

## Q3 2019 Earnings Call

### Company Participants

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

### Other Participants

- Alex Zukin, Analyst
- Brent Thill, Analyst
- Christopher Eberle, Analyst
- Heather Bellini, Analyst
- Jay Vleeschhouwer, Analyst
- Jennifer Lowe, Analyst
- Kash Rangan, Analyst
- Keith Weiss, Analyst
- Kirk Materne, Analyst
- Mark Moerdler, Analyst
- Saket Kalia, Analyst
- Sterling Auty, Analyst
- Walter H. Pritchard, Analyst

### Presentation

#### Operator

Good afternoon. I'd like to welcome you to the Adobe Third 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 at the end of 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.

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In our call today, we will discuss Adobe's third quarter fiscal year 2019 financial results. 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 datasheet 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.

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Before we get started, we want to emphasize that some of the information discussed in this call, particularly our revenue and operating model targets, and our forward-looking product plans, is based on information as of today, September 17th, 2019, and contains forward-looking statements that involve risk and uncertainty. Actual results may differ materially from those set forth in such statements. For a 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 will discuss GAAP and non-GAAP financial measures. A 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 will now turn the call over to Shantanu.

**Shantanu Narayen** {BIO 3332391 <GO>}

Thanks, Mike and good afternoon. Q3 was a record quarter for Adobe, with strong revenue and continued growth across our entire business. We delivered \$2.83 billion in revenue in Q3, representing 24% year-over-year growth. GAAP earnings per share for the quarter was \$1.61, and non-GAAP earnings per share was \$2.05.

Adobe's strategy to empower people to create and transform how businesses compete is fueling our continued success. The ability to deliver a personalized relationship with every customer using digital technology is a mandate for every business. Internal efficiency, including a paper-to-digital revolution, is critical to achieving that imperative. In addition, design and creativity has never been more relevant. Everyone has a story to tell from professional photographers, to immersive content and experience designers, to students and small business owners, and they need to tell it on an ever increasing number of canvases.

Adobe is innovating to expand these market opportunities, and customers around the globe continue to count on Adobe Creative Cloud, Document Cloud and Experience Cloud to run their businesses, transform how they work, and bring their creative ideas to life. In our Digital Media business, we drove strong revenue growth in both Creative Cloud and Document Cloud in Q3. Net new Digital Media Annualized Recurring Revenue

or ARR was \$386 million, and total Digital Media ARR exiting Q3 grew to \$7.86 billion. Q3 Creative revenue was \$1.65 billion, which represents 22% year-over-year growth. Creative Cloud is the creativity platform for all. Through a relentless focus on innovation across different media types, devices, and segments Creative Cloud has become the one stop shop for creative applications and services as well as the leading source for creative inspiration, learning, training and community. Our goal is to ensure that Creative Cloud applications and services make every creative possibility a reality for every one of our customers.

Adobe's vision is that mobile devices and tablets should be used for creation in addition to consumption. Adobe Lightroom, our complete system for photo editing, achieved significant growth on mobile devices with Q3 monthly active users growing 130% year-over-year. In Q3, new Adobe IDs created from Adobe mobile apps rose more than 40% year-over-year, showing that mobile continues to be a healthy on-ramp for subscriptions. In Q3 we announced Adobe Fresco, a groundbreaking drawing and painting app, which will be available first on iPad later this fall. Fresco digitally reimagines the process that artists have traditionally used whether it's chalk, pastels, oil, or watercolor paint. Like Photoshop transformed and democratized photography, we believe Fresco will change how artists use digital to draw and illustrate. Apple will feature Fresco in hundreds of its retail stores as part of its iPad Pro Big Draw campaign.

At Adobe we believe that creative skills should be a core part of school curricula and that STEAM, not just STEM, should be a focus in education. We've expanded our Adobe Ambassador Network to target more than 100 colleges across the country, where students evangelize creativity and lead on-campus workshops to help fellow students learn to use Adobe creative products. Last week, we launched a new program with Reddit to encourage young creators to contribute their personal designs to a giant, global canvas on the Reddit front page. This was the biggest community event on Reddit based on total contributions and participation. These types of partnerships give us an opportunity to introduce Creative Cloud to millions of next-generation creators. Adobe MAX is the world's largest creativity conference. In November, we'll welcome our global creative community and partners, more than 15,000 live attendees and nearly one million virtual attendees and unveil significant new Adobe Creative Cloud innovation.

With Document Cloud, we are accelerating the transformation of paper to digital processes and reinventing how people scan, edit, collaborate, sign and share digital documents. Q3 Document Cloud revenue and net new ARR were records for a quarter, and we grew total Document Cloud ARR to \$993 million. Key Document Cloud customer wins in Q3 included Deutsche Bank, Saudi Aramco, Dell and the US Department of Veteran Affairs. As with our creative products, our Document Cloud customers increasingly expect business processes to be seamless across desktop and mobile devices. In Q3 more than 2.5 billion PDFs were opened in Adobe Reader on mobile devices.

