Company Name: Adobe Systems
Company Ticker: ADBE US
Date: 2017-12-14
Event Description: Q4 2017 Earnings Call

Market Cap: 86,265.03
Current PX: 175.00
YTD Change($): +72.05
YTD Change(%): +69.985

Bloomberg Estimates - EPS
Current Quarter: 1.248
Current Year: 5.507
Bloomberg Estimates - Sales
Current Quarter: 2038.040
Current Year: 8721.967

Q4 2017 Earnings Call

Company Participants

- Mike Saviage
- Shantanu Narayen
- Mark S. Garrett

Other Participants

- Jennifer Swanson Lowe
- Walter H. Pritchard
- Brent Thill
- Ross MacMillan
- Stan Zlotsky
- Mark Grant
- Jay Vleeschhouwer
- Samad Samana
- Saket Kalia
- Keith Frances Bachman
- Tom Mao
- Taylor J. Reiners
- Adam Holt

MANAGEMENT DISCUSSION SECTION

Mike Saviage

GAAP and Non-GAAP Financial Measures

During this call, we will discuss GAAP and non-GAAP financial measures

Shantanu Narayen

Business Highlights

Revenue and GAAP EPS

- FY2017 was another strong year for Adobe, highlighted by record Creative Cloud, Document Cloud, and Experience Cloud revenue, and capped off by the first ever $2B quarter in company history
- In Q4, we delivered revenue of $2.01B, which represents 25% y-over-y growth
- GAAP EPS in Q4 was $1, and non-GAAP EPS was $1.26
- For the year, we grew total revenue to $7.3B, which represents 25% annual growth
- GAAP EPS in FY2017 was $3.38, and non-GAAP EPS was $4.31

Digital Experience

- Our strong results are validation of the relevance of Adobe's mission to change the world through digital experiences
- That vision serves a broad and diversified set of customers from artists, students, and anyone with a story to tell, to the world's most prestigious brands, media companies and institutions, all of whom are betting their future on Adobe as they embrace the opportunities of digital transformation

Digital Media, Creative Cloud, and Adobe Document Cloud

- In Digital Media, Creative Cloud, and Adobe Document Cloud are fundamental to how people and businesses communicate, entertain, and engage with each other
- We exited the year with more than $5.2B of Digital Media Annualized Recurring Revenue, or ARR
- The net ARR increase in Q4 was $359mm, fueled by our ability to attract and retain new users, deepen product engagement, and drive new opportunities through services
- Creative Cloud remains the gold standard for creativity and design
- Tens of millions of people use Creative Cloud, and it is becoming the creativity platform for all
    - We achieved Creative revenue of $1.16B in Q4
- For the year, we achieved Creative revenue of $4.2B, which represents 31% y-over-y growth

Adobe XD

- At our annual MAX Creativity Conference in October, we introduced the next generation of Creative Cloud, including a set of new applications across the design, video, and photography segments
- Highlights included the introduction of Adobe XD, our tool for end-to-end UX and UI design
    - Adobe Dimension, which greatly simplifies 3D design
    - Adobe Character Animator, which brings 2D puppets to life using voice, facial expressions, and gestures
    - And Adobe Lightroom CC, our photography cloud service that works across desktop, mobile and web to edit, organize, store, and share photos

Flagship Products

- We have delivered on Creative Cloud's promise to bring continuous innovation through updates to our flagship products, including Photoshop, Illustrator, and Premiere Pro
- We introduced a premium version of Adobe Spark, our tool for helping everyone communicate their ideas visually
- Spark with premium features offers enhanced customization capabilities for branded graphics, web pages, and video stories, and is a key part of Adobe's strategy to introduce our creative tools to a wider audience of storytellers

Adobe Stock

- The value of Creative Cloud is enhanced through the delivery of innovative, new cloud services
- Adobe Stock has continued its steady growth as we innovate in areas like aesthetic search, and introduced new features and content such as Motion Graphics templates
- We've continued to add new contributor features to Adobe Stock, allowing our community to customize their portfolios and present their best work

Executive Appointment

- Last week, we announced that Scott Belsky, co-founder of Behance, returned to Adobe as Chief Product Officer and EVP of Creative Cloud and has joined my staff
- Scott is one of the most admired leaders in the design community
- In this role, he will focus on product delivery and driving long-term innovation for Creative Cloud products and services
- Scott will partner closely with Bryan Lamkin, EVP and General Manager of Digital Media, as we continue to push the boundaries of what's possible with Creative Cloud and drive continued growth and customer engagement

Digital Document Service

- The world's leading digital document service, Adobe Document Cloud, is enabling businesses to transform inefficient paper-based processes to digital
- In Q4, Document Cloud revenue was $235mm, and we grew Document Cloud ARR to $600mm
  - We achieved annual revenue of $837mm for Document Cloud in FY2017
- Mobile has become the new frontier for Document Cloud
- This quarter, we announced new updates to Adobe Scan, which leverage Adobe Sensei to capture and create intelligent PDFs on your mobile device
- To date, Adobe Scan has had more than 5mm downloads

