

Company Name: Adobe
Company Ticker: ADBE US
Date: 2018-09-13
Event Description: Q3 2018 Earnings Call

Market Cap: 134,505.43
Current PX: 274.69
YTD Change(\$): +99.45
YTD Change(%): +56.751

Bloomberg Estimates - EPS
Current Quarter: 1.886
Current Year: 6.812
Bloomberg Estimates - Sales
Current Quarter: 2428.478
Current Year: 8989.923

Q3 2018 Earnings Call

Company Participants

- Mike Saviage
- Shantanu Narayen
- John Francis Murphy

Other Participants

- Jennifer Swanson Lowe
- Brent Thill
- Ross MacMillan
- Jay Vleeschhouwer
- Walter H. Pritchard
- Brad Alan Zelnick
- Saket Kalia
- Alex J. Zukin
- Kash Rangan
- Sterling Auty
- Mark L. Moerdler
- Heather Bellini
- Kirk Materne
- J. Derrick Wood

MANAGEMENT DISCUSSION SECTION

Mike Saviage

Financial Measures

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

A reconciliation between the two is available in our earnings release and in our updated investor datasheet on Adobe's Investor Relations website

Shantanu Narayen

Q3 Operating Results

Earnings Overview

- Q3 was a record quarter for Adobe
- We delivered \$2.29B in revenue, representing 24% y-over-y growth
- GAAP EPS for the quarter was \$1.34 and non-GAAP EPS was \$1.73

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Business Transformation

- Adobe is empowering people to create and transforming how businesses compete
- Our execution against this strategy is driving strong financial results across our Digital Media and Digital Experience businesses
- In every market around the world, students, creatives, enterprises and governments are choosing Adobe Creative Cloud, Document Cloud and Experience Cloud to deliver the transformative digital experiences required to compete and win today

Digital Media Business

- In our Digital Media business, we achieved strong growth in both Creative Cloud and Document Cloud revenue in Q3
- Net new Digital Media annualized recurring revenue or ARR was \$339mm
 - And total Digital Media ARR exiting Q3 grew to \$6.4B
- Key Digital Media customer engagements in the quarter included:
 - The U.S. Department of Education
 - Facebook
 - Marks & Spencer
 - And Walmart
- Creative Cloud has become the creativity platform for all, with millions of highly engaged subscribers and a strong base of trialists whom we actively convert each month into paying customers
- Whether it's YouTubers looking for an intuitive video solution or mobile-first photography enthusiasts, we continue to see significant opportunities for growth in new customer segments as well as untapped potential in emerging markets

Project Rush

- Video continues to be an explosive category
- In June, we previewed Project Rush, a new video editing app that makes creating and sharing online video content easier than ever
- Whether your passion is vlogging about food or posting a cool skateboarding clip, Project Rush gives users a way to create video projects across surfaces, providing them with maximum creative flexibility
- This week at IBC, we shared a slate of new video creation capabilities that will speed up video production and enable more seamless workflows for professional editors and animators
 - This includes Adobe Sensei-powered features for audio editing, color grading and animation in Premiere Pro, Audition, Character Animator and other video tools

Lightroom CC

- Lightroom CC, our cloud-based photography service, continues to attract new customers

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- We announced a number of updates to Lightroom CC and Lightroom Classic for Mac, Windows, Android and iOS and shipped several improvements, including new in-app learning capabilities, support for new cameras and more than 1200 different lenses
- We previewed a brand-new feature, Best Photos, which combines Adobe Sensei intelligence with user-made edits to quickly recommend the best photos within an album

Adobe XD

- Adobe XD, our all-in-one UX solution for designing and prototyping websites and apps, is quickly becoming the leader in the screen design category, with strong monthly active usage among customers
- This quarter, we unveiled new open platform capabilities which allow users to customize their workflow with a broader ecosystem of community and partner plug-ins
- As students around the world head back to school, Adobe is partnering with educators and institutions to ensure that creativity, a core 21st century skill, is a central part of curriculum and that students have access to the creative tools they need

Adobe Spark

- Adobe Spark, our app for easily creating high-quality graphics, web pages and video stories, is a cornerstone of this effort
- This quarter, we were proud to partner with the Ministry of Skill Development in India to enable more than 1mm students to access Spark

Creative Cloud

- Next month, we'll host MAX, the world's largest Creativity Conference
- We'll unveil new capabilities across Creative Cloud that will enable our customers to push the boundaries of creativity across modalities like voice and touch, and emerging media types, including 3D and augmented reality

Document Cloud

- Adobe Document Cloud is the world's leading digital document service, enabling individuals and businesses to automate inefficient paper-based processes
- In Q3, we achieved record revenue for Document Cloud of \$249mm
- PDF creation, sharing, reviewing, scanning and signing is accelerating across devices and Adobe's document business is experiencing strong growth
- Over 50B PDFs were opened in Adobe products in the last year

Major Advancements to Adobe Document Cloud

- In a few weeks, we'll announce major advancements to Adobe Document Cloud, including an update to our flagship Acrobat DC solution, which will radically transform what's possible with PDF on mobile devices
- In August, we teamed up with Samsung for the launch of the new Galaxy Note9 and its intelligent assistant, Bixby