Adobe Scan, which has become the top document scanning app for both iOS and Android, has close to 35 million installs, with downloads increasing more than 30% year-over-year in Q3. Strong uptake of our Document Cloud mobile applications, as well as continued strength in Acrobat subscription adoption is driving momentum in the

business. In addition, we launched new web-based services that offer instant access to Adobe PDF creation and compression capabilities from any browser. We believe these services are not only relevant to individuals looking to quickly get work done, but also developers who need to build best-in-class PDF document support into their web applications. We are investing in creative marketing campaigns to drive awareness of these capabilities and target new users.

Adobe Sign, our leading cloud-based electronic signature solution, continues to gain traction among businesses and organizations. This quarter we introduced Adobe Sign for Small Business, providing small and mid-market businesses enterprise level e-signature capabilities. In our Digital Experience business, we achieved Experience Cloud revenue of \$821 million for the quarter, which represents 34% year-over-year growth. Our vision is to help every business become an experience business. This means enabling them to deliver engaging experiences that anticipate and meet the needs of their customers at every stage of their journey, from acquisition to purchase and renewal. We believe customer experience management is a significant growth opportunity for Adobe. Experience Cloud is the industry's most comprehensive offering providing content and commerce, customer journey management, and customer data and insights to power experience-driven businesses across all industries. In Q3, Experience Cloud was named a Leader in seven Gartner Magic Quadrant and Forrester Wave reports. Key Experience Cloud wins in Q3 included Delta Airlines, T-Mobile, Capital One, and Best Western.

We are the undisputed leader in this large and growing market, and we continue to expand the opportunity in front of us, extending our footprint from B2C to B2B, from enterprise to mid-market, and from the CMO to the CIO, CTO, and CEO. Content and commerce are the foundation for every digital business. We continue to drive strong performance with Adobe Experience Manager for multi-channel experience delivery. Through integration with Magento Commerce, we are making every experience shoppable. This has led to strong performance of our integrated content and commerce offering, and Magento Commerce bookings growth of more than 40% year-over-year in Q3. Multi-channel campaign management is another differentiated pillar of the Adobe Experience Cloud. The integration of Marketo with Adobe Campaign gives Adobe the industry's strongest offering in the customer journey management and orchestration space across both B2B and B2C.

Earlier this year we introduced Adobe Experience Platform, the industry's first real-time platform for customer experience management. Adobe Experience Platform will solve a critical challenge every enterprise is facing, how to harness massive amounts of valuable customer data that is siloed and not easily accessible or actionable. Adobe Experience Platform stitches together data from across the enterprise creating real-time unified customer profiles, enabling the activation and delivery of hyper-personalized experiences. By combining Adobe Experience Platform with Adobe Analytics, Adobe Audience Manager and our new real-time Customer Data Platform, or CDP, we are creating a new, comprehensive customer data and insights offering for the digital enterprise that is unmatched. Adobe Experience Platform has been several years in the making and we've seen tremendous enthusiasm from customers for this solution with multiple pilot deployments already in market. We continue to be the leader in customer experience management, which has a TAM of more than \$70 billion by 2021. While we

experienced some bookings delays in Q3, our robust product roadmap and customer pipeline positions us for multiple years of strong growth.

At Adobe, we continue to invest in our employees, who are the heart and soul of our company. Last week at our annual Adobe For All Summit, we reaffirmed global gender pay parity for our workforce and shared new details and data on our opportunity parity initiative, which examines fairness in promotion rates and access to new opportunities for our employees. Adobe is the leader in several large and growing categories: creativity, digital documents and customer experience management. We remain excited about the opportunities in front of us and confident in our ability to drive strong top line and bottom line growth.

John?

### **John Murphy** {BIO 16018871 <GO>}

Thanks, Shantanu. In Q3 FY19, Adobe achieved record revenue of \$2.83 billion, which represents 24% year-over-year growth. GAAP diluted earnings per share in Q3 was \$1.61 and non-GAAP diluted earnings per share was \$2.05. Business and financial highlights in Q3 included record digital media revenue of \$1.96 billion, including record creative revenue of \$1.65 billion and record Adobe Document Cloud revenue of \$307 million; strong net new Digital Media ARR of \$386 million; record Digital Experience revenue of \$821 million; remaining performance obligation or RPO, grew to \$8.77 billion; cash flow from operations of \$922 million; repurchasing 2.6 million shares of our stock; and approximately 92% of our revenue in Q3 was from recurring sources.

In our Digital Media segment, we achieved record revenue with 22% year-over-year growth. The addition of \$386 million net new Digital Media ARR during the quarter grew the total to \$7.86 billion. Within Digital Media, we achieved another strong quarter with our creative business. Creative revenue grew 22% year-over-year in Q3 and we increased Creative ARR by \$314 million. Strong acquisition, upsell and retention of Creative Cloud subscriptions continued during Q3 and were driven by new user growth, helped by many global initiatives to generate demand, including targeted campaigns and promotions, a large funnel of users coming from desktop and mobile; and leveraging Adobe's brand and new products to expand into adjacent creative categories; increasing adoption of single app offerings, including Adobe Premiere Pro for video and Adobe Illustrator for artwork; continued growth in international markets, including greater than 40% year-over-year unit growth in key emerging markets; ongoing success in the enterprise, including new logos, seat expansion and services adoption which drives higher contract value; and adoption of creative services including Adobe Stock, where revenue grew greater than 30% year-over-year.

