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Adobe Inc. (ADBE)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Q3 FY 2024 Adobe Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Jonathan Vaas, VP of Investor Relations. Please go ahead.

Jonathan Vaas

Vice President-Investor Relations, Adobe Inc.

Good afternoon and thank you for joining us. With me on the call today are Shantanu Narayen, Adobe's Chair and CEO; David Wadhvani, President of Digital Media; Anil Chakravarthy, President of Digital Experience; and Dan Durn, Executive Vice President and CFO.

On this call, which is being recorded, we will discuss Adobe's third quarter fiscal year 2024 financial results. You can find our press release, as well as PDFs of our prepared remarks and financial results, on Adobe's Investor Relations website.

The information discussed on this call, including our financial targets and product plans, is as of today, September 12, and contains forward-looking statements that involve risk, uncertainty and assumptions. Actual results may differ materially from those set forth in these statements. For more information on those risks, please review today's earnings release and Adobe's SEC filings.

On this call, we will discuss GAAP and non-GAAP financial measures. Our reported results include GAAP growth rates as well as constant currency growth rates. During this presentation, Adobe's executives will refer to constant currency growth rates unless otherwise stated. Non-GAAP reconciliations are available in our earnings release and on Adobe's Investor Relations website.

I will now turn the call over to Shantanu.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

Thanks, Jonathan. Good afternoon and thank you for joining us. Adobe had an outstanding third quarter. We saw strength across Creative Cloud, Document Cloud and Experience Cloud, achieving revenue of \$5.41 billion, representing 11% year-over-year growth. GAAP earnings per share for the quarter was \$3.76 and non-GAAP earnings per share was \$4.65, representing 23% and 14% year-over-year growth, respectively.

Our success reflects our strong execution against an ambitious innovation agenda to deliver value to our customers. The product advances we've launched in the past 18 months are delighting a huge and growing universe of users and enterprises, empowering them to unleash their creativity, accelerate document productivity and power their digital businesses.

Our vision revolves around Adobe's deep technology platforms across Creative Cloud, Document Cloud and Experience Cloud, which, when integrated, provide significant differentiation and value. We are amplifying creativity and productivity by enabling the convergence of products like Photoshop, Express, and Acrobat as knowledge workers and creatives seek to make content more compelling and engaging.

We are bringing together content creation and production, workflow and collaboration, and campaign activation and insights across Creative Cloud, Express and Experience Cloud. New offerings include Adobe GenStudio and Firefly Services empower companies to address personalized content creation at scale with agility and enable them to address their content supply chain challenges.

Adobe's customer-centric approach to AI is highly differentiated across data, models and interfaces. We train our Firefly models on data that allows us to offer customers a solution designed to be commercially safe. We have now have released Firefly models for Imaging, Vector and Design and just previewed a new Firefly Video model. Our greatest differentiation comes at the interface layer with our ability to rapidly integrate AI across our industry-leading product portfolio, making it easy for customers of all sizes to adopt and realize value from AI.

Firefly-powered features in Adobe Photoshop, Illustrator, Lightroom and Premiere Pro help creators expand upon their natural creativity and accelerate productivity. Adobe Express is a quick and easy create-everything application, unlocking creative expression for millions of users. Acrobat AI Assistant helps extract greater value from PDF documents. Adobe Experience Platform AI Assistant empowers brands to automate workflows and generate new audiences and journeys. Adobe GenStudio brings together content and data, integrating high-velocity creative expression with the enterprise activation needed to deliver personalization at scale. Overall, we're delighted to see customer excitement and adoption for our AI solutions continue to grow and we have now surpassed 12 billion Firefly-powered generations across Adobe tools.

I'll now turn it over to David to discuss the momentum in our Digital Media business.

David Wadhvani

President-Digital Media Business, Adobe Inc.

Thanks, Shantanu. Hello, everyone. In Q3, we achieved net new Digital Media ARR of \$504 million and revenue of \$4 billion, which grew 12% year-over-year, fueled by innovation in both our Creative and Document businesses. With Document Cloud, we continue to reinvent how people create, edit, share, review and sign digital documents with PDF and Acrobat across mobile, web and desktop.

For decades, PDF has been the de facto standard for storing unstructured data, resulting in the creation and sharing of trillions of PDFs. The introduction of AI Assistant across Adobe Acrobat and Reader has transformed the way people interact with and extract value from these documents. In Q3, we released significant advancements, including the ability to have conversations across multiple documents and support for different document formats, saving users valuable time and providing important insights. We are thrilled to see this value translate into AI Assistant usage, with over 70% quarter-over-quarter growth in AI interactions.

In addition to consumption, we're focused on leveraging generative AI to expand content creation in Adobe Acrobat. We've integrated Adobe Firefly image generation into our Edit PDF workflows. We've optimized AI Assistant in Acrobat to generate content fit for presentations, emails and other forms of communication, and we're laying the groundwork for richer content creation, including the generation of Adobe Express projects.

The application of this technology across verticals and industries is virtually limitless. Tata Consultancy Services recently used Adobe Premiere Pro to transcribe hours of conference videos and then used AI Assistant in Acrobat to create digestible event summaries in minutes. This allowed them to distribute newsletters on session content to attendees in real-time.

We're excited to leverage generative AI to add value to content creation and consumption in Acrobat and Reader in the months ahead. Given the early adoption of AI Assistant, we intend to actively promote subscription plans that include generative AI capabilities over legacy perpetual plans that do not.

