Q1 2019 Earnings Call

Company Participants

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

Other Participants

- Alex Zukin, Analyst
- Brad Zelnick, Analyst
- Brent Thill, Analyst
- Jay Vleeschhouwer, Analyst
- Jennifer Lowe, Analyst
- Keith Weiss, Analyst
- Kirk Materne, Analyst
- Richard Davis, Analyst
- Ross MacMillan, Analyst
- Saket Kalia, Analyst
- Shankar Rajamohan, Analyst
- Sterling Auty, Analyst
- Tom Roderick, Analyst
- Unidentified Participant
- Walter Pritchard, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. I would like to welcome you to Adobe First Quarter Fiscal Year 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

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

Mike Savage {BIO 1512655 <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 first quarter fiscal year 2019 financial results. By now, you should have a copy of our earnings press release, which crossed the wire approximately one hour ago. We've also posted PDFs of our earnings call prepared remarks and slides and an updated investor datasheet on adobe.com. If you'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, March 14th, 2019 and contains forward-looking statements that involve risk and uncertainty. Actual results may differ materially from those set forth in such statements. For a discussion of these risks and uncertainties, you should review the Forward-Looking Statements Disclosure in the earnings press release we issued today, as well as Adobe's SEC filings.

On our Q4 FY '18 call in December, we provided targets for fiscal year 2019 and for Q1 FY '19 based on revenue accounting standard ASC 605. As required, we have adopted ASC 606 for FY '19, and today are reporting our results based on ASC 606. Where applicable, we will call out differences in our results between ASC 605 and ASC 606 for comparison purposes against our prior ASC 605-based targets.

On this call, we will discuss GAAP and non-GAAP financial measures. A reconciliation between the two is available in our earnings release and on Adobe's Investor Relations website. Call participants are advised that the audio of this conference call is being webcast live and is also being recorded for playback purposes. An archive of the webcast will be made available on Adobe's Investor Relations website for approximately 45 days, and is the property of Adobe. The call audio and the webcast archive may not be re-recorded, or otherwise reproduced or distributed without prior written permission from Adobe.

I'll now turn the call over to Shantanu.

Shantanu Narayen {BIO 3332391 <GO>}

Thanks, Mike and good afternoon.

Fiscal 2019 is off to a strong start for Adobe as we delivered another record quarter in Q1. We achieved $2.60 billion in revenue, representing 25% year-over-year growth. GAAP earnings per share for the quarter was $1.36, and non-GAAP earnings per share was $1.71.

Adobe empowers people to create and transforms how businesses compete, a highly differentiated strategy that we continued to execute well on in Q1. Across all industries and geographies, we are helping customers large and small transform themselves and their businesses with Adobe Creative Cloud, Document Cloud and Experience Cloud.

In our Digital Media business, we achieved strong revenue in both Creative Cloud and Document Cloud in Q1. Net new Digital Media Annualized Recurring Revenue or ARR was $357 million, and total Digital Media ARR exiting Q1 grew to $7.07 billion. Q1 Creative revenue was $1.49 billion, which represents 22% year-over-year growth. Adobe Creative Cloud is democratizing creativity by delivering innovative new ways for everyone, from businesses to students to creative professionals to hobbyists to tell their story.

Our flagship digital imaging and video solutions, including Photoshop, Premiere Pro and After Effects have long been the go-to tools for indie and feature filmmakers and editors. At this year's Academy Awards, both Adobe Photoshop and After Effects received Scientific and Engineering awards for their contributions to the filmmaking industry. It's a tremendous honor for Adobe, and we're very proud of the product and engineering teams who contribute to the development and ongoing innovation in these iconic products. Most recently, Photoshop was used in the making of Spider-Man, Into the Spider-Verse which won this year's Oscar for Best Animated Film.

Our photography business including mobile usage continues to show strong momentum. The number of Lightroom CC mobile subscribers has increased by more than 400% over the past year. Beyond film and photography, Adobe is pushing the boundaries of creativity onto new canvases and broadening the appeal of Creative Cloud to entirely new segments of users. New media types, including 3D, video and augmented reality, continue to emerge, which will enable more immersive and engaging digital experiences. In January, we acquired Allegorithmic, the industry standard in tools for 3D material and texture creation for gaming and entertainment.

The addition of Allegorithmic further expands Creative Cloud into interactive content design and allows us to better equip video game creators, Visual FX artists working in film and television, designers and marketers to deliver the next generation of immersive experiences. Premiere Rush CC, our popular video editing app for social media creators is expanding its footprint to Android, and was recently showcased at Samsung's Galaxy S10 event. We continue to innovate with Adobe XD, our solution for designing and prototyping websites and apps, adding expanded collaboration, prototyping and voice capabilities, all supported by a growing ecosystem of plug-ins and integrations with companies like Microsoft, Slack and Atlassian.

We feel passionately that creative skills are a critical component for success across K-12 and higher education classrooms. We recently announced a partnership with the Royal Shakespeare Company in England. Together, we'll make new creative teaching resources and tools, including Creative Cloud and Adobe Spark, available to teachers, and to millions of students learning the works of Shakespeare in schools throughout the UK. This quarter, we partnered with the California State University System to give students and staff at 21 campuses access to our full suite of Creative Cloud tools. Since Adobe launched Spark for Education in April 2018, over 7 million licenses have been provided to students and teachers worldwide.

With Adobe Document Cloud, we're reinventing how people create, scan, edit, collaborate, sign and share documents, and leading the paper-to-digital revolution. Document Cloud revenue in Q1 was a record $282 million and we grew Document Cloud

ARR to $856 million. Overall momentum for Acrobat is fueled by strong demand for Adobe PDF among individuals and businesses worldwide. Our mobile footprint continues to grow. Adobe Reader and Adobe Scan downloads have now surpassed 600 million, and our partnership with Samsung contributed significantly to downloads of Adobe Scan in Q1.

