. I think it's clear that despite the revenue growth and investment that the operating margin of the company has improved throughout the year, and I think we remained very focused on profitability. If you look at seasonally how that should play out over the second half of the year, our guide for Q3 shows EPS increasing by approximately I think, \$0.12 despite seasonality, and we certainly expect Q4 to be a strong seasonally finish to the year. And I think to give you some color on that, why we are not updating our annual targets, we would expect that sequential EPS growth from Q3 to Q4 to be about 3 times the growth from Q2 to Q3.

So hopefully that gives you some color on how we think about the investments, we certainly continue to believe in investing for the revenue growth that we're seeing. And it also clearly gets us back to north of 40% margin. So hopefully that gives you some color on seasonality as well as while the question was on gross margins, how we think about operating margins and expenses.

Q - Tom Roderick {BIO 6678063 <GO>}

Really helpful, Shantanu. Thank you.

A - Mike Savage {BIO 3176226 <GO>}

Operator, I think we'll take one more question please.

Operator

Thank you. We'll take our final question from Walter Pritchard with Citi. Please go ahead.

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

Hi, thanks. Question on the digital experience side, you talked in the past about 25% growth of the book of business, including the two acquisitions. I'm wondering, sort of how things are tracking so far this year, and what you've learned in terms of first half growth as that trend progresses into second half?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yes. As you know Walter, we don't update how we're doing against the bookings during the year, as we think about the underlying dynamics of the industry and the need for

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digital experience solution. Nothing diminishes the belief that we have that continues to be a large growth opportunity. I think as you could see from the subscription revenue growth that we see, we continue to focus on executing against that. And so I will certainly provide more colors, we've said on that on an annual basis. But just big picture the up available opportunity, I think continues to be large.

And given Mike said that was the last question. Maybe just as a quick summary again. It's clear that we have the right strategy and the focus on delivering great customer value. We're pleased with the first half financial results, we expect that momentum to continue in the second half, the strategy of empowering people to create and helping businesses transform. We believe that continues to be a north of 100 billion addressable market opportunity.

And we were really pleased with the attendance that we saw at the customer events in the DX, whether it was the Summit in US and Europe, whether it was Marketo Marketing Nation, whether it was a Magento Imagine. I think that just reflects both the leadership that we have in product strategy and vision as well as the strength of the customer and partner community. And FY '19 is shaping up again and we expect it to be another record year for revenue, and I think the innovation roadmap and opportunity, positions us really well for future growth. We appreciate all of you joining us today, thank you.

A - Mike Saviage {BIO 3176226 <GO>}

And this concludes our call, thanks everybody for joining us.

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