

Company Name: Adobe Systems
Company Ticker: ADBE US
Date: 2017-06-20
Event Description: Q2 2017 Earnings Call

Market Cap: 69,787.30
Current PX: 141.44
YTD Change(\$): +38.49
YTD Change(%): +37.387

Bloomberg Estimates - EPS
Current Quarter: 1.006
Current Year: 4.060
Bloomberg Estimates - Sales
Current Quarter: 1817.154
Current Year: 7213.357

Q2 2017 Earnings Call

Company Participants

- Mike Saviage
- Shantanu Narayen
- Mark S. Garrett

Other Participants

- Ross MacMillan
- Walter H. Pritchard
- Tom Mao
- Stan Zlotsky
- Mark Grant
- Mark L. Moerdler
- J. Derrick Wood
- Saket Kalia
- Alex J. Zukin
- Sterling Auty
- Jay Vleeschhouwer
- Samad Samana

MANAGEMENT DISCUSSION SECTION

Mike Saviage

Financial Measures

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

Shantanu Narayen

Business Operating Results

Revenue and EPS

- Adobe had a record quarter with revenue of \$1.77B, representing 27% y-over-y growth
- GAAP EPS in Q2 were \$0.75, and non-GAAP EPS was \$1.02
- We are executing on our strategy of enabling our customers to design and deliver best-in-class digital experiences

Digital Transformation

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- Digital transformation continues to be the burning agenda for:
 - Creative professionals
 - Enterprises
 - Governments
 - And educational institutions
- Adobe is now the go-to company for creating world-class digital customer journeys from design to delivery to measurement and monetization

Adobe Sensei

- At the core of our ability to drive transformative change across all customer segments is Adobe Sensei, our artificial intelligence and machine learning framework which is being deployed across all Adobe solutions to solve our customers' greatest experience challenges

Digital Media Business

- Central to our strong performance this quarter was record revenue in our Digital Media business
- We achieved \$1.21B in Digital Media revenue in Q2, a 29% increase y-over-y
- We exited the quarter with over \$4.56B of Digital Media annualized recurring revenue or ARR
- The net ARR increase in Q2 was \$312mm and was driven by continued strength in our:
 - Creative Cloud
 - And Document Cloud businesses
- Creative Cloud is the one-stop shop for millions of creative people globally, and we continue to successfully:
 - Migrate CS customers
 - Acquire new customers
 - Expand into new market segments
 - And add value through new services
- In Q2, we exceeded the \$1B mark for Creative product revenue for the first time, an increase of 34% y-over-y
- Creative Cloud growth was driven by healthy net new subscription adoption, strong retention and positive trends in our average revenue per user or ARPU

Adobe Stock Business

- Our Adobe Stock business continues to accelerate driven by customer demand for powerful visual content
- Last week, we introduced Aesthetic Filters, our next-gen search capability leveraging Adobe Sensei to streamline one of the most cumbersome, time-consuming tasks for creatives, finding the perfect image or video for creative projects
- With nearly 90mm assets, Adobe Stock is becoming the most comprehensive marketplace for digital assets

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- And this week, we announced the availability of new collections from Reuters and Stocksy, with USA TODAY Sports coming soon

Video Business

Premiere Pro

- In our video business, Premiere Pro continues to be the leader in the category with 49% y-over-y growth in single-app subscriptions
- At NAB, we unveiled a major update to Premiere Pro, which will help filmmakers and video producers create, deliver and monetize their video assets faster than ever before
 - This latest update delivers new features for graphics and titling, animation, polishing audio and sharing assets, support for the latest video formats such as HDR, VR and 4K, and new integrations with Adobe Stock
- Our leadership in video applications is attracting a new set of creatives to our platform

Innovative New Apps

- With flagship applications like Photoshop, Illustrator and After Effects, and innovative new apps like Character Animator, we have the most comprehensive video authoring solution
- New customers buying single apps like Premiere Pro will be a great base to convert over time to a full Creative Cloud subscription
- In addition to video, we continue to innovate in new categories like Experience Design, 3D and mobile apps, including Adobe Spark, which greatly simplifies the process of designing social graphics, web stories and animated videos
 - These offerings will expand our footprint and bring new customers to Creative Cloud

