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 third 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.
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, September 13th, 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 2018, and our quarterly reports filed on Form 10-Q in fiscal 2018.

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.
SHANTANU NARAYEN

Thanks, Mike and good afternoon.

Q3 was a record quarter for Adobe. We delivered $2.29 billion in revenue, representing 24% year-over-year growth. GAAP earnings per share for the quarter was $1.34, and non-GAAP earnings per share was $1.73.

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.
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 $339 million, and total Digital Media ARR exiting Q3 grew to $6.40 billion. Key Digital Media customer engagements in the quarter included The US 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.

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, our cloud-based photography service, continues to attract new customers. 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, 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 – 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 a million students to access Spark.

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.
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 $249 million.

PDF creation, sharing, reviewing, scanning and signing is accelerating across devices and Adobe's document business is experiencing strong growth. Over 50 billion PDFs were opened in Adobe products in the last year. 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. 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 has become one of the most popular mobile scanning apps, with nearly 14 million 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. 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.
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.

In Q3 we achieved Experience Cloud revenue of $614 million with strong bookings across Adobe Marketing Cloud, Analytics Cloud and Advertising Cloud. Key customer deals in the quarter included NBA Properties, Commonwealth Bank of Australia, The Federal Aviation Administration, CBS Interactive and Navy Federal Credit Union.

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

In Q3, Adobe was once again recognized for our technology leadership by top industry analysts. 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 8th year in a row. Additional leadership recognition included the Forrester Wave: Customer Analytics Solutions and the Gartner Magic Quadrant for Personalization Engines.
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 #1 ‘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.

As we look to Q4, we are excited about the opportunities ahead. We expect a strong close to Adobe's 2018 fiscal year and are confident that we have the right strategy, products, people, customers and partners to sustain our growth and momentum.

John.
JOHN MURPHY

Thanks, Shantanu.

In the third quarter of FY18, Adobe achieved record revenue of $2.29 billion, which represents 24% year-over-year growth. GAAP diluted earnings per share in Q3 was $1.34 and non-GAAP diluted earnings per share was $1.73. We delivered another quarter of strong performance across product offerings and geographies, while also successfully integrating Magento.

Highlights in Q3 included:

- Record Digital Media revenue, including Creative revenue of $1.36 billion and Adobe Document Cloud revenue of $249 million;
- Record Digital Experience revenue of $614 million, which represents 21% year-over-year growth;
- Net new Digital Media ARR of $339 million;
- Deferred revenue growth of 23% year-over-year;
• Cash flow from operations of $955 million;
• Returning $714 million of cash to our stockholders through stock buyback;
• And approximately 90% of our revenue in Q3 was from recurring sources.

In Digital Media, we grew segment revenue by 27% year-over-year. The addition of $339 million net new Digital Media ARR during the quarter grew the total to $6.40 billion exiting Q3.

Within Digital Media, we achieved another record quarter with our Creative business. Creative revenue grew 28% year-over-year in Q3 and we increased Creative ARR by $289 million. 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% year-over-year 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.

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.

With Document Cloud, we achieved record revenue of $249 million, which represents 21% year-over-year 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% year-over-year revenue growth.
In our Digital Experience segment, we achieved record Adobe Experience Cloud revenue of $614 million, which represents 21% year-over-year growth. Experience Cloud subscription revenue grew 25% year-over-year. 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 is off to a strong start and contributed subscription and services revenue of $27 million 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.

From a quarter-over-quarter currency perspective, FX decreased revenue by $13.8 million. We had $16.8M million in hedge gains in Q3 FY18, versus $0.3 million in hedge gains in Q2 FY18; thus the net sequential quarterly increase to revenue considering hedging gains was $2.7 million.

From a year-over-year currency perspective, FX increased revenue by $27.7 million. We had $16.8M million in hedge gains in Q3 FY18, versus $0.2 million in hedge gains in Q3 FY17; thus the net year-over-year currency increase to revenue considering hedging gains was $44.3 million.
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.

- Trade DSO of 41 days
- Cash flow from operations of $955 million
- Deferred revenue of $2.71 billion
- Cash and short-term investments of $4.94 billion
- Repurchased approximately 2.9 million shares

Our trade DSO was 41 days, which compares to 50 days in the year-ago quarter, and 44 days last quarter. Deferred revenue grew to a record $2.71 billion, up 23% year-over-year. With strong bookings, deferred revenue was in-line with our expectations. Given Q3 FY18 ended on August 31st, deferred revenue was impacted by having one less billing cycle for many enterprise customers when compared to Q2 FY18 and Q3 FY17.

Our ending cash and short-term investment position exiting Q3 was $4.94 billion. The quarter-over-quarter decline in our cash position was due to the Magento acquisition.

Cash flow from operations was $955 million in the quarter.

In Q3, we repurchased approximately 2.9 million shares at a cost of $714 million. We currently have $150 million remaining of our $2.5 billion authority granted in January 2017. We expect this authorization to be exhausted by the end of fiscal year 2018. 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 Q4 FY18, we expect normal seasonal year-end strength in our business and are targeting:

- Revenue of approximately 2 billion 420 million dollars;
- Digital Media segment year-over-year revenue growth of approximately 22%;
- Digital Experience segment year-over-year 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 495 million shares;
- GAAP earnings per share of approximately $1.42;
- Non-GAAP earnings per share of approximately $1.87; and
- Net new Digital Media ARR of approximately $385 million.

Our Q4 FY17 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 year-over-year 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 $30 million of Magento revenue in Q4.

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

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

Thanks, John.

Adobe MAX returns to Los Angeles and is quickly approaching. Day One of our user conference is Monday October 15th, 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. 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 #1136856. International callers should dial 404-537-3406. The phone playback service will be available beginning at 5pm Pacific Time today, and ending at 8pm Pacific Time on September 19, 2018.

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