MIKE SAVIAGE

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 second quarter fiscal year 2018 financial results. By now, you should have a copy of our earnings press release which crossed the wire approximately one hour ago. We've also posted PDFs of our earnings call prepared remarks and slides, financial targets and an updated investor datasheet on Adobe.com. If you would like a copy of these documents, you can go to Adobe's Investor Relations page and find them listed under Quick Links.
Financial Disclaimer

Some of the information discussed in this presentation, particularly our revenue and operating model targets, and our forward-looking product plans, is based on information as of today, June 14th, 2018, and contains forward-looking statements that involve risk and uncertainty. Actual results may differ materially from those set forth in such statements.

For a discussion of these risks and uncertainties, you should review the Forward-Looking Statements Disclosure in our press release issued today, and Adobe's SEC filings, including our annual report on Form 10-K for fiscal 2017, and our quarterly reports filed on Form 10-Q in fiscal 2018.

During this presentation, we will discuss non-GAAP financial measures. The GAAP financial measures that correspond to non-GAAP financial measures, as well as the reconciliation between the two, are available on our Website.

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, June 14th, 2018, and contains forward-looking statements that involve risk and uncertainty. Actual results may differ materially from those set forth in such statements. For a discussion of these risks and uncertainties, you should review the Forward-Looking Statements Disclosure in the earnings press release we issued today, as well as Adobe's SEC filings.

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

Call participants are advised that the audio of this conference call is being webcast live in Adobe Connect, and is also being recorded for playback purposes. An archive of the webcast will be made available on Adobe's Investor Relations website for approximately 45 days, and is the property of Adobe. The call audio and the webcast archive may not be re-recorded, or otherwise reproduced or distributed without prior written permission from Adobe.

I will now turn the call over to Shantanu.
Thanks, Mike and good afternoon.

Adobe delivered record revenue in our second quarter with strong financial results. Q2 revenue was $2.20 billion dollars, which represents 24% year-over-year growth. GAAP earnings per share for the quarter was $1.33, and non-GAAP earnings per share was $1.66.

Adobe enables individuals, companies, governments and educational institutions to design and deliver transformative digital experiences – immersive, intelligent experiences that inspire, entertain, and drive loyalty and growth. The breadth of our product portfolio, the deep science embedded in our Adobe Cloud platform, the insights derived from the trillions of data transactions we process every year on behalf of our customers, and our global ecosystem of partners and developers have made Adobe the leader in enabling great customer experiences.
In our Digital Media business, we achieved strong growth in both Creative and Document Cloud revenue in Q2. We added net new Digital Media Annualized Recurring Revenue, or “ARR” of $343 million, which grew total Digital Media ARR exiting Q2 to $6.06 billion.

We continue to drive steady adoption of Creative Cloud subscriptions and services by individuals, teams and enterprises across all segments and geographies. This resulted in another strong quarter for Creative Cloud, with Creative revenue growing to $1.3 billion.

At Adobe, we believe everyone has a story to tell. Our strategy to empower more of the world’s storytellers to express themselves depends on our ability to make our tools more accessible, enjoyable and invaluable to a broader set of creative customers – from creative pros, to hobbyists, to young creatives.

Experience Design is one of the fastest growing creative segments and we recently introduced a new starter plan for Adobe XD, our all-in-one UX/UI design platform. Adobe XD is the most modern, cloud-based solution available for designing, prototyping and collaborating with colleagues across multiple platforms. We recently announced several new integrations between XD and designers’ existing workflows inside of tools such as Photoshop and Illustrator. We launched a $10 million design investment fund to support designers and developers who innovate and push the boundaries of Experience Design.
Enabling creativity in the Education segment remains a passion for Adobe. Adobe Spark Premium, our application for everyday communicators to transform their ideas into beautiful visual stories, is now available to every student globally. We've achieved strong adoption of Spark in school districts across the nation. To further bolster our commitment to K-12 students, we introduced a new offering that gives students more affordable access to applications including Photoshop, Illustrator, Premiere Pro, and XD. These actions are part of our commitment to partner with educators, promote STEAM, and ensure art and creativity remain an essential part of education and professional development.