Document Cloud

- The world's leading digital document service, Adobe Document Cloud, is addressing growing customer demand for more efficient digital processes
- In Q2, Document Cloud revenue was \$200mm, and we grew Document Cloud ARR to \$520mm exiting the quarter
- Acrobat units across Creative Cloud and Adobe Document Cloud combined grew double digits y-over-y, fueled by a record number of new subscriptions in the quarter
- Adobe is focused on delivering innovative capabilities to enable PDF creation in the mobile era

Adobe Scan

- We recently introduced a new app called Adobe Scan, which turns a smartphone or tablet into a PDF creation tool that can do both scanning and intelligent text recognition through integration with Document Cloud
- In its first 12 days, the Adobe Scan app had over 750,000 downloads across iOS and Android

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Recognition

- Adobe is recognized as the leader in the Digital Marketing category, and we have expanded our ambition to solve enterprises' broader customer experience mandate

Adobe Experience Cloud

- At Adobe Summit in March, we unveiled Adobe Experience Cloud, a comprehensive set of cloud services designed to give enterprises everything they need to deliver exceptional customer experiences
- Adobe Experience Cloud includes:
 - Adobe Marketing Cloud, an integrated set of industry-leading solutions to help marketers differentiate their brands and engage their customers
 - Adobe Advertising Cloud, the industry's first end-to-end platform for managing advertising across traditional TV and digital formats
 - And Adobe Analytics Cloud, the core system of data and intelligence for the enterprise
- We drove a record \$495mm in Adobe Experience Cloud revenue in Q2, representing 29% y-over-y revenue growth
- We managed more than 135 trillion data transactions on behalf of our customers over the past four quarters across our solutions
 - This massive volume of data feeds Adobe Sensei, enabling our Experience Cloud solutions to better understand, predict, and personalize customer interactions
- We announced the availability of our first set of joint solutions with Microsoft to help enterprises transform cross-channel experiences and campaign orchestration using:
 - Adobe Experience Cloud and Microsoft Azure
 - Dynamics 365
 - And Power BI

Ad Tech Momentum

- In addition, we will collaborate on an industry standard to create semantic data models that will define language for marketing, sales, and services, which will accelerate the delivery of digital experiences at scale across the entire enterprise
- Adobe's ad tech momentum continues to build
- We have now integrated Adobe Audience Manager into Adobe Advertising Cloud, enabling advertisers to identify high-performing segments and do automated, data-driven media planning and buying across all channels, including linear TV
- Adobe Experience Cloud continues to be the leader across multiple industry analyst categories

Major Recognitions

- Forrester Research named Adobe as the only leader in Digital Intelligence Platforms, an emerging market segment bringing together:

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- Digital data management
- Digital analytics
- And customer engagement optimization technologies
- They also recognized Adobe Advertising Cloud as a leader in the Omnichannel Demand-Side Platforms and Adobe Audience Manager as a leader in Data Management Platforms
- Gartner recognized Adobe as a leader in its Magic Quadrant for Multichannel Campaign Management, where they placed Adobe furthest in the Leaders quadrant for completeness of vision out of 22 vendors evaluated in the report

Global Attendance

- Interest in Adobe Experience Cloud continues to be strong
- We had record attendance at our U.S. and EMEA summits, as well as our symposia in:
 - New York
 - London
 - Mumbai
 - Toronto
 - And Sydney

Major Customer Wins

- Major customer wins this quarter included Best Buy, Cisco, Morgan Stanley, and Verizon
- Last week, Adobe joined the Fortune 500 list for the first time, an exciting milestone for our company
- This quarter, we were also included on Forbes' Best Large Employers list and LinkedIn's Top Global Companies list, and received Great Places to Work recognition in the UK and Germany
- People are our greatest asset at Adobe, and we continue to invest in creating an innovative culture and exciting work environment to attract and retain the best talent in the industry

Summary

- With the introduction of Adobe Experience Cloud, we have expanded our vision and our market opportunity
- Our brand coupled with our deep technology platforms are further distancing us from the competition
- We have the world's best customers, partners, and employees, and we look forward to a strong H2

Mark S. Garrett

Q2 Financial Results

Earnings Highlights

- In Q2 FY2017, Adobe achieved record revenue of \$1.77B, which represents 27% y-over-y growth

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- GAAP diluted EPS in Q2 was \$0.75, and non-GAAP diluted EPS was \$1.02
- Highlights in Q2 included:
 - Our first \$1B quarter of Creative revenue
 - Achieving strong net new Digital Media ARR of \$312mm
 - Record Adobe Experience Cloud revenue of \$495mm
 - Strong y-over-y growth in operating profit and net income
 - Record deferred revenue with strong cash flow from operations
 - And 86% of Q2 revenue came from recurring sources