In addition, Adobe Reader is now available in the Made for Samsung section of the Galaxy App Store, increasing our potential reach to millions of Samsung smartphone users. We recently launched the PDF Like a Boss global advertising campaign to drive further awareness for new Document Cloud, Acrobat and Adobe PDF capabilities. Last month, we announced a partnership with the PGA TOUR, which will feature our new campaign in TV coverage for 10 tournaments this year. Adobe Sign has strong momentum and has become the e-signature solution of choice for organizations across all industries. We continue to enable resellers such as Nintex to sell Adobe Sign to thousands of partners, public, private and government organizations on their platforms.

In our Digital Experience business, we achieved Experience Cloud revenue of $743 million for the quarter, which represents 34% year-over-year growth. The success of our Digital Experience business is bolstered by several industry tailwinds, the mandate for enterprises and organizations to digitally transform their businesses and the need to deliver the world-class end-to-end customer experiences consumers have come to expect. More and more businesses are choosing Adobe Experience Cloud, the industry's only end-to-end solution for marketing, advertising, analytics and commerce, serving both B2C and B2B customers.

Key Experience Cloud customer wins in the quarter include HSBC, NBC Universal, Bass Pro Shops and WebMD. Delivering exceptional experiences requires a lot more than tapping into a customer database to deliver a personalized email. Businesses need a full range of capabilities from creation through commerce, and acquisition through renewal. For today's digital businesses, it's not enough to have data, you need the right data, behavioral, transactional and operational to understand your customer, and the intelligence to act on it in context.

With our Adobe Experience Platform and breadth of Adobe Experience Cloud solutions, Adobe is enabling enterprises to achieve a unified, real-time view of their customers and harness these insights to deliver engaging digital experiences. Last year we made several significant investments to further expand the range of capabilities we offer to Experience Cloud customers with the acquisitions of Magento, with its best-in-class ecommerce capabilities, and Marketo, the leader in B2B marketing engagement. We're off to a strong start with both Magento and Marketo, and we're successfully integrating them into Adobe Experience Cloud. This is creating an unmatched value proposition for customers and growing Adobe's addressable opportunity in the Customer Experience Management category.

We're focused on product integration while driving acceleration of the Magento and Marketo businesses, leveraging Adobe's brand, enterprise sales and go-to-market organization, while maintaining a strong global footprint in the mid-market. With Magento, we're driving momentum by cross-selling our commerce offering to existing

Adobe Experience Manager customers. With Marketo, we delivered our first integrated deployment of Adobe Experience Platform Launch, our tag management system. We're seeing strong interest from strategic Adobe accounts, many of which are B2C, who have significant B2B operations as part of a broader digital transformation strategy.

Industry analysts continue to recognize Adobe Experience Cloud as the market leader. This quarter, Adobe Experience Cloud was named a leader in the Gartner Magic Quadrant for Digital Experience Platforms and once again achieved the strongest position in the quadrant out of 17 vendors for Completeness of Vision.

Our upcoming Summit in Las Vegas will be our largest to-date, and we will welcome the Marketo Marketing Nation community to the event. We're excited to share our Customer Experience Management vision, strategy and technology roadmap with our customers and partners. At Adobe, our employees are our greatest asset and we are proud to have a brand that continues to be recognized for its innovation, progressive workplace practices, and commitment to the communities in which we do business. For the third consecutive year, we were named one of Fast Company's Most Innovative Companies. Forbes recently recognized Adobe as one of its Best Employers for Diversity and Fortune included Adobe on its annual Most Admired Companies in Software list again this year.

Adobe is the clear leader in empowering people to create and helping businesses transform to deliver the customer experiences needed to compete and win in today's competitive climate. These two tremendous market opportunities are fueling our business. With the world's best employees, customers and partners, we are well positioned for further growth and continued success in 2019. John?

John Murphy {BIO 16018871 <GO>}

Thanks, Shantanu. Our strong results in Q1 reflect a solid start to fiscal year 2019. As we discussed on our Q4 FY '18 call in December, we provided targets for Q1 FY '19 based on ASC 605. We are reporting results today based on our adoption of ASC 606 as required. Where applicable, we will call out differences in our results between 605 and 606 for comparison purposes against our prior 605-based targets.

In Q1 FY '19, Adobe achieved record revenue of $2.6 billion under 606, which represents 25% year-over-year growth when compared to $2.08 billion reported in Q1 FY '18 under 605. Q1 FY '19 revenue would have been $2.58 billion under 605, which represents 24% growth. Based on 606, GAAP diluted earnings per share in Q1 was $1.36 and non-GAAP diluted earnings per share was $1.71. Based on 605, GAAP diluted EPS in Q1 would have been $1.31 and non-GAAP EPS would have been $1.65. This compares to our EPS targets based on 605 of $1.14 on a GAAP-basis and $1.60 on a non-GAAP basis.

Business and financial highlights in Q1 included, Digital Media revenue of $1.78 billion, including Creative revenue of $1.49 billion and Adobe Document Cloud revenue of $282 million, net new Digital Media ARR of $357 million, digital experience revenue of $743 million, exiting the quarter with deferred revenue of $3.22 billion, cash flow from operations of $1.01 billion, repurchasing 2.1 million shares of our stock through stock buyback and approximately 91% of our revenue in Q1 was from recurring sources.

In Digital Media, we grew segment revenue by 22% year-over-year under both ASC 606 and ASC 605. The addition of $357 million net new Digital Media ARR during the quarter, grew the total to $7.07 billion. Exiting Q1 ARR included an approximately $20 million cumulative adjustment from adoption of ASC 606. Within Digital Media, we achieved another strong quarter with our Creative business. Creative revenue grew 22% year-over-year in Q1 and we increased Creative ARR by $292 million.