In Q3, we achieved Document Cloud revenue of \$807 million, growing 18% year-over-year. We added \$163 million of net new Document Cloud ARR. Other highlights include: expanded Acrobat customer value with multi-document support for AI Assistant, enhanced meeting transcript capabilities and support for larger documents; optimized AI Assistant for mobile, web and desktop experiences, including voice-enabled conversations on Android; continued strength of PDF-based collaboration, with shared links growing greater than 70% year-over-year; increased top of funnel through Acrobat Web, with monthly active users growing over 35% year-over-year as a result of link sharing and our Microsoft Edge and Google Chrome extensions; key enterprise customer wins include Amazon, Charles Schwab, Disney, Home Depot, KPMG, RedBull, Sutter Health, and the U.S. Treasury Department.

With Creative Cloud, the demand for creative expression and design across media types and surfaces has never been greater. Consumers are sharing edited photos more than ever. Students need to create school presentations that stand out. Creative professionals are being asked to create more images, designs and videos faster than ever before. Small businesses are looking to engage prospects on social channels and large enterprises are defining their content supply workflows to deliver personalization at scale.

AI has the potential to empower creative professionals, communicators, consumers and organizations of all sizes to be more creative and productive. Our strategy is to build technology that will create more streamlined and precise workflows within our tools, through features like Text-to-Template in Express, Generative Fill in Photoshop, Generative Recolor in Illustrator, Generative Remove in Lightroom and the upcoming Generative

Extend for video in Premiere Pro. We're exposing the power of our creative tools and the magic of generative AI through Firefly Service APIs so organizations can generate and assemble content at scale.

As we integrate Firefly innovations throughout our tools, usage continues to accelerate, crossing 12 billion generations since launch. The introduction of the new Firefly Video model earlier this week at IBC is another important milestone in our journey. Our video model, like the other models in the Firefly family, is built to be commercially safe, with fine-grained control and application integration at its core. This will empower editors to realize their creative vision more productively in our video products, including Premiere Pro.

With Express, we're on a multi-year strategic journey to dramatically expand our reach across customer segments. Adobe Express is our AI-first content creation application fulfilling our mission to enable creativity for all. The all-new release of Express across web and mobile earlier this year has been embraced by millions of users.

They love how easy it is to create anything in Express with strong enthusiasm for our image editing features, powered by Photoshop, video editing capabilities, powered by Premiere Pro, document and presentation workflows, powered by Acrobat, and unparalleled generative AI features, powered by Adobe Firefly. Our integration of Adobe Stock and design templates with our unique Firefly Design Model ensures that content created in Express can stand out.

Express empowers a broad array of individuals and businesses, from solopreneurs to the largest enterprises in the world. We're continuing to grow Express as we ramp our go-to-market activities to support recent product releases, including Express for individuals, Express for Education, Express for Teams and Express for Enterprises. As a result, in Q3, we drove 70% year-over-year growth in cumulative exports. We onboarded over 1,500 businesses and millions of students. In Q3, we achieved \$3.19 billion in revenue, which grew 11% year-over-year in constant currency. Net new Creative Cloud ARR was \$341 million.

Other highlights include: new AI-powered features in Photoshop that accelerate core creative workflows and streamline repetitive tasks. Generative Fill in Photoshop was upgraded to Firefly Image 3, Generative Image was made generally available, and the new Selection Brush and Adjustment Brush Tools were introduced, making selective edits easier than ever; broad innovations in Illustrator, including significant improvements to vector generation, enhancements to text-to-pattern and the all-new Generative Shape Fill. These advances unlock new ways for pro designers and illustrators to quickly bring their vision to life.

Strong adoption of the latest version of Lightroom and Lightroom Mobile, which now includes the new Generative Remove feature. Millions of users have non-destructively removed unwanted objects from their photos with a single click. Strong demand for Firefly Services, which provide APIs, tools and services for content generation, editing and assembly, empowering organizations to automate content production while maintaining quality and control. Total API calls tripled quarter-over-quarter.

Acrobat Pro single app continues to be a growth driver in Creative Cloud, reflecting the increasing adoption of PDF as a preferred format to create, collaborate and share visually compelling content. Key enterprise customer wins include The Brandtech Group, Dentsu, Estée Lauder, Google, MediaMonks, Meta, MLB, Newell Brands, PepsiCo, Stagwell Group and the US Navy.

We look forward to hosting Adobe MAX, the world's largest creativity conference, next month in Miami, where we will welcome more than 10,000 members of our global community and engage with hundreds of thousands more online. We will hear from inspiring creators and unveil innovations across our clouds. In summary, we are excited

about the pace and caliber of innovations across our Digital Media products and the continued execution across multiple growth drivers.

I'll now pass it to Anil.

Anil Chakravarthy

President-Digital Experience Business, Adobe Inc.

Thanks, David. Hello, everyone. In Q3, we achieved Experience Cloud revenue of \$1.35 billion. Subscription revenue was \$1.23 billion, representing 12% year-over-year growth. Customer Experience Management remains top of mind for B2C and B2B companies around the world as they focus on digital strategies for customer acquisition, engagement, retention and expansion.

Enterprises want an integrated platform to deliver personalized experiences at scale to their customers, while maximizing the ROI of their marketing and customer experience investments. Through the integration of Experience Cloud and Creative Cloud, Adobe is uniquely positioned to combine the right content, data and journeys in real-time for every customer experience.

