Q4 2018 Earnings Call

Company Participants

- John Francis Murphy, Chief Financial Officer & Executive VP
- Michael Saviage, Vice President, Investor Relations
- Shantanu Narayen, Chairman, President & Chief Executive Officer

Other Participants

- Brad Alan Zelnick, Analyst
- Brent Bracelin, Analyst
- Brent Thill, Analyst
- Heather Bellini, Analyst
- Jay Vleeschhouwer, Analyst
- Jennifer Swanson Lowe, Analyst
- Kash Rangan, Analyst
- Keith Eric Weiss, Analyst
- Kirk Materne, Analyst
- Mark L. Moerdler, Analyst
- Saket Kalia, Analyst
- Sterling Auty, Analyst
- Taylor J. Reiners, Analyst
- Thomas Michael Roderick, Analyst
- Walter H. Pritchard, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. I'd like to welcome you to Adobe Fourth Quarter Fiscal Year 2018 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

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

Michael 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 fourth quarter and fiscal year 2018 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'd 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 operating model targets and our forward-looking product plans, is based on information as of today, December 13, 2018, 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.

During this call, we will discuss GAAP and non-GAAP financial measures. A reconciliation between the two is available in our earnings release and in our updated investor datasheet on Adobe's Investor Relations website.

Call participants are advised that the audio of this conference call is being webcast live in Adobe Connect 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. Fiscal 2018 was an outstanding year for Adobe, and I'm thrilled with what we've accomplished. Our vision to empower people to create and transform how businesses compete has never been more relevant, and we welcomed millions of new customers to Adobe.

From students, to creative professionals, to government agencies and the world's most successful brands, customers everywhere are turning to Adobe to tell their story, drive their digital businesses and change the world.

This year, we delivered significant innovation across Creative Cloud, Document Cloud and Experience Cloud. We made strategic acquisitions, which have expanded our offerings and addressable markets, and we forged key partnerships that bring us increased scale.

These actions have resulted in record revenue and impressive growth across all our businesses. As we enter 2019, Adobe is well-positioned to build on this momentum, delight our customers and continue to deliver impressive long-term top and bottom line growth.

Total Adobe revenue was $9.03 billion in FY18, which represents 24% annual growth. GAAP earnings per share in FY 2018 was $5.20; and non-GAAP earnings per share was $6.76. Total Digital Media annualized recurring revenue, or ARR, exiting the year grew to $6.83 billion. FY 2018 Creative revenue was $5.34 billion, which represents 28% year-over-year growth. We achieved annual revenue of $982 million for Document Cloud. And in our Digital Experience business, Experience Cloud revenue for the full year was $2.44 billion, representing 20% year-over-year growth.

We closed the year with another record quarter, delivering Q4 revenue of $2.46 billion, representing 23% year-over-year growth. GAAP earnings per share for the quarter was $1.37; and non-GAAP earnings per share was $1.83. These results include the acquisition of Marketo and the associated financial impacts that come with a large transaction. Excluding Marketo, we met or exceeded all of our Q4 and annual targets.

Adobe believes everyone has a story to tell. Tens of millions of people around the world tell their story with Creative Cloud, whether it's in a high school magazine, a mobile app, a documentary at Sundance, or an enterprise website.

We achieved record Creative revenue of $1.45 billion in Q4, with 26% year-over-year growth. In Q4, our Creative business was fueled by strong performance across all segments, particularly among consumers. Black Friday and Cyber Monday were two of the largest single selling days in company history.

We focused on expanding the value of Creative Cloud for existing customers, while extending its capabilities to meet the needs of broad new segments of users. In October, we held our annual MAX Creativity Conference. MAX has become a movement, with reach and impact well beyond the physical event. This year, hundreds of thousands of creative customers tuned in online to watch MAX, and millions more continue to view MAX content.

Product announcements at MAX included: major updates to our flagship Creative tools, including Photoshop, Lightroom, Illustrator, InDesign and Premiere Pro; the introduction of Premiere Rush, the first all-in-one, easy-to-use video editing app for social media creators, simplifying video creation and sharing on leading platforms such as YouTube and Instagram.

Online video is one of the fastest growing creative segments; and Rush is a cornerstone of our strategy to unlock this opportunity for millions of new customers; exciting new innovations, powered by Adobe Sensei, inside of Adobe XD, include new technology for prototyping experiences and applications for voice-enabled devices, such as Amazon Echo; and new apps, including Photoshop on the iPad, which will bring the power and precision of Photoshop to a touch device; and Project Gemini, a new drawing and painting application that brings unprecedented watercolor and oil painting capabilities to the digital canvas.

In our Document Cloud business, we're revolutionizing how people scan, edit, collaborate, sign and share Adobe PDFs, whether they're consumers, small businesses or large enterprises. Document Cloud revenue in Q4 was $259 million, and we grew Document Cloud ARR to more than $800 million.

We continue to accelerate our pace of innovation with Document Cloud, investing to modernize the PDF experience on every device and surface, and building on the document intelligence available from the billions of PDFs in market to power AI-driven experiences.

We recently shipped an all-new Acrobat DC with connected mobile apps like Adobe Scan and Acrobat Reader Mobile to create, share and collaborate with PDFs across smartphones and tablets. Adobe Sign, our e-signature solution, continues to gain momentum across businesses through new integrations and partnerships, including Dropbox, Microsoft Dynamics and ServiceNow.

Digital transformation continues to be the mandate for CEOs across the globe. To compete and win today, both B2C and B2B businesses must provide a world-class, end-to-end customer experience across every touchpoint. With Experience Cloud, Adobe is reimagining customer experience management and delivering the industry's only end-to-end solution for marketing, advertising, analytics and commerce, purpose-built for the modern enterprise.