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- With the introduction of Adobe Scan for Bixby Vision, we're providing PDF scanning capabilities to Samsung users through Adobe Sensei and Adobe Document Cloud

Adobe Scan

- Adobe Scan has become one of the most popular mobile scanning apps, with nearly 14mm downloads to date
- Adobe Sign continues to revolutionize the electronic signature market and has become the solution of choice for customers, particularly in highly regulated industries such as:
 - Government
 - Healthcare
 - And financial services

Adobe Sign Business

- This year, Adobe Sign received FedRAMP Tailored authorization, meeting the U.S. government's rigorous security standards
- As part of our collaboration with the Cloud Signature Consortium, which is furthering an open standard for cloud signatures, we support key industry standards and guidelines such as HIPAA and the ESIGN Act
- Overall, we continue to drive strong growth in the Adobe Sign business

Experience Cloud

- Adobe Experience Cloud is the leading customer experience platform for the modern enterprise, helping companies deliver predictive, personalized, real-time digital experiences across every touch point
- Our unique differentiation stems from the breadth and depth of our offerings, and the unparalleled intelligence we derive from the trillions of transactions we process on behalf of our customers

Revenue Drivers

- In Q3, we achieved Experience Cloud revenue of \$614mm, with strong bookings across:
 - Adobe Marketing Cloud
 - Analytics Cloud
 - And Advertising Cloud

Major Customer Deals

- Key customer deals in the quarter included:
 - NBA Properties
 - Commonwealth Bank of Australia
 - The Federal Aviation Administration
 - CBS Interactive

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- And Navy Federal Credit Union

Magento Acquisition

- In June, we completed our acquisition of Magento, bringing its industry-leading commerce capabilities to Adobe Experience Cloud for B2B and B2C customers
- We delivered the first integrated deployment of Adobe Experience Manager and Magento Commerce Cloud this quarter
 - Expanding Magento's reach in the global enterprise space continues to be an area of opportunity for Adobe, as is expanding other Experience Cloud solutions deeper into mid-sized businesses where Magento has a strong market position
- Next month, we'll host over 2,000 customers at MagentoLive in Barcelona, where we'll share more details about how we're integrating Experience Cloud with the Magento Commerce Cloud

Advertising Cloud

- Adobe Advertising Cloud enables marketers to deliver search, display, video and TV advertising across a growing number of screens and formats
- We recently announced new capabilities for TV ads in partnership with LiveRamp, as well as new fraud protection features and support for emerging formats including digital audio ads on smart speakers and home devices
- Our leading offering in data-driven TV advertising continues to see strong interest from brands and agencies as we bring more refined targeting options to linear and addressable TV
- We continue to deliver new innovation across our entire set of Experience Cloud solutions, including new email and cross-channel marketing capabilities in Adobe Campaign, and Attribution IQ inside of Adobe Analytics Cloud
- Growth in our Digital Experience business is enhanced by a strong network of global partners

Strategic Partnership

- Our strategic partnership with Microsoft continues to gain traction among enterprise customers as we bring more joint solutions to market
- More than 100 enterprises now leverage Adobe and Microsoft's joint digital experience offerings, including:
 - Bank of America Merchant Services
 - Cintas
 - CDW
 - And Virgin America Airlines

Recognitions

Technology Leadership

- In Q3, Adobe was once again recognized for our technology leadership by top industry analysts

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- Adobe was named the only leader in the Forrester Wave: Experience Optimization Platforms and we were named a leader in the Gartner Magic Quadrant for Web Content Management for the eighth year in a row
- Additional leadership recognition included the Forrester Wave: Customer Analytics Solutions and the Gartner Magic Quadrant for Personalization Engines

Best Employer and Workplace

- Adobe's employees have always been our greatest asset
- We pride ourselves on recruiting and retaining world-class talent and making Adobe a place where our employees can do their best work
- Last week, Forbes ranked Adobe as the number one Best Employer for New College Graduates and we were recognized by Fortune as one of its Best Workplaces for Millennials
- The Great Places to Work Institute recently included both Adobe India and Adobe Australia on its Best Workplaces lists

Outlook

As we look to Q4, we're excited about the opportunities ahead

We expect a strong close to Adobe's 2018 FY and are confident that we have the right strategy, products, people, customers and partners to sustain our growth and momentum

John Francis Murphy

Financial Results

Revenue and EPS

- In Q3 FY18, Adobe achieved record revenue of \$2.29B, which represents 24% y-over-y growth
- GAAP diluted EPS in Q3 was \$1.34 and non-GAAP diluted EPS was \$1.73
- We delivered another quarter of strong performance across product offerings and geographies, while also successfully integrating Magento

Major Accomplishments

- Highlights in Q3 included:
 - Record Digital Media revenue, including Creative revenue of \$1.36B and Adobe Document Cloud revenue of \$249mm
 - record Digital Experience revenue of \$614mm, which represents 21% y-over-y growth
 - Net new Digital Media ARR of \$339mm
 - Deferred revenue growth of 23% y-over-y
 - Cash flow from operations of \$955mm