The revenue growth we are driving across our categories, content, commerce and workflows, data insights and audiences, and customer journeys, all built on the Adobe Experience Platform, demonstrate the strength of our business. Global brands trust Adobe to build their content supply chain and deliver personalization at scale, making us the number one digital experience platform in the industry.

Customers are embracing the opportunity to address their content supply chain challenges with Adobe GenStudio. With native integrations across Experience Cloud and Creative Cloud, GenStudio empowers marketers to quickly plan, create, store, deliver and measure marketing content and drive greater efficiency in their organizations.

Financial services leader Vanguard is creating an integrated content supply chain to serve the strategic goal of deepening their relationships with a broad range of investors. Leveraging the GenStudio solution, Vanguard was able to increase quality engagement by 176% by focusing on one-to-one personalization and to realize millions in savings by improving content velocity and resource allocation with an end-to-end content creation workflow.

Other highlights include: the general availability of Adobe Content Hub, further enhancing the value of Adobe Experience Manager Assets. Content Hub enables brands to reimagine how creative assets are used across their organization and with external agencies, driving content velocity and major efficiency gains. AEM Assets is used by the majority of the Fortune 50, including eight of the 10 largest media companies, nine of the 10 largest financial services companies and eight of the 10 largest retailers.

Increasing importance and adoption of Workfront to streamline workflows across marketing organizations and agencies. We extended our leadership in this category through the general availability of Adobe Workfront Planning, which delivers a comprehensive view of all marketing activities in an organization and enables teams to optimize marketing planning and execution. Global brands including Deloitte, Interpublic Group and NASCAR are using Workfront Planning to drive productivity gains and meet the rising demand for highly personalized marketing campaigns.

Continued momentum for Adobe Experience Platform and native applications, including Real-time Customer Data Platform, Customer Journey Analytics and Adobe Journey Optimizer. We expanded our AEP portfolio with the general availability of Adobe Journey Optimizer B2B Edition, which leverages generative AI to deliver

personalized experiences to buying groups, the decision-makers, practitioners and stakeholders responsible for major purchasing decisions.

Strong industry analyst recognition, including the Forrester Wave for B2B Revenue Marketing Platforms, and three IDC Marketscape reports across Digital Asset Management and Headless Digital Commerce for both enterprise and mid-market. Key customer wins include Dentsu, Home Depot, Humana, IBM, Johnson & Johnson, Mayo Clinic, Newell Brands, Premier League, Stagwell Group, TD Bank and UPS.

We look forward to unveiling new customer experience management innovations across content, data and journeys at MAX next month, showcasing integrations across Express, Creative Cloud and Experience Cloud for freelancers, solopreneurs and marketers across agencies and enterprises. Our pace of innovation, commitment to customer value, global partner ecosystem, and category-defining solutions position us to continue our market leadership.

I will now pass it to Dan.

Daniel J. Durn

Chief Financial Officer & Executive Vice President-Finance, Technology Services and Operations, Adobe Inc.

Thanks, Anil. Today, I'll start by summarizing Adobe's performance in Q3 fiscal 2024, highlighting growth drivers across our businesses, and I'll finish with financial targets. In Q3, Adobe achieved record revenue of \$5.41 billion, which represents 11% year-over-year growth as reported and in constant currency.

Our focus on both growth and profitability has been a cornerstone of our operating philosophy for years, rooted in strategic prioritization, relentless innovation, and laser-focused execution. Our Q3 results reflect this approach. We're making significant investments in our technology platforms, launching global campaigns to expand our customer base, and attracting top-tier talent, while delivering world-class cash flows and profitability.

Third quarter business and financial highlights included: GAAP diluted earnings per share of \$3.76 and non-GAAP diluted earnings per share of \$4.65; Digital Media revenue of \$4.00 billion; net new Digital Media ARR of \$504 million; Digital Experience revenue of \$1.35 billion; cash flows from operations of \$2.02 billion; and RPO of \$18.14 billion exiting the quarter.

In our Digital Media segment, we achieved Q3 revenue of \$4.00 billion, which represents 11% year-over-year growth, or 12% in constant currency. We exited the quarter with \$16.76 billion of Digital Media ARR, growing our ending ARR book of business 13% year-over-year in constant currency.

Adobe achieved Document Cloud revenue of \$807 million, which represents 18% year-over-year growth as reported and in constant currency. We added \$163 million of net new Document Cloud ARR, which was a record for a Q3, growing our ending ARR book of business 24% year-over-year in constant currency.

Q3 Document Cloud growth drivers included: usage and MAU growth across Adobe Reader and Acrobat; usage and MAU growth via third party ecosystems, including Google Chrome and Microsoft Edge extensions, which are driving free-to-paid conversion; demand for Acrobat desktop and mobile subscriptions across all customer segments and geographies; strength in monetization of our AI Assistant with new Acrobat subscriptions; strength in SMBs driven by our reseller partner network; and strength in enterprise and public sector sales, with a number of large deals closing in the quarter.

We achieved Creative revenue of \$3.19 billion, which represents 10% year-over-year growth, or 11% in constant currency. We added \$341 million of net new Creative ARR in the quarter, growing our ending ARR book of business 11% year-over-year in constant currency.

Q3 Creative growth drivers included: new subscriptions for Creative Cloud All Apps across customer segments, including Teams, Enterprise, and Education with back-to-school demand; strength across our Acrobat Pro, Illustrator, Lightroom and Photoshop single apps on Adobe.com; growing demand for our AI-first Adobe Express offerings in mobile, emerging markets and education; early monetization of our new Firefly Services solution in the enterprise segment; continued momentum with new subscriptions in emerging markets; and contribution from customers stepping up to our higher-value Creative plans at renewal.