In our Digital Experience business, we achieved Experience Cloud revenue of $690 million for the quarter, which represents 25% year-over-year growth. Key Experience Cloud customer wins in the quarter include Unilever, The Home Depot, Telegraph Media Group, Geico, Heathrow Airport and the U.S. Department of Veterans Affairs.

Delivering exceptional customer experiences demands deep customer insights and a platform built for action. We continue to invest in building the industry's first open platform for customer experience management, the Adobe Experience Platform. The Adobe Experience Platform will deliver a true, unified view of the customer for both CMOs and CIOs.

In partnership with Microsoft and SAP, the recently announced Open Data Initiative is aimed at eliminating the data silos that exist across enterprises. It will enable enterprises to harness and take action on massive volumes of customer data to deliver personalized, real-time customer experiences.

We're excited to have early support for ODI from leading brands, including: Coca-Cola and Walmart. Adobe's retail reports, powered by Adobe Analytics data, have become the industry bellwether for holiday shopping forecasts and other digital media, commerce and cultural trends.

Adobe analyzed over 1 trillion visits and 55 million product SKUs across U.S. retail sites this holiday season. Data showed that online sales reached $7.9 billion on Cyber Monday, making it the largest online shopping day of all time in the U.S.

In October, we completed our acquisition of Marketo, the leader in B2B marketing engagement, and we're off to a great start. Marketo strengthens our offering to customers, combining Experience Cloud's analytics, personalization, commerce and content capabilities with Marketo's B2B marketing engagement platform, helping customers automate and orchestrate mission-critical marketing campaigns and activities from lead management and customer engagement to account-based marketing and revenue attribution.

The addition of Marketo, along with our recently integrated commerce capabilities via our acquisition of Magento, widens Adobe's lead in customer experience management across both B2B and B2C in all industries. We're well-positioned to continue capitalizing on this growing opportunity that we estimate to have a total addressable market of more than $71 billion by 2021.

Adding Marketo to our Digital Experience business immediately accelerates overall revenue growth for Adobe, and other financial benefits will ramp during FY 2019 as the accounting impact from the transaction dissipates.

Adobe is the clear leader in the markets we serve: creativity, digital documents and customer experience management. Our solutions have become indispensable to millions of customers, whether they are in the design department or the IT department, the classroom or the boardroom.

At Adobe, it is our 20,000 global employees that form the heart and soul of our business. In October, we achieved global gender pay parity, a critical milestone in Adobe's commitment to providing employees with a workplace that is diverse and inclusive. Last week, we were named one of Fortune's Top 100 Best Workplaces for Diversity. Adobe was once again ranked on the Dow Jones Sustainability Index, a key barometer tracking sustainability-driven companies.

In 2018, we made significant investments across our product portfolio, entered new markets and made strategic acquisitions, which we believe will fuel continued top and bottom line performance. We expect 2019 to be another year of strong product innovation and financial results.

John?

John Francis Murphy {BIO 16018871 <GO>}

Thanks, Shantanu. We're pleased with our Q4 and full year fiscal year 2018 results. We're excited about our acquisition of Marketo, which closed on October 31. And as part of my prepared remarks, I will review our consolidated Q4 and FY 2018 results and outline

Marketo's impact in comparison to our targets previously provided, which excluded Marketo.

In FY 2018, Adobe achieved record annual revenue of $9.03 billion, which represents 24% year-over-year growth. GAAP EPS for the year was $5.20 and non-GAAP EPS was $6.76.

Noteworthy achievements during the year include: Creative revenue of $5.34 billion, which represents 28% year-over-year growth; Adobe Document Cloud revenue of $982 million, which represents 17% year-over-year growth; adding a record $1.45 billion of net new Digital Media ARR during the year and exiting FY 2018 with $6.83 billion of Digital Media ARR; Adobe Experience Cloud revenue of $2.44 billion, which represents 20% year-over-year growth; generating more than $4 billion in operating cash flow during the year; returning $2 billion in cash to stockholders through our stock repurchase program; and growing deferred revenue to approximately $3 billion; and increasing our unbilled backlog to approximately $5 billion exiting the year. Together, this represents approximately $8 billion of contracted revenue.

Total annual revenue growth, excluding Magento and Marketo, was approximately 22%, well ahead of the revenue target we provided entering the year. In the fourth quarter of FY 2018, Adobe achieved record revenue of $2.46 billion, which represents 23% year-over-year growth. GAAP diluted earnings per share in Q4 was $1.37; and non-GAAP diluted earnings per share was $1.83.

Excluding the impact of the Marketo acquisition in Q4, we estimate GAAP EPS would have been $1.48 and non-GAAP diluted EPS would have been $1.90, both of which would have exceeded the earnings targets we provided in September.

Business and financial highlights in Q4 included: Digital Media revenue of $1.71 billion, including Creative revenue of $1.45 billion and Adobe Document Cloud revenue of $259 million; record net new Digital Media ARR of $430 million; Digital Experience revenue of $690 million, which represents 25% year-over-year growth; deferred revenue growth of 22% year-over-year; record cash flow from operations of $1.1 billion; returning $397 million of cash to our stockholders through stock buyback; and approximately 90% of our revenue in Q4 was from recurring sources.

In Digital Media, we grew segment revenue by 23% year-over-year. The addition of $430 million net new Digital Media ARR during the quarter grew the total to $6.83 billion exiting Q4. Within Digital Media, we achieved another strong quarter with our Creative business. Creative revenue grew 26% year-over-year in Q4, and we increased Creative ARR by a record $373 million.

Key growth drivers included: strong net new subscriptions across user segments and geographies, driven by robust traffic and customer acquisition on adobe.com, and helped by typical year-end benefits, including enterprise seasonality, post-MAX traffic and holiday campaigns which drove strong consumer adoption; education market success, driven by our year-long effort to increase our focus on Creative Cloud use by students and schools; continued momentum with Creative Cloud in emerging markets; services adoption, including continued strength with Adobe Stock revenue, which grew by more than 25% during the year; and pricing optimizations in North America.