Digital Media

- In Digital Media, we grew segment revenue by 29% y-over-y
- The addition of \$312mm net new Digital Media ARR during the quarter grew total Digital Media ARR to \$4.56B exiting Q2
- Within Digital Media, we delivered Creative revenue of \$1.01B, which represents 34% y-over-y growth
 - In addition, we increased Creative ARR by \$285mm during Q2 and exited the quarter with \$4.04B of Creative ARR

Creative Cloud

- Driving the momentum with our Creative business was continued solid demand for Creative Cloud across all segments, including individual, team and enterprise
- We saw particular strength on Adobe.com and in the education market
- International adoption of Creative Cloud was notable, particularly in Germany and Japan
- Q2 ARR performance was also driven by solid retention as well as q-over-q ARPU growth across all key offerings

Adobe Stock

- Adobe Stock contributed to this performance with another quarter of record revenue
- We are also pleased to see the growing subscription base for Adobe Stock adding to overall ARR

Document Cloud

- With Document Cloud, we achieved revenue of \$200mm, and Document Cloud ARR grew to \$520mm exiting Q2
- Across Creative Cloud and Document Cloud, Acrobat unit growth accelerated when compared to last quarter and again achieved double-digit y-over-y growth
- In addition, Adobe Sign growth continues, and we expect the recent Document Cloud launch with new Acrobat, Sign and Scan functionality to contribute to the overall Document Cloud performance moving

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forward

Digital Marketing

- In Digital Marketing, we achieved record Adobe Experience Cloud revenue of \$495mm, which represents 29% y-over-y growth
- We are hard at work integrating TubeMogul into our new Advertising Cloud solution, and Q2 performance with the TubeMogul business continues to track as we outlined earlier this year
- TubeMogul gross revenue recognized in the quarter was de minimis as forecasted
- Mobile remains a key driver for our Experience Cloud business
- Mobile data transactions grew to 57% of total Adobe Analytics transactions in the quarter
- Experience Cloud success is fueled by a large ecosystem of partners including systems integrators and digital agencies
 - They are working with us and our joint customers to create digital strategies, plan and execute implementations, and achieve value realization
- In Q2, partners were involved in approximately 50% of our bookings
- From a q-over-q currency perspective, FX increased revenue by \$0.4mm
- We had \$13.3mm in hedge gains in Q2 FY2017 vs. \$18.3mm in hedge gains in Q1 FY2017
 - Thus, the net sequential currency decrease to revenue considering hedging gains was \$4.6mm

Currency Perspective

- From a y-over-y currency perspective, FX decreased revenue by \$19.2mm
- We had \$13.3mm in hedge gains in Q2 FY2017 vs. \$3.6mm in hedge gains in Q2 FY2016; thus, the net y-over-y currency decrease to revenue considering hedging gains was \$9.5mm
- We experienced stable demand across all major geographies during the quarter

Balance Sheet and Cash Flow Summary

- In Q2, Adobe's effective tax rate was 24% on a GAAP basis and 21% on a non-GAAP basis
- Our trade DSO was 46 days, which compares to 43 days in the year-ago quarter and 46 days last quarter
- Deferred revenue grew to a record \$2.07B, up 23% y-over-y
- Our ending cash and short-term investment position exiting Q2 was \$4.93B
- Cash flow from operations was \$645mm in the quarter
- In Q2 we repurchased approximately 2mm shares at a cost of \$266mm, and we exhausted our \$2B authority granted in January 2015
- In Q3, we will begin utilizing our new \$2.5B authority granted in January 2017

Financial Outlook

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Q3 2017

- Now, I will provide our financial outlook
- In Q3 2017, we are targeting:
 - Revenue of approximately \$1.815B
 - Net new Digital Media ARR of approximately \$300mm
 - Digital Media segment y-over-y revenue growth of approximately 26%
 - Adobe Experience Cloud y-over-y revenue growth of approximately 25%
 - Share count of approximately 501mm shares
 - Net non-operating expense of approximately \$14mm on both a GAAP and non-GAAP basis
 - Tax rate of approximately 24% on a GAAP basis and 21% on a non-GAAP basis
 - GAAP EPS of approximately \$0.72
 - And non-GAAP EPS of approximately \$1
- Given our business momentum, we continue to expect total Adobe revenue, Digital Media ARR and EPS to all grow sequentially from Q3 to Q4