Digital Marketing

- Adobe created and is the leader in the digital marketing category, which has redefined the enterprise software landscape
- Today, we are targeting the much broader Experience business opportunity, which we estimate to be $53B addressable market in 2020
- In Q4, we achieved Adobe Experience Cloud revenue of $550mm, resulting in annual revenue of $2.03B

Adobe Experience Cloud

- In an era when entire industries are being disrupted, every business must now compete for the hearts and minds of their customers with every click and every interaction
- With Adobe Experience Cloud, we are transforming how businesses compete in this new reality

- Our offering includes Adobe Marketing Cloud, Adobe Analytics Cloud, and Adobe Advertising Cloud, making it the industry's most complete and integrated offering
- Adobe Advertising Cloud is the first end-to-end platform that helps marketers manage their ad spend across all digital formats, including display, search and video, as well as traditional TV

Acquisition of TubeMogul

- It's been a year since our acquisition of TubeMogul, and we have successfully integrated the technology with Adobe Media Optimizer
- This has played a key role in driving strong Advertising Cloud performance and leadership in the digital advertising space
- We introduced several advancements to our Advertising Cloud, including the release of the Adobe Advertising Cloud Mobile App, the industry's first mobile app for cross-channel advertising campaign management

Magic Quadrant

- Adobe Analytics Cloud continues to be the intelligence engine for the enterprise, combining digital and offline data to help brands move from insight to action
- Recently, Gartner positioned Adobe as a leader in its Magic Quadrant for Digital Marketing Analytics research report for the third year in a row
- Adobe was also recognized as a leader in the recent The Forrester Wave: Web Analytics report
- Adobe Experience Cloud processed approximately 65 trillion data transactions for its customers in Q4, and 186 trillion data transactions in the trailing four quarters
- The insights gleaned from this data provide a valuable window into customer behavior and business trends

U.S

- Our annual Holiday Shopping report has become the industry benchmark for measuring the trajectory of e-commerce spending and trends
- This year, we accurately predicted Cyber Monday to be the largest online sales day in U.S. history
- Underscoring the importance of delivering a great mobile shopping experience, revenue driven by smartphones hit an all-time high of more than $1.59B on Cyber Monday

Microsoft

- Together with Microsoft, we are now enabling enterprise marketers to deliver one-to-one personalization of web content at scale, and connect any lead generation data captured on the web to their CRM system through Adobe Experience Manager integration with Microsoft Dynamics 365
- To date, more than 50 enterprises leverage Adobe and Microsoft's joint offerings, including Air Canada, Great-West Life Assurance, and the U.S. Army
- Other significant customer wins in the quarter included Allianz, Barclays, BNP Paribas, IKEA, J.P. Morgan, Mattel, and Opel

Sensei

- The centerpiece of our innovation efforts across Adobe is Sensei, our artificial intelligence and machine learning framework
- We've invested heavily to make Sensei a foundational part of our offerings to both our creative and enterprise customers
- With Adobe's massive volume of content and data assets fueling Adobe Sensei, and our unmatched domain expertise in creativity, documents, and experiences, Sensei is a critical differentiator for our business

Business Results

- Last week, we celebrated Adobe's 35th anniversary
- I know I speak for our 18,000 Adobe employees around the world when I share how proud we are of everything we've achieved as a company, not only the strong business results, but the impact Adobe has made in the markets we serve and in the communities where we do business
  - We were recently recognized by Glassdoor as a 2018 Best Places to Work, as well as a World's Best Workplace and one of the Best Workplaces for Diversity by Fortune

Ongoing Efforts

- We recently announced that Adobe has achieved equal pay between men and women in the U.S., an important milestone in Adobe's ongoing efforts to create an inclusive and rewarding environment for all employees
- The pride in what we've accomplished is exceeded by our excitement about Adobe's future
- With our strong brand, our compelling strategy, and our culture of innovation, our best days remain ahead of us
  - We're looking forward to a fantastic 2018

Mark S. Garrett

Financial Highlights

GAAP EPS

- Our earnings report today covers both Q4 and FY2017 results
- In FY2017, Adobe achieved record annual revenue of $7.3B, which represents 25% y-over-y growth
- GAAP EPS for the year was $3.38, and non-GAAP EPS was $4.31
- This performance is the result of strong execution against our strategy and noteworthy achievements, including record Creative revenue with 31% y-over-y revenue growth and exiting the year with $4.63B of Creative ARR
  - Record Document Cloud revenue of $837mm and exiting the year with $600mm of Document Cloud ARR
  - Record Adobe Experience Cloud revenue of $2.03B, which represents 24% annual y-over-y growth
  - Generating a record $2.91B in operating cash flow during the year

- Growing deferred revenue to approximately $2.5B, and increasing our unbilled backlog to approximately $3.9B exiting the year, together, this represents approximately $6.4B of contracted revenue
- And returning over $1.1B in cash to stockholders through our stock repurchase program