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- Returning \$714mm of cash to our stockholders through stock buyback
- And approximately 90% of our revenue in Q3 was from recurring sources

Digital Media

- In Digital Media, we grew segment revenue by 27% y-over-y
- The addition of \$339mm net new Digital Media ARR during the quarter grew the total to \$6.4B exiting Q3
- Within Digital Media, we achieved another record quarter with our Creative business
- Creative revenue grew 28% y-over-y in Q3 and we increased Creative ARR by \$289mm

Major Growth Contributors

- Several key factors contributed to this growth, including:
 - Strong net new subscriptions across user segments and across the U.S., Europe, Japan and Asia-Pacific, driven by robust traffic and customer acquisition on adobe.com
 - strength in new individual app subscriptions with the Photography Plan and Acrobat
 - Continued momentum with Creative Cloud adoption in emerging markets
 - Retention of users migrating from promotional to standard prices at annual cycles
 - New pricing introduced in North America
 - Seat expansion and adoption of services in the enterprise
 - And strength with Adobe Stock, which achieved greater than 30% y-over-y revenue growth during the quarter
- We transitioned our adobe.com sites in Europe to comply with new GDPR requirements, and we are successfully engaging with potential and existing customers, allowing us to continue to drive growth in revenue and ARR

Future Opportunities

- Retention, upsell, new customer acquisition and conversion remain huge opportunities which we address through digital marketing campaigns, frequent targeted promotions, and the introduction of new offerings across desktop and mobile

Document Cloud

- With Document Cloud, we achieved record revenue of \$249mm, which represents 21% y-over-y growth, and we delivered another solid quarter of Document Cloud ARR growth
- Acrobat unit growth across Creative Cloud and Document Cloud was again greater than 20%
- Adobe Sign achieved greater than 25% y-over-y revenue growth

Digital Experience

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- In our Digital Experience segment, we achieved record Adobe Experience Cloud revenue of \$614mm, which represents 21% y-over-y growth
- Experience Cloud subscription revenue grew 25% y-over-y
- Experience Cloud performance in Q3 was driven by success across our Analytics Cloud, Marketing Cloud and Advertising Cloud offerings, with particular strength in Audience Manager, which is our data management platform, and in Adobe Campaign

Magento

- Magento was off to a strong start and contributed subscription and services revenue of \$27mm in Q3
- Strength in demand, a longer than anticipated stub period in Q3 and a smaller than anticipated write-down of deferred revenue contributed to this success

Revenues

- From a q-over-q currency perspective, FX decreased revenue by \$13.8mm
- We had \$16.8mm in hedge gains in Q3 FY2018 vs. \$0.3mm in hedge gains in Q2 FY2018
 - Thus, the net sequential currency increase to revenue considering hedging gains was \$2.7mm
- From a y-over-y currency perspective, FX increased revenue by \$27.7mm
- We had \$16.8mm in hedge gains in Q3 FY2018 vs. \$0.2mm in hedge gains in Q3 FY2017
 - Thus, the net y-over-y currency increase to revenue considering hedging gains was \$44.3mm

Tax Rate

- In Q3, Adobe's effective tax rate was 5% on both a GAAP and a non-GAAP basis
- The GAAP rate was lower than targeted due to larger than expected tax effects related to share-based payments, as well as a favorable resolution of an income tax matter
- Our trade DSO was 41 days, which compares to 50 days in the year-ago quarter and 44 days last quarter

Deferred Revenue

- Deferred revenue grew to a record \$2.71B, up 23% y-over-y
 - With strong bookings, deferred revenue was in line with our expectations
- Given Q3 FY2018 ended on August 31, deferred revenue was impacted by having one less billing cycle for many enterprise customers when compared to Q2 FY2018 and Q3 FY2017

Cash Flow

- Our ending cash and short-term investment position exiting Q3 was \$4.94B
- The q-over-q decline in our cash position was due to the Magento acquisition
- Cash flow from operations was \$955mm in the quarter

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- And in Q3, we repurchased approximately 2.9mm shares at a cost of \$714mm
- We currently have \$150mm remaining of our \$2.5B authority granted in January 2017
 - We expect this authorization to be exhausted by the end of FY2018
- On May 21, we announced that our board has authorized an incremental \$8B stock repurchase program through FY2021, which will be funded from future cash flow generation

Q4 FY2018 Financial Outlook

Now, I will provide our financial outlook

In Q4 FY2018, we expect normal seasonal year-end strength in our business and are targeting:

- Revenue of approximately \$2.420B
- Digital Media segment y-over-y revenue growth of approximately 22%
- Digital Experience segment y-over-y revenue growth of approximately 20%
- Tax rate of approximately 6% on a GAAP basis and 5% on a non-GAAP basis
- Share count of approximately 495mm shares
- GAAP EPS of approximately \$1.42
- Non-GAAP EPS of approximately \$1.87
- And net new Digital Media ARR of approximately \$385mm