Q4 2017

- When modeling segment and total revenue estimates for Q4 2017, it is important to factor the material amount of perpetual revenue reported in our Digital Marketing business in Q4 2016, which we do not expect to reoccur in Q4 of this year
- Considering this and our strong performance YTD, we now expect total Adobe revenue y-over-y growth to be approximately 23%, an increase from our prior target

Summary

- In summary, a record Q2 achievement demonstrates we are executing well against a large growth opportunity
- We remain excited about our prospects for the rest of the year and beyond

Mike Savage

Upcoming Conference

Adobe MAX is scheduled this fall during the week of October 16

Day one of our conference is Wednesday, October 18, and Adobe management will have a meeting with financial analysts and investors that afternoon

An invitation with registration information will go out within the next month and more details about the conference is available at max.adobe.com

Shantanu Narayen

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Closing Remarks

I just wanted to end by saying we're really pleased with our performance in H1 FY2017, both by delivering great top line growth as well as bottom line earnings

I think what excites us really is the long-term opportunities that we have to continue to empower people to bring their creativity to life as well as to enable businesses to transform themselves

And from our point of view, it's this combination of content to create the world-class digital experience customer journeys that have become so important and the analysis of that data to deliver great business outcomes we think is what differentiates the modern enterprise

- And we have a unique mission-critical solution in that entire lifecycle

We continue to invest in deep technology

We didn't touch much on AI and ML, but that we believe will continue to distance us from our competitors

QUESTION AND ANSWER SECTION

<Q - Ross MacMillan>: I had one for Shantanu and a follow-up for Mark. Shantanu, just you mentioned Premiere Pro and the success you're having there with the single-app product and then you commented that that could be a mechanism to drive more sales into full Creative Cloud. And I guess I just had a question on the overall strategy in terms of the potential to create new bundles in the Creative Cloud with the analogy being the Creative Suite when I think you had six different suite types. So I just wondered if you could just elaborate on that for a second and help us think about the opportunities going forward to kind of segment the Creative Cloud product portfolio? Thanks.

<A - Shantanu Narayen>: Yes, thanks, Ross. I'm happy to do so. Also, I wanted to say upfront, Mark and I are actually on different coasts. I was visiting the Tech Council, so I'm in New York, and Mark is in San Jose, as usual.

The strategy, Ross, with Creative Cloud was initially, as you know, to migrate existing customers, and so it was really important for us to simplify the offering and have a CC complete that we thought would be the right solution for the broad swath of customers that we have. And as you're aware, that has played out really well.

We always knew that, as we wanted to attract new customers, the single-app product would be a great stepping stone to get people into the platform and then convert them into full units. This is something that we did in the past whether it was with InDesign during the print era or think products like Dreamweaver or Photoshop or Illustrator. They have always been great ways to attract new customers who may have a real experience with one product and then focus on multiple products.

And video is clearly being one of those new categories where more and more people are using video, and the fact that Premiere Pro is such a great product in video, we're attracting customers to the platform and then we will convert them into CC complete. But it's through promotions as well as training.

So that's the way to really think about it, which is when we're doing new customer acquisition, just the way photography has played out really well with photography expansion and market expansion, we think video will be the same. We're equally excited about XD and what's happening with screen designs. So think about it as bring more customers into the platform through single apps and then convert them to higher ARPU servicing products.

<Q - Ross MacMillan>: That's helpful. And just to follow up for Mark on the ARR, you've obviously exceeded now Q1, Q2, and guiding a bit above where certainly we were for Q3. It looks like you're going to do better than your \$1B for the year, but you didn't raise that number. Just maybe any thoughts around the \$5B exit target and how we should think about that. Thanks.

<A - Mark S. Garrett>: Yes, actually, if you don't mind, Ross, before I answer that question, I want to clarify something. As we were reading our prepared remarks, I caught something that needs clarification. So in the end of my

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prepared remarks, we talked about how we now expect Adobe revenue y-over-y growth to be approximately 23%. That's for the full year. It wasn't clear whether that was the full year or the quarter. So just to be very clear, we expect the full year to be up 23% y-over-y. So just make sure you think about that as you update your models.