Our momentum with Document Cloud accelerated in Q3. We achieved Document Cloud revenue of \$307 million, which represents 24% year-over-year growth, and we added a record \$72 million of net new Document Cloud ARR during the quarter. Strong Document Cloud performance during Q3 was driven by subscription demand across key routes to market with individuals, small and mid-market businesses, and large enterprises. The continued migration of Acrobat perpetual customers to subscriptions, enterprise services

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adoption and the conversion of free mobile Reader users to paid subscriptions. Adobe Sign revenue grew greater than 25% year-over-year.

In our Digital Experience segment, we achieved quarterly Experience Cloud revenue of \$821 million, which represents 34% year-over-year growth. Experience Cloud subscription revenue was a record \$679 million, growing 37% year-over-year. While we had strong overall revenue in Q3, our subscription bookings growth for Marketo in the mid-market did not meet our expectations, which is being addressed by increasing our focus and investment on demand generation and inside sales. In addition, there were Analytics Cloud subscription bookings delays with related shortfalls in consulting services bookings and revenue associated with the launch of our new Adobe Experience Platform. We are confident the enhanced innovation in Analytics Cloud, the introduction of our real time CDP product, and the ongoing global roll out of the Adobe Experience Platform will convert strong customer demand and the current pipeline into bookings starting in Q4. We now expect to grow our total Digital Experience subscription bookings in fiscal 2019 by greater than 20% year-over-year.

From a quarter-over-quarter currency perspective, FX decreased revenue by \$8.5 million. We had \$10.8 million in hedge gains in Q3 FY '19 versus \$9 million in hedge gains in Q2 FY '19, thus the net sequential currency decrease to revenue considering hedging gains was \$6.7 million. From a year-over-year currency perspective, FX decreased revenue by \$38.3 million. The \$10.8 million in hedge gains in Q3 FY '19 versus \$16.8 million in hedge gains in Q3 FY '18 resulted in a net year-over-year currency decrease to revenue considering hedging gains of \$44.3 million. In Q3, Adobe's effective tax rate was 5% on a GAAP basis and 11% on a non-GAAP basis.

Our trade DSO was 44 days, which compares to 41 days in the year-ago quarter and 42 days last quarter. Remaining Performance Obligation or RPO was approximately \$8.77 billion exiting Q3, which compares to \$8.37 billion exiting Q2. Deferred revenue exiting Q3 was \$3.26 billion. Our ending cash and short-term investment position exiting Q3 was \$3.65 billion, and cash flow from operations was \$922 million in the quarter. In Q3 we repurchased approximately 2.6 million shares at a cost of \$750 million. We currently have \$5.85 billion remaining of our \$8 billion repurchase authority granted in May 2018 which goes through 2021.

Turning to our targets, considering second half Digital Experience bookings and consulting revenue, in Q4 FY19 we are targeting revenue of approximately \$2.970 billion. Digital Media segment year-over-year revenue growth of approximately 20%. Net new Digital Media ARR of approximately \$450 million. Digital Experience segment year-over-year revenue growth of approximately 23%. Net non-operating expense of approximately \$20 million. Tax rate of approximately 11% on a GAAP and non-GAAP basis. Share count of approximately 490 million shares. GAAP earnings per share of approximately \$1.68 and non-GAAP earnings per share of approximately \$2.25.

We look forward to a strong finish for the year, and sharing insights with you about our strategy and opportunities at our financial analyst meeting at MAX. I'll now turn the call back over to Mike.

## Mike Saviage {BIO 3176226 <GO>}

Thanks, John. Adobe MAX is less than two months away. On day one at our user conference in Los Angeles on Monday, November 4th, we will host a financial analyst meeting in the afternoon. Invitations, including discounted MAX registration information, were sent to our analyst and investor email list over the summer. Please contact Adobe Investor Relations via email at [ir@adobe.com](mailto:ir@adobe.com) if you have not registered and wish to attend. More information about the event can be found online at [max.adobe.com](http://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 7673180. 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 September 24th, 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

Thank you. [Operator Instructions] Our first question today from Keith Weiss with Morgan Stanley.

### Q - Keith Weiss {BIO 6993337 <GO>}

Thank you guys for taking the question. And very nice quarter, particularly on the Digital Media side of the equation. It does sound like you guys are having some sort of go-to-market and disruption impacts on the Digital Experience side of equation. I was hoping you could dig in a little bit further to help us explain exactly what's going on that side of the business. What does it take to fix that? Because definitely something like you were much more optimistic about that business a quarter ago.