Our Q4 FY2017 Digital Media segment included a material amount of Acrobat perpetual licensing revenue

As we continue to migrate the business to subscriptions, we do not expect material Acrobat perpetual licensing this Q4

- This is factored into our Digital Media y-over-y revenue growth target

Given the lower than expected write-down of Magento deferred revenue that we discussed earlier, we expect some slight upside to our original target of \$30mm of Magento revenue in Q4

We look forward to a strong Q4 close and another record year for Adobe

Mike Saviage

Upcoming Conferences

Adobe MAX returns to Los Angeles and is quickly approaching

Day one of our user conference is Monday, October 15

- And we will host a financial analyst meeting that afternoon

At the meeting, our executive team will discuss Adobe's vision, strategy and opportunities to continue to drive sustained revenue growth

Invitations to MAX and our financial analyst meeting with registration information were sent out in early July

If you wish to attend MAX and our financial analyst meeting, please send an email to ir@adobe.com

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- More details about MAX and our exciting lineup of speakers and educational sessions are available at max.adobe.com

If you wish to listen to a playback of today's conference call, a Web-based archive of the call will be available on our IR site later today

- Alternatively, you can listen to a phone replay by calling 855-859-2056
- Use conference ID number 1136856
- International callers should dial 404-537-3406

The phone playback service will be available beginning at 5:00 PM Pacific Time today and ending at 8:00 PM Pacific Time on September 19, 2018

Shantanu Narayen

Closing Comments

I think Q3 reflected another quarter from our perspective of both strong execution and validation that the strategy of empowering people to create and helping businesses transform is working

When you look at Q4 targets, I think it reflects the momentum that we continue to drive across all geographies and all offerings

- And we're really excited about sharing more at MAX about how we intend to continue to expand addressable markets and the strategic initiatives that we will focus on as a company to drive sustained growth on both the top and bottomline and deliver more value to our customers

QUESTION AND ANSWER SECTION

<Q - Jennifer Swanson Lowe>: I wanted to ask about, coming into this quarter, there were some concern that GDPR could have an impact on Q3 Digital Media ARR. Obviously, the results speak for themselves that there wasn't as much of an impact there as maybe was contemplated initially. But if I put that in the context of Q4 ARR guidance and given sort of Adobe's long history of conservatism, the seasonality there is maybe even a little better than I would've expected going into Q4 relative to what you did last year. So, can you talk a little bit about there was no impact from GDPR or was just less than maybe you thought it could be? And does that sort of set up a more positive dynamic headed into Q4 around ARR?

<A - Shantanu Narayen>: Sure, Jennifer. I mean, there are a couple of questions in there. First, some color on GDPR. As we know, requirements and regulations for all businesses that are transacting online continue to evolve. But from our perspective and looking at Q3, we don't think it'll fundamentally change the relentless move that all businesses have to do more online, which is driven by customer preference. We did transition our own adobe.com sites to meet these requirements, and we'll continue to tweak and evolve our technology to lead the market, and as you pointed out, our results show that we achieved strong results in Q3.

When we look at the transition between Q3 and Q4, I think it's important to remember a couple of things. The first is Q3 tends to be seasonally weak, and so, Q4 is our seasonally strong quarter. Education comes back and education will show its strength in Q4. I think with MAX coming up and all of the innovation that we continue to show with respect to MAX, which will be exciting, I hope you're attending, is also going to be in Q4.

So, Q3 ARR was strong. The business continues to have momentum. I think John spoke in his prepared remarks also as to strength that we saw across offerings. I'll highlight mobile. Mobile, we continue to drive a lot of new customer acquisition through units. Single app of Acrobat and the photography continue to do well. So, we continue to innovate

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in creativity and there's strong demand there, Jennifer.

<Q - Jennifer Swanson Lowe>: Okay. Great. And maybe just one last one for me, the pricing increase in the U.S. was obviously sort of a big topic amongst investors. Is there any notable benefit to ARPU as a result of that or does it just sort of become rounding error given the size of the business?

<A - Shantanu Narayen>: Well, I think our primary focus, again, putting it in big picture, continues to be attracting new customers and delivering value. Certainly, the new pricing that we introduced was accretive to us, but we continue to attract new customers. And they are seeing the benefit, as you point out again, with all of the innovation that we delivered, Lightroom, XD, Character Animator, Spark and Dimension, it was clearly the right time to introduce new pricing. And we have also quite a bit of experience with that as currency has fluctuated in other countries.

The one other thing I might mention here is I know there have been some questions to Mike about promotions and how we look at promotions as well. And from our point of view, they continue to be compelling events to drive a call to action. And then, we see a double benefit because not only do we attract new customers to the platform, but with strong retention rates that, at renewal time, leads to a further increase in ARR, which, again, when you think about Q4, given annual cycles, that's another thing that factors into our guidance for Q4. So all in all, we think business is good.