Notable growth drivers in Q1 included, new customer acquisition across all offerings and geographies, subscription momentum and strength with Creative Cloud enterprise deployments, continued growth in emerging markets, ARPU increases, particularly in markets where price optimizations were introduced last year and services adoption including continued momentum with Adobe Stock, which again achieved greater than 20% year-over-year revenue growth.

We achieved record Document Cloud revenue of $282 million in Q1, which represents 22% year-over-year growth, and we added $65 million of net new Document Cloud ARR during the quarter. In addition to delivering another strong quarter with Acrobat and Document Cloud, some of the revenue strength in Q1 is attributed to a benefit from the move to ASC 606 revenue recognition. Notable drivers of Document Cloud growth include, continued strength with Acrobat subscription adoption, helped by a steady on-ramp and conversion of free mobile app usage to paid subscriptions, strength with enterprise adoption of Acrobat and Document Cloud services and the strong performance with Adobe Sign.

In our Digital Experience segment, we achieved record quarterly Experience Cloud revenue of $743 million, which represents 34% year-over-year growth. There were minor benefits from adoption of ASC 606, and year-over-year growth would have been 32% under ASC 605. Experience Cloud subscription revenue was a record $612 million.

In addition to new revenue from our recent Magento and Marketo acquisitions, Experience Cloud performance in Q1 was driven by success across many offerings, with strength in Adobe Campaign and Adobe Experience Manager. Cross-sell of Magento within existing Experience Cloud accounts was notable and Marketo delivered solid results in their first full quarter as part of Adobe. Our Publishing segment, which includes OEM contracts, saw a sizable benefit from the move to ASC 606 and benefited from a large renewal deal in the quarter. From a quarter-over-quarter currency perspective, FX decreased revenue by $6.6 million. We had $8.5 million in hedge gains in Q1 FY '19, versus $30.5 million in hedge gains in Q4 FY '18, thus the net sequential currency decrease to revenue considering hedging gains was $28.6 million.

From a year-over-year currency perspective, FX decreased revenue by $14.7 million. The $8.5 million in hedge gains in Q1 FY '18 resulted in a net year-over-year currency decrease to revenue considering hedging gains of $7.2 million. In Q1, Adobe's effective tax rate was

4% on GAAP-basis and 11% on a non-GAAP basis. Our trade DSO was 46 days, which compares to 47 days in the year ago quarter, and 49 days last quarter.

Deferred revenue grew to a record $3.22 billion, up 25% year-over-year. Remaining Performance Obligations, RPO, a financial measure required with reporting under ASC 606 was approximately $8.13 billion exiting Q1. RPO includes approximately $600 million of non-cancelable and non-refundable committed funds related to some of our enterprise customer agreements. These funds do provide our customers options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Our ending cash and short-term investment position exiting Q1 was $3.23 billion and cash flow from operations was $1.01 billion in the quarter.

In Q1, we repurchased approximately 2.1 million shares at a cost of $491 million. We currently have $7.35 billion remaining of our $8 billion repurchase authority granted in May 2018 which goes through 2021.

Now I will discuss our financial targets. We are providing ASC 606-based annual fiscal 2019 targets that reflect our Q1 results. In FY '19, 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 $1.5 billion, 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 $5.59 and non-GAAP earnings per share of approximately $7.80.

We anticipate Q3 and Q4 year-over-year revenue growth rates to be similar to the growth rate implied in our Q2 revenue target. As in prior years, we expect summer seasonality which can lead to sequentially lower net new Digital Media ARR in Q3, followed by normal year-end strength in Q4. As the impact of lost deferred revenue due to purchase accounting from our acquisitions of Magento and Marketo tapers off during FY '19, and as we grow our business, we expect quarterly operating margins to increase in the second half of the year.

In Q2 we are targeting -- Q2 revenue of approximately $2.700 billion, Digital Media segment year-over-year revenue growth of approximately 20%, net new Digital Media ARR of approximately $370 million, Digital Experience segment year-over-year revenue growth of approximately 32%, other expense of approximately $36 million, tax rate of approximately 12% on a GAAP basis, and 11% on a non-GAAP basis, share count of approximately 495 million shares, GAAP earnings per share of approximately $1.20 and non-GAAP earnings per share of approximately $1.77.

As a reminder, Q2 continues to be impacted by lost deferred revenue and acquisition-related costs. In summary, Q1 was a great start to what we expect will be another record year for Adobe. We look forward to seeing many of you at Summit.

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

Mike Savage {BIO 1512655 <GO>}

Thanks, John. Adobe Summit is just around the corner. Day one of The Digital Experience Conference in Las Vegas at the Venetian-Palazzo is Tuesday, March 26. In addition to the day one general session, we will host a Q&A session with financial analysts and investors in attendance at 2 pm Pacific Time. Invitations to the conference with registration information to Summit were sent out in January. More details about Summit and the agenda are available at summit.adobe.com.

We would also like to extend an invitation to the Adobe EMEA Summit in London on May 15th. If any Europe-based investors or analysts wish to attend, please email us at ir@adobe.com and we will send you registration information. 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, 4657707. 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 March 20th, 2019.

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

Questions And Answers

Operator

(Operator Instructions) We have your first question comes from the line of Brad Zelnick from Credit Suisse. Your line is now open.

Q - Brad Zelnick {BIO 16211883 <GO>}

Excellent. Thanks so much and congrats on a good start to the year. If I'm limited to one question, my question is for John. John, how should we think about the impact of 606 on a quarterly basis for the remainder of the year? Will it be a tailwind to both revenue and margins for each quarter relative to 605? Thanks.

A - John Murphy {BIO 16018871 <GO>}

Sure. No, I think as we had talked about at Analyst Day and further in December at our earnings call, overall 606 does not have a material impact to our results. What you're seeing in Q1 is the pull forward of revenue by recognizing some OEM contracts upfront that otherwise would have been recognized throughout the year but otherwise, we don't expect a material impact for the year.