And then maybe one for John. Is there any margin impact in terms of the increased investment and inside sales and some of the go-to-market stuff that is going to take to get Experience Cloud back up to the growth rates you guys are expecting?

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

Great. Keith, as you pointed out it was a strong quarter. We were pleased with the growth across the businesses. Since I suspect that there'll be a couple of people asking about Digital Experience. Let me go into a little bit more color on that particular opportunity. And let me clarify that there wasn't any impact associated with macro. The interest from enterprises, all sizes, different verticals in our comprehensive solutions remains incredibly strong. And even if you look at the targets that we've provided, it's clear that we are delivering strong revenue growth while actually accelerating the subscription bookings

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year-over-year on what is a much larger book of business because we do an apples-to-apples comparison.

I think as you think about Q3, it's clear we have leading solutions in the first mile and the last mile. So Adobe Experience Manager campaign and Magento had strong growth. The Magento acquisitions being viewed exceedingly well by customers. It's clearly very strategic and we grew the book of business greater than 40% in Q3 and actually have done a really good job of taking Magento into the enterprise.

The other part that we are absolutely clear about is that there is a new generation of enterprise software that's going to emerge, which will be required to digitally engage with customers across all these multiple channels. What it has to do is deliver first mile content experiences. That's the content and commerce fees. It has to segment audiences now in real time across multiple channels. You have to do customer journey management and orchestration and you have to provide data and insights to enable these AI services. We've been focused on this opportunity, just like we created the Digital Marketing category. We believe this is absolutely crucial for the Experience business and so we build the Adobe Experience Platform from scratch to deliver what we call dome [Phonetic] in terms of how we run our own digital business. Customers are really excited. It's the first software actually that exist that's designed to specifically integrate the needs of the CMO, the Chief Revenue Officer, and the CIO.

So our strategy with the Adobe Experience Platform is that we want to actually augment the analytics capability, the Audience Manager capability with what we are doing with these new services as well as the real-time CDP in the market. We're really excited about the multiple installations that we have as well as the interest globally. You know you can argue we were maybe a tad aggressive Keith, about the timing adoption, but this phase shift that we've seen in no way diminishes the magnitude of the opportunity or my belief in the lead that we have. And so as I think about the business, as we think about the targets, we are leading in this particular category we saw as I said some delays in the bookings, but that has in no way changed our excitement and optimism about the business. So hopefully that helps to give you some color associated with each of the businesses.

The last thing I would say is that we talked about Marketo specifically, and there I would say our natural inclination was to perhaps focus our aspirations on the enterprise business, serve our existing customers that's going well. Mid-market continues to be a huge growth opportunity. We have the leading product in that space and much like we drove growth in the Magento business, our focus will now be the same on Magento as well as Marketo. And so we've created a unified organization it's going to drive a line demand generation, customer support. We have the right individuals in the field, it's organized the right way. So I'm excited about that as well. I know I was a little long, but I thought I'd just give you color associated with all of those businesses and again the Adobe Experience Platform that is really our platform that deals with future of what we are doing around analytic services, what we are doing around campaigns services. And so when bookings are light you certainly see some impact on consulting as well.



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

And Keith this tends to your question on investments. You know they've been factored into the targets that we issued for Q4. And as you can see in those targets, we continue to expand our operating margin as we had expected through the year, as we said the second half would accelerate expansion. So the investments are embedded in those targets. And as Shantanu said, we're focused on really driving the mid-market motion like we did with Magento.

**Q - Keith Weiss** {BIO 6993337 <GO>}

Excellent. Thank you guys.

**Operator**

Next we'll hear from Kirk Materne with Evercore ISI.

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

Thanks very much. Maybe I'll flip over to the Digital Media side of the business, which also had a really strong quarter. Shantanu, maybe the stat that stood out to me was actually some of the subs growth in the emerging markets. And can you just provide a little bit more detail on that sort of -- how do you feel like you're monetizing those opportunities? How that's coming along? And maybe just talk a little bit about the opportunity maybe internationally, because I know that you are just taking off right now. Thanks.

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

Sure Krik. And yeah, when we look at Digital Media ARR both across the Creative as well as the Document business, we just continue to see strength. If you look at our targets for the combined year, I mean it's clear that driving approximately \$1.6 billion of net new Digital Media ARR, creativity and design have never been important. A couple of points. The first is mobile. What we've been doing with the mobile applications and having mobile be an on-ramp, especially in international as well as key emerging markets. What we've seen with the Lightroom system that we've developed, photography is such a universal phenomenon and Lightroom is a great product.

So we're driving adoption across a couple of dimensions. The first is the number of people who come in from mobile and only buy a mobile subscription through an app store. The people who come in through mobile, but then realize that there is more to Adobe's creative offerings and then come in and download a desktop application as well as then adopt it. We're seeing significant growth for Document Cloud also in these international markets as they are migrating from the perpetual version of the product as well as engaging on the web. This is something that we started to talk about, which is people just coming from a web, they want to create a PDF. They want to export PDF that's seeing traction.