As we outlined at our Financial Analyst meeting in October, we're focused on numerous initiatives to continue to fuel Creative Cloud growth in the coming years. We achieved record Document Cloud revenue of $259 million in Q4, which represents 10% year-over-year growth, and we added $57 million of net new Document Cloud ARR during the quarter.

As we discussed previously, in Q4 FY 2017, we achieved a significant amount of perpetual Acrobat revenue through the channel which impacts year-over-year comparisons. Acrobat unit growth across Creative Cloud and Document Cloud was greater than 30% during the year, and Adobe Sign revenue grew by more than 25% during FY 2018. With strong Acrobat subscription and Document Cloud services adoption, we exited FY 2018 with more than $800 million of Document Cloud ARR and solid momentum.

In our Digital Experience segment, we achieved record quarterly Experience Cloud revenue of $690 million. Magento exceeded the $30 million target we shared previously for Q4, and Marketo added $21 million during the quarter.

Digital Experience year-over-year segment growth was 25% in Q4, inclusive of Marketo; and 22% excluding Marketo, ahead of our Q4 target of approximately 20%. For the year, Digital Experience year-over-year segment growth was 20%, inclusive of Magento and Marketo. We finished the year with strong subscription bookings in line with our target.

In Q4, Experience Cloud subscription revenue grew 30% year-over-year; and for the year, we achieved 26% year-over-year Experience Cloud subscription revenue growth, both including Magento and Marketo. Experience Cloud performance in Q4 was driven by success across our offerings, with particular strength in Analytics, AEM Assets and Magento Commerce. Our go-to-market relationship with Microsoft resulted in strong bookings in Q4 and during the year.

From a quarter-over-quarter currency perspective, FX decreased revenue by $9.5 million. We had $30.5 million in hedge gains in Q4 FY 2018, versus $16.8 million in hedge gains in Q3 FY 2018. Thus, the net sequential currency increase to revenue considering hedging gains was $4.2 million.

From a year-over-year currency perspective, FX increased revenue by $7.9 million. We had $30.5 million in hedge gains in Q4 FY 2018, versus $1 million in hedge gains in Q4 FY 2017. Thus, the net year-over-year currency increase to revenue considering hedging gains was $37.4 million.

In Q4, Adobe's effective tax rate was 3% on both a GAAP and a non-GAAP basis. Both rates were lower than targeted due to a more favorable-than-expected geographic mix of earnings, as well as the favorable resolutions of certain income tax matters.

Our trade DSO was 49 days, which compares to 55 days in the year-ago quarter and 41 days last quarter. Deferred revenue grew to a record $3.05 billion, up 22% year-over-year. Our ending cash and short-term investment position exiting Q4 was $3.23 billion; and cash flow from operations was $1.1 billion in the quarter. The quarter-over-quarter decline in our cash position was due to funding of the Marketo acquisition.

In Q4, we repurchased approximately 1.6 million shares at a cost of $397 million. During FY 2018, we repurchased 8.7 million shares at a cost of $2 billion. We currently have $7.85 billion remaining of our new $8 billion repurchase authority granted in May, which goes through 2021.

Now, we will discuss our financial targets for the coming year. Entering FY 2019, we are excited about our business momentum, our market leadership position and the large addressable markets we presented at our recent Financial Analyst meeting in October. The strategic acquisitions we made in FY 2018 increase FY 2019 revenue growth targets, with some added complexity in describing our financial outlook. I'll explain some of the details as I walk you through our targets.

As we stated previously, we will report our FY 2019 results based on the new ASC 606 accounting standards beginning in March with our Q1 results. The targets we're providing today are based on ASC 605 as we are still in the process of integrating Marketo into our financial systems to report results utilizing ASC 606.

We continue to believe that moving to ASC 606 in FY 2019 reporting will not materially impact our revenue. However, we now expect there will be a slight improvement to earnings through the year as we benefit from capitalization of sales commissions.

We measure ARR in constant currency during a fiscal year. And if necessary, we revalue ARR at year-end for current currency rates. Adverse FX rate changes between December of last year and this year have resulted in a $123 million adjustment and lowers our beginning FY 2019 Digital Media ARR balance to $6.71 billion.

This expected revision is reflected in our updated investor data sheet and our FY 2019 net new growth target, and our quarterly results will be measured against this revalued amount during FY 2019.

In FY19, we are targeting: total Adobe revenue of approximately $11.150 billion; Digital Media segment revenue growth of approximately 20%; net new Digital Media ARR of approximately $1.45 billion, an increase above our preliminary target provided in October; Digital Experience segment revenue growth of approximately 34%; Digital Experience subscription bookings growth of approximately 25%; a GAAP tax rate of approximately 10% and a non-GAAP tax rate of approximately 11%; GAAP earnings per share of approximately $5.54; and non-GAAP earnings per share of approximately $7.75.

Certain factors are reflected in our FY 2019 annual targets, specifically: approximately $35 million of adverse revenue impact due to current FX rates, which have moved against us since we provided preliminary FY 2019 targets that were based on September spot rates;

approximately $75 million reduction in revenue from the write-down of deferred revenue for Magento and Marketo due to purchase accounting; and the increase in tax rates between FY 2018 and FY 2019.

In Q1 FY 2019, we are targeting: revenue of approximately $2.540 billion; Digital Media segment year-over-year revenue growth of approximately 20%; net new Digital Media ARR of approximately $330 million; Digital Experience segment year-over-year revenue growth of approximately 31%; other Expense of approximately $39 million; tax rate of approximately 3% on a GAAP basis and 11% on a non-GAAP basis; share count of approximately 495 million shares; GAAP earnings per share of approximately $1.14; and non-GAAP earnings per share of approximately $1.60.

For modeling purposes, after Q1, we expect total revenue in each quarter to grow by approximately the same year-over-year growth percentage implied in our targeted revenue growth rate for the year.

