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ADBE.OQ - Q2 2022 Adobe Inc Earnings Call

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OVERVIEW:

Co. reported 2Q22 revenue of \$4.39b, GAAP diluted EPS of \$2.49 and non-GAAP diluted EPS of \$3.35. Expects FY22 revenue to be approx. \$17.65b, GAAP EPS to be approx. \$9.95 and non-GAAP EPS to be approx. \$13.50. Also, expects 3Q22 revenue to be approx. \$4.43b, GAAP EPS to be approx. \$2.35 and non-GAAP EPS to be approx. \$3.33.

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PRESENTATION

Operator

Good day, and welcome to the Q2 FY '22 Adobe Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jonathan Vaas, VP of Investor Relations. Please go ahead.

Jonathan Vaas - Adobe Inc. - VP of IR

Good afternoon, and thank you for joining us. With me on the call today are Shantanu Narayen, Adobe's Chairman 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 second quarter fiscal year 2022 financial results. You can find our Q2 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, June 16, and contains forward-looking statements that involve risk, uncertainty and assumptions. Actual results may differ materially from those set forth in these statements. For a discussion of these risks, you should review the factors discussed in today's press release and in 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 adjusted growth rates in constant currency. During this presentation, Adobe's executives will refer to constant currency growth rates, unless otherwise stated. Reconciliations between the two are available in our earnings release and on Adobe's Investor Relations website.

I will now turn the call over to Shantanu.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Thanks, Jonathan. Good afternoon, and thank you for joining us.

Adobe had a strong Q2, driven by the secular shift to digital that is transforming how we live, work and play. In Q2, we achieved a record \$4.39 billion in revenue, representing 15% year-over-year growth. GAAP earnings per share for the quarter was \$2.49 and non-GAAP earnings per share was \$3.35.

In our Digital Media business, we drove strong growth in both Creative Cloud and Document Cloud, achieving \$3.2 billion in revenue. Net new Digital Media annualized recurring revenue, or ARR, was \$464 million. And total Digital Media ARR exiting Q2 grew to \$12.95 billion.

In our Experience Cloud business, we achieved \$1.1 billion in revenue, and subscription revenue was \$961 million for the quarter.

The digital economy runs on Adobe's tools and platforms. Customers from individuals and small businesses to the largest enterprises are using our products to unleash their creativity, accelerate document productivity and deliver personalized customer experiences. Digital experiences - from apps on our devices to digital documents we consume, edit and sign to personalized online shopping experiences are made possible by Adobe. Our mission to enable the world's digital experiences has never been more relevant, and we remain focused on executing our long-term growth initiatives.

We are delivering mission-critical products that serve an ever-increasing base of customers, and we have a track record of strong growth and profitability. In my conversations with customers "(added by company after the call)" around the world, it is clear that digital is playing a pivotal role in powering the economy and enabling the world to keep moving forward.

I will now turn it over to David to share more about our momentum in the Digital Media business. David?

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

Thanks, Shantanu, and hello, everyone. Adobe products have always been the solution of choice for the world's creators, whether they're designers, photographers, filmmakers or illustrators. Today, the explosion of the creator economy is enabling even more individuals, solopreneurs and small business owners to express themselves in creative ways, whether it's a hobby, a side hustle or a full-time job. Every creator and business is reimagining how they build their brand and engage their audiences in a digital-first world, underscoring the rapidly growing demand for content and creativity.

Adobe Creative Cloud offers the most comprehensive portfolio of products and services across every creative category, including imaging, photography, design, video and 3D and immersive.

We continue to invest across our core flagship products, including a heavy dose of new AI features. As demand for content increases, content creators are looking to Adobe to help them work together efficiently. We're responding by integrating collaboration capabilities directly into our flagship applications that enable creative teams to collaborate with each other and with stakeholders.

As communicators have become a growing part of our Creative Cloud customer base, we've expanded our offering to include Adobe Express, our new template-based easy-to-use web and mobile product. Express creates an opportunity to serve a broader base of communicators who need lightweight task-based tools to create everything from social media posts, logos and flyers for their small businesses to party invitations and posters

for their personal needs. Real estate entrepreneur, Chrishell Stause, is a great example of a social media influencer who is leveraging Adobe Express to transform how she markets her properties and engages her followers. She's one of millions of users promoting their products and services with Adobe Express.

In Q2, we achieved net new Creative Cloud ARR of \$357 million and revenue of \$2.61 billion, which grew 14% year-over-year. Q2 highlights include continued innovation in the imaging category. This quarter, we launched powerful new capabilities in Photoshop, including Photo Restoration Neural Filter that detects and restores damage photos in seconds. Neural Filters are one of Photoshop's most used AI-powered features. They have now been used by millions of users and applied to hundreds of millions of images. We're also delivering enhancements to Photoshop on the web, including new editing features, support for mobile browsers and integrated learning content.

Video production also continues to explode, and Premiere Pro remains a leader in video creation, editing and now collaboration with Frame.io. The new integration between Frame and Premiere Pro and After Effects is streamlining review and collaboration workflows across stakeholders. Frame had another strong quarter with new customer wins, including Epic Games and NBC Universal, which are using it to manage their video content supply chain, something that Anil will talk more about in a few minutes.

We're also seeing the emergence of new categories like 3D as customer demand for metaverse-ready content continues to increase. Substance 3D had its strongest Q2 ever as customers like HUGO BOSS, Mattel and Unity rely on it to deliver immersive experiences across fashion, gaming and e-commerce. We continue to rapidly innovate in this space, including delivering native Apple hardware support for Painter, Designer and Sampler, enabling creators to work faster than ever before. The Substance team also delivered a new SDK for developers who want to integrate 3D capabilities into their applications.