So -- and frankly, stock. We actually did some really interesting work with stock. Stock was primarily a US product, but as you have more international content, as you have the search capabilities available. So the services revenue is also increasing. So you know just

across the board as we talk about new customer acquisition, as we talk about focus on engagement, mobile certainly has momentum and services like Adobe Stock, both in the US as well as international.

And the last thing I'd say is that the DDOM that we have really gives us insight into what's effective in those markets. So rather than have a one size fits all, where we spend our money digitally, how we engage with our customers, how do we price the products appropriately, China is again seeing really good growth as it relates to our team offering in Creative Cloud. And so across the board, it just reflects creativity is important and we're the leader.

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

Thank you.

## Operator

Our next question comes from Brent Thill with Jefferies.

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

Great. Shantanu, just back on the Digital Experience business. If you plug in your fourth quarter guide, you're going to come in a few points below your full-year guide. And I'm just curious, I think the Marketo mid-market and some of your explanations makes sense, but this has been something historically that's been fairly inconsistent. I guess the question is how do you get back to more consistency in making numbers in this business. And if you could just comment, as it relates to your leader, why it's taking so long to get some of the seat for the new role. Thank you.

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

Well a couple of questions in there Brent. And the first one is, I would say, as I pointed out at the beginning, we are growing our subscription book of business, which is a much larger subscription book of business, greater in 2019 than we did in 2018. So I think putting that in perspective, I would say, clearly with the mid-market our motion was perhaps a lot more in the enterprise, we saw tremendous success with Magento in the enterprise and creating a demand generation machine. I think having that aligned the organization, part of what I've done is I've been running this business is to align all of them quicker. I wish I'd done it even earlier in terms of having a combined Magento and Marketo mid-market offering because that demand generation is a machine. So I'm confident that we will see improvements as a result of those organizational changes.

And the Adobe Experience Platform, when you look at it Brent, nobody as delivered something like this. It is so innovative, we talk about it being groundbreaking, and much like we did with digital marketing, which is when we first came out. We were decades ahead of the competition we feel excited about that. Customer interest is high. There is an ongoing on-ramp and maybe we were tad aggressive, but when you're the leader and you're driving such innovation we have to be optimistic about what we are doing for

customers and we experience firsthand what it takes. So we're confident that we will continue to grow that business the way we have.

And as it relates to the organization. I think I mentioned this last time as well. I intentionally put that on hold, because I needed to get all of those organization aligned. The product road map, the innovation road map that exist right now Brent, is stronger than it's ever been. As a result, I think of how Abhay's helped over the last six months. What we are doing with delivering new services, the AI and intelligence services that are available, the delivery of the Adobe Experience Platform, what we've done with content and commerce. Aligning that and getting that unified that is clearly the sweet spot of where Abhay is helping and where I've focused. And I think that would not have happened without somebody doing that directly. And so I'm actually pleased that I did it and aligned the organization first. So it's in great shape for somebody when they come in.

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

Great. Thank you.

## Operator

Our next question comes from Jennifer Lowe with UBS.

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

Great, thank you. And maybe just to follow up on Brent's question a little bit, because there was a number of different -- different items that came up there both in terms of getting greater product alignment in terms of Marketo and Magento and also organizational alignment. So is it possible, just sort of at a high level, give us a sense of how much of this is a product-related issue of just trying to get the products working together versus just organizational? And as you think about how long this will take to kind of get back to where you'd like to be, is that something that could happen in a quarter or two or could this be a more extended timeline to get all the things working the way you want them to?

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

So Jennifer again multiple questions there. First let me end with that which is in Q4, we expect substantial increase in quarter-over-quarter bookings in that particular business. So let me start off by that. I think when you introduce and upgrade to the analytics, which is now available through the Adobe Experience Platform, the customer adoption has been good. It doesn't have to do with the product issue. The product is years ahead of the competition, as I said. It's a new motion, I mean what we went through as we went through our digital transformation, people have to get ready for that adoption and we are seeing that right now we're seeing the on-ramp. So I would put that less as any product issue, definitely not a customer demand issue. And it's just one of those things that you work through and you work through aggressively to ensure that customers get the value that they want. And again in Q4, we expect a substantial increase in quarter-over-quarter bookings based on the pipeline and based on what we would do.

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

Okay. Thank you.

## Operator

Next we'll hear from Mark Moerdler with Bernstein Research.

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

Thank you and congrats on the quarter also. This quarter even with the integration work in sales expansion driven by Marketo and Magento acquisitions, you delivered a really good operating margins. Given what you're looking it sounds like you're going to do in terms of the increased mid-market focus in other areas. Is there any reason why we shouldn't continue to see that margin continue to move up? Thank you.

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

Well, Mark if you look at our sort of guidance for Q4 and look at what the operating margin guidance would be, on the revenue that we outlined and GAAP and non-GAAP EPS. It's clear that we are continuing to focus on the margin as well. And I think at the beginning of the year, we had said you would start to see margins back in the 40%, that's certainly there. However, big picture, I would say we're really focused on the long-term opportunity and continuing to drive top line growth, but the margins and the leverage in the model, you saw that in Q3 as well across the business. And you are right in that the mid-market motions more marketing and generated by demand through the website and less through a direct sales. So that would be better margins than perhaps an enterprise business.