In addition, after Q1, we expect net new Digital Media ARR in each quarter to be sequentially similar as that achieved in past fiscal years from quarter to quarter, with typical summer seasonality which can lead to sequentially lower net new ARR in Q3, as well as normal year-end sequential strength in Q4 net new ARR.

As the impact of lost deferred revenue due to purchase accounting tapers off during FY 2019 and as we grow our business, we expect quarterly operating margins to increase sequentially. We also expect quarterly year-over-year earnings growth rates to increase during the year.

In summary, FY 2018 was another record year for Adobe as demonstrated by our strong revenue and earnings growth and exceptional cash flow from operations. More importantly, during the year, we've invested in the business to continue our momentum over the long-term.

Our growth targets for the coming year reflect our confidence in our ability to execute, and we expect to exit FY 2019 with a business that continues to exhibit strong top line growth, expanding profit margins, and earnings growth rates that equal or exceed top line growth rates.

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

Michael Saviage {BIO 3176226 <GO>}

Thanks, John. Adobe Summit returns to Las Vegas in March. Day one of our Digital Experience conference is Tuesday, March 26. Invitations with registration information to Summit will be sent out in January. More details about the Summit are available at summit.adobe.com.

If you wish to listen to a playback of today's conference call, a web-based archive of the call will be available on our IR site later today. Alternatively, you can listen to a phone replay by calling 855-859-2056; use conference ID number 8459218. International callers should dial 404-537-3406. The phone playback service will be available beginning at 5 pm Pacific Time today, and ending at 9 pm Pacific Time on December 19, 2018.

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

Q&A

Operator

Your first question comes from the line of Walter Pritchard with Citi. Your line is open.

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

Hi. Thanks. I'm wondering, for Shantanu, on the Creative side, as we look to next year or fiscal 2019 and the ARR that you're talking about; can you help us understand maybe how some of the drivers that you saw this year may evolve into 2019? Which of the drivers there do you expect to continue, which do you expect to strengthen, and any that you expect the sort of wane in terms of driving that $1.45 billion ARR?

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Walter. I mean, first, as it relates to FY 2018, we're certainly thrilled with the performance. And when you think about both Q4 and FY 2018, we actually saw strength in ARR across all offerings, as well as all geographies.

Q4 was characterized, I would say, with typical seasonal enterprise strength that we see at the end of Q4. We saw a bunch of consumer strength, as we also said in our prepared remarks. But whether it was the individual offering, the team offering or the enterprise offering, they just continue to show quite a bit of momentum. And we expect that momentum, frankly, to continue into FY 2019.

So I think from the individual products, when you think about what's happening with the photography bundle, what's happening with Acrobat, what's happening with the video products, clearly, we've identified that we're working on some new categories like HD and what we showed with augmented reality and virtual reality, continued offering of services, which is adding to this.

But as you remember, even during MAX, we announced a numerous set of initiatives that we expect will all continue to drive emerging markets, continued adoption of our services. So we're just really pleased. And I think it's important to remember even when you look at the $1.45 billion target for next year that FX did go adversely against us.

And so, when we think about both new units, as well as renewal of units that happens next year, if they are internationally, that's actually going to be adverse relative to FY 2018. So, clearly, I think indicating that the momentum that we saw in 2018 will continue.

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

Thank you.

Operator

Your next question comes from the line of Saket Kalia with Barclays Capital. Your line is open.

Q - Saket Kalia {BIO 16417197 <GO>}

Hi, guys. Thanks for taking my question here. Shantanu, just to maybe think a little higher level. Can you just talk about how the Digital Experience sales force might change this year now that it has just a lot more to sell and potentially different types of customers to sell into with both B2C and B2B? How do you think about the sales force can sort of go to market in 2019 with the addition of Magento and Marketo?

A - Shantanu Narayen {BIO 3332391 <GO>}

Saket, what we've done is, even in fiscal 2018, as we've segmented the market and we think very strategically about what's happening in what we call the strategic accounts, versus the corporate accounts, versus the territory accounts, we've got a go-to-market that's optimized around what's the best way to generate pipeline, what's the best way to have, what we would call, named account salespeople versus the specialists. And the more comprehensive the offering, the more it actually strengthens our ability to drive pipeline and then convert existing customers.

FY 2018 was characterized, I think, by return to momentum that we saw in subscription bookings. We've certainly seen good adoption, as we mentioned of our Analytics and AEM products, as well as Magento.

And so, what I'm excited about in FY 2019 is when you think about what we had with Adobe Campaign and the B2C high-volume e-mail and cross-channel campaign capability and when you think about what Marketo bought in B2B with the lead management and account-based marketing capability, we now have really a far more comprehensive offering for the enterprise to manage and personalize their end-to-end customer journeys across all channels.

So we've already demonstrated integration. Magento is being integrated with AEM. So it just feels like there's more demand for our products, there's more refinement of our go-to-market, and there's a strengthening, frankly, of the offering which should help.

Q - Saket Kalia {BIO 16417197 <GO>}

Very helpful. Thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks.

Operator

Your next question comes from the line of Brad Zelnick with Credit Suisse. Your line is open.

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

Thanks very much, and congrats on a strong finish to a great year. Shantanu, at MAX, you spoke a bit about Adobe's data-driven operating model. But I think it'd be helpful if you could spend a moment reminding us why this is a competitive advantage and how it contributes to the visibility and predictability that you have in your business.

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Brad, and thanks for the comments. I mean, going back to the data-driven operating model, I mean, it's a vocabulary that's so prevalent now within Adobe. And when we talk about discover, try, buy, use and renew, I think it just enables us to have tremendous focus across each parts of it.