Q - Brad Zelnick {BIO 16211883 <GO>}

That was a quick answer, if I could slip in a quick, quick follow-up. The $20 million ARR benefit to -- from ASC 606, how does that split between Document Cloud versus Creative in the quarter? Thanks again.

A - John Murphy {BIO 16018871 <GO>}

So that was a cumulative catch-up adjustment against the $7 billion base of ARR, so it's really quite immaterial and the split was really more on the Creative versus Document.

Q - Brad Zelnick {BIO 16211883 <GO>}

Thanks again.

Operator

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

Q - Brent Thill {BIO 1556691 <GO>}

Thanks, good afternoon. John, there were some questions about some of the promotional activity towards the end of the quarter. And I think many noted that Creative Cloud AR was more in line and historically you've been beating that number. So can you just talk to the promotional activity and what happened? Was that just a coincidence at the end of the quarter or is this just ongoing promotional activity that you've seen historically that we shouldn't read too deeply into? Thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, the short answer Brent is, you shouldn't read too deeply into it. The slightly longer answer is, when I think about the business and the momentum that we saw across Creative Cloud, Document Cloud and Experience Cloud it's clear, we're off to a strong start. With respect to the Creative and Document businesses specifically, we've talked to you about the state of the art DDOM model that we have, the Data-Driven Operating Model and the fundamental strategy continues to be to acquire new customers, we're very aware of what is the activity that enables us to attract them, how we can make it a compelling event. But if you look at our success that we've had associated with attracting new customers to the platform, up selling them. And if you look, Brent, also at the Q2 targets that we're providing as well as the raise in ARR for the year, I think that should reflect the continued confidence and momentum that we have against the overall addressable market.

Q - Brent Thill {BIO 1556691 <GO>}

Perfect. Thank you.

Operator

Your next question comes from the line of Ross MacMillan from RBC Capital Markets. Your line is now open.

Q - Ross MacMillan {BIO 1994797 <GO>}

Thanks so much. Just along the same lines, I guess, just if I pull $20 million of that cumulative benefit, I think your net new ARR would have been a little bit better than your initial guide. But then I look at your Q2 net new ARR guide and it's certainly a lot better than I would have thought given that adjustment off of Q1. And I wondered if you could just maybe talk about why that second quarter guide is where it is and relative to Q1 and is there certain things you'd highlight, so for example, the price changes on international and Doc Cloud I think go into full effect for the current quarter. But I was just curious as to that kind of transition adjusting out the $20 million cumulative adjustment from Q1 to Q2? Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, Ross, I mean I think when we look at the business from a seasonal perspective, we do see traditional change between Q2 and Q1, that's been something that you can go back and look at fiscal '18 as well and you see the same trends. Remember, in fiscal '18 there was that sort of catch-up as it related to the systems. So you see a nice growth in Q1 '19 over Q1 '18 and you see the same sequential change then if you look at it, whether it was in '18 or it was in '19. And I think where we continue to see momentum in the business, John certainly alluded to some of those in his prepared remarks, Enterprise continues to do well, mobile and the adoption of mobile continues to do well. Acrobat, we're seeing tremendous strength in the Acrobat business, if you look at the 22% revenue growth that we talk about both in the Creative part of the business as well as in the Document part of the business, we're continuing to see that.

And remember, in addition to new customer acquisition, there is a very significant installed base that exists with the perpetual version of Acrobat as we move them to the subscription offering, that's part of the reason why we're spending money in advertising and awareness of the new Document Cloud features. And this is a traditional, with December slowing a little bit as it relates to the Creative, you start to see the momentum in the business. So nothing different from what we've seen in past years.

Q - Ross MacMillan {BIO 1994797 <GO>}

Thank you.

Operator

Next question comes from the line of Saket Kalia from Barclays. Your line is now open.

Q - Saket Kalia {BIO 16417197 <GO>}

Hi guys, thanks for taking my question here. Shantanu, just to maybe switch gears off of Digital Media towards Digital Experience, given the change in management therewith Brad Rencher moving on, can you just talk a little bit about the search for his replacement? And perhaps just as importantly, how that organization can change structurally now with a bigger slate of things to sell and a bigger team?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, first, Saket ,let me talk a little bit about the momentum that we're seeing in the business, I was actually with customers the last two weeks on the road in both US and Europe and all the meetings that you have, whether it's with CEOs, CMOs and CIOs, they're absolutely reflecting the urgency of digital engagement and an appetite really to work with Adobe, because we have viewed, not just as a leader in the technology strategy part of it, but a company that can share results -- lessons, as a result of our own transition.

So very pleased with the success that we saw in that business in Q1. I think it was 34% growth under 606, 32% under 605, so really strong part of that and I think we highlighted as well the success that we're seeing with both Magento and Marketo. And so Magento, the integration with AEM and the success that we're seeing there, Marketo, which is the leader in B2B. So, fundamental market dynamics continue to be very favorable. My immediate and direct involvement, and frankly, the alignment of the entire DX organization that was previously matrixed at Adobe, the whole goal was intended to accelerate the momentum in what is very clearly a large and growing opportunity for Adobe.

And so, Saket, what we've done is, we are actually integrating the two recent acquisitions quicker where appropriate, Magento and Marketo to enable the synergies between the businesses. I touched on what was happening there. Operationally, Matt's been running the combined go-to market, Abhay has been running and helping us with the product roadmap. And so I think the scale and the momentum of that business, that's now north of on a $3 billion run rate allows us the luxury of attracting world-class executives in growing internal talent, but net-net I would say, the direct involvement that I have in the alignment of the entire organization is frankly allowing us to operate at a faster pace.

Q - Saket Kalia {BIO 16417197 <GO>}

Got it. Thank you.