For ARR, we're very pleased how that's playing out, Ross, obviously, relative to our expectations. And we're not updating annual targets, but clearly we're on a great trajectory. We had a great H1. And as you know, there's just lots of positive trends that are driving ARR up, everything from ARPU growing across each of the offerings. We've consistently said ARPU continues to grow across each of the offerings, bringing new people into the franchise, selling them services, migrating the base over, and all those trends continue. So we are very optimistic about ARR in general.

<A - Shantanu Narayen>: And, Ross, the other thing I might add here is that we're really focused on the \$20B large opportunity that exists for this entire business. We were pleased also in addition to the stuff that Mark said with how both Germany and Japan have started to adopt Creative Cloud and Stock as well. So our focus is continue to execute on the near term, but focus on the large untapped opportunity that we have.

<Q - Walter H. Pritchard>: Mark, I'm wondering just on the ARR guidance for Q3, that seems like a stronger performance than you've seen in the last couple years given that's a pretty seasonally light quarter. And you had strength in areas like Germany and Japan, which might be weaker that quarter as well. I'm wondering what gives you the confidence. And what areas of the business do you expect to see the strength in Q3 ARR for Digital Media?

<A - Mark S. Garrett>: Yes, we touched on it, Walter. We do have seasonality in prior years in Q3, so I don't think this is anything unusual in terms of strength. We just continue to see momentum across the business, though. It's everything from international, whether that's Germany or Japan. Like I said, ARPU going up across all the different offerings. We continue to migrate the base over. We continue to attract new users. Stock is contributing to ARR. We're starting to see the benefit of less piracy across the offering. So all of those factors just play into our performance in H1 and what we see moving forward.

<Q - Tom Mao>: Mark, as some of your original ETLA deals come due, can you talk about how that's impacting ARPU for Creative Cloud now that you have a subscription version for the enterprise?

<A - Shantanu Narayen>: Yes, maybe even I can touch on what we are hearing when we go meet with all of these customers from enterprises. The two points I would make is, firstly, ARPU is actually increasing. One of the things we track is the amount of the Creative Cloud ETLA customers who are adopting services when they renew their contract. And the second thing we're actually tracking right now is the actual number of users who are downloading and using the product and training it so that we can ensure that our customers get the value associated with it. And both of those are going well. That, again, and even answering Walter's question, gives us confidence as to the ARR moving forward in the Digital Media business. But fundamentally, it's the adoption of services. It's the deployment of the Creative Cloud applications and the usage and training associated with it that have all done well for us in the enterprise customer base.

<Q - Tom Mao>: And just more broadly in the Digital Media business, can you talk about – I think you touched on this a little bit, but just some of the drivers for ARPU increases outside of Adobe Stock?

<A - Shantanu Narayen>: I think we've always said that, as it relates to getting people onto the platform, the first step is on promotional prices to get them onto the platform. I think we mentioned in the prepared remarks that retention continues to be strong. People are using increased number of products. And so I think when we look at ARPU, that's really the reason, and foreign exchange hasn't had an impact. So it's true usage as well as adoption of more products that's driving ARPU.

<Q - Stan Zlotzky>: So, one question for Shantanu and then one for Mark. For Shantanu, since the marketing summit, what has the customer feedback been like on the partnership with Microsoft? What are customers most excited about? And with this combined solution, which parts of the market are you looking to address near term and then more long term as the solution matures? And then a quick one for Mark, recurring revenue now just hit 86%. How much further can that go as we go and as we look at 2018 and beyond? Thank you.

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<A - Shantanu Narayen>: I think big picture actually, when you look at what our customers are saying, they're all struggling with digital transformation, and they want to understand how we can help them create this digital customer journey and help them take advantage of all of the technology trends that are happening. The combination of Adobe and Microsoft in that regard is clearly providing a more comprehensive solution than each one of us alone. And as they are thinking about which is the cloud provider that they standardize on, the fact that we have a great application on Azure also really provides great go-to-market synergy between the two field organizations.

The first solutions that we identified and we've actually started to deliver are the Adobe Experience Manager solution, which is a managed service on Azure. The second solution is being able to run Campaign integrated with Dynamics, so think of it as a complete CRM as well as a messaging and campaign and orchestration solution. And clearly, being able to look at all of the data that they have in Experience Cloud and visualize that through Power BI.