Turning to our Digital Experience segment, in Q3, we achieved revenue of \$1.35 billion, which represents 10% year-over-year growth as reported and in constant currency. Digital Experience subscription revenue was \$1.23 billion, growing 12% year-over-year as reported and in constant currency.

Q3 Digital Experience growth drivers included: strong subscription revenue growth at scale of AEP and native applications, up greater than 50% year-over-year; strong subscription revenue growth with Adobe Experience Manager and Workfront; success in booking transformational deals as well as individual solution selling; continued strength in retention and expansion across our enterprise customers; and growing pipeline for our GenStudio solutions to address the content supply chain opportunity.

Turning to the income statement and balance sheet, in Q3, Adobe delivered year-over-year EPS growth of 23% on a GAAP basis and 14% on a non-GAAP basis. This was primarily driven by revenue growth and disciplined prioritization of our investments, which resulted in operating margin strength in Q3. The company continues to deliver world-class margins while making significant investments in AI model training and inferencing capacity.

Adobe's effective tax rate in Q3 was 17.5% on a GAAP basis and 18.5% on a non-GAAP basis. RPO exiting the quarter was \$18.14 billion, growing 15% year-over-year as reported, or 16% in constant currency. Current RPO grew 12% year-over-year exiting the quarter.

Our ending cash and short-term investment position at the end of Q3 was \$7.52 billion, and cash flows from operations in the quarter were \$2.02 billion. In Q3, we entered into a \$2.5 billion share repurchase agreement, and we currently have \$20.15 billion remaining of the original \$25 billion authorization granted in March 2024.

We will now provide Q4 targets, which factor in current macroeconomic conditions and year-end seasonal strength. For Q4, we're targeting total Adobe revenue of \$5.50 billion to \$5.55 billion; Digital Media net new ARR of approximately \$550 million; Digital Media segment revenue of \$4.09 billion to \$4.12 billion; Digital Experience segment revenue of \$1.36 billion to \$1.38 billion; Digital Experience subscription revenue of \$1.23 billion to \$1.25 billion; tax rate of approximately 16% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of \$3.58 to \$3.63; and non-GAAP earnings per share of \$4.63 to \$4.68.

In summary, I'm proud of our year-to-date performance, which stems from a powerful combination of product leadership, rapid innovation, diversified business and financial discipline. Given the massive markets we are catalyzing, I am confident in our ability to drive growth and industry leadership.

Shantanu, back to you.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

Thanks, Dan. Adobe's focus on responsible innovation, with customers at the center, continues to be a unifying purpose for the company. The Content Authenticity Initiative, which we founded in 2019, now counts over 3,300 members across the digital ecosystem, all committed to enhancing trust and transparency with Content Credentials.

In five years, this mission has gone from a vision to reality with companies including Amazon, Google, Leica, Meta, Qualcomm, Sony, TikTok and others all committing to implementing Content Credentials. The US Department of Defense became the first federal government agency to implement Content Credentials by applying them to official DoD images.

We're teaming up with Governor Gavin Newsom on a new initiative to boost digital and media literacy skills in K-12 schools and higher education institutions in California. By providing educational content, programming, and resources to schools across the state, we can help empower California's future workforce for success in an AI-powered world and use this as a blueprint for other states and countries.

Next week, we will bring employees together for our annual Adobe for All conference to celebrate our vision and purpose and the impact that has on our customers and communities.

I am confident that Adobe's culture, innovative product roadmap, global market opportunity, trusted brand and the unwavering commitment of our employees will continue to drive our success.

Thank you, and we will now take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And the first question will come from Alex Zukin with Wolfe Research.

Alex Zukin

Analyst, Wolfe Research LLC

Q

Hey, guys. Thanks for taking my question, and congrats on what looks like a very strong quarter. It's one question, but it's a two-parter. The quarter itself, particularly on the Digital Media ARR, looked very strong. It looked unseasonably strong because you haven't grown net new ARR sequentially in a 3Q, I think in almost four years. So, maybe just comment like what drove this unseasonable strength? Is it pricing, AI traction, and particularly the Document Cloud net new ARR?

But at the same time, given all the product momentum you went through in the script, it's a bit confusing to understand why the Q4 guide is the lowest it's ever been sequentially for a Q4 on net new Digital Media ARR, which I think makes people a little nervous about maybe the go-forward, the next year performance. And so maybe just address this dichotomy, because it looks kind of seasonally a little bit different than what we're used to, and I think it's weighing on the stock after-hours.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

A

I'm happy to start, Alex, and then David can certainly also add to that. I mean, to your point, we had a strong quarter. And when I think about Digital Media, Document Cloud, to the point that you made, Acrobat continues to perform. The AI Assistant and the SKU that we have associated with Acrobat continues to perform well. As we had said, we expect Creative to show growth on growth year-over-year, and so that also played out exactly as we expected.

And it was a strong end when you look at it as it relates to the last few weeks' performance. We saw the typical strength that we would see going into Q4. I can see how you're saying you're looking at the sequential guide. We're looking at it and saying it's the strongest ever Q4 target that we have put out there for Q4, Alex, and so I think we just continue to focus.

We would expect Creative to again grow when you talk about growth over growth, net new ARR in Q4, and all of the new initiatives that we're talking about, AI, et cetera, continue to perform. So, from our perspective, when we look at what we guided to the second half of the year, to your point, Q3 is stronger. We expect a seasonally strong Q4, and then continued innovation should continue to drive growth.