Operator

Next question comes from the line of Alex Zukin from Piper Jaffray. Your line is now open.

Q - Alex Zukin {BIO 18006605 <GO>}

Yeah, hey guys. Thanks for taking my question. I wanted to ask about the partnership with Microsoft and kind of maybe just if you could give us an update on the impact it's having on the Digital Experience business? And then maybe how you're thinking about that partnership given the Marketo, Magento integration as well?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, I mean big picture, it's clearly one of the most successful partnerships we've had, I'll make a little bit of a plug for Adobe Summit for those of you who are there, Satya will be joining us on day two and so you know, on Wednesday, so I think you'll hear from him as well, his perspective on not just the current partnership and what we've been able to do, but some of the new opportunities that are emerging ahead of us, whether it's ODI, where we are continuing to make progress.

And I think speaking for Adobe, we're certainly excited about the ability to have Magento and Marketo as well work on their cloud platforms. The current success is all based on what we've done with AEM and Adobe Experienced Manager and Adobe Campaign, but the go-to-market alignment. I mean again, when I was on the road in Europe as I was mentioning, as well as in America, executives all around the fact that they're all moving to a cloud-based environment for native applications and they see not just rhetoric but actual evidence of how Adobe and Microsoft have partnered to make our technology work together and for us to connect the disparate SaaS-based systems. It's working, it's humming, it's actually exceeded our targets as I think we mentioned for '18, we expect the same kind of success in '19.

Operator

Next question comes from the line of Jennifer Lowe from UBS. Your line is now open.

Q - Jennifer Lowe {BIO 6926228 <GO>}

Great. Thank you. So as we look at through the incremental investments into the business in terms of sales and marketing and R&D at this point, how much of that is going towards the traditional Creative business, the Document Cloud business versus the Marketing Cloud? And has that shifted at all, particularly in Creative as you start to go after a broader set of (inaudible) or continued expense (inaudible)?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, Jennifer. And as you look at the OpEx and if you look at the margins, I mean just recall again, you know, sort of the impact of Marketo and Magento. But big picture. unless you're trying to get me in trouble with my product organization, I would say we see so much opportunity across each of the three businesses, and I think we're investing in all three on the Creative side, certainly we've touched on the new applications that are coming out on iPads, we've talked about the innovation in the fundamental desktop applications, we've alluded to with the acquisition of Allegorithmic, our excitement around what we can do with immersive media on XD, what we've done with respect to fundamentally changing the nature of collaboration and allowing people to collaborate in a meaningful way, we talked about some good partnerships there with Slack and Atlassian in addition to Microsoft, the new voice-enabled applications. So on Creative, there is an absolutely significant amount of product innovation that's underway that will be delivered to customers.

Acrobat, what we are doing the strategy around delivering more functionality with verbs around documents, things that we've done with Scan and Create and Sign, Document Cloud had a really successful business. And clearly with Experience Cloud, delivery of the platform, I hope you're going to be at the Summit where we'll share more and show more.

So -- and I think underlying all of this, the investment that we're making in the core cloud infrastructure for us to not only deliver value but over time, reduce the COGS because we're going to get more efficient there as well as on AI and ML. So, really comprehensive roadmap that exists against all of those, Jennifer. And given the opportunity, when you have $100 billion addressable market, I think we've done a good job of balancing the long-term, while continuing to deliver great value for shareholders.

Q - Jennifer Lowe {BIO 6926228 <GO>}

Thank you.

Operator

Next question comes from the line of Kirk Materne from Evercore. Your line is now open.

Q - Kirk Materne {BIO 5771115 <GO>}

Yes, thanks very much and congrats on a nice start to the year. Shantanu, you mentioned that Matt's running the combined go-to-market efforts for the Experience Cloud. And in your prepared remarks, you mentioned some good initial cross sell of Magento. Can you just just maybe remind us about how sort of the go-to market's working right now, are Adobe sales reps able to sell Magento and Marketo, are you leaving those somewhat apart for now? Can you just remind me of how that sort of playing out in the early stages and where you maybe hope to have that by the end of the fiscal year? Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

Sure. I mean, I think when we first acquired both Magento and Marketo, we had the field organizations a little distinct, they were part of the business unit as part of the -- as opposed to part of the field organization. What we've done is we've got a complete aligned pipeline generation right now for the entire Experience Cloud and so the marketing initiatives, the partner initiatives and the organic sales initiatives are aligned around getting a very healthy pipeline. And what we are doing is really now then with be enterprise sales force focused on delivering the entire value to the customers. I mean, so many of these customers are already customers of other Adobe solutions. And so the ability to plug in commerce and to plug in B2B marketing directly into that pipeline, we had a really strong quarter with Magento in the Enterprise segment. And while we're doing that, we want to make sure that the mid-market motion that exists globally is not impacted and so I think having this really unified single message, single sales kickoff, I think is showing success. And you know, Steve, who is CEO of Marketo and Mark Lavelle, they are helping us make sure that we understand the nuances of how to best market Magento and Marketo, but to leverage again, as I said, the Adobe brand. And so, having that one unified running the business is definitely accelerating the integration and presenting a very unified view to the customer.

Q - Kirk Materne {BIO 5771115 <GO>}

Thank you.

A - Shantanu Narayen {BIO 3332391 <GO>}

Maybe the one other thing I would mention there is the number of partners actually having a single unified view is enabling us to get all of our existing partners in addition to, I think as we said, the hundreds of thousands of people on the open source community, having that all aligned enables us to paint a much bigger picture as well very quickly.

Operator

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

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Thank you. Shantanu, I'd like to ask you to comment on three internal programmatic initiatives that Adobe clearly seems to be investing in or ramping up, those being first, retention which you described at the MAX meeting as quote, the new growth. Number 2 monetization and then thirdly, self service particularly for EC. And if you could just comment on how you are looking at those generally and how any or all of those might be informing your guidance for this year and beyond?