I think most companies start off with really good awareness at the top of the funnel, which is on the discover phase. But what I think we have done is actually provided a really good mathematical underpinning to what we needed to do across each of those. So I know you have and others in the past have asked us questions about how we think about promotions. We have incredible data about what is the right way to target those customers, how do they then convert into paying customers, in which countries do trials work, in which countries do trials not work; in terms of the buying, what are the right offers, how do you make recommendations, how do you convert people and upsell them into other offerings.

And on the use, which is where I would say in FY 2018 we spent the most time, clearly, as the base grows larger and larger and larger, it's in the utilization of the products and ensuring that they get value that the greatest upside exists for Adobe.

And so, the best example I could give you is, once I was at a Wednesday meeting where the entire team was talking about what was happening in real time and they were making decisions in real time. So having this mathematical underpinning in a model and empowering people in real time across every geography to make the right decisions based on data, I think that's really the power of this model and I think you've seen that in our results.

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

Thank you.

A - Michael Saviage {BIO 3176226 <GO>}

Thanks, Brad.

Operator

Your next question comes from the line of Alex Zukin with Piper Jaffray. Your line is open.

Q - Taylor J. Reiners {BIO 21029255 <GO>}

Hi. Thanks for taking my question. This is Taylor Reiners on for Alex. One of the interesting points we picked up from our conversations with partners is that it seems like AEM Forms has been picking up quite a bit. Just wondering if you could dig in a bit more on the momentum you've been seeing there. And then, maybe any comments on what you've been seeing within the e-signature market?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah. I mean, I think the whole paper-to-digital movement just continues to be a big driver of what's happening in digital transformation. And so, if you think about most enterprises, what they have to do is they first have to create this website to engage with customers; and then, allowing them to transact businesses digitally is a big imperative.

And so, to that end, what we've done both on the Acrobat side as well as on the AEM Forms side to allow everything from ad hoc workflows as well as more structured workflows to happen using our products, it's clearly a drive that we see. Government tends to be a big area of usage for AEM Forms, as you can imagine. And the usage of PDF there is high because governments can never mandate that citizens buy software in order to engage with customers.

And so, I think that's the reason for the underlying strength. And AEM, as a platform, it's – we also talked about AEM assets and how content management has grown. And from our point of view, as we think about documents, sign is just one of the many verbs that we focus on. The entire document opportunity is such a large opportunity. And signing is something that we've enabled. We have this incredible reach in terms of the client that we have and the footprint allows us to sign things.

But it's again all about creating those documents and sharing those documents and scanning those documents. And so, our strength in PDF as a format, our strength in the Web content management and our strength in these verbs (00:34:31), including the ability for people to sign, I think, is what gives us confidence that this will continue to drive business for us.

Q - Taylor J. Reiners {BIO 21029255 <GO>}

Thanks, and congrats on a good quarter.

A - Shantanu Narayen {BIO 3332391 <GO>}

Thank you.

Operator

Your next question comes from the line of Kirk Materne with Evercore ISI. Your line is open.

Q - Kirk Materne {BIO 5771115 <GO>}

Yeah. Thanks very much now, and I'll echo the comments around another strong and great year. I guess, Shantanu, I was wondering just about Magento. It seems like that came in a little bit above your expectations, and I know it's still early. But commerce seems to be an area that almost every enterprise is interested in to some degree or the other. I was just kind of curious about how that's helping round out – I think you talked about this a little bit earlier, but how that is specifically helping you round out sort of your offering, especially of B2C clients as that's an area you used to have to partner with other people around. So I was just kind of curious if you could just comment specifically on Magento. Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure, Kirk. I mean, strategically there are two things that we're excited about with the Magento Commerce solution. The first is, for larger enterprises, the ability to now finally close the loop. We have the content management, we have audience segmentation. And at MagentoLive in Barcelona, we actually already have shown how you can integrate AEM with Magento Commerce.

So that's been one of the strategic wins for us as people are thinking about next generation commerce with mobile being a more fundamental part of it. So just having that built-in integration, having the ability for our salespeople to sell the entire solution to our customers, it's clearly an advantage.

The other strategic area of focus for us with Magento is really where Magento was very strong, namely in the midmarket and small and medium businesses. The fact that we have technology and content management and analytics and personalization to add to that as an out-of-box offering for those set of customers is also a strategic advantage for us. And, certainly, Marketo adds to that in terms of the offering for that particular segment of customers.

So it's across both these dimensions that we do it. And underlying all of that, I think, is they're over 300,000 developer, the ecosystem that they have, that's in effect for us a channel. And that I think with Adobe's brand and that distribution and reach, I think we should continue to capitalize on that opportunity.

Q - Kirk Materne {BIO 5771115 <GO>}

Thanks. It's helpful. Happy holidays.

A - Shantanu Narayen {BIO 3332391 <GO>}

Happy holidays, Kirk.

Operator

Your next question comes from the line of Jennifer Lowe with UBS. Your line is open.

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

Great. Thank you. Congrats on the quarter, and thank you for the detail on Marketo and Magento impacts in Q4. And maybe rolling that to fiscal 2019, I think there's a few breadcrumbs in there that would let us get to the revenue impact and the interest expense impacts associated with Marketo. But can you just talk a little bit about the expense line impacts of Marketo embedded in the guidance, both in terms of direct cost acquired with Marketo and also opportunities to invest in that business, given that private equity has been controlling the purse strings for a while?

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, first, Jennifer, I think they were a little bit more than breadcrumbs, but we appreciate the call-out in terms of us trying to be transparent associated with that business. Maybe I'll take a little step back, and then John can add colors. But I think we just look at it and say Q4 and FY 2018, the financial results were clearly stellar. At MAX, as you know, we provided sort of the preliminary targets for FY 2019, ARR of 1.4 billion, Digital Media revenue growth of 20%.

At that point what we had said was that we expect DX revenue growth of 20% and subscription bookings growth of 25%. And as you know, at that point, it did not include Marketo because the deal hadn't closed. But we highlighted two things. We highlighted that it would probably – the earnings would be impacted moving forward as you factor in Marketo and the tax rate would also impact our earnings profile.