Non-GAAP Diluted EPS and Revenue Growth

- In Q4 FY2017, Adobe achieved record revenue of $2.01B, which represents 25% y-over-y growth
- GAAP diluted EPS in Q4 was $1, and non-GAAP diluted EPS was $1.26
- Highlights in Q4 included record Creative revenue of $1.16B
  - Record Adobe Document Cloud revenue of $235mm
  - Record Adobe Experience Cloud revenue of $550mm
  - Record net new Digital Media ARR of $359mm
  - And record cash flow from operations of $833mm

Digital Media

- In Digital Media, we grew segment revenue by 29% y-over-y
- The addition of $359mm net new Digital Media ARR during the quarter grew the total to $5.23B exiting Q4
- Within Digital Media, Creative revenue grew 30% y-over-y, and we increased Creative ARR by $315mm during Q4
- The strong quarter for our Creative business was achieved across several areas:
  - Strong net new subscriptions, helped by increased adobe.com traffic after the Adobe MAX announcements and EOY promotions
  - Stable or improving ARPU across key offerings
  - The attachment of services with team and enterprise offerings
  - And continued momentum with Adobe Stock

Document Cloud

- With Document Cloud, we achieved record revenue with 23% y-over-y growth
- The performance in Q4 was driven by continued strength with Acrobat subscription adoption, normal Q4 enterprise seasonality, and strong year-end Acrobat perpetual product licensing through the channel
- Unit growth for Acrobat DC across Creative Cloud and Document Cloud accelerated again in Q4, pushing total y-over-y Acrobat unit growth to over 20% for FY2017
- Adobe Sign also achieved strong results, and contributed to Document Cloud ARR growth

Digital Marketing

- In Digital Marketing, we exceeded $2B of Adobe Experience Cloud revenue for the year, with 24% annual revenue growth

- Advertising Cloud had a strong year, and we achieved the expectations we set in January for TubeMogul
- Excluding the addition of TubeMogul, Experience Cloud subscription revenue grew 22% y-over-y during FY2017
- Subscription revenue growth was helped by strong performance with Adobe Experience Manager, Adobe Campaign, and Adobe Audience Manager during the year

Adobe Experience Cloud

- In Q4, we achieved record Adobe Experience Cloud revenue of $550mm, which represents 18% y-over-y growth
- We drove strong sequential subscription bookings growth from Q3 to Q4, reflecting typical enterprise year-end strength
- Multi-solution selling in our top accounts and strong bookings of the Adobe-Microsoft solutions drove this sequential growth

FX

- From a q-over-q currency perspective, FX increased revenue by $11.1mm
- We had $1mm in hedge gains in Q4 FY2017 vs. $0.2mm in hedge gains in Q3 FY2017, thus, the net sequential currency increase to revenue considering hedging gains was $11.9mm
- From a y-over-y currency perspective, FX increased revenue by $4.1mm
- We had $1mm in hedge gains in Q4 FY2017 vs. $8.1mm in hedge gains in Q4 FY2016, thus, the net y-over-y currency decrease to revenue considering hedging gains was $3mm
- In Q4, Adobe's effective tax rate was 22% on a GAAP basis and 21% on a non-GAAP basis

DSO

- Our trade DSO was 55 days, which compares to 47 days in the year-ago quarter, and 50 days last quarter
- Our DSO has increased slightly over the past year given the nature of the Advertising Cloud business model and the addition of the TubeMogul business
- Deferred revenue grew to a record $2.49B, up 24% y-over-y
- Our ending cash and short-term investment position exiting Q4 was $5.8B.

Share Repurchasing

- Cash flow from operations was a record $833mm in the quarter
- In Q4, we repurchased approximately 1.9mm shares at a cost of $297mm
- During the year, we repurchased $8.2mm shares, returning $1.1B to stockholders
- We have approximately $1.9B remaining of our $2.5B stock repurchase authority granted in January 2017

Outlook

ARR

- Now I'll provide our financial outlook
- Entering FY2018, we are excited about our momentum and the large addressable markets we discussed at our recent Analyst Meeting
  - We remain well-positioned to continue to deliver strong top line and bottom line growth
- As you know, we measure ARR on a constant currency basis during a FY, and if necessary, we revalue ARR at year-end for the current currency rates
- FX rate changes between December of last year and this year have resulted in $154mm increase in Digital Media ARR
  - This increases our FY2018 beginning Digital Media ARR to $5.39B
- The effect of this revision is reflected in our updated investor datasheet, and ARR results will be measured against this amount during FY2018

Revenue and EPS

- In FY2018, we are targeting total Adobe revenue of approximately $8.725B
  - Digital Media segment revenue growth of approximately 23%
  - Adobe Experience Cloud subscription revenue growth of approximately 20%
  - Adobe Experience Cloud total revenue growth of approximately 15%
  - GAAP EPS of approximately $4.40
  - Non-GAAP EPS of approximately $5.50
  - Net new Digital Media ARR of approximately $1.1B
  - And Adobe Experience Cloud subscription bookings growth of approximately 20%
- We expect quarterly revenue, EPS, and Digital Media ARR results to follow similar seasonality as was achieved in FY2017