Adobe's video editing and production tools – including Adobe Premiere Pro and After Effects – are the gold standard for creating films and video from the silver screen to the mobile screen. At NAB, Adobe unveiled innovative updates to Creative Cloud's digital video tools. In addition, partners including Canon, RED Cameras, AMD, and Sony announced tools and updates that allow users to work in an integrated, collaborative production environment.

Our mission is to push the limits of creativity and storytelling while supporting exciting new mediums. We provided a sneak peek of Project Aero, a powerful new augmented reality, or "AR" authoring tool at Apple's WWDC last week. Project Aero is a system that makes it easier for designers and developers to create immersive content and bridge the gap between the physical and digital worlds. With close to one billion AR-enabled devices expected to be in market next year, AR can drive a new wave of digital transformation and creativity.

In addition to the world's best desktop and mobile tools, Creative Cloud services are driving growth in our business while offering new ways to inspire our customers and accelerate their creative process. Adobe Stock achieved record revenue in the quarter, with greater than 25% year-over-year growth. Adobe Stock now has a library of more than 100 million images, videos and creative assets including new curated HD and 4K videos, as well as Motion Graphics templates.
Adobe Document Cloud is the world’s leading digital document service, enabling individuals and businesses to digitize inefficient paper-based processes. In Q2 we achieved record revenue for Document Cloud of $243 million. Document Cloud subscriptions and Acrobat perpetual licensing drove 22% year-over-year revenue growth, and $47 million in net new Document Cloud ARR.

This week marks the 25th anniversary of Acrobat and PDF – the innovation that ushered in the era of digital documents. Twenty-five years later, the pace at which we’re innovating with Document Cloud has only accelerated as digital documents become more collaborative and mobile. More than 800 million PDFs are opened in Adobe Acrobat Reader on mobile devices each month. Adobe Scan, our mobile PDF creation app powered by Adobe Sensei that turns your phone or tablet into a scanning and text recognition tool, has been downloaded more than 10 million times.

Adobe Sign, our digital signature solution for Document Cloud, continues to have strong momentum. Today, over half of Fortune 100 companies use Adobe Sign. Last September we teamed up with Microsoft to integrate Adobe Sign into Microsoft Office 365. Next week we’ll be unveiling industry-first innovations in Adobe Sign focused on delivering superior digital document experiences to millions of customers.
Adobe Experience Cloud is the most comprehensive, integrated, and actionable set of solutions in the market, designed to help companies deliver consistent, continuous and compelling experiences across every touch point and channel. In Q2 we achieved Experience Cloud revenue of $586 million, and strong bookings across Adobe Marketing Cloud, Adobe Analytics Cloud and Adobe Advertising Cloud. Key customer deals in the quarter included Audible, Intuit, Shell, H&R Block, Japan Airlines, PNC Bank and Samsung.

In May we announced our intent to acquire Magento, a leading commerce platform. Commerce is an integral part of an end-to-end customer experience as consumers and businesses now expect every interaction to be shoppable. The addition of Magento Commerce will enable commerce to be seamlessly integrated into Adobe Experience Cloud, delivering a single platform that serves both B2B and B2C customers globally while providing the flexibility to scale to serve mid-market and large enterprise customers. The Magento Platform is supported by a robust community of more than 300,000 developers and a partner ecosystem that provides thousands of pre-built extensions, including payment, shipping, tax and logistics.

The acquisition of Magento will make Adobe the only company with leadership in content creation, marketing, advertising, analytics and now commerce – enabling real-time personalized experiences across the entire customer journey – whether on the web, mobile, social, in-product or in-store. We believe the addition of Magento expands our available market opportunity, builds out our product portfolio, and addresses a key underserved customer need.
When combined with our world-class content and data platform, and leveraging our Sensei machine learning and AI framework, this latest capability will further differentiate Adobe Experience Cloud as the leading platform for Experience Businesses. We expect the acquisition to close next week.