A - Shantanu Narayen {BIO 3332391 <GO>}

Can you maybe just, before I answer that Jay, talk a little bit about the middle one, what did you mean by monetization? We're trying to monetize everything, so I just want to make sure I --

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Yeah. Well, what I'm looking at for example, you're looking to bring people on that are specifically focused in the monetization area, I realize it's an ongoing thing, but it looks like something that you are incrementally focusing on, particularly in Creative Cloud and new services and Experience Cloud, I'm just -- I'm going off of some of the internal investments you seem to be making.

A - Shantanu Narayen {BIO 3332391 <GO>}

Got it, got it. No, those are good questions, I mean first on the retention, while retention is the -- and I still continue to believe that retention is the new growth. The focus there really has been a lot on engagement and understanding how people can get the value out of our products. I think we use our own campaign products to communicate with people, I think what Scott Belsky has done with, what he described at Max at the First Mile initiative, which is when people first come on board, how they can get advantage of our products.

I think the integration with Adobe Stock and enabling them to participate and not have the fear of a blank slate. And I would say the community and be hands and the success that we're seeing for people to get benefit of participating in a larger community, all of that is helping with the retention and that will just continue to be ongoing focus for us because the more you retain, not only do you get the benefit of those customers, they also serve as (inaudible).

The monetization side, I think the more we can get people at the early part of the funnel, whether it's coming in through mobile, whether it's coming in, you know with Reader and Acrobat and then converting them, that just continues to be a way for us to get our brand out there and it's certainly serving as a good funnel. The other area where we are seeing success there, Jay, is the fact, the system approach that we're taking, products like a Lightroom, where you can use Lightroom exactly the same on mobile or on a tablet or on a PC. The retention rates for products like that are certainly higher because people are seeing more value associated with that.

And if the self-serve is, again all about top of the funnel and making sure that we can get people to experience Adobe products, that's certainly been a part, I think the last number we probably shared was a 100 million IDS that we've been able to create. And going back to, I think a question that maybe Brent asked earlier, certainly we provide promotions to some of those people who otherwise may not have even made the leap from a free product to a paid product. So I think the DDOM is where we continue to emphasize our internal effort to make sure that we're optimizing and delivering value at the same time.

Q - Jay Vleeschhouwer {BIO 1498201 <GO>}

Okay. Thank you.

Operator

Next question comes from the line of Walter Pritchard from Citi. Your line is now open.

Q - Walter Pritchard {BIO 4672133 <GO>}

Hi, thanks. Question for John on the Experience side. I guess a little challenged to try to understand maybe as we move past all of the moving parts on deferred revenue write downs and acquired revenue and so forth. Could you help us understand what the business is growing, either -- if we were to look at it all-in with everything part of the past year and the current year, or if we were to maybe strip out some of the things that were acquired, it feels like we're working with numbers maybe in the mid-teens and the reported numbers are in the mid '30s and there's a lot of kind of room between I think for people to interpret how fast you may be growing on the Experience side?

A - John Murphy {BIO 16018871 <GO>}

Sure. Thanks, Walter. I think when you look at the Digital Experience business, it's a portfolio of solutions and services and products, and certainly Magento and Marketo being the newest additions, so that provide an accelerated growth for the total Digital Experience business. So our target that we're really comfortable with is that in the combined, because we're selling everything right now, so it's 34% for the year. We don't necessarily parse out what Magento is doing, what Marketo is doing because its integrated sales approach at this point now.

So for us, we're looking at the larger opportunity in the Digital Experience space as we talked about at Analyst Day and these new assets, help us accelerate that opportunity. And then subscription bookings growth has been very strong. And really, we're pretty pleased with the performance this quarter and with the momentum that we have for the rest of the year.

Q - Walter Pritchard {BIO 4672133 <GO>}

So, I mean John on that, I mean it doesn't feel like though we get past that -- the end of year there, we're going to be growing 34%, that seems -- I guess I feel like people are going to miscalibrate the models as they look forward at the growth rate. Any help as we sort of look at it that way? I think that's the real confusion, I think that we get the guidance and even the 606 impact.

A - Shantanu Narayen {BIO 3332391 <GO>}

I think, Walter if you look at it taking a step back and you think about, the book of business, I think the most apt comparison is we take Magento, we take Marketo, we bring it into the beginning book of business and when we say we're growing that book of business by 25%, that sort of shows the growth of what is the core part of the business, namely software as a service and licensing. When you take the fact that consulting as a result of the partner ecosystem that exists is less of a focus for us. Hopefully that gives you a sense of the underlying sort of dynamics in that business and our excitement because at the scale at which we are to continue to grow subscription bookings at that rate and to continue to expand, I think, reflects the momentum we have.

Q - Walter Pritchard {BIO 4672133 <GO>}

Okay. Thank you.

Operator

Next question comes from the line of Richard Davis from Canaccord. Your line is now open.

Q - Richard Davis {BIO 1497599 <GO>}

Hey, thanks. (Technical Difficulty).

A - Mike Savage {BIO 1512655 <GO>}

We can't hear you, whoever it is, sorry.

Q - Richard Davis {BIO 1497599 <GO>}

Yeah, hold on. Can you hear me now?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yes.

Q - Richard Davis {BIO 1497599 <GO>}

Can you hear me now? Sorry about that.

A - Mike Savage {BIO 1512655 <GO>}

Yes.

Q - Richard Davis {BIO 1497599 <GO>}

(Technical Difficulty) broad product line, so I realize it's hard to answer, but is there a way to think about the customer wins that you're getting that are rip and replace versus kind of new budget dollars because, I mean you're getting both, right? I mean there's more budget dollars go into marketing tech and customer stuff, but there's also rip and replace. Is there a mix and how does that feel?