Tax Rate and Operating Cash Flow

- In Q1 FY2018, we are targeting revenue of approximately $2,040,000,000
  - Digital Media segment y-over-y revenue growth of approximately 25%
  - Experience Cloud y-over-y total revenue growth of approximately 15%
  - Tax rate of approximately 9% on a GAAP basis, and 21% on a non-GAAP basis; share count of approximately 500mm shares
  - GAAP EPS of approximately $1.15
  - Non-GAAP EPS of approximately $1.27
  - And net new Digital Media ARR of approximately $275mm
- As a reminder, our operating cash flow is seasonally higher in Q4, and typically decreases sequentially in Q1 due to several year-end related disbursements made during our first quarter

Summary

In summary, 2017 was another strong year for Adobe

We are the market leader across our key businesses, and are executing well against a large and growing addressable market

We're excited about what lies ahead for Adobe, and look forward to sharing more progress with you in the coming year

Mike Saviage

Q4 Highlights

LiveCycle and Connect

- Beginning with our Q1 FY2018 earnings report in March, we will modify our segment reporting moving forward
- LiveCycle and Connect, which have been reported in our Digital Marketing segment, will be moved to a new segment called Publishing, which will include the current Print and Publishing segment products
  - We will also rename our Digital Marketing segment to Digital Experience

Digital Marketing

- As we've done in the past, we will publish an updated investor datasheet in late January with historical information adjusted to reflect the segment changes
- The updated datasheet will coincide with the issuance of our Annual Report on Form 10-K for FY2017, which will also reflect these changes
- Adobe Summit, the world's largest digital marketing conference, is scheduled for the last week in March, with day one on Tuesday, March 27
- An invitation with registration and discounted Summit pricing information will be sent out in January to our investor and analyst e-mail list
- More details about the conference will be available at summit.adobe.com

QUESTION AND ANSWER SECTION

<Q - Jennifer Swanson Lowe>: Mark, I wanted to follow up a little bit on the comment you made about the traffic uptick you saw post-MAX to the adobe.com site. And you also added promotional activity in there, but specifically the post-MAX uptick, was that sort of what you normally would see after a MAX event, or was it different this time? And what were the types of products that were really benefiting from that uptick in traffic? Was it the traditional fully-configured Creative Cloud, or were you seeing more activity around some of the newer product offerings?

<A - Shantanu Narayen>: Why don't I take that? And in terms of what we saw after MAX, if you recall, MAX was perhaps the most productive release ever in the history of the company in terms of the five new products that we had introduced.

At the end of Q4, if you look at the business that we have, both in terms of single app adoption, which continues to grow as well as the CC Complete, which continues to grow, I would say the photography offering continues to be a very popular offering. We introduced a new version of Lightroom, and so that's seeing good traction.

The second product I would highlight would be XD, which is the product for screen design, everything that the creators are doing in terms of designing new interfaces for products across a variety of screens, and then we saw the traditional strength in the existing products that we continue to see, namely, Photoshop, Illustrator, the video products continue to do well as well.

So, I think this is something that we do standard, which is we just continue to make sure that we're delivering great innovation for our customers. MAX certainly represents the culmination of a lot of effort. And so as expected, the attention that we bring to it drives more traffic.

<Q - Jennifer Swanson Lowe>: Okay. Great. And maybe just one more if I can. On the Experience Cloud, I know in Q3 there was some color around extending sales cycles, bigger deals, the longer sales cycles. I'm curious if that was the trend you saw in Q4 as well, or if there's any change there?

<A - Shantanu Narayen>: We had a really strong close to the end of the year so the sequential increase in bookings from Q3 to Q4 as is consistent with year-end seasonality, we were pleased with the strength associated with that in terms of the subscription bookings for the years as well. We were pleased with that, Advertising Cloud had a good quarter as well.

So the opportunity continues to be really large, as we talked about, the $53B opportunity that we have. We're the undisputed leader, and our innovation is really helping our enterprise customers with their digital transformation needs.

<A - Mark S. Garrett>: Yeah. And I would add – just add a little bit to that, subscription bookings were up 20% for the quarter and for the full year, which is what we had targeted back at Q3. And the subscription organic revenue, I said this in my prepared remarks, even without the benefit of Tube, was up 22% y-over-y. And that subscription revenue, as we've said, is the way we're really going to start to measure the health of the business. So we were really pleased with both of those.

<Q - Walter H. Pritchard>: Mark, I'm wondering if relative to what you're thinking about for ARR, the progression in the number for the year, do you expect any impact from customers buying ahead of this price increase, and any impact you saw generally in terms of customer behavior reacting to that move you made?

<A - Mark S. Garrett>: So we have not seen any indication that people are buying just ahead of the price increase. We just think the strength that we saw in Q4 was coming off, as Shantanu said, MAX, as well as just Q4 seasonality. And the truth of the matter is if people are buying ahead of the price increase, that's great because just like we do with promotions, that brings people into the franchise and allows us to move them up the ladder, so to speak, later. So either way, we're happy, but we don't think that Q4 was a result of people buying early.