<Q - Brent Thill>: Shantanu, you've seen a steady reacceleration in Experience Cloud, and I'm curious if you could just talk to what you're seeing there. And I think, tying into that, just coming off of \$1.8B acquisition, there's obviously some chatter about you looking to be more acquisitive. Just given the reacceleration in Experience Cloud, maybe just talk through your appetite for larger transactions. I realized you have [ph] maybe (26:44) dollar buyback also on your plate.

<A - Shantanu Narayen>: I think, big picture, the whole digital transformation agenda, Brent, continues to be front and center to every C-level executive. We had strong bookings. I think we talked about that a couple of times both in my prepared remarks as well as in John's. And I think the strength of our product portfolio, which continues to be differentiated. Magento was off to good start. I mean, the fact that they have both B2B and B2C, I think, continues to help. We saw some good deployments of Adobe Experience Manager. So big picture, we, again, are continuing to see a lot of demand for our solutions. We had some great events that we had all around the world. We normally do Japan and Sydney and Singapore during the quarter. And so, I think it's digital transformation and customer centricity and loyalty that's driving the Digital Experience business. As you know, we will never comment on a market rumor.

<Q - Ross MacMillan>: I actually – Shantanu, I wanted to ask a little bit around the announcement you – that's coming up on the Adobe Document Cloud. And I wondered if there's any sort of where you could maybe give us a little preview of that here or at least directionally talk about what the intent is there.

And then, related to that, John, the comments around the Acrobat perpetual license being not material, couple that with the deceleration in Digital Media revenue in Q4 relative to the strength in net new ARR, my math, I was trying to back into it, would suggest a little bit below \$100mm of perpetual win last year and maybe most of that's going to go away. And I wondered if you could just maybe comment on whether that's directionally right. Thanks.

<A - Shantanu Narayen>: Ross, to answer your first question, we continue to see a lot of demand in people are really both automating in efficient paper-based processes, as well as using mobile devices to deal with PDF. I think we mentioned that over 50B PDFs are being opened in our documents alone. And so, I think, as we think about the document business, in particular, among the customer pieces of feedback that we're getting, the first one, clearly, is that they want access to that PDF across all devices. They continue to want to have mobile devices being a PDF creation device. So, we talked a little bit about scanning and storage, therefore, so that people can actually have access to their content across devices.

The other area, I would say, that a lot of people are looking at is certainly collaboration and what we can do with respect to collaboration and allowing different people to participate in a document workflow. And certainly, signing and the interest in signing, whether that's ad hoc completely using the Acrobat product and desktop readers or complete workflows where signing is an ingredient within the enterprises. Hopefully, that gives you a flavor for how we are thinking about how we will continue to innovate in Document Cloud.

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And the one other thing I'd mention is deeper focus on partnerships and what we are doing to ensure that PDF is embedded within other ecosystems. We certainly introduced recently support for both Sign in SharePoint as well as in Outlook. So that, hopefully, gives you a flavor of where we are focused with the document business.

<A - John Francis Murphy>: And Ross, just in regards to your comment on the perpetual revenue with Acrobat, really what we're trying to explain is that in Q4 FY2017, we actually had large perpetual revenue in that quarter and we still sell both perpetual and subscription, and what we're expecting this quarter is not quite as large perpetual revenue this quarter because we see continued momentum as customers are migrating to subscriptions. So, for us, it's really kind of following our strategy for the business and we're excited about it.

<Q - Jay Vleeschhouwer>: Two things for Shantanu. At Summit six month ago, you talked about the strategic objectives or road map for Experience Cloud and you said that what you want to do is deliver unified experience, streamlined integration of Experience Cloud. I wish I assume you were referring to both content and data and the multiple solutions. And then, also deliver what you called domain specific expertise via AI. And when you look back over the last 6 months, and more importantly, perhaps, over the next 12 months, could you talk about some of the key things that you achieved, particularly in the area of integration, which had been a bit of an issue within the portfolio a while back, and maybe talk about that, vis-à-vis, the Experience Cloud road map?

And at MAX last year, in the context of talking about your various new products within CC, you made a very interesting comment that XD could be the next InDesign. In other words, it would be your next big wholly new product. And as such, when do you think XD might become your next nine-figure business, particularly when you think about the fact that you have no incumbent to go up against as you did with InD?

<A - Shantanu Narayen>: So Jay, let me take both of those questions. First, with respect to what we are doing on the Experience Cloud, an area of innovation that we're particularly excited about is enabling for all enterprises to have a unified customer profile where we are getting all of the behavioral demographic data for customers across all of our different solutions. It's something that customers are already testing out in beta. And if you think about that, what it really means for us is this unified customer profile can become the central nervous system in an enterprise, not just therefore targeting the CMOs but increasingly having the CIOs look at that as the basis for how they want to integrate a unified customer experience across all of the different enterprise solutions that might exist.

And so, that, also, then allows us to your second question about the domain specific AI. With Adobe Sensei, we have the ability for people not only to have our AI be applied to their dataset, but for also their own AI, and their data science continues to be leveraged using the datasets that they have. So both of those, we started to deliver them.

When I look at the results of the bookings in Q3, the multi-product implementation and sales continues to be strong. So, it's clearly an effective tool for us to go in and have more of the entire CMO deck be served by Adobe. So both of those, we continue to do it. I'm sure Brad will give an update at MAX as well in terms of how we see that. And so, we look forward to that.