And so, I think it's the fact that together we have a more comprehensive solution, the fact that the field organization and the marketing organization is very aligned, and the fact that, unlike all other partnerships which are press releases, the fact that we've actually executed against it and delivered value I think is leading to a lot of interest in our joint solutions.

<A - Mark S. Garrett>: And in terms of recurring revenue, that's my favorite number. It does just keep creeping up. It's going to keep going up a bit, but it's not going to go to 100% and we're always going to have some revenue that's going to be recognized upfront. But I do expect that it keeps slowly increasing. Hard to say exactly where it settles in.

<Q - Mark Grant>: I just wanted to follow up real quick on enterprise as you talked about some of those renewals from the ETLAs from three years ago and with the announcements that you made around Experience Cloud at Summit. Are you seeing an improvement in customer response there given the introduction of the Experience Cloud and that integrated suite? And what's the impact that you're seeing on typical contract values in the enterprise as you bring that up?

<A - Shantanu Narayen>: Yes. If you put yourself in the shoes of a customer, if you're in retail, what you're trying to do is ensure that all the assets that you have from creation of these assets all the way out to delivery are in a consistent lifecycle of content all the way from our content creation tools to when it's delivered either through a mobile application or on the website. If you're in advertising or you're creating a campaign, you want to make sure that the brand content that you've created in one country rolls out exactly with the same fidelity across multiple countries.

So, when we go customer after customer, they're trying to ensure that all of the digital content that's exploding, they have a good way to deal with it and to roll it out with the fidelity and the efficacy that they expect. That's where the combination of what we've done with Creative Cloud with the ETLA option and AEM assets, the Experience Manager asset solution is a clear leader in the marketplace. And when I alluded to the fact that services and tracking the service usage within CC ETLA, that's what we're trying to do which is to make sure that they have the ability to do asset management.

So the interest level, I would say three or four years ago, we were pitching this vision of how they could corral all their assets across the enterprise in a global way. Today, they are absolutely utilizing it and getting benefit out of it. So there's no question that we've been able to solve a customer pain point.

<Q - Mark L. Moerdler>: I'd like to ask a question both to Shantanu and to Mark. Given the strong revenue growth for Adobe over the last few years and the expected growth this year of 23%, what would you think are the largest impediments to driving roughly 20% y-over-y growth for the next few years? Is it external issues such as market size, law of large numbers or is it more internal issues such as sales staff or breadth of product offering in Digital Marketing? How should we think about it?

<A - Shantanu Narayen>: Well, Mark, I think the first thing we always try to do is to state the overall opportunity and TAM that's available for us. And we identified that that was an over-\$60-billion market opportunity available to us. So I think you start with that.

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I think you look at the tailwinds that exist in the categories that we are, namely, content creation and what's happening on the media side with new media types, what's happening with augmented reality, virtual reality, more people coming into the Creative franchise. And frankly, as we've always said, people having and wanting a story to tell.

On the Digital Marketing side, continuing to help businesses transform. Just like on the individual side, we're empowering people to create. It's a massive opportunity associated with it. So we look at it and say big picture there's no question that the market opportunity is available.

Within the company, we want to make sure we're really focused on building these deep technology platforms. I think at Summit, Mark, you saw us talk about what we are doing with the data platform and these key strategic partnerships to ensure that we build a moat around our offering, and that's what we're focused on. And we have to continue to execute and focus on our customers, but as long as we keep our customers front and center, the opportunity is there. If you're trying to get us to back into a long target right now, we're not going to do that. But we're really pleased with what we did in H1, and we're going to continue to execute against this opportunity.

<Q - Mark L. Moerdler>: That's excellent. I appreciate that. We're just trying to get an understanding of how we should think about it. Any color would be appreciated.

<Q - J. Derrick Wood>: Nice job on the quarter. A question on the partner front. One of the things we've heard, I've been hearing recently is that demand for certified developers on Adobe, especially the Marketing Cloud, is really starting to outstrip supply. So, are there incremental investments you guys are looking at in terms of driving more partner enablement in the channel? And I guess, as a follow-up, I'd be curious if the integration with Microsoft or other ISPs can attract new third-party developers or resellers to your cloud.

<A - Shantanu Narayen>: Yes, Derrick, that's a great question, and I think we said at Summit – and this is true not just of the U.S. Summit, but all around the world – the number of partners who are there and creating digital practices that are based solely on Adobe's Experience Cloud solutions is growing quite dramatically.