What we tried to do is update all of that today to both reflect the continued momentum and demonstrate that – so from a currency perspective, currency went against us. So since September, despite that, we raised our ARR target from 1.4 billion to 1.45 billion. We've kept the revenue growth for Digital Media at 20% despite again, as I said, foreign exchanges going against us.

In Digital Experience, which is your question, as we think about it, the segment revenue target we've raised to 34% year-over-year growth. So, clearly, we are reflecting the continued momentum that we would expect as a result of getting Marketo. The base is much larger right now. And so, including that base what we said is that we expect to drive 25% subscription bookings growth for this much larger book of business, and that's already factored in how we think about the operating expense in terms of what goes for Marketo and actually what goes for the entire DX business.

And then, what we tried to do is reflect that – while we continue to be excited about the potential of earnings, once you factor in the accounting impact of purchase accounting, that's approximately $75 million for Magento and Marketo primarily in the first half of the year, that's like a $0.15 impact in non-GAAP earnings.

So that's sort of how we think about it. We're certainly investing for growth. You see that as we talk about a 25% growth in the entire subscription bookings growth. And we try to reflect what the accounting impacts are as well in that business, which should taper off starting the middle of the year and towards Q3 and Q4. So, hopefully, that helps set the context of how we move from MAX.

And if you think about it from an operational basis, Marketo is actually not dilutive. So what you have to do is factor in what's happening with accounting for deferred revenue. You have to factor in, as you said, the financing and what happens in that particular area, as well as you have to think about what's happening with respect to tax rates.

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

Thank you.

Operator

Your next question comes from the line of Brent Thill with Jefferies. Your line is open.

Q - Brent Thill {BIO 1556691 <GO>}

Good afternoon. On Digital Media ARR, you raised the guidance by 3.5% or $50 million going into 2019. I guess can you just outline your confidence to make that big a raise right out of the gate here?

A - Shantanu Narayen {BIO 3332391 <GO>}

Brent, again, I think it just reflects the momentum that we saw in Q4. I think we outlined a number of different initiatives that we just continue to drive. I mean we're certainly going to see the benefits of pricing and how we continue to optimize that around the world. It's the new product introductions that are coming and just continued strength in Acrobat in emerging markets.

We continue to do a good job combating piracy. We're seeing good strength at, what we call, named user deployment within the enterprises, I think continued strength in Sign and Stock and what that's doing to the particular business. So just across all of the various priorities that we outlined. We just continue to feel good about the opportunity, and we have to continue to execute, Brent.

Q - Brent Thill {BIO 1556691 <GO>}

Thank you.

A - Michael Saviage {BIO 3176226 <GO>}

Next question.

Operator

Your next question comes from the line of Kash Rangan with Bank of America. Your line is open.

Q - Kash Rangan {BIO 22095432 <GO>}

It's nice to hear Brent's voice and go right after Brent. Happy holidays, Adobe team. Congratulations from my end. Shantanu, I am curious when you comb through your natural intelligence and artificial intelligence from Sensei, what is your current read because I think you're one of the very few companies that has reported the Q4 and is giving guidance for Q1. What is your take on the emerging markets especially and some of the volatility you've seen, granted that U.S. seems to be a pocket of strength? What is your take on these other questionable economies and your prognostication behind how you'd see those markets play out for Adobe next year? Thank you very much.

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, Kash, happy holidays to you as well. I mean, from our perspective, I think we're no economists. What we see is that both creativity as a important initiative for everybody just continues to be really an area of emphasis and digital transformation and the digital tailwinds or headwinds that enterprises are seeing depending on their perspective.

So I think what gives us confidence is that it doesn't matter which country you're in, Digital has become an imperative for enterprises. And for individuals, the importance of creativity and design has never been more important. And so, we will just continue to monitor it.

We see strength across emerging markets as well. We've talked about that. I think the fact that we have a differential pricing scheme that allows us to target customers in those emerging markets might help. But overall, clearly, the exposure in that area for us is probably lower than some of the other companies that you're covering.

A - Michael Saviage {BIO 3176226 <GO>}

Next question, please.

Operator

Your next question comes from the line of Jay Vleeschhouwer with Griffin Securities. Your line is open.

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thank you. Good evening. Shantanu, I'd like to follow-up on two broad statements Adobe made about its business, one at MAX and one at Summit. At MAX, the company said that Creative Cloud, at least, is at an inflection point in terms of moving from desktop largely to more of a multi-surface device TAM. And at Summit, you noted that your objective in Digital Experience is to enable or establish what you call that experience system of record.

On the former, could you talk about how you're thinking about your correlation of Creative Cloud new business to new hardware business as compared to the old days of packaged software in terms of the correlation to hardware sales? And then, for the latter, do you think that you've established now the experience system of record, you are de facto, you've done that or do you think that's still aspirational?

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, Jay, first, as it relates to our belief and assertions around multi-surface, it stems from a very simple observation that we want to enable our products to be used wherever inspiration strikes. And second, I think to your question, the capabilities of these new devices, whether they be tablets, or whether they be mobile devices, are infinitely more powerful than the prior generation. And so, whenever there's a step function in capability, or there's a new modality like voice or touch or other interfaces that emerge, all of them represent opportunities for Adobe.

We pioneered our own offering in that particular space with Lightroom and we are seeing good results with Lightroom, which is clearly a space where people want to be able to manage their pictures on any device that they want.

The second category in which we've shown a lot of capability in this particular space is with XD, where again the number of people who design products and the number of stakeholders in that entire design workflow is probably significantly larger than those who design. So those were the two first flagship products that showed it.

But I think at MAX, we clearly announced that not only would we be bringing our flagship products like Photoshop to the iPad, but in addition to that we would be doing brand-new products that took advantage of this media like Project Gemini, where people would use a stylus and a tablet to draw.