And with respect to your question on MAX, certainly, XD and screen design has been an area of fairly deep investment for us. It's the only cross platform solution, I think, we talk about not just helping design mobile applications but every screen. I mean, you have all of this content that's been delivered to screens across retail, across even fast food, and our products, all the way from content creation to content management and delivery is powering that. Collaboration is another area for XD. And it's harder than it was in the InDesign as a result of more and more people using the Creative Cloud entire suite to look at just an individual product, but both from an individual product, monthly average usage of XD, as well as the adoption in Creative Cloud all apps. We continue to be pleased with how XD is doing. And that just serves as additional value to all of our Creative customers.

<Q - Walter H. Pritchard>: Question for you, Shantanu, on the Experience side from a product perspective. I'm wondering if you feel like sort of going down market where you have a lot of competition in that space. Do you feel like your product is adequately positioned there? And if not, what else do you need to get that whole Experience suite down market into more of the mid-market?

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<A - Shantanu Narayen>: Yeah, I think, Walter, we were looking for a nice beachhead to start to think about how we could leverage the strength that we had in the enterprise down into whether that's departments, mid-market, commercial, sort of if there's another way in which people look at it, and that has been an area where we have seen some good adoption. And so, our job was to continue to leverage Magento within the enterprise and to leverage Magento's base and their ecosystem of developers by allowing them. And I would say both the Adobe Experience Manager and Adobe Analytics are products that can be used in that particular category to create websites as well as to have analytics in there. So, it will continue to be an area.

I think you're also seeing this product now being used within B2B installations as they all want to create a direct relationship with customers. So, you have a lot of these companies that have billions of customers but don't have direct access to those folks because they go through a distribution channel. So hopefully, that gives you some indication of how we are continuing to expand the customer set that we target with Experience Cloud.

<Q - Brad Alan Zelnick>: Shantanu, continuing on the Digital Experience theme, can you talk a bit about your relationship with Microsoft in Digital Experience? And is there any way to size or scope these types of deals or think about the number of products included? And are you seeing accelerating adoption now that you've been in market for some time?

<A - Shantanu Narayen>: The first answer, Brad, is we're definitely seeing accelerated adoption as a result of our products having been delivered on Azure. And I think, going back to what I talked about with respect to the customer profile, what we are seeing are people are standardizing on Azure increasingly as an infrastructure for their cloud-based solutions and we are a really great solution on top of that in order to be able to bring this unified customer profile that exists. And so, the success is leading to larger deals. It's leading to higher close rates. And frankly, I think more and more of both the Microsoft field force as well as the Adobe one are now looking at it and saying, this is something that's resonating with customers. And so, it is accelerating.

<Q - Saket Kalia>: Shantanu, perhaps, a more strategic question for you on Magento, understanding that it's still relatively early, I guess, as you look at other commerce clouds out there, how could you differentiate Magento, either technically or perhaps from a pricing packaging perspective, over time?

<A - Shantanu Narayen>: Yeah, Saket, I mean, a couple of things. The first is I would not underestimate the importance of commerce being tied into content management systems and analytics because while commerce is closing the loop, the real activity is happening when you're doing A/B testing or where you're delivering content. And from my point of view, what was really attractive about Magento, in addition to this really closing the loop and making every experience shoppable, is the fact that they were the only player who had both B2B, as well as B2C, as well as digital goods and physical goods.

And the other thing that I think they brought to bear, which is really paying off, is this ecosystem. What's happened in the commerce market, if you think about it, is that there are so many separate customization efforts. Having this large ecosystem of over 300,000 developers leads to both more rapid time to value for the enterprise customers. And honestly, they actually serve, in many ways, as a channel because they are helping with the ability to quickly install Magento as a way to bring us into more deals. And so, that was the strategic rationale. I mean, it was a clear – as you know, we had integrations with a whole bunch of different vendors, but the customers really wanted a solution end to end from Adobe and we're pleased that we're able to deliver it, and it's off to a good start.

<Q - Alex J. Zukin>: So just maybe a strategic one on mid-market and B2B, you've mentioned it a couple of times now. So I guess my question is basically, if I think about from a go-to-market perspective, how are you thinking about attacking the mid-market opportunity? And is the Microsoft partnership something that could evolve to be helpful there? And then, what about the B2B market, in addition to Magento, makes that uniquely interesting for Adobe at this point in time?

<A - Shantanu Narayen>: Yeah. I mean, first, to your question, Alex, partners certainly play a huge role in terms of the amplification of how effectively we can get in and meet all of those customers in the mid-market. But we also have and we've always had ability through inside sales as well as the ability through partners to target them. So, that isn't

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rocket science. We certainly have the ability to do that. And with Magento, we have the product as well that serves them well.