A - Shantanu Narayen {BIO 3332391 <GO>}

You know, I would say when we looked at 2018, we were doing a lot more of the existing customers and we put a pretty good emphasis on new logos as well that is really helping bring a lot more people, I think the whole B2B space that we've talked about now with the combination of Magento and Marketo, that's been good. But to your point, there is a fair amount of expansion within existing customers and the expansion is coming from two different sources, the first is the expansion is coming from the cross-sell of new products that we're acquiring into existing customers as people see the benefits of the integration. The upsell is also coming from more usage of the current products as they are seeing more efficiency gains and/or additional benefits associated with it.

So we're pretty focused on all three of those, I mean you want to keep growing new logos and going after greenfield territory, I think we're getting more international expansion, that continues to be new logos. But within accounts, we are very focused and in most of the accounts, we're very diligent about making sure as we look at a particular account, that we're not just measuring renewal, but we are measuring growth in those particular accounts. And so hopefully, that gives you some color of what it is. You're right, we don't break that out, I wouldn't know how to break that out frankly, for a business this size. But internally, we're absolutely inspecting all three of those.

Q - Richard Davis {BIO 1497599 <GO>}

Super. Thank you.

Operator

Next question comes from the line of Keith Weiss from Morgan Stanley. Your line is now open.

Q - Keith Weiss {BIO 6993337 <GO>}

Excellent. Thank you guys for taking the question. I think your question for John, just digging into sort of the ASC 606 impacts, I just want to make sure I understand sort of how it's impacted that guides. So if we look at Q1, you beat the original guide on Q1 by $0.11 and it looks like about $0.05 of that came from sort of the underlying fundamentals on a like-for-like basis and $0.06 from ASC 606 impacts. But the full year guide only moves by $0.05.

So am I reading it correctly that sort of that $0.06 benefit that you saw in Q1 on ASC 606, you see actually a headwind that sort of like you have a lower earnings or is there a negative impact throughout the year?

And then related to that on the last quarter in Q4, you guys mentioned that you did expect to see sales and marketing benefits and won't be much of a change to revenues

ARR, but you did expect to see sales and marketing benefits from different commissions, does that still apply, is there still that benefit that's coming through?

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, I think maybe Keith, I'll just start and then I'll certainly have John add more color to it. I mean first big picture, when we look at the momentum in the business, it just continues the way we had imagined. The way you have to think about it is, you're right, I mean if you look at the sort of $60 million above the guide that we had done, you also have to factor in that there was actually foreign exchange that was probably a little bit more of a headwind. So we actually had a very strong quarter, what happens in some of the accounts as you're recognizing the revenue upfront rather than recognizing them ratably. And so that's part of the reason for how you should think about what might that also play out in Q2 for the same reason, namely deferred revenue. But in terms of how we looked at the targets for 606 for fiscal '19, we wanted to give you an update. It's early in the year, the business is doing well, on the ARR front, which has nothing to do with 606 or 605, moving forward we were very clear about the success that we're continuing to have. And so that's part of the way we are doing it, but we are excited about the business.

A - John Murphy {BIO 16018871 <GO>}

Yeah, I guess just to add onto that in relation to the sales and marketing benefit that we had talked about last quarter, it's really because of the Marketo acquisition. So it's a slight benefit that we're seeing from the capitalized commissions related to the Marketo business. So you can see it a little bit of that benefit here in Q1, when you look at OpEx under 605 and 606 and you'll see that through the year. But certainly as Shantanu said, I think it's just being a little cautious in terms of how the rollout of the different contracts are in terms of upfront revenue versus recognized through the rest of the year.

Q - Keith Weiss {BIO 6993337 <GO>}

Got it. Thank you guys.

Operator

Next question comes from the line of Kash Rangan from Bank of America Merrill Lynch. Your line is now open.

Q - Shankar Rajamohan

Hi, thanks for taking the question. This is Shankar on behalf of Kash. I have a question on XD and just a question on how you think about the total TAM opportunity for that business. It seems like when you talk to partners and customers use it, is this not UX designers, UA designers using it, but there are more developers also on the platform. And when you think about the total opportunity both in terms of units and dollar, how do you think about it and does XD provide you an opportunity to drive more enterprise wide adoption of your Creative Cloud?

A - Shantanu Narayen {BIO 3332391 <GO>}

You know, when we think about XD in particular, I mean, I think the biggest picture sort of message that I would send is, we look at it and say everything is going to have a screen and if everything is going to have a screen and it's going to have digital content delivered to it, whether you're in your automotive, whether you're in a retail store, whether you're having a watch, we think XD is a perfect application to design prototype and deliver content for all of those different devices.

So it's not just UX designers, it's certainly developers, as developer breaking that designer-developer bridge that exists today to deliver great applications, that's another use case. I think your question around Enterprise is actually spot on. We're seeing a fair amount of success in adoption in the Enterprise, because enterprises are standardizing on the collaboration between the marketing organization, the product organization and the engineering organization and we're seeing some good traction there. New apps like Voice, that's certainly an area where XD, I think continues to shine.

And so we're just excited, I mean, every time you see one of these new applications, you see both new app adoption among new customers, the monthly average usage of XD is growing very nicely and you certainly see that as an additional benefit to the full value Creative Cloud and that's also true. I know you didn't ask the question, but when you think about Allegorithmic as well, it's the same thing, we start to attract a whole new set of customers with Allegorithmic, it gives us the opportunity to have a higher priced all-apps bundle for people who are doing even more high-end work. And so both from a top of funnel acquisition as well as from optimization, that's how we think about each one of these different categories.

Q - Shankar Rajamohan

Thank you so much.

Operator

Next question comes from the line of Tom Roderick from Stifel. Your line is now open.