<A - Shantanu Narayen>: And Walter, big picture in terms of the overall demand for Creative Cloud, it continues to be clearly the one-stop shop for creativity, and the increase in ARR that we issued as a target is more a reflection of just the continued comprehensive nature of the offering, the adoption that we're continuing to see in international markets rather than necessarily anything different in terms of what we expect for the price increase, which, as we said at the analyst call, we expect to be low this year.

<Q - Brent Thill>: On Experience Cloud, Shantanu, are there new [ph] revs (30:36) to market or new ways you're thinking about distribution for that business as you head into the new FY?

<A - Shantanu Narayen>: Yeah. Brent, I mean, as that business continues to expand and continues to grow well, I think the first phase of that business was clearly everything that we were doing direct with large verticals in what we would call the strategic accounts in specific verticals, and B2C was a big push associated with that. We're seeing quite a bit of adoption in B2B.

And consistent with the way I think every other enterprise software company would do, we're looking not just at the strategic and corporate accounts, but expanding into greenfield territory, both in the United States and abroad. So that continues to be an area of push. And as you can imagine, that happens both with our direct sales force, as well as with the ecosystem of partners that continues to be really key for us in terms of growth in that business.

We talked and touched on the Microsoft partnership and how that's yielding some good implementations with customers, and we expect that momentum to continue. But also whether it be digital agencies or SI partners, they're certainly bringing us into more of their accounts. So just continued expansion, and we're pleased with the execution that we have there.

<Q - Brent Thill>: Mark, just to clarify on Experience Cloud to Jen's question, I wanted to be clear. The deals that did push from Q3, it sounded like some of those came back into Q4. But did you see any other deals extend out into the next FY that were not closed yet?

<A - Shantanu Narayen>: Brent, maybe I'll take that one as well. I mean, the pipeline just continues to be an evergreen pipeline, and we're continuing to both close deals, we're continuing to upsell when we look at the number of large deals that we have, and we think about the number of customers who are adopting multi-solution deals, that has certainly increased, which we look at as good validation of the comprehensive and integrated nature of our product. But you've been tracking enterprise software for a long time. We had a great sequential bookings quarter between Q3 and Q4, but pipeline is an evergreen thing that we will continue to put a lot of focus on.

<Q - Ross MacMillan>: Maybe, Shantanu, first, just on the Document Cloud, you've highlighted Acrobat DC units of 20% growth. Any context for that in terms of history? And then I had a follow-up for Mark.

<A - Shantanu Narayen>: Sure, Ross. I mean, I think it's driven a lot by PDF adoption on mobile devices and PDF continuing to be the best way for people to share files across devices. When we think about PDF adoption, it actually accelerated in Q4 over the rest of the year, which, as we had been saying all along, was pretty strong. Primarily, we are seeing people adopt the subscription, which is consistent with what we are doing across the Creative Cloud.

But we also saw some traditional strength that we expect at the end of the year with respect to enterprises continuing to either true up or do licensing of the perpetual version. We're pleased with that, and that provided some nice upside. There's a significantly larger install base of Acrobat that isn't on the subscription.

And as people continue to adopt both the subscription offering, which is the primary offering, as well as the perpetual, that just signifies good growth opportunity for us. But specifically, we saw quite a bit of licensing of the perpetual new Acrobat DC product at the end of the year as enterprises use the EOY cycle to true up and buy more product.

<Q - Ross MacMillan>: That's helpful. And, Mark, just a clarification. So when you rebase the EOY Digital Media ARR, the way I think about it is it's a rebase on the base. So $154mm and $5.23B is about a 3% rebase. And then every new ARR dollar that comes in in FY2018 is going to be commensurately higher at 3%. And I just wanted then to think about that in the context of what you'd said previously about net new ARR of $1B, and now, $1.1B. I would argue that's 10% higher, not 3% higher so it's an implicit raise. And I just wanted to make sure I was thinking about that correctly.

<A - Mark S. Garrett>: For sure, this is an implicit raise.

<A - Shantanu Narayen>: Explicit raise, Ross.

<Q - Ross MacMillan>: Explicit raise. I'm just a bit [indiscernible] (35:23).

<A - Mark S. Garrett>: Yeah, yeah, the $100mm has little to do with currency. It's more based on our overachievement through the year and what we expect to deliver in 2018. So, it's not a currency-related raise.

<Q - Stan Zlotsky>: Around the large deals that you're seeing of [ph] ground (36:05) Experience Manager and Pro Services that are associated with those deals, should we expect, given the complexity of these deals, that your Pro Services would maybe tick up a little bit in order to dedicate the proper resources to these large strategic implementations?

<A - Shantanu Narayen>: Stan, at the analyst meeting, we actually talked about given the robustness of the ecosystem that we will be leveraging the ecosystem more to do the actual implementation of these, whether they be for the entire Marketing Cloud or for Adobe Experience Manager specifically. That's part of the reason why when we talk about our bookings growth, it's going to be greater than the revenue growth that we report that includes services.