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

Perfect .Thank you, I appreciate

## Operator

Jay Vleeschhouwer with Griffin Securities has our next question.

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

Thank you. Good evening. Shantanu, I'd like to ask a sequel to the technology question I asked a quarter ago, although without the plethora of three letter acronyms that we talked about at the time and still have a little bit intend to understand how you're thinking about your technology or platform as a driver to content velocity usage and ultimately retention.

So the question tonight is about AEM. Next year is the 10th anniversary of the Day acquisition. And best we can tell, you've quintupled or more the revenue from that product. So perhaps you could just talk about how you're thinking about the ongoing momentum in AEM, any fundamental investments or architecture you work, you need to do or are doing in AEM to continue to drive that as the focal point of DX? And then just a quick clarification. In terms of the fixes that you talked about at least for the mid-market, in

DX are you planning to accelerate or implement any more of the self-service capabilities that we've talked about there besides the inside sales and other things you talked about tonight?

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

So let me answer the second question first Jay, which is certainly both the Magento and Marketo. We have both sales of capabilities as well as a ecosystem of partners. As you know with Magento having the the open source community help us, not just with bringing us leads, but also helping integrate with any point of sale or inventory or supply chain systems. It's a huge advantage and I think we're leveraging that. And also as it relates to Magento, we've already integrated that with our AEM.

On AEM, content just continues to be a significant, significant differentiator and I referred to it earlier as the first mile experience that every customer has with the digital enterprise, some really exciting things underway there. As you know, when we acquired Day Software that was a perpetual business. I think we effectively transitioned it to be managed services business. We have some really exciting plans underway that we're starting to deliver to customers as it relates to fully satisfying that and making that even more self-serve in terms of people using that technology. When you think about what's happening with what's called headless content management, that's area of significant investment for us. So that people can automate their content production.

AEM Assets, which is the assets product, there is a lot of excitement for that for content velocity as you pointed out. We talk a little bit less about AEM Forms, but AEM Forms also is a way in which people want to use AEM technology. So AEM has really become a platform, it your web infrastructure. What's really exciting for us is there isn't a digital event that happens, whether its debates, companies introducing product launches, sports events that aren't completely run sort of on Adobe technology and that's really exciting to see when we see these spikes in our traffic we know what's happening on -- in virtually every online event an AEM is at the core of that.

AEM had a strong quarter. It continues to be a way in which people are re-platforming their web and so stay tuned for more, but hopefully that gives you a glimpse of some of the things that we're doing. The move to SaaS, the move towards headless content and asset management are maybe three of the ones I'd identify.

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

Thanks Shantanu.

**Operator**

Our next question will come from Heather Bellini with Goldman Sachs.

**Q - Heather Bellini** {BIO 2268229 <GO>}

Great, thank you. I just wanted to go back to a couple of questions that were asked previously. One, just thinking through the Digital Experience and some of the comments

you made, can you give us a sense, is it -- is there anything to do from a competitive standpoint here? Is it really all go to market and I'm just wondering kind of who you're seeing most frequently, and if that's changed.

And then I think to Jen's question, kind of talking about margins. I was wondering if you could speak a little bit about OpEx growth. And based on your comments and your guide for the -- for Q4 and as such the full year, when we think about your comment about investing for growth and margins, how should we be thinking about the pace of OpEx growth going forward? I mean you guys have been 20% or higher for the last few years, obviously there's M&A included in that, but should we be expecting just given the opportunities that are ahead of you kind of similar type growth rates as we start to think about the periods ahead? Thank you.

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

Sure. So let me answer the first question. While there may be some point solutions that have point competitors or products that aren't there in the market that do similar technology. For the vast majority of what we offer in Digital Experience, we're the undisputed leaders and really as we talk about the innovation for new things like Adobe Experience Platform, the real-time CDP what we are doing with intelligent services, Heather -- there really isn't anybody else who is offering capability similar to what we have in the market.

I think as it relates to M&A, if that was the question, there is nothing major that we look at and feel like is gap currently in our portfolio. I think you know the combination of Magento and Marketo and what we've done with the Adobe Experience Platform that gives us without a doubt the leading platform and significant portfolio to continue to drive growth. I think what we are doing on the document side with the verbs and having the ability for people to embed PDFs, so think of it as a PDF service. We're pretty excited about the opportunity associated with that and we talk about creative.

So hopefully that gives you a flavor as we talk about the \$100 billion addressable market that's really driving our growth at this point.

### **Q - Heather Bellini** {BIO 2268229 <GO>}

And then the question on OpEx rate, OpEx growth.