David Wadhvani

President-Digital Media Business, Adobe Inc.

A

Yeah. And maybe I'll just add a couple things to what Shantanu said. Again, just a little bit more context behind the strength in Document Cloud. Obviously, link sharing and what we've done with reader distribution across mobile, web and desktop, that's really what continues to drive this business. And that underlying strength is going to continue not just in Q3, but it's going to be something that we're able to bet on and grow on going forward, because we got a lot of flow optimizations associated with that.

As we look at Creative Cloud, again, we have a broader set of offerings than we've ever had, right. We have things like – with Creative Cloud, we have higher value, higher priced offers, thanks to the AI innovation that's happening in the base plans that are impacting how the Creative Cloud business is doing. We also have a broader set of offerings than we've ever had.

Now, with web and mobile, including freemium and lower-priced offerings that are driving more proliferation, and the blend of those two things also sort of comes into the strength of the quarter and how we see things going out. But as you look at the second half overall, we came into the second half with a strong expectation of how the second half is going to play out, and frankly it's playing out as we expected in terms of the aggregate Q3, Q4 number.

In terms of the specifics on timing, Q3 was a little stronger than you expected and for a good reason, given seasonality. I think a lot of that can be explained by a few deals that would have historically just closed in Q4 closing earlier than expected in Q3, and that changed the dynamic in terms of the linearity that you would typically see between Q3 and Q4.

Alex Zukin

Analyst, Wolfe Research LLC

Q

Very helpful, guys. Thanks again.

Operator: And our next question will come from Mark Murphy with JPMorgan.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Thank you so much, and I'll add my congrats. David, I'm wondering if you can compare the AI monetization opportunity that you're sensing with the image models relative to the future potential with your audio and video models. Just for instance, how many tokens might be consumed when someone is generating a video versus an image?

And then tying in with that, just how optimistic are you maybe being able to solve some of the limitations with the current video generation models where the facial expressions can lack realism, or they can't handle the object interactions, or they don't provide enough detail or resolution in the videos?

David Wadhvani

President-Digital Media Business, Adobe Inc.

A

Yeah. Happy to take that. Let me just sort of take a little bit of a step back and talk about the core strategy that we have for AI and the conversion then in terms of how we think about monetization. So, I think we've been incredibly consistent with what we've said dating back a year or a year-and-a-half ago where we talked about the fact that we were going to develop the broadest set of models for the creative community, and we were going to differentiate the models based on quality, commercial safety, integratability into our tools and controllability.

And as you've seen very methodically over the last 18 months, we continue to bring more and more of that innovation to life. And that fundamentally is working, as we've now started to integrate it much more actively into our base. If you look at it with photography, we now have in our tool Generative Remove, we have AI-Assisted edits. In Design, we have Generative Pattern, Generative Fill Shape.

We have – in Photoshop, we have Gen Remove. We also have Gen Fill, and I can continue on with all the generations. But we've also now started to integrate it in Firefly Services for what we're enabling enterprises to be able to access and use in terms of batch work and through APIs. If you look at sort of how that's played out, as we talked about, we're seeing accelerated use in generative credits being consumed because of that deeper integration into all of our tools, and that is playing out as we expected.

When you look at then how that converts to monetization, first and foremost, we've integrated it, a lot of that value, into our core products with more value and more pricing. We're also seeing that when people use these generative features, they retain better. We're also seeing that when people come to Adobe to try our Creative Cloud applications or Express application, they're able to convert better. And so, there are all these ancillary implied benefits that we're getting.

But in terms of direct monetization, what we've said in the past is that the current model is around generative credits, which is, I think, where you're going with this. And we do see with every subsequent capability we integrate into the tool, total credits consumed going up.

Now, what we are trying to do as we go forward, we haven't started instituting the caps yet. And part of this is, as we've said all along, we want to really focus our attention on proliferation and usage across our base. We see a lot of users excited about it. It's some of the most actively used features that we've ever released, and we want to avoid the generation anxiety that people feel. But we're watching very closely as the economy of generative credit evolves, and we're going to look at instituting those caps at some point when we feel the time is right and/or we're also looking at other alternative models.

What we did with Acrobat AI Assistant has proven to be very effective, and so we're also considering other opportunities like having standard CC plans that have a core set of generative capabilities, but also having premium API – sorry, premium AI plans that will include things more like video and other things. So, we're very happy about the innovation that's coming, and we see the opportunity to engage very deeply in the monetization, but we want to play it out over time and proliferation continues to be our primary guide.

And then lastly, in terms of quality, I don't know if you had a chance to see some of the videos we put out there, integrated directly into Premiere, also text-to-video, image-to-video, more controllability. We have also the ability now to generate not just scenes with humans and dogs and organic animals, but all these like overlays and things that creative professionals actually want to work with. And so, we're very excited about the set of things that they can get out of the box and get going. And human faces and things will just continue to get better. We have a lot of great research that you'll start to see, and I hope you get to play with the models because we've taken a huge step forward there.

Shantanu Narayen
Chair & Chief Executive Officer, Adobe Inc.

A

Mark, maybe I'll just add...

Mark R. Murphy
Analyst, JPMorgan Securities LLC

Q

Wonderful. Thank you.

Shantanu Narayen
Chair & Chief Executive Officer, Adobe Inc.