So, a great ecosystem of partners, I think we're focusing on some specialized services with these customers, which is at the very strategic level. But for the most part, we have a great set of partners who will be doing the heavy-lifting associated with the implementation of not just Experience Manager, but the rest of our solutions, and in fact, our clouds with the customers.

<Q - Stan Zlotsky>: Great. And just a quick follow-up. The 50 joint customers that you now have with Microsoft, you mentioned a few sample logos. But from a go-to-market perspective, how do these opportunities typically develop? Who brings who into the deals? And are the logos that you mentioned, are they kind of representative of the typical logo that we would see within that list of 50? Thank you so much.

<A - Shantanu Narayen>: Stan, I think the real goal for us was to demonstrate that we're open for business. The stuff is actually working, customers are excited about it. As you can expect in these cases, it's both joint selling between Microsoft and us. It's us bringing them into deals, it's them bringing us into deals, and it's partners bringing both of us into deals. So it's the usual combination that you see in the enterprise in terms of how people adopt software.

<Q - Mark Grant>: Just a quick one for me on Marketing and Analytics. We got the announcement last month of the partnership with Google Analytics and Salesforce. I just wanted to get your thoughts on how you interpret that, what you think the competitive landscape is going to be looking like over the next little while, and just any interpretation you can offer there. Thanks.

<A - Shantanu Narayen>: Well, I think we've always talked about how we have been the leaders in creating those categories and how the Analytics that we have is, without a doubt, one of the secret sauces and the biggest competitive advantage that we continue to have. Enabling integration between that Analytics as well as our other solutions has been over a five-year effort, and we've integrated it. And I think it's just a reflection that others in the marketplace are understanding that Adobe has a significant competitive advantage with respect to everybody else.

But big picture, this is an incredibly large opportunity. We're the leader. We're going to continue to innovate. We're seeing great customer wins, and there will be competition in the space as well as we expect.

<Q - Jay Vleeschhouwer>: One each on Creative Cloud and the Digital Marketing business. On Creative Cloud, when we think about the new product road map that you laid out at MAX and couple that with the creation of a new position with Scott's joining in the company as Chief Product Officer, could you perhaps talk about some of the objectives or – over the next number of years for Creative Cloud? And what I have in mind specifically is, would you think there's any sense to perhaps re-segmenting the product line as you once did with CS and use that as a means to further drive ARPU upside?

Secondly, on the Marketing Cloud, you've spoken in the past of having four dozen or more use cases across multiple industries and as well an objective of eventually having more of a single sign-on or a usage model across all the products. Could you, in that score, talk about perhaps the momentum across the various verticals or use cases that you're seeing or have talked about?

<A - Shantanu Narayen>: Sure, Jay. I mean, first on the Creative Cloud, the success that we've continued to see, it's the golden age of creativity and design right now. And when you think about what's happening with augmented reality, virtual reality, artificial intelligence, the kinds of mobile apps that are being created at Adobe, we're just attracting the best.

And as you know, we focus tremendously on product. Scott is phenomenal at that. And we're just attracting the best in the world to continue to help us push the envelope on being then design and creativity application, so thrilled to have them on board. I would not read into that necessarily anything different with respect to segmenting that.

I would definitely read into that, that we continue to focus on innovation and making sure that we lead that market the way we've been doing. And with respect to your question on the Marketing Cloud, we will continue to demonstrate all of the different use cases. We will continue to focus on vertical industries.

We will focus on sort of how people are using this at high level for things like personalization or multi-channel engagement with our customers. But from our point of view, the integration associated with these products, every year, it gets better. So the notion of single sign-on that you're talking about and the fact that our customers can think about audience segmentation and demographics or campaigns or promotion or content velocity already within this platform, we're so far ahead of where the rest of the market is. But you can correctly continue to expect us to make both the integration better, as well as the individual point products better.

<Q - Samad Samana>: So, I had a question on the company's partner program. It's something that your competitors in enterprise software talk about a lot, and I think the company has been talking a lot more about them as well. I was wondering if maybe you could help us understand how much of Experience Cloud bookings they help you co-sell, and maybe how we should think about that contribution changing in FY2018 as you come off of the changes that you put in place in FY2017?

<A - Shantanu Narayen>: Yeah, I mean, I think when you look at the partner program, there are multiple dimensions to it. But very quickly, the first dimension to it certainly is that all of our products, when we architect our products, just allow developers whether they be individual developers, whether they be enterprises, whether they be systems integrators or agencies to extend our products.

And so, them having their secret sauce to augment our products is a key part of one of our partner strategy. With respect to implementation and strategy services, again, the traditional Sis and digital agencies are very much part of the ecosystem in terms of both implementation, architecture, services, and strategy.

And as is probably similar to everybody else in the space, when you think about the large deals and the large customers that we have, most of these customers have engagements with some partners as well. And so the partner involvement in these accounts will only continue to increase with the strategic nature of this. But everybody has an Adobe practice. You'll see at our kickoff that we have, they are very well-represented as well as at our Summit, where we have a Partner Day. So we are pleased with the partner interest, and we will continue to leverage it because it's in our best interests, as well as in the customer's best interests.