We continue to host successful customer Summits across the globe where we roll out new innovations across Adobe Experience Cloud, including major enhancements to the Adobe Cloud Platform. Recent advancements include a new Unified Customer Profile that combines data across an enterprise, intelligent services, and General Data Protection Regulation, or “GDPR” readiness – all aimed at solving key challenges facing marketers, data scientists and developers.

Adobe was once again recognized for our leadership in technology segments that help to deliver and orchestrate experiences across the entire customer journey. We were named a Leader in the Forrester Wave: Digital Asset Management for Customer Experience, achieving the highest score for “current offering” of the vendor leaders. Adobe was positioned as a Leader in the Gartner Magic Quadrant for Multichannel Marketing Hubs. In this inaugural report, Adobe had the strongest ranking for “completeness of vision” among the 21 vendors evaluated.
Adobe Sensei, our artificial intelligence and machine learning framework forms the foundation of the innovative “Adobe Magic” across Creative Cloud, Document Cloud and Experience Cloud. We were pleased to be recognized again as one of the World’s Most Innovative Companies by Forbes for 2018. The talent and passion of our more than 18,000 employees worldwide continues to be the catalyst for Adobe’s success. We take pride in making Adobe one of the world’s best workplaces and cultivating a diverse and innovative team of global employees. This summer we’re pleased to welcome over 1000 interns and university graduates to Adobe, the largest such group in company history.

Adobe has the right strategy, partners, products and people in place to win. We look forward to building on the momentum we’re driving across our entire business and expect a strong second half of the year.

John.
Thanks, Shantanu.

In the second quarter of FY18, Adobe's momentum continued with record revenue of $2.20 billion, which represents 24% year-over-year growth. GAAP diluted earnings per share in Q2 was $1.33 and non-GAAP diluted earnings per share was $1.66. We drove strong performance across our product offerings and geographies during the quarter.

Highlights in Q2 included:

- Record Digital Media revenue, including Creative revenue of $1.30 billion and Adobe Document Cloud revenue of $243 million;
- Record Adobe Experience Cloud revenue of $586 million;
- Net new Digital Media ARR of $343 million, and exiting Q2 with $5.37 billion of Creative ARR;
- Deferred revenue growth of 27% year-over-year;
• Cash flow from operations of $976 million;

• Returning $589 million of cash to our stockholders through stock buyback;

• And approximately 89% of our revenue in Q2 was from recurring sources.

In Digital Media, we grew segment revenue by 28% year-over-year. The addition of $343 million net new Digital Media ARR during the quarter grew the total to $6.06 billion exiting Q2.

Within Digital Media, we achieved another record quarter with our Creative business. Creative revenue grew 29% year-over-year in Q2 and we increased Creative ARR by $296 million. Several key factors helped drive this growth, including:

• Strong net new subscriptions across user segments and geographies, helped by robust traffic and conversion on Adobe.com;

• Continued momentum with Creative Cloud adoption in emerging markets;

• Stable or increasing ARPU across key offerings, which continues to be driven by retention of users on promotional prices migrating to standard prices, as well as attachment of services in the enterprise and the recently introduced price increase in North America;

• And strong growth with Adobe Stock.
With Document Cloud, we achieved record revenue of $243 million, which represents 22% year-over-year growth. The performance in Q2 was driven by continued momentum with Acrobat subscription adoption as well as strength in the enterprise with Acrobat and Document Cloud services.

In our Digital Experience segment, we achieved record Adobe Experience Cloud revenue of $586 million, which represents 18% year-over-year revenue growth. Subscription revenue grew 24% year-over-year. Experience Cloud performance in Q2 was driven by success across our Analytics Cloud, Marketing Cloud and Advertising Cloud offerings. Experience Cloud data transactions grew to 97 trillion in the quarter, with 60% of Analytics transactions driven by mobile device usage.
From a quarter-over-quarter currency perspective, FX increased revenue by $15.2 million. We had $0.3 million in hedge gains in Q2 FY18, versus $1 million in hedge gains in Q1 FY18; thus, the net sequential currency increase to revenue considering hedging gains was $14.5 million.