A

...a little to what David said, which is great. I spent a couple of hours with our video team. They have just absolutely hit it out of the park. I mean, the work that they've done which is leveraging the image models with video, and again I think to David's point, the integration with Premiere, that's what we've always said, it's the integration of the model and the application that differentiates it.

I think when other models first came out, people were like, wow, you can describe it. That's just such a small part of where the value is, and the real value is you have a video, you want to extend it. It's a game changer in terms of what we can do. So, really excited about the stuff that we're doing in video. And again to David's point, this will be monetized differently from the way we have for images which was part of the sort of base value pricing.

So, the way I answer your question is – and the third thing I would say is, remember, we have the ability to create custom models as well. And so when you ingest the video that people want to edit, the ability to extend that is not just dependent on what the model is, but also on what the new data is. And again, that represents really a unique ability for us. So, hopefully all those three demonstrate why we're leading the pack in terms of how people can derive value in the nonlinear editors, which is where the action is going to be.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Thank you very much.

Operator: And moving on to Keith Bachman with BMO.

Keith Bachman

Analyst, BMO Capital Markets Corp.

Q

Hi. Thank you very much. I appreciate you taking the question. I wanted to pick up a little bit on how we should be thinking about, David, just monetization. And will consumption you think – as we start to turn the year, can consumption contribute to ARR growth as we look at FY 2025, because I think there's pervasive fears that the state of competition may in fact limit your ability to turn on that monetization, if you will, from either consumption or price. And I just wanted to see if you could lace in consumption against the backdrop of competition.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

A

From our perspective, Keith, I think when you look at what we have with the apps and the models, we just continue to think that's uniquely differentiated. Firefly Services, which is you can think of that also as a consumption model where we have that, it's off to a really good start. Our ability to give enterprises the ability to automate content, create custom models within enterprises, we're seeing real traction because it's a differentiated solution and that it's designed to be commercially safe.

And as it relates to the core subscription models, again, David said this, but I'll reiterate it, which is the core subscription models for products like Photoshop and Illustrator, I think the differentiation is the combination of the model and the technology. And in video, I think we will find additional ways to monetize it.

So, I'm not sure who specifically you're referring to as it relates to competition in this space, but from our perspective, it's just unique. I mean, if we look at the acceleration of what we have seen of generations in Photoshop, Illustrator, Lightroom, it's clear that we're actually extending the value rather than having other people catch up.

David Wadhvani

President-Digital Media Business, Adobe Inc.

A

And then one other thing I'd just emphasize there is that the commercial safety is so important to businesses of all sizes frankly, and that is something that we feel very, very differentiated on, in addition to everything Shantanu said.

Keith Bachman

Analyst, BMO Capital Markets Corp.

Q

Okay. Great. And then perhaps for my follow-up, I wanted to pick up on Alex's first question. But you're guiding net new ARR down 3% year-over-year in Q4, and I think investors are thereby taking that as perhaps a framework when you look at next year. But is there anything that net new ARR will be down next year? And I know you don't want to give guidance for next year, but just any kind of thoughts you want to address as it relates to the guidance associated with net new ARR being down in Q4 versus a framework that we might want to apply for the FY 2025 net new ARR.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

A

You're right, Keith. We're not going to give FY 2025 guidance. We'll certainly share more at MAX, and we would expect, like we did last year, that at the December earnings call, we'll give color on fiscal 2025 ARR. But I'd say a couple of things.

First, as it relates to again the performance of the second half, because to Alex and your question, if there are questions around Q3 and Q4 and what that trend means, again, we will hope to have record net new ARR in fiscal 2024, which I think is a great thing. We gave \$19.50 billion at the end of Q2. We're clearly on track to beat that number, which we take as a positive sign.

And the other thing maybe perhaps tactically for you folks to think about as well, as it relates to the Q4 guidance, typically you have Black Friday and Cyber Monday in the same quarter. This time, Cyber Monday I believe is in Q1. And so, as it relates to our Q4 performance, it's the highest target that we have ever issued. We will go out and continue to execute and continue to innovate. So, that's the way I look at the business, Keith.

Keith Bachman

Analyst, BMO Capital Markets Corp.

Q

Okay. Thank you, Shantanu.

Operator: And the next question will come from Saket Kalia with Barclays.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Hey, guys. Thanks for taking my question. David, maybe for you. You touched on some of the drivers in Document, which was super helpful, but I'd love to maybe go one level deeper into some of the dynamics in that business, which, of course, continues to grow net new ARR at a really nice clip. So, maybe we can just talk a little bit about are there any pricing headwinds or tailwinds that we should keep in mind specifically for Document Cloud? And also, maybe you can give us a sense for sort of where Document Cloud is in its journey to maybe becoming more of a subscription-heavy business. Do those make sense?

David Wadhvani

President-Digital Media Business, Adobe Inc.

A

The first part does. Let me try to address the whole thing. The question on subscription-heavy, it is a very strong subscription business for us already. But I'll touch on that, and hopefully I'll address your question.

So, first, if we take a step back and look at Document Cloud, I mean, the foundation of everything we're doing here is incredibly strong and it's a machine we've had for a long time, but it continues to perform incredibly well. And what I mean by that is the platform proliferation of what we have with Acrobat and Reader. The fact that we have 40 years into this business, the rise of PDF and PDF becoming the de facto standard for content as – unstructured content as a whole is a remarkable foundation for us to be building on. And the distribution we have across desktop, web, mobile, including web extensions, is really the foundation of everything we do, because that becomes the top of funnel for us.