I think from our point of view, we continue to ensure that we're providing the best training solutions for these customers, our Professional Services organization is available to help them on board, to help with architectural services that they might need, and to continue to be the eyes and ears, but we're thrilled with the number of practices that have been created in every large SI, as well as every large digital agency that exists. And so, we just have to continue to focus on providing the best training, allowing them to download and use our products. All of them are our customers, so they have first-hand experience of everything that they're doing in this particular space.

And with respect to your second question, you're absolutely right. They are a couple of key both digital agencies and SI partners who view the fact that Microsoft and Adobe are working so closely together to actually create a joint practice, where they have real experience with integrating these two and delivering that as value to their customers. So, as long as Azure continues to grow and do as well as it has and Experience Cloud does, there will be a market for somebody who's an expert in specifically the integration of these two offerings.

<Q - Saket Kalia>: Maybe just to build on that last question for you, Mark. In the prepared comments, you mentioned that partners were involved with about 50% of bookings in the Experience Cloud. Qualitatively, could you just talk about how services revenue in the Digital Marketing business has trended and maybe how you're thinking about it going forward?

<A - Mark S. Garrett>: Yes. Services marketing has clearly increased in that business over time as we've driven more implementations into customers, but that is not a critical number for us. From our perspective, a lot of customers want us to do the services, but we're very happy if that partner ecosystem picks up some of the services work as well. So it's going to be a mix of us doing it as well as a third-party ecosystem.

<A - Shantanu Narayen>: The one thing I might strategically add from a color perspective is one of the things we are doing is, as they become more and more facile at doing each of the individual point products, we're focusing our services a little bit more on architecture and the integration between these products as a way to supplement and augment their offerings. And so, again, I think as Mark said in the prepared remarks, we're thrilled that we have more

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partners and that they are driving more revenue for themselves, and we're happy to augment that through higher-end architectural services as required.

<Q - Alex J. Zukin>: I wanted to ask a go-to-market question around Experience Cloud. Can you maybe comment about the current structure of the sales organization? And maybe as you move toward these bigger solution-oriented sales and it's less individual product focused is – how are you realigning or thinking about strategically with the sales organization?

And then just a follow-up for Mark, any impacts on deferred revenue that we should be aware of from the ETLA to Creative Cloud conversion or anything else?

<A - Shantanu Narayen>: I'll take the first part. Certainly, big picture, when we think about our go-to-market with the sales organization, and I'm assuming you mean primarily in Digital Marketing, it's a very traditional named account and organized by vertical with our sales organization in Digital Marketing.

So think of it as a financial services or retail or travel and hospitality, media and publishing sales organization, so that our customers clearly understand the vocabulary of the people that they're dealing with, named accounts because these named accounts are increasingly relying on us as the complete mission-critical solution for them. And then we have the equivalent of what you might call either territory or commercial, which our customers who are not yet named accounts or other verticals that exist. And we certainly have specialists as well, and these specialists are able to augment what exists with the named accounts.

So the field organization is being structured like that all around the world. It's executing against that. One of the new initiatives that we also have in the field organization is a strategy group that's actually enabling them to have a recipe all the way from going from a digital transformation all the way to how they can start to execute us. So more and more customers are asking us to be their trusted strategic advisor in that particular respect, and we've stepped up to do that as well.

<A - Mark S. Garrett>: And then, Alex, as it relates to deferred revenue, yes, there are a couple things that you should probably know in there. As you know, it's comprised of both Digital Media and Digital Marketing invoiced bookings. On the Digital Media side, ETLAs continue to perform well, and that flows through deferred. More and more of our business is going through Adobe.com, some of which goes through deferred and then some frankly doesn't flow through deferred.

And then in Digital Marketing, there's a seasonal component to deferred. So in Digital Marketing, you usually see a decline from Q1 to Q2 because in Q4 we have a very strong booking quarter, and those Q4 bookings are typically billed and hit deferred in Q1, so then you'll see a bit of a seasonal decline in Q2. It was a little bit different than that last year, not to complicate things, because we had the extra week last year in Q1, and that extra week ended up billing in Q2. But typically you do see in Digital Marketing a seasonal decline from Q1 to Q2.

<Q - Sterling Auty>: I'd be curious if you could compare and contrast the drivers of the strength in Creative Cloud today vs. a year ago, and specifically wondering how much of the strength is what you're doing in the enterprise vs. continued conversions of legacy Creative Suite vs. just upsell and expansion within existing Creative Cloud users.