So we're well on our way on that journey. We're really excited about what we can do. We also showed, as you know, voice-enabled applications in XD that integrated with Echo. So if you start to think about a world where every single screen you're going to be able to talk to that screen, we want to enable people to use our apps to create applications for that screen. So that's on the MAX front, excited about it, but we're early in the journey and we think there's a lot more that we can do that'll enable people to tell their story with ease.

On the Digital Experience side, with the enterprise system of record, I think the ODI announcement that we made in conjunction with SAP and Microsoft was the next step in that particular journey, where all three companies have talked about the need to have this unified customer profile, where in real-time you can action it and you can integrate that with support systems, supply chain systems, financial systems, and certainly the marketing systems which is what we are pioneering. We made some good progress in that.

The interest, honestly, in that is pretty high because every CIO is worried about how do I get this unified customer profile. So, again, I would say that that's a multi-year journey for us to deliver value. Our experience platform is already been delivered to customers.

They're giving us feedback in real-time. Our applications much like we did with the Creative suite of product will all build on top of the score content and data platform.

But that's what we do, Jay. I mean, we're excited about the product journey and building deep technology moats. And so, I would say, off to a great start, but there's so much more that we can do in terms of delivering value to our customers and further strengthening our differentiation against the competition.

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Okay. Thanks, Shantanu.

Operator

Your next question comes from the line of Heather Bellini with Goldman Sachs. Your line is open.

Q - Heather Bellini {BIO 2268229 <GO>}

Great. Thank you. I mean, Shantanu, I had actually two questions. I think just to follow-up on something that Kash asked. I was wondering, given digital transformation is a top area of focus for CEOs, I'm trying to get a sense for how resilient do you think this spending could be if the macro environment were to become more challenging. And then, I had a follow-up on piracy.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah. Heather, my belief is that the customers – there's no way that customer expectations are going to change in terms of how they transact businesses with enterprise. And as you know, if economic climate changes, there's even more reason to prioritize on the first few imperatives that are essential.

And so, if you just look at what's happening with mobile devices as the only form of interaction with enterprises, we just continue to think that digital will be very important and very central to the C-level mandate. So that gives us confidence that we need to continue to drive it. I mean, we will certainly monitor what happens if there is.

But you don't want this to become a self-fulfilling prophecy, where everybody says, hey, what do we do if there's a slowdown and then people cut spending. We haven't seen that so far. So that's how I would describe this as a priority. And we help with the top line driving revenue for customers. And so, I think that's the important part of our mandate and offering.

Q - Heather Bellini {BIO 2268229 <GO>}

Right. So for the CEOs you talk to or the CMOs, it's much more than about the fear of not spending because of their competitors' spend than they're falling further behind. Is that kind of the way to think about it?

A - Shantanu Narayen {BIO 3332391 <GO>}

That's exactly the way to think about it. And it's also the way they – every one of them knows that if they are not using digital as an enabler, there's some small company out there that's going to completely disrupt their business using a mobile app and digital technology. So the heightened importance of digital, I think, is their front and center for every enterprise.

Q - Heather Bellini {BIO 2268229 <GO>}

Great. And then, just the last one would just be a follow-up on your comments on piracy and you've mentioned some good success that you're having there. Is there a way to help think about the tailwinds that this could add to your Creative business?

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, I think we've seen that, Heather, right through our journey.

Q - Heather Bellini {BIO 2268229 <GO>}

Yeah.

A - Shantanu Narayen {BIO 3332391 <GO>}

The affordability of Creative Cloud from day one has been one of the drivers of the new growth; a new customer acquisition that we've highlighted every year, including at MAX. And so, I think that continues to give us confidence. I think the pricing upfront, which allows more people to enter the platform, I think that's another way in which we are combating piracy.

And third is the fact that we don't have boxes. There used to be a real gray market associated with selling our boxes, that's also gone away. That's not to say that people aren't finding ways to somehow get their hands on Creative Cloud. And our brand continues to be strong even in areas where there are malicious users of our product.

But we made significant traction and we continue to focus on driving value through services. And I would say a step function for us as all of these assets are in the cloud, then they become DOA unless you're a legitimate user of Adobe products.

Q - Heather Bellini {BIO 2268229 <GO>}

Right. Great. Thank you so much, and happy holidays.

A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Heather. Happy holidays.

Operator

Your next question comes from the line of Keith Weiss with Morgan Stanley. Your line is open.

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

Excellent. Thank you, guys. Nice quarter, and thanks for taking the question. Maybe one for John, so he doesn't feel completely left out on this call. If we strip out the acquired assets, Marketo in particular, how are you thinking about sort of operating leverage within sort of the core Adobe businesses into FY 2019? Do you think this is another year where you could see the nice expansion that you have been seen in the underlying operating margins? Or is there like a broader investment at core going on through FY 2019 as well?

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

Thanks very much, Keith. I think when you think about our core business, we have that operating leverage as we've shared throughout FY 2018 before the acquisitions. And what we tried to articulate in the prepared remarks was that because the accounting implications coming with the acquisitions for purchase accounting, you have this really the kind of first half to third quarter impact of the deferred revenue, for instance, on the operating side. And as that tapers off during the year, we believe the leverage in our model continues to return to growth in terms of operating margins. And so, we see that expanding as we exit the year into a familiar territory that I think you've seen before.

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

Got it. That's all.

Operator

Your next question comes from the line of Mark Moerdler with Bernstein. Your line is open.

Q - Mark L. Moerdler {BIO 16855032 <GO>}

Thank you very much. Again, another congratulations from us. Can you give us a sense of where you are in the journey of Acrobat's subscription? And how to think about the negative impact of the move to perpetual license and subscriptions on the Document Cloud revenue growth?