You layer on top of that the fact that generative AI in general has come out, where unstructured content, especially PDF unstructured content, the 3 trillion PDFs out there that we believe are out there, has suddenly inherently much more valued than it did a year ago. And this whole ecosystem is set up well for us.

In addition to that foundation, we've also been, over the course of the last few years, really transitioning the way people share, because if you think about PDFs and Acrobat in general, one of the most important things people do is they produce the PDF to share it with others often for comment and review engagement. And by increasing sharing via links versus sharing as an attachment, we see a lot more engagement and interaction that we're able to benefit from, and that also helps with the top of funnel, and we can provide more value.

Then on that platform, what we've done is with AI Assistant, we've focused on consumption for the last nine months, starting with the ability to look at a single PDF and ask questions of that PDF. Then we added support for multi-docs, so you can now have five or six PDFs that you're having a conversation with. We added support for multiple formats, so you can look at PDFs, but you can also drag in Word documents or PowerPoint documents or a link to a meeting transcript that you have.

We are adding – in the process of adding language support for other languages optimizations. We're now starting to work on document-type optimization. So if it's a contract, we know how to optimize the results even better than if it's a marketing document. And that's all about consumption. But in addition to consumption, we're now expanding, because these conversations that happen with these documents are inherently about getting some insight and then sharing that insight.

We have also started to do things that you can create richer content on the back end of it. So, Firefly is embedded now in Edit PDF workflows. We have the conversational content and now we're able to generate emails and presentations and those kinds of things. We've now embedded in the convert PDF workflows the ability to output to Express and create richer media outputs. And you can start to see all of this stuff coming together in a very real way already, but also in the months ahead.

The last thing I want to say on this, too, is that what's really working out well for us is that when we are out pitching this opportunity, not just in terms of the individuals that use it but also businesses, is that we don't have any security concerns, right. Our data governance model is the same data governance model that's happened. If you have access to the documents, you can have conversations with the documents.

And so it makes it a much easier thing for enterprises to adopt, because there's no systemic or governance changes. And so all of that continues to drive more adoption. And as I said on the prepared remarks, Document

Cloud is substantially a subscription business, but now with AI Assistant being available to subscribers and not as directly to perpetual users, we expect that to continue to transition even further.

Saket Kalia

Analyst, Barclays Capital, Inc.



Super helpful. Thanks, guys.

Operator: And the next question will come from Jay Vleeschhouwer with Griffin Securities.

Jay Vleeschhouwer

Analyst, Griffin Securities, Inc.



Thank you. Good evening. David, I'd like to follow up on something that you said on the second quarter call, and that was that you said at the time that you were for the rest of the year going to "pour gas on your GTM" and as well engage in a full funnel campaign later in the year. So, the question is, could you update us on that?

I mean, it does seem to be in no small part [ph] corroborated (00:49:35) by some of your internal investments that we've been able to see, for example in your ICX team, your go-to-market positions across multiple products, strategy positions, and so forth. But you've made this commitment for a substantial expansion. But do you think you need going forward to continually accelerate the pace of investments in go-to-market, or do you think at some point, perhaps soon, you can begin to taper that off and then leverage that capacity through revenue growth and thereby margin expansion?

David Wadhvani

President-Digital Media Business, Adobe Inc.



Jay, I think we might have to have you join our marketing organization given how much you know about the market dynamics, but a great question. And so, first and foremost, again, if we're going to talk about Express, let's take a little bit of a step back and understand the dynamics of where we are in the evolution.

I think what we had talked about in Q2 was that not only do we feel like we have an incredible product now, but that product is built on a brand-new platform that has the ability to develop AI functionality as a native part of that platform. So, the speed of innovation that we've been adding capabilities to Express has really been a breakneck speed, and we're very excited about that.

Features like native integration of Firefly so that everything that's generated here is commercially safe, which again, like I said, is important to individuals and to businesses, but doing it with more control, things like style and structure match, and integrated into the image viewer, the video viewer, editor, and the design surfaces. So, very excited about that.

In addition to those basic capabilities that are so foundational, this is really the design model that we've been talking about, Firefly design model. This is where it's surfacing the most. And so, you combine what we're doing with templates and the design model, and people are able to create and effectively get access to an infinite number of templates, right, we believe that we're moving from a template-centric set of tools for communicators to an AI-centric set of tools, and we feel that with our design model and everything we have, we're fundamentally going to create better content that stands out ultimately.

We also have great workflows that we've developed with Photoshop and Illustrator and Acrobat, and we've integrated all of this in ways that are fundamentally effective for businesses, including bulk creation and assembly

capabilities. So, small businesses all the way through enterprises are able to leverage this for their designer to marketer workflows.

In addition to all of that innovation, to your point, we've really been focused on the go-to-market since last time. Since we last spoke or right before we last spoke, in Q3, we expanded the offer set significantly. We've always had Express for individuals in market, but we added Express for Teams, Express for Enterprise, and we just launched Express for Education this back-to-school year with a lot better support for classrooms and teacher/student workflows as well.

On the marketing side, we've been ramping that very actively. It's a net new audience to Adobe. I mean, that's something to really recognize. This isn't about shifting existing audience over solely. It's about getting access to net new audience. And so for that, we have to employ both traditional means with a focus on awareness campaign, but also leveraging social, because that's where this audience is. So, you'll see us doing a lot more on social as a result.

And then on the back of all that, we're ramping our direct sales. We have a very at-scale inside sales motion that we're starting to lean into. We have a very significant direct sales motion that we have in enterprises and mid-market that we're leveraging. Adobe.com journeys, we have a lot of businesses and individuals coming on Adobe.com and doing a lot more optimization in the App Store.