From a year over year currency perspective, FX increased revenue by $51.3 million. We had $0.3 million in hedge gains in Q2 FY18, versus $13.3 million in hedge gains in Q2 FY17; thus, the net year-over-year currency increase to revenue considering hedging gains was $38.3 million.

In Q2, Adobe’s effective tax rate was 4% on a GAAP-basis and 5% on a non-GAAP basis. These rates are below the targets we provided due to a structural change we made during Q2 in how we serve foreign customers based on the new U.S. Tax Act. Our recent international tax structure change will benefit our tax rates for the remainder of FY2018 as well as next year.

Our trade DSO was 44 days, which compares to 46 days in the year-ago quarter, and 47 days last quarter.

Deferred revenue grew to a record $2.63 billion, up 27% year-over-year.

Our ending cash and short-term investment position exiting Q2 was $6.33 billion.
Cash flow from operations was $976 million in the quarter.

In Q2, we repurchased approximately 2.6 million shares at a cost of $589 million. We currently have $900 million remaining of our $2.5 billion authority granted in January 2017. We expect this authorization to be exhausted by the end of this fiscal year. On May 21st we announced that our Board has authorized an incremental $8 billion stock repurchase program through fiscal year 2021, which will be funded from future cash flow generation.

Now I will provide our financial outlook. In January we updated our financial targets to reflect provisions of the new U.S. Tax Act which became law during our fiscal Q1. The Tax Act affords companies like Adobe the ability to make changes to the way we serve our foreign customers with our international corporate structure. During Q2 we made a structural change and the effect of it results in even lower tax rates than we discussed previously for both this year and subsequent fiscal years.

In fiscal 2018, we anticipate an incremental six percentage point reduction in our GAAP and non-GAAP tax rates when compared to the rates we provided in January. We are now expecting a GAAP tax rate of approximately 7% in Q3 and Q4 of fiscal 2018; and a non-GAAP tax rate of approximately 5% in Q3 and Q4 of fiscal 2018.

Our November fiscal year calendar and the timing of certain Tax Act provisions make our FY18 a unique year from a tax rate perspective. We indicated in January that we anticipated our tax rates would stabilize at a new rate of approximately 18% on both a GAAP and a non-GAAP basis in FY19. Based on the structural change we made in Q2, we now estimate our tax rates in FY19 will stabilize at GAAP and non-GAAP rates of approximately 14%.
Turning to Q3 FY18, we are targeting:

- Revenue of approximately 2 billion 240 million dollars;
- Digital Media segment year-over-year revenue growth of approximately 25%;
- Digital Experience segment year-over-year revenue growth of approximately 15%;
- Tax rate of approximately 7% on a GAAP basis, and 5% on a non-GAAP basis;
- Share count of approximately 498 million shares;
- GAAP earnings per share of approximately $1.27;
- Non-GAAP earnings per share of approximately $1.68; and
- Net new Digital Media ARR of approximately $310 million.

Our Q3 targets do not reflect our pending acquisition of Magento Commerce. We have received regulatory clearance and anticipate closing the acquisition next week. For the second half of calendar year 2018, Magento's internal plan projected achieving approximately $100 million in revenue. After the transition to Adobe's November fiscal calendar and the write-down of deferred revenue due to purchase accounting rules, we anticipate Adobe will report approximately $40 million of Magento revenue in the second half of Adobe's fiscal 2018, with approximately $10 million of it in our fiscal Q3. We expect the closing of Magento to be slightly dilutive to our Q3 GAAP earnings per share target. We do not expect the closing to impact our non-GAAP Q3 earnings per share target.

In Q4, we anticipate normal seasonal strength and a strong finish to the year.

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

Thanks, John.

Adobe MAX returns to Los Angeles this fall, and Day One of our user conference is Monday October 15th. We plan to host a financial analyst meeting on the afternoon of the 15th, and an invitation with registration information will be sent out in early July. More details about MAX 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 #4599054. International callers should dial 404-537-3406. The phone playback service will be available beginning at 5pm Pacific Time today, and ending at 5pm Pacific Time on June 20, 2018.

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