<Q - Samad Samana>: That's helpful. And then maybe, Mark, if I can just ask a follow-up. The guidance for 15% growth in Q1 for Experience Cloud, I believe implies kind of flat revenue from Q4 to Q1. Could you maybe help us think about seasonality for that business and how we should think about the growth cadence across the quarters?

<A - Mark S. Garrett>: I mean, we had said that if you model out the business next year, it'll follow typical patterns that you saw in 2017. So I think you should expect, whether that's total company or even down to the segment level, things following along similar growth patterns to what you saw in 2017.

<Q - Saket Kalia>: Mark, perhaps a less exciting question [ph] in (45:28) about the business, but topical nonetheless, I guess I just wanted to ask about tax structure and the impact of potential reform. So I guess, understanding that a lot of this is still very uncertain, can you just give some broad brushes about how pre-tax income and tax rates in the U.S. may be compared to the rest of the world, and how you're thinking about potential tax reform for Adobe?

<A - Mark S. Garrett>: I mean, obviously as you said, based on the fact that this isn't final yet, I can't comment too much. I will say we clearly believe that the tax code needs to be overhauled, that it's outdated. We clearly are excited about the proposition to freely access foreign cash.

So, based on what I see, this is all very positive for Adobe. It would result, we believe, in a lower tax rate for us. It would result, we believe, in our ability to access foreign cash. The good news for Adobe as well is that we've been accruing for a significant percentage of our foreign cash at a 30% tax rate.

So, if this passes at a 14% rate on all our foreign cash, you wouldn't see a significant P&L hit because basically we've already accrued that tax, which is great from Adobe's perspective. So we'll see where it plays out, but based on what we see so far, it's very positive from our perspective.

<Q - Keith Frances Bachman>: I was wondering if you'd care to make some comments on cash flow for FY2018. And the context of the question is either as a percent of revenue or cash flow growth rates you mentioned previously, and it was in Q4, your days receivable were up. Is there anything you want to call out or give us any kind of context for cash flow guidance for FY2018 rather?

<A - Mark S. Garrett>: Yeah. Hi, Keith. Yeah, so the only significant change to the way we've been executing so far is that, as I said, DSOs are up a little bit because of the TubeMogul business just being a different kind of a business from a collections perspective. But outside of that, we gave you margin and earnings guidance for next year that will continue to drive good strong cash flow.

I did say Q1, there's some seasonality in cash flow because we make a lot of year-end disbursements based on accruals that we make in Q4. But we're continuing to drive growth in cash flow. That's about all I can tell you right now, but I fully expect that cash flow will be up again significantly next year.

<Q - Keith Frances Bachman>: Okay, great. Then I'll ask a quick follow-up then if I could. Your total book business, the $6.9B was up about 18%, so strong growth. But relative to your guidance of revenue growth, it's a little less than what the revenue guidance is. How should we think about that number as a proxy going forward in terms of the total book business relative to revenue guidance? Thanks.

<A - Mark S. Garrett>: So deferred revenue was up 24%.

<Q - Keith Frances Bachman>: Yes.

<A - Mark S. Garrett>: Unbilled – yeah, unbilled maybe was up less than that y-over-y. But we're pretty pleased with just that total number of $6.4B and the growth that that generates going into next year. It's a little hard to take just that and think about how that compares to revenue growth, because they're a little bit apples and oranges. Not all of revenue comes off of deferred or unbilled. So you...

<Q - Keith Frances Bachman>: Right.

<A - Mark S. Garrett>: ...kind of have to look at them separately.

<Q - Tom Mao>: So, I was actually wondering about the transition of ETLA contracts to subscription and how that's impacting your growth in Creative Cloud. And what are your expectations for that transition heading into 2018?

<A - Shantanu Narayen>: Tom, on the Creative Cloud side, a lot of those transitions have actually happened, and what we are actually seeing and what we focus on even more right now are two things: one is named user deployment, so ensuring that the adoption of the new Creative Cloud within enterprises is high; and second, adoption of services.

So, I would say the transition of enterprise customers from buying perpetual to buying Creative Cloud is largely behind us, and really the focus is on adoption of all the new products and services that we have and on ensuring that the named account deployment is going well from their point of view. I would say on the Acrobat side, there's still probably some install base that exists, but on the Creative Cloud, it's largely behind us.

<Q - Tom Mao>: Got it. And can you just touch upon your thoughts on the opportunities for Document Cloud heading into FY2018 as – seems like it was picking up momentum in the quarter?

<A - Shantanu Narayen>: Well, we talked about right through the year how the unit growth has really been driving momentum, not just in the Document Cloud but also since some of that is reflected in the Creative Cloud – in Creative Cloud, and it's primarily subscriptions. In fact, all of the subscriptions and services that we continue to see such as Sign and the Scan product is driving more PDF adoption. And so, we continue to think that PDF will be a really important format as people move from inefficient paper-based processes to electronic processes.

<Q - Taylor J. Reiners>: I had a follow-up question on the ETLA question. One of the things that we've been hearing in our conversations is that you've been having a lot of increased success on renewals moving ETLA customers from point solutions to the entire Creative Cloud portfolio. So wondering if you could speak to what inning you're at with respect to this expansion dynamic?