And then, as we think about B2B, what's really happening – I mean, think of yourself as a consumer goods company. You may be a consumer goods company where you have 1B people use your product every day, but you don't have the ability to have those customers in your profile because you're going through a distribution channel. They're increasingly understanding that they have to create that direct relationship with customers. And so, it's going to be a big part of the expansion of how we look at our business because they're all looking at Adobe to help them do what we frankly did in many ways, which was have a direct relationship with our customers. So, B2B2C is already a major trend that's happening and we're a key part of digitally enabling that.

<Q - Alex J. Zukin>: Got it. And maybe just one follow-up, if you think about Experience Cloud growth, and if we back out Magento from the quarter and your guide to kind of core market – core Experience Cloud revenue growth is in the mid-teens, is that what you consider healthy and what we should expect going forward? Do you see that accelerating over time? What's the right way to think about it?

<A - Shantanu Narayen>: Yeah, I think when you look at Experience Cloud, I think it's important to remember what we said at the beginning of the year as we are focused a lot more on subscription bookings and subscription revenue growth and to really understand that from our point of view when you look at Q1, Q2, Q3 and the targets for Q4, it's actually ahead of what we had said. And so, we think we have a great offering. We're the leader in that market and continuing to focus on the massive addressable opportunity is what we are doing. But clearly, 2018, we were going through that, as well as as we talked about having the partner ecosystem take on more of the services part of it. And you can – you probably see that as well if you look at financial data sheets that we provided.

<Q - Kash Rangan>: Yeah. I'm just an employee of BofA, not part of management, to be very clear about that. Shantanu, a question for you. You talked about conversion rates from free products to paid subscribers for Creative in a way that I've not heard before. Can you just expand on that in the context of your previous observations that the TAM for the Creative Cloud product in this cycle is a multiple of the TAM that existed in the days by gone? So, how is this all working out conceptually? Do you still continue to believe that to be the case? It does look like the front end of the funnel is expanding at a rate greater than we all anticipated. I know it's more of a question/observation but just really want to draw you out on your thoughts on why this Creative cycle is a much bigger cycle and why is it taking much longer in this cycle than what we all expected? Thank you.

<A - Shantanu Narayen>: Well, Kash, I think we've always talked about the fact that if you look at the installed base of Creative and the number of creatives that exists, it's a massive number. And when you think about what's happening with the segment like photography or when you think about what's happening with mobile and you think about what's happening with emerging markets and students, those have always been areas of tremendous interest for us, I would say where we have really matured is when you think about the data-driven model that we're using to run that particular business, and Bryan's going to touch in more detail on this at MAX, the fact that we understand what we have to do on the discover, try, buy, use and renew part of that workflow, we have got so much better at understanding how people are discovering us and why trialists is a key part of getting people both aware of our products, using our products, and then, converting. And so, I wouldn't say that that's new. I would say that we're getting better and better at it as we understand how to tailor our offerings.

I think the other thing that we've always talked about is the fact that we now have more offerings enables us to further attract new customers to the platform with the only all apps, we did not have the kind of offerings that we have right now. The fact that we can do it with mobile, we have multiple photography offerings, there's just far more scrutiny and focus on how we attract new customers to the platform, Kash. And I think in the past, we've thrown out that we have over 100mm IDs that have been created by these trialists, and that's how we look at expanding the top of funnel.

<Q - Kash Rangan>: So that's the ultimate TAM, [ph] 100mm (47:27), in an ideal case?

<A - Shantanu Narayen>: Well, I think we talk about it more with respect to the over [ph] 30B (47:33) that exist in Digital Media between what we have as Document Cloud and Creative Cloud. And I know the question that has also

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always come by is piracy and are we affecting piracy. There's no question that we're continuing to impact piracy with the business model and the fact that we're allowing people to trial and then convert more effectively.

<Q - Sterling Auty>: In the prepared remarks, there was a comment about customers increasingly coming direct to adobe.com to transact the business. It's been some time. I'm wondering if you could give us a sense of how much of your business is now being transacted direct through your e-store or through adobe.com. And is there still further margin benefit to be captured moving forward from further increase in that percentage?

<A - Shantanu Narayen>: Yeah, Sterling, I mean, when I look at the Digital Media business, I'd maybe separate a little bit of what's happening in the Creative side of that business with what's happening on the Acrobat side of the business. In the Creative side of the business, and there maybe a few countries that are the exception, but the vast majority of consumers are directly interfacing with us on adobe.com. We certainly have, as you know, an enterprise ETLA. That did really well, as enterprises are adopting more and more services that's increasing the ARPU that exists with enterprises. So, I would say the Creative business is primarily happening through adobe.com, except, again, as I said, in some countries where retailers have strong presence.

On the document side of the business, I think, given a lot of people still buy Acrobat when they buy a new PC, as well as in conjunction with Office, the channel continues to be an important partner for us. And that's why we continue to offer both the subscription now, which is increasingly the preferred way in which people are buying Acrobat DC. But I would say there it's still a fairly large percentage of our business and an important part of how we go to market.

So hopefully, that gives you some color of what it is. But more and more is happening on adobe.com. And as we expand the base and as we renew online and we hopefully upsell them to higher value products, all of those represent both ARR as well as margin improvement opportunities.