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

Yeah, well on all expense really, I mean I think when we look at margins in general where our goal is to continue to invest in top line growth, but then obviously drive efficiency is both and how we look at our COGS and how we're looking at the rest of the P&L. And so you see that here in Q3, we're able to -- very through a lot of like relentless fiscal discipline contributed to the lower OpEx in Q3 than probably was modeled and that came through obviously in the EPS performance. And you'll see that again in Q4 as we model that out, you see the operating margin expand again in Q4 based upon our target. So we're diligently focused on that from time to time like we did with the acquisitions. We

found opportunities to invest in growth and we'll do that, but the idea is to really always focus on growing our earnings as fast, if not faster than revenue.

**Q - Heather Bellini** {BIO 2268229 <GO>}

Great, thank you.

**Operator**

Our next question will come from Saket Kalia with Barclays Capital.

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

Hi guys, thanks for taking my question here. John, maybe for you, and I apologize for the background noise, Adobe continues to do a good job on generating new Creative ARR and so as you think about next year understanding that we aren't giving guidance yet, can you just talk about some of the puts and takes to how ARR may look next year, particularly with some of the benefit of pricing that we got in fiscal '19?.

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

When I look at ARR more philosophically, because obviously we have Analyst Day coming up where we'll actually talk a lot about next year, we've laid out many, many times the different drivers that we have and Shantanu covered a number of them when he talked about that earlier to the earlier question. So we have international markets, we've got new products, we've got single apps and mobile on-ramp that are really driving new users to the platform and that's one of our biggest growth areas and that's still a focus for us. We have -- I think other folks have asked about promotions before as well and we use those and we've seen through DDOM model that they're very effective in driving new users and then converting those to paid users. So overall, we've got a number of vectors that we believe we can continue to grow ARR in the future and beyond.

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

Very helpful, thank you.

**Operator**

Alex Zukin with RBC Capital Markets has our next question .

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

Thanks for taking the question. So maybe just the first one about the -- if it's possible to unpack kind of where the greater magnitude of the bookings -- kind of headwinds came from, whether it was more the mid market Marketo side or whether it was the analytic side? And then just maybe one for John, about the cash flow out performance in the quarter, it was bit below our numbers. Was there -- were there any one-time issues there that should self-correct?

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

Yes. Alex, as it relates to the bookings, I would, in order of sort of priority, first talk about the Analytics as its moving to the Adobe Experience Manager. So the combination of Analytics and Audience Manager sort of moving to Experience Platform with the real-time CDP and then, to a lesser extent, the Marketo mid-market. So that's sort of how I would look at it as people are transitioning and upgrading to the Adobe Experience Platform.

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

And on cash flow, we're actually pretty happy with the performance, but we did have some onetimes in the quarter. We ended up taking advantage of some favorable vendor pricing by doing a couple large prepayments. And then also, we had some timing of some tax payments in the quarter as well. So those impacted that but had -- excluding those items, would have been well above \$1 billion in the quarter.

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

Perfect. Thank you guys.

**Operator**

Next we'll hear from Sterling Auty with JP Morgan.

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

Thanks. Hi guys. You mentioned the softness in the Marketo bookings was specifically mid-market, can you give us a sense of what percentage of that business is usually targeted towards mid-market? And is there a different kind of product set or requirement than what you're currently offering that you think you need to deliver to get it back on track?

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

No, Sterling. I think first to put it in perspective, we saw growth. We are talking about the acceleration in mid-market the way we did it for Magento in terms of sort of growing it across the enterprise. And so I think it's really all about having the demand generation machine, which is easier to fix in terms of getting that sort of motion going again in the company.

And in terms of it being self-serve, I mean the product is actually applicable already across the mid-market and enterprise. So there no product issues there, it really has been, as I said, the natural inclination was to go in the enterprise. And so, continuing to accelerate the mid-market in addition to enterprise, like we are focusing on Magento and having that as an aligned organization so we can leverage our marketing is the two changes we've made.

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

And the general split, enterprise versus mid-market in that business?



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

We have such good market share across both of those segments as the leading B2B segment, it really is well penetrated across both if there is any -- this -- probably more penetration in the mid-market and the smaller size of the large enterprises than the large enterprise. Sterling, if I were to give you some color on the current penetration within the enterprise.

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

Okay, thank you.

**Operator**

Our next question will come from Kash Rangan with Bank of America Merrill Lynch.

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

All right, thank you very much. Shantanu, I just want to clarify. Generally, when you put out a new -- newly integrated platform, the enterprise market is the one that's a little bit more demanding, and they are the ones that are likely to delay purchasing. But here, it appears that it's more on the mid-market side. So I'm just curious to get a little bit more color. What else do you need to see in the product by which the customer base can move forward with confidence? And I've got to believe that just based on the new guidance for Q4 that we're not expecting a snap back in Marketing -- or what used to be called Marketing Cloud bookings. So therefore, should we expect -- what are we expecting for this year to actually happen next year while not being specific about growth rate? Thank you so much.

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

So Kash, first with respect to the bookings, let me again reiterate what we said in the prepared remarks, which is we would expect the overall subscription book of business for all of the Experience Cloud across mid-market, across enterprise and across all solutions to be greater than 20%. So I wanted to make sure that that was understood despite what we saw in Q3.