<A - Shantanu Narayen>: Well, I think the focus that the field organization has in that particular area is really making sure that people understand that there is a complete offering. And we have customer success managers who are in there, ensuring that people get the value out of it. That's a program that's really been working. We do Adobe Days, we do Evangelism. And as design is becoming more prevalent within enterprises, I think adoption of either the individual products or the complete product within enterprises is increasing.

As with the adoption of the Creative Cloud, we started in North America, and now we continue to roll that out. But we think that as we've laid out even for individual users moving the core, migrating the core to Creative Cloud, and then doing both the market expansion and value expansion even with an enterprise customers based on the new offerings continues to be headroom for us.

<Q>: I have a question on the Marketing Cloud. As you work through the adoption curve and get into the midsize businesses, can you talk about the adoption trends for marketing solutions? Do you see customers adopting more point solutions vs. more of the full suite? And is that – how much of that is factored into the FY2018 guidance report?

<A - Shantanu Narayen>: Well, I'll answer the second question first. I mean, we clearly look at everything that's happening in the marketplace as we think about the guidance that we have because we take it very seriously. But I think I would say, in terms of adoption with new customers, the multi-solution adoption is primarily the way in which we are going to market because people see if they're using content management, having content management with Analytics is really the way to go, as well as the audience segmentation, part of Audience Manager.

And so, the fact that we have this comprehensive offering from visitor acquisition to delivery of the content, to measurement and monetization, it's really the way we go to market to reflect the depth of our suite and the importance of the platform adoption.

<Q>: Got it. Got it. And then quick follow-up. On the Microsoft partnership, you talked about the 50 logos that you added on. Can you also talk about any upselling that you achieved based on the partnership into existing customers?

<A - Shantanu Narayen>: Well, I think this is so early, but the initial success that we are seeing is really good, and it was just to reflect when you think about whether it's the dynamics integration with Campaign, whether it's what we are doing with Adobe Experience Manager with Azure, what's happening with Power BI, that people are adopting both solutions and the momentum in the business is strong.

<Q - Adam Holt>: I just had two quick ones. One for you, Mark. This is sort of another embarrassment of margin riches and as we look into next year, you're looking at 40% margins plus. You're getting into rare air for software companies. Do you think that there's actually margins upside from 40%? Are we kind of getting to the level where you have to reinvest for the growth rates that you all want to achieve?

<A - Mark S. Garrett>: Yeah, obviously we are very fortunate to be able to have, in my perspective, both significant top line growth at 20-plus percent and significant margin growth at scale already. We've done a great job over the years of managing margin. If there's anything we know how to do at Adobe, that's it. If there are things that we feel that we need to invest in to drive growth, we will do that.

But outside of that, we can deliver margins. So, I'm not going to guide beyond the 40%-ish that we talked about for next year, but we make those trade-offs every month as we go through spending in the company, and clearly, want to drive growth.

<Q - Adam Holt>: And if I could just a quick follow-up for Shantanu. When we had talked with Bryan Lamkin at our event a couple of weeks ago, he was pretty constructive about the services opportunity, and you called it out relative to one of the drivers for the Digital Media cloud. Could you maybe break down how you see that unfolding? What services you're most excited about? And how big that can potentially be from a revenue stream? Just order of magnitude, not guidance obviously. Thanks so much.

<A - Shantanu Narayen>: Well, thanks, Adam. And as it relates to services, the one that we're seeing a fair amount of traction in y-over-y had quite significant growth was Stock as it relates to Creative Cloud, as well as Sign as it relates to the Document Cloud.

But in addition to that, I mean, when we think about the Creative Cloud total addressable market, and we think about market expansion in the $5.7B, I think we had talked about it as a 2020 addressable, and $7.1B for value expansion.

I think the other things such as storage, Collaboration, I think, is a big opportunity ahead of us, the number of people who do the design within an enterprise as it relates to the number of people who will engage in that Collaboration. So, I expect to see Adobe do more in that particular space.

But I think just continuing to afford our customers the ability to come training, we’ve always had as a – and learning content is something that’s an opportunity associated with it. So at the analyst meeting, Adam, we gave some numbers, but hopefully that also gives you some color in terms of the different services that we have.

Shantanu Narayen

Q4 Highlights

Strategy

- And since that was the last question, what I wanted to say was as we celebrate our 35th anniversary, I know all of us here at Adobe are really proud of the impact that we’ve had on society, and really that continuous innovation that we’re delivering across the world by all of our employees.
- It feels the strategy that we have, empowering people to create and helping businesses transform, is really resonating
  - They represent large addressable markets with very significant tailwinds
- The relentless execution we continue to demonstrate means that we’re pretty unique from a financial perspective in terms of both driving top line and bottom line growth profitably, with significant operating margins.
- We had outstanding financial results in Q4 and FY2017, and our focus in FY2018 on continuing to deliver great value to an incredibly diverse set of customers, and so we remain really enthusiastic about the opportunities ahead of us.