<Q - Mark L. Moerdler>: Thank you very much and congratulations on the quarter. I'd like to drill a little more for those who haven't experienced digital marketing. When you look at that overall market, there's a lot of fragmentation within the market. How should we think about the drivers of growth going forward? Is it more market consolidation or market growth? Which do you think is the bigger driver that's going to help drive that business for you?

<A - Shantanu Narayen>: Well, I think you're right in terms of fragmentation. I think the fact that we have a platform is a clear differentiator and allows us to get a disproportionate share. We talk a lot about the number of multi-solution deals and we're going to continue to, I think, do well in that particular respect. Outside the U.S. continues to be a really important market opportunity for us. I think we've said with commerce now as part of the portfolio that we have, that's an over \$60B TAM and that's available for us. But a lot of the small players that existed in different categories, we're clearly getting the request from our customers that across all of these channels, they want one unified way of personalizing the experience. And so, I think the consolidation that's happening in that space, Mark, is as a result of when people are using more and more of our solutions, their ability to address that customers is significantly better than when all these fragmented solutions don't talk to each other. And that's our goal to be the experience platform to enable them to run their business online.

<Q - Heather Bellini>: I just had two quick questions. Obviously, you guys had great performance with Magento this quarter. And I know you mentioned that it closed a little early and you didn't have the amount of the write-down that you were expecting. But when you think about the comments you made about the upside to your guide for Q4, you had guided to \$30mm, how do we think about the magnitude there? Because I would imagine there are some good seasonality in the business and you'll catch the tail end of the start of – I'm sorry, the beginning at the tail end of the quarter of the holiday shopping season.

And then, I also had a question, if we look out to ARR build, obviously, you outperformed very nicely there this quarter as you typically do. And if we look out to the next FY, is there any reason or anything that would cause you – or cause it – cause the change in ARR in the next FY to be below what you're guiding to this year, the net change?

<A - Shantanu Narayen>: I'll take the question on ARR and then maybe John can give you more color on the Magento. I think on the ARR, Heather, at the FA meeting, we'll talk a lot more about it. I think we're focused on a strong close for Q4 and we'll give you more color on the interesting things that are happening at MAX. We continue to

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be excited about the long-term opportunity.

<A - John Francis Murphy>: Heather, in regards to Magento's deferred revenue, when we acquired the company, of course, everyone goes through and evaluates the deferred revenue and whether or not you have [indiscernible] (54:01) how much of a haircut. And so, when we did the announcement, we really didn't have that work [ph] done, so we worked (54:08) through the quarter. We ended up realizing that we ended up with a much smaller haircut than we expected. Much of that haircut was really realized in Q3, so we had a slight upside in Q4.

<Q - Kirk Materne>: Shantanu, can you just talk a little bit about stock this quarter? Actually, you sort of called it out in your prepared remarks being up 30% y-over-y, which is pretty obviously very strong. So, I was just wondering if there's anything specific this quarter you all saw in terms of just better cross-selling, new net sort of demand gen, anything you want to just maybe add in terms of some color around that specific product. Thanks.

<A - Shantanu Narayen>: Kirk, I would just say we continue to execute against the opportunity and we've always maintained that the people who contribute stock and the people who use stock are our customers. And I would say the success was both in the enterprise where we're certainly now having large stock deals that allow them to have access to our entire assets. The fact that the content inventory is improving across a different variety of media types, I think, that continues to play a role. And if you look at our apps, I think one thing we're continuing to do better is the integration of the stock portfolio that we have and the Sensei-based features that we have to find the right asset as a means to accelerate content creation, is also, I think, starting to show benefits. And last but not least, I mean, we do have offerings that have both the creative products as well as stock as part of an offering. We think that's great value and that continues to be something that we are making available to our customers. So I think across the board, we continue to be excited about stock as a service that people will look at as an extension of the Creative Cloud.

<Q - J. Derrick Wood>: I wanted to ask about churn in your Digital Media business. So, I'm curious have you seen any impact on retention rates with – since the price change in U.S.? And then, if you take a longer term view, I think churn has been steady for some time in the mid-teens range. Do you see anything you can do to improve that or is that just kind of the natural state of the market going forward?

<A - Shantanu Narayen>: I think with respect to churn and retention, which continues to be a huge area of focus for us, I think the way we continue to be focused on it, it continues to do well, so that we haven't seen really any change in the aggregate as it relates to churn. But the thing that we will continue to do is the more offerings you have and the more those offerings can be tailored allows us to actually target and retain more of the customer base. So, I think that is one of the things with mobile. We're able to do that. And we continue to be really focused.

I mean, in that sense, I just look at it and say when there's a long tail of creators, the deeper our offering is, whether it's Spark Premium at one end of the spectrum or the ability to do one PDF conversion all the way to the entire Creative suite or Creative suite plus Acrobat app, that's the way in which you can continue to make sure that you're delivering value to a broader and broader swath of customers.

And outside the U.S., the ability to have differential pricing and look at that differential pricing also is another way that we will continue to focus on retention on sales and continuing to have people have value. And so, I think that's the way we look at it.

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