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, Mark, as you know, we have actually used a different strategy for Acrobat than we used for Creative Cloud, because in that particular business perpetual just continues to be an important area of both new customer acquisition for us; as well as, I think, we've done a good job of bridging.

And so, you've clearly seen – now, the business continues to do well. We talked about the unit growth that we're seeing in Acrobat. And so, we don't particularly see a headwind as it relates to perpetual moving to subscriptions the way we saw in the Creative. We just want to continue to focus on driving more unit growth, and that's really our focus.

What is still a big opportunity, however, which maybe the other part of your question, is that there's a larger and larger install base that as we add more value in the services and apply our AI services, that'll continue to be a forward-looking opportunity for us with Document. So I think that's all factored and tailored in the targets that we provided for next year.

Q - Mark L. Moerdler {BIO 16855032 <GO>}

Excellent. I really appreciate it. Congrats.

A - Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Mark.

Operator

Your next question comes from the line of Sterling Auty with JPMorgan. Your line is open.

Q - Sterling Auty {BIO 2070271 <GO>}

Yeah. Thanks. Hi, guys. So trade negotiations with China are dominating the headlines. If we actually see an agreement that brings true IP protection and a real open market in China, how big could that market be for Adobe? What could that do to your revenue and revenue growth going forward?

A - Shantanu Narayen {BIO 3332391 <GO>}

Well, Sterling, one way you can look at it is, you can say what is the number of PCs and mobile devices that are used in China and how does that compare to what's being used in the U.S. And if you look at what our revenue is in the U.S., I mean that would, I think, at the high end show the potential of what that could be because creativity is just as important in China.

And you could actually argue we're one of the few companies, U.S. technology companies that really doesn't have an alternative in China. So we feel good about it. But even if those trade agreements that you allude to happen, I think it would take a little while for that to completely translate into our business.

So having said that, the China business for us has been doing well. As you know, we introduced CC. We focused on the team offering because we thought that would be the right beachhead for us to focus on. And the other area that we focus on is companies doing business in China. How do we make sure that they have a site license, so to speak, or enterprise license agreement that allows us to do it. So from a purely mathematical and install base perspective, it's massive how that translates. We haven't clearly baked any of that, sort of, inflection point or dramatic shift into our numbers.

Q - Sterling Auty {BIO 2070271 <GO>}

Got it. Thank you.

A - Michael Saviage {BIO 3176226 <GO>}

Operator, we're coming up in the top of the hour here. Why don't we take two more questions, please?

Operator

Certainly. Your next question comes from the line of Brent Bracelin with KeyBanc Capital Markets. Your line is open.

Q - Brent Bracelin {BIO 2447337 <GO>}

Thanks. I wanted to follow-up on the operating margin question that Keith kind of went down and taking a little bit of a different tack here. Full year operating margins have risen by more than 200 basis points, I think, for five consecutive years. You're now above 40%, phenomenal kind of progress here, highest in over 10 years.

My question is, going forward, I get the first half accounting impact. But as you think about the opportunity in the $70 billion Experience Cloud, do you plan to invest incremental dollars to accelerate the share in the Experience Cloud? Or do you think you can actually drive margins well above 40% on a blended basis?

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

Great. Thanks very much, Brent. I think when you look at the Digital Experience business, we've always long believed that that business can actually have margins typical of a SaaS business. We continue to invest in the Digital Experience, of course, obviously recently with the two acquisitions. And so, our goal there is to help them integrate and make sure that they can accelerate our growth in that space. That market's huge. So as we continue to invest in that market, certainly, we want to see operating leverage in it and they'll be healthy for the business overall.

If we look at the top line growth and we look at bottom line growth really is what we're trying to drive. And so, our long-term model has always been to grow our earnings as fast as the top line or faster. So once we kind of get past this noise of accounting through the year, more so in the first half, and it trails off in the third and fourth quarter, you'll see the operating margin for the total company kind of return to historical levels.

Q - Brent Bracelin {BIO 2447337 <GO>}

Thank you.

Operator

And your last question comes from the line of Tom Roderick with Stifel. Your line is open.

Q - Thomas Michael Roderick {BIO 16235529 <GO>}

Hi. Thank you. So the company took some pricing up here last March in Creative Cloud, I guess, just in North America. But would love it if you could provide just a little bit of feedback as to how the price bumps that were put in place have been received by both new and installed customers. And can you add any color there as to whether you've seen any changes to net dollar retention stemming from the price bumps? Just overall some color on how this has gone would be great? Thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure. I think it's gone completely in line with our expectations. I mean, we have just a significant amount of experience with that. As you know, we look at FX in other countries as well to also look at pricing. So it's not the first time that we have made changes to Creative Cloud pricing since the time it was introduced.

From our perspective, it was on the heels of a MAX where we introduced five new products, which was the sort of most significant innovation after the original introduction. We continue to be focused on a lot more innovation driving value for our customers, and I think you'll continue to see it. But North America went very much in line with our expectations.

And as we said, our goal is to continue to drive new customers to the platform. That remains front and center, but nothing that I would say stood out in our experience. And I think that's just because of the diligence that we did, which is, we're thoughtful about it, we want to continue to attract customers to the platform with promotional pricing and deliver them the value which enables us to give more credence to whatever pricing changes we might do.

But since the last question, I mean, I'll also start off by wishing everybody on the call happy holidays. Thank you all for joining us. We're certainly thrilled with Q4 and FY 2018. I think we had a very, very strong year. And I think it's a clear indication that our strategy of empowering people to create and helping businesses transform is working.

We think it represents, as we have said at our MAX Financial Analyst meeting, a massive addressable market opportunity. And the FY 2019 financial targets reflect the momentum that we expect to continue to drive across all offerings and geographies. And we're excited about the product innovation road map that we have for all of our customers. And again, wanted to thank you all for joining us today.

A - Michael Saviage {BIO 3176226 <GO>}

And this concludes our call. Thanks, everyone.