Q - Tom Roderick {BIO 6678063 <GO>}

Hey, gentlemen, thanks for taking my questions. So just maybe just kind of building on Keith's question that he just asked a little bit earlier regarding 606 and the impact to EPS, but just sort of thinking about the second quarter in particular, if I look at the full year, great guidance above where we all were for the second quarter, I think our models were a little bit heavy, maybe by somewhere in the magnitude of around $0.10 or $0.11. Can you just kind of talk to some of the seasonal investments that might be taking place in addition to some of the 606 impact that might have pulled some of that profitability forward, just so we get a sense of what's impacting that Q2 EPS guidance? Thank you, guys.

A - Shantanu Narayen {BIO 3332391 <GO>}

Yeah, I think part of it where you also have to factor in was the Q1 over performance and you know the operating margin that we showed in Q1, so I wouldn't be surprised if some of you had modeled it, where I think as I've looked at the models, Q2 and Q3, where you are probably a little ahead of where the numbers were, not fully understanding the Marketo and Magento, both sort of impact of deferred revenue and the purchase accounting impact and you're probably a little light on Q4 as it related to how we thought the year would play out. But so I look at it and say there is a little over achievement in Q1, we've guided to good operating margins in Q2 based on the revenue that we have. And we've, I think, guided that Q3 and Q4, once the impacts of Marketo and Magento deferred revenue and purchasing accounting taper off, then you are back to where you may have modeled it, but John, anything to add?

A - John Murphy {BIO 16018871 <GO>}

Yeah, I think that's exactly right, we had said that the first half of FY '19 was going to be more greatly impacted by the deferred revenue haircuts. And I think you're probably modeled a little bit more linearly in terms of return of the operating margin and it really does and actually accelerate towards the back end of the year, so we exit FY '19 at rates that you typically see in our performance in the past.

Q - Tom Roderick {BIO 6678063 <GO>}

And then as we get into FY '20, just sort of more standard seasonality, not this method, upfront haircut that we got this year, right?

A - John Murphy {BIO 16018871 <GO>}

Yeah, that's right.

A - Shantanu Narayen {BIO 3332391 <GO>}

That's absolutely correct.

Q - Unidentified Participant

Very good. Thank you, guys, appreciate it.

A - Mike Savage {BIO 1512655 <GO>}

We're coming up an hour here, we'll take two more questions, operator.

Operator

Two more questions. Next question comes from the line of Mark Moerdler from Bernstein. Your line is now open.

Q - Unidentified Participant

Hi, thanks for taking the question. This is Tim for Mark. I wanted to talk a little bit more about ODI, and specifically if you could talk about where you guys are on the road map and maybe feedback that you've gotten from customers? Thanks.

A - Shantanu Narayen {BIO 3332391 <GO>}

I think the core strategy of ODI and three large companies getting together to say we're going to agree on the taxonomy, we're going to agree on an API and we're going to ensure interoperability between the data that exists today in silos, there hasn't been a customer that isn't excited about the fact that we're all stepping up to do that and allow enterprises to get value out of all of the data that they have in different silos. So I would say a big picture, first, there's a lot of excitement, it clearly builds on the progress that Adobe and Microsoft have made over the last few years as we've integrated Power BI and Campaign or the work that we've done with AEM, I think you'll see at Summit having more people on the ingestion or ETL side also sign up and say they're going to enable all of this data that exists in silos to get normalized.

I mean, the Holy Grail of what we are trying to do with ODI with a whole bunch of partners is to bring all of the data that exists into this real-time sketched platform that is a common taxonomy. People don't care about where their data is stored, people care about, can I action it in real time? And that is really the goal of ODI, we're making good progress, we'll share more at Summit. But the core value proposition really resonates with customers.

Q - Unidentified Participant

Thanks guys.

Operator

Last question comes from the line of Sterling Auty from JP Morgan. Your line is now open.

Q - Sterling Auty {BIO 2070271 <GO>}

Yeah, thanks. Hi guys. Earlier in the call, Shantanu, you mentioned the importance of adding customers as the growth algorithm. So within Creative Cloud, I'm curious, what is the biggest pocket of new users that you're still tapping into? And what kind of ARPU or pricing are you getting on those customers versus what you've seen traditionally?

A - Shantanu Narayen {BIO 3332391 <GO>}

You know, Sterling, the sort of -- there are so many different opportunities there, if I had to pick one, I would still say mobile, imaging and imaging is the area where there is the most. But what we've done with Premiere Rush, we talked about that Spark having 7 million people and that being a real ceding ground for what we can do in education, I think that's very significant. The aura that comes from us doing high-end work with AR and what we're doing with Allegorithmic, while the numbers may not be small, don't underestimate the importance of how that attracts a whole new generation of creators to our platform. But I would say, imaging and PDF still continue to be the two largest areas of acquisition for new customers in the Creative Cloud and I would highlight Spark as well, only because you know Spark is this incredibly easy product that everybody from K-12 to teachers are starting to use and the more we get that standardized in school districts, and frankly in some cases, entire countries as sort of the platform of choice for education. I think that'll continue to be a way in which we expose young creative talent to the joys of using Adobe products.

But Sterling, since you had the last question, let me just summarize by saying, I think when we think about the Q1 financial results, I think it's again a clear reflection of the core strategy on the enterprise side helping businesses transform on the content side, empowering people to create, that strategy resonates and our execution against that strategy continues to be strong.

We think design and creativity have never been as important as they are today. And whether you call it digital transformation, like you call it in the US or digitization as it's called in Europe, it just represents an incredible opportunity for us to continue to grow and deliver value to our customers, we're excited about Summit, we hope we'll see a bunch of you there.

One thing I'll also mention is that it actually integrates Marketo's Marketing Nation. So we're welcoming that community as well to Summit in a few weeks and the targets that we provided, I think reflect the momentum we continue to drive across all geographies. So, Q1 was off to a great start. Thank you for joining us today.

A - Mike Savage {BIO 1512655 <GO>}

And this concludes our call. Thanks everyone for joining.