<A - Shantanu Narayen>: Yes, Sterling, I think when we identified the three strategies that we were going to continue to focus on, which is migration of the Creative Suite base, market expansion, and delivering new services, I think you have to look at it across each one of those. On the migration side, certainly we had I think identified in November of 2016 that we have about 7mm people left to convert. We are continuing to make good progress against that. We had said that Japan and Germany had lagged. That's now showing good progress. So the migration continues well.

From a new customer acquisition, the new customer acquisition has been very healthy. And I think the fact that we combated piracy, you can't buy a box anymore on one of those e-commerce channels that you were able to. The fact that it's a low price of entry, like I mentioned, Sterling, with video or with XD, we have new categories where we're leading the platform, that continues to be really healthy. It starts off a lot with single app, and so people come on with a single app and then they move them into the complete suite.

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Education had a strong quarter, so that was good. And on the CC ETLA and team, I think we're just executing against all of this. Our awareness of the customer, our ability for them to get value out of the entire offering is improving. And I would say big picture, Sterling, I think the biggest thing that's driving it is the creation of good design and content has never been more important, whether that's for the web, whether it's for mobile applications.

And so it's not like I can point to one thing that's actually fueling this business.

It's the fact that we have the most comprehensive offering. We're innovating and we're executing because we understand each customer in a more unique way and are addressing our offering to target them in a personalized way using our Digital Marketing solution. So I can't point at one thing but are pleased with our progress against all of the initiatives we identified.

<Q - Jay Vleeschhouwer>: Two questions for both Shantanu and Mark. Mark, you highlighted the role of Adobe.com, as you typically do on the call. Could you just talk about the margin leverage that you're continuing to get from the growth of Adobe.com? Do you think that's largely played out, or do you think there's further margin leverage benefits you can get from Adobe.com as the business continues to grow, or perhaps you offer some new structural ways of doing business with Adobe, perhaps with new combined products, single sign-on and the like.

Secondly, with respect to Document Cloud, your ARR increased just over \$100mm there y-over-y. At that rate, it would probably take you another four or five years to get to \$1B ARR for Document Cloud. But given the size of the Acrobat base more than double the Creative base and the conversion more and more to subscription, could you foresee a perhaps material acceleration in the ARR accretion for Document Cloud and thereby get to a much higher nine-figure number sooner?

<A - Shantanu Narayen>: Maybe I'll start off with the latter one, Mark, and then you can – which is on the Document Cloud side, Jay, I think it's really important to remember that Acrobat's also available as part of the Creative Cloud offering and is doing extremely well as part of the Creative Cloud offering. It's probably something I should've mentioned even in Sterling and the other questions that are coming. I think we mentioned that Acrobat is seeing a record number of subscriptions and is doing well both in the Creative Cloud funnel as well as in the Document Cloud funnel. And I think we've identified many times that one of the choices that we've made is to offer Acrobat as a single app more in the Creative Cloud funnel so that we can then upsell them to our imaging solutions.

So don't just look at the Document Cloud ARR or the revenue when you think about how well Acrobat's doing because PDF's actually doing well across both Creative Cloud and Document Cloud. And I'll let Mark answer the second question.

<A - Mark S. Garrett>: Yes. And then as it relates to Adobe.com, Jay, as you know we've been scaling Adobe.com dramatically over the past several years as we've gone through this transition. There is no doubt that that has contributed to improved margin. I think it will continue to contribute to improved margin as we continue to scale up the business on Adobe.com. It's a major, major channel for us now and clearly a very profitable one.

<Q - Samad Samana>: Hi. Congrats on a great quarter. Mark, I have a question for you. When I look at the Experience Cloud forecast for Q3, it looks like a deceleration which I'm a little surprised given the y-over-y comp and the added TubeMogul revenue. Can you maybe remind us if there is a lot of license revenue in Q3 last year? And also, I think you've mentioned ASV growth in the past for Marketing Cloud; maybe what that was so we can reconcile the forecast with our models.

<A - Mark S. Garrett>: Yes. There was some perpetual in the third and especially Q4 last year, as I said in my prepared remarks. You've also got, as we've said for quite a while now, the mix of ASV subscription and services revenue as well in there, and sometimes the services revenue plays into that. But if you look at it across the year, it's tracking nicely against what we've said.

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