And that's really what you're starting to see in the numbers we shared with strong usage at 70% year-over-year, cumulative exports, strong business momentum with over 1,500 businesses sold, and really great – our best back-to-school season ever with millions of students now enabled on it. So, that's the foundation. And if you're – the one thing I would say is, yes, we started pouring gas on it, and we're going to pour more gas on it, not less, in the months and years ahead.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

A

Maybe two other things, Jay, just big picture, I mean, we continue to invest in all of the key long-term things, whether it's training of models, whether it's Express, whether it's AP in apps, whether it's GenStudio, while delivering what I think are phenomenal margins, and so we'll continue to make those trade-offs in terms of growth and profitability. And maybe a little tongue-in-cheek, part of the reason why David has the ability to invest as much in marketing is he uses the best marketing technology in the world from Anil.

David Wadhvani

President-Digital Media Business, Adobe Inc.

A

That is true.

Jay Vleeschhouwer

Analyst, Griffin Securities, Inc.

Q

Thank you.

Operator: And our next question will come from Tyler Radke with Citi.

Tyler Radke

Analyst, Citigroup Global Markets, Inc.

Q

Yes. Thanks very much for taking the question. Wanted to ask you about the Digital Experience side of the business. So, RPO looked pretty strong in terms of sequential additions. The implied guide for Q4 was a bit lighter than consensus. I know you did talk about some unusual dynamics in terms of seasonality, Cyber Monday, but could you just talk about the strength and underlying dynamics you're seeing in the business heading into Q4? Thank you.

Anil Chakravarthy

President-Digital Experience Business, Adobe Inc.

A

Yeah. When we look at the Digital Experience business, we are pleased with the overall execution of the business. We have a big opportunity with what we call personalization at scale where, whether it's the B2C company or B2B company, the ability to deliver personalized customer experiences to consumers or to hundreds of thousands of business customers, individuals within businesses, this is important for every company in the world and we have the integrated platform and the applications to be able to help them deliver those kinds of experiences.

And we have the unique ability to bring together the right content, the customer data, and the customer journeys across our Experience Cloud and the integration with Creative Cloud to deliver those personalized experiences, and that's pretty unique to what we can do at Adobe. And that's one of the things that we're seeing in the dynamic in the enterprise market is the enterprises are scrutinizing all the deals that they want to do. I think in this case, they look at our offerings and see the ability to not only help with growth, they also look at the efficiency gains that we can help them create, and that's helping us as enterprises scrutinize their spend.

And when you look at our guide, obviously we are focused on most closely on our subscription business, and that's the business that continues to grow strongly, and showing good performance on the subscription business. And our overall revenue is a combination of subscription and services where we really are focused on working with a broad global partner ecosystem to make sure that we deliver services to our customers and help them realize value from our offerings.

Tyler Radke

Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Jonathan Vaas

Vice President-Investor Relations, Adobe Inc.

A

Hey, operator, we're at the top of the hour. We'll sneak in one more question and then wrap up. Thank you.

Operator: Thank you. That question will come from Brent Thill with Jefferies.

Brent Thill

Analyst, Jefferies LLC

Q

Thanks. Dan, just back to the guide, can we just drill in? I know you mentioned there were a couple of factors that were contemplated, but I'm just curious if there is anything else that you're seeing that is different in terms of end demand or any softness. I know the US decelerated a bit, EMEA has accelerated.

Shantanu Narayen

Chair & Chief Executive Officer, Adobe Inc.

A

No, Brent. I mean, I think we had a strong Q3, and we continue to see the momentum in the business. And it's our typical considered targets that we do, and I focus on execution. So, we're not seeing anything as it relates to a change in the business dynamics. I also mentioned that the last few weeks of Q3, as you know, the summer seasonality ends, we saw the traditional strength that we expect to see on our web traffic.

So, I think MAX is coming up. We have our exciting agenda in terms of what we're going to be talking about in terms of MAX. And so, I mean, if I take a step back and think about it, given this is the last question, from my perspective, strong Q3 across every aspect of our business. Revenue, EPS, Digital Media ARR, DX, subs revenue, Acrobat certainly also continued to show the strength.

We have momentum in the business and the innovation roadmap, I mean, across all of the key initiatives that we've been talking about, whether that's Express, GenStudio, and the excitement that people have associated with automating all of that content, AEP and Apps on the data side, imaging and video, the work that the Digital Media team has done on Photoshop and on Illustrator, and then what's coming down the pike on video and Firefly Services.

I think the AI monetization as well, which I know is a theme of a number of people that have asked, whether it's Acrobat, whether it's the premium SKUs as it relates to Experience Cloud, whether it's what's happening on Gen Fill and the usage of Gen Fill, Lightroom and Lightroom Mobile. I think we're clearly demonstrating how AI can both drive value for our customers, and therefore, we acquired new customers and retained customers better. So, it feels good. We look forward to seeing all of you at MAX, and we're going to just continue to focus on innovation and delighting our customers. But thank you for joining us.

Jonathan Vaas

Vice President-Investor Relations, Adobe Inc.

Yeah. Thanks, Shantanu. And we do look forward to the investor event that we'll be holding in Miami at MAX on October 14 where we will be doing a Q&A with management. We hope to see many of you there. And with that, thank you for joining the call, and this concludes the event.

Operator: Thank you. That does conclude today's conference. We do thank you for your participation. Have an excellent day.

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