I think as it relates to your first question, the integrated platform that is really aimed more at the enterprise and that's the natural migration of analytics and Audience Manager customers. I think the mid-market is specifically as it relates to Marketo. So I just wanted to clarify that and so there are no issues with respect to adoption in the enterprise, if anything as I said we were maybe a tad aggressive with how quickly they would adopt it. But we do expect to see substantial bookings in Q4 quarter-over-quarter.

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

Got it. And the outlook for this combined newly integrated platform going into next year, what are the things that you could do our customers can do that they could not too with the previous product. Just trying to understand qualitatively how this changes things for Adobe, that's it. Congrats.

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

Well, you know, I think what we've been through, Kash, with our own move to digital, the ability to have a real-time platform where you can actually activate what happens to customers across multiple channels, it doesn't exist. I mean the first generation of dealing with these customers is a record in our database. That is completely inadequate in terms of how people can engage with customers. So this is absolutely groundbreaking in terms of what can be done. So think of it as how many times have you gone to a website, you bought a product and then the ad for that product continues to dog you for weeks. And maybe sometimes to add insult to injury, it actually says there's a discount now available for that product. That's sort of the thing that we're addressing. Or when you call in to a customer support and you've done something in a retail store or you've done something online, and it has no idea about who you are and what you did. So I think this real-time CDP, the other massive movement that you know is happening is between known and unknown and a movement towards that with browsers. So we're the first to convert what was our leading position with DMP or data management into real-time CDP or a customer data platform.

So this is the ability to have one single unified view of a customer across multiple channels, understand how you acquire them, understand how you engage with them. So that's really what I think is an imperative for every company doing digital transformation. So that's our opportunity and our lead.

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

Exciting. Thank you so much. Best wishes.

### **A - Mike Savage** {BIO 3176226 <GO>}

Operator, we're coming up on the top of the hour. Maybe we'll take two more questions, please.

### **Operator**

Thank you. Our next question will come from Walter Pritchard with Citi.

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

Hi, thanks. Sorry for the background noise here. John, just a question for you on pricing as a driver. I've noticed in the past what you've outlined and in this quarter you've outlined the different -- some of the different drivers in the script. And I didn't see pricing there, I'm wondering sort of how pricing in both the expiration of promotional pricing as well as some of the pricing actions you've taken over the last 18 months are faring as drivers of the Creative business compared to what you've seen in our recent quarters? Thanks.

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

Sure Walter. Pricing is certainly is a lever, it's not one that we have ever used really as a driver for an annual price increase to increase ARR for instance. One of the things that we

look at is with the value that we're providing to the customers and when we provide the value and we see that value resonate with customers then we price it accordingly. What we saw this year of course was the price increase that we did I should say last year for North America and then this year internationally in Australia and Japan, we've seen those price increases be well accepted. We've customers who have stayed on the platform and the value was resonating. So it's something that we'll look at, it's not a core driver, but something that is one of the many levers that we can use to grow.

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

Great. Thanks, John.

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

You bet.

## Operator

Our final question will come from Chris Eberle with Nomura Instinet.

**Q - Christopher Eberle** {BIO 16478096 <GO>}

Hey guys, thanks for taking the call. Just wanted to touch on advertising really quickly. We had noticed that in back in August, Google had shut out Adobe DSP from their ad exchange. Can you talk about if that had any effect at all or maybe just kind of remind us the size of that business now and if its material at all? Thanks.

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

So the easy answer to that is it really had no impact. That was a one day in one part of Europe as a result of a customer who used it inappropriately and we were back up and running. So that really had no issue. I mean the advertising business for us is an important part of the Experience Cloud business. It allows the CMOs to have real attribution associated with their marketing spend, it helps with customer acquisition as the on-ramp to a digital business. So it plays a strategic role and we have good offering and that it cuts across all of the different channels that people are looking to acquire customers on namely, TV, search, display and video. So I think in particular where we are strongest right now is certainly in helping people with the new media types such as video and TV. So that's it as it relates to the ad business.

I mean given that was the last question, I continue to believe that Adobe is not just driving, but we are creating large market opportunities. We were pleased with our fiscal performance in Q3. And I'm particularly pleased with the product road map and innovation that we're delivering across all three clouds to what is increasingly an incredibly diverse set of customers. Our strategy empowering people to create and helping businesses transform is certainly working and we are executing against that strategy. Design and creativity have never been more important, you've seen the strength in both the creative as well as the document business. And digital transformation and digitization continues to be an incredible opportunity. Clearly FY '19 will be another record year with strong cash flow and margin expansion. And as a plug, I'm particularly

excited about the innovation that we're going to showcase at MAX, is going to be our largest creative event and I hope to see you join us in LA for both MAX as well as our FA meeting. Thank you for joining us today.

## **A - Mike Savidge** {BIO 3176226 <GO>}

This concludes our call. Thanks everyone.

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