And finally, we're excited about the momentum we're seeing for Adobe Express, with millions of monthly active users and strong growth in traffic and new users in Q2. We continue to bring the magic of Photoshop imaging, Premiere video and Acrobat PDF capabilities like background removal, QR code generation, video resizing and PDF editing to Express. And we released our new Content Scheduler feature, thanks to our recent acquisition of ContentCal, allowing creators to quickly create preview, schedule and publish social media content.

We're also excited to kick off our Express Your Brand partnership with Meta, which will enable over 200 million businesses to grow their online presence using Adobe Express. And our product-led growth strategy allows us to use millions of data points to continuously test, learn and optimize the entire Express experience from search to export.

Adobe Express recently received the Editor's Choice Award on the App Store, recognizing top apps for design, functionality and performance.

We're very excited about the strong demand for Creative Cloud offerings globally, driven by acquisition, engagement and retention from our data-driven operating model across individuals, SMBs and enterprises. Key enterprise customer wins include Activision, Bertelsmann, Hasbro, Honda Motor, Daimler AG, NCSOFT, Services Australia, State of California and WPP.

In our Document Cloud business, digital document workflows are automating manual paper processes across our personal and professional lives. Whether it's a legal contract, invoice or school permission slip we now need to scan, edit, share and sign from anywhere. Adobe Document Cloud offers the most comprehensive intuitive tools for document productivity across every device and platform.

In Education, the University of East London is adopting Document Cloud to manage workflows for enrolling 17,000 students from 135 countries. In Financial Services, TSB Bank is transforming the online banking experience by enabling customers to quickly and securely complete common tasks like loan applications that could previously only be done in branches.

In Q2, we achieved net new Document Cloud ARR of \$107 million and record revenue of \$595 million, which grew 28% year-over-year. Q2 highlights include strong growth in monthly active users across desktop, mobile and web. The rising volume of search traffic for Acrobat verbs remains a productive funnel to Acrobat web, which surpassed 50 million monthly active users in Q2, more than doubling year-over-year.

Mobile app momentum remains strong with billions of PDFs opened in Acrobat Mobile and hundreds of millions of cumulative Adobe Scan installs.

Acrobat and Adobe Sign integration continues to drive strong demand for Adobe Sign as users increasingly send PDFs for signature directly from the unified Acrobat experience. Acrobat and Adobe Express integrations now give hundreds of millions of Acrobat users the ability to embed customized templates and make their PDFs visually stunning. And Acrobat and Sign APIs are thriving as customers increasingly customize, integrate and automate document services.

We're thrilled with the momentum we see in the Acrobat ecosystem and our business performance across routes to market and customer segments, including key enterprise customer wins with Automatic Data Processing, Duke Energy, Quanta Services and U.S. Bank.

We continue to see strong demand for our products in the second half of FY '22. We'll continue to win in the Digital Media business through product innovation across Creative Cloud and Document Cloud, which are targeting a broad and growing base of customers. Our tremendous scale, consistent marketing investments, proven data-driven operating model and new product-led growth investments are accelerating our momentum across our new and established businesses.

I'll now pass it to Anil.

Anil S. Chakravarthy - Adobe Inc. - President of Digital Experience Business

Thanks, David. Hello, everyone. Even in this uncertain economy, every business continues to prioritize its digital investments. Our June Adobe Digital Index report, which leverages trillions of data points from Adobe Analytics, found that consumers spent \$1 billion more online in May compared to April. Year-to-date, shoppers have spent over \$377 billion online, which is roughly 9% more than the same period last year. Driving this digital momentum is the imperative for personalized customer experiences at scale.

Adobe Experience Cloud is the leader in the customer experience management category, offering a comprehensive set of integrated applications and services, spanning data insights and audiences, content and commerce, customer journeys and marketing workflow.

Built natively on Adobe Experience Platform, our Real-Time Customer Data Platform, Real-Time CDP, provides businesses with a single view of their customers' data across every channel, allowing them to create precise segments and deliver personalized experiences regardless of when and where a customer interacts with their brand. Adobe delivers real-time data with more than 24 trillion audience segment evaluations per day.

The Home Depot is the latest in a large and growing set of industry-leading customers who are adopting Adobe's Real-Time CDP as the underlying platform to power their digital business. Real-Time CDP provides a comprehensive view of The Home Depot's customers across e-commerce, mobile and in-store purchases, enabling them to build customer loyalty and grow their business. In Q2, we continued to drive outstanding Experience Cloud growth, achieving a record \$1.1 billion in revenue.

Subscription revenue was \$961 million for the quarter, representing 18% year-over-year growth. Q2 highlights include native integration across Real-Time CDP, Customer Journey Analytics and Adobe Journey Optimizer is a significant differentiator, allowing brands to orchestrate, measure and optimize the entire customer experience.

New innovations such as Segment Match enable brands to securely share customer segment data with business partners while respecting customer privacy. Major enterprises are adopting Real-Time CDP as their platform of choice, with key customer wins this quarter, including Autodesk, National Football League and U.S. Bank. Expanding Experience Cloud leadership in the health care industry by making Adobe Journey optimizer and Real-Time CDP HIPAA ready through Healthcare Shield. This quarter's customer win with CVS is a great proof point of this massive market opportunity.

New services in Adobe Analytics, delivering a single workspace for brands to unify data and insights from new media types such as 3D and streaming media with traditional channels to get a holistic view of customer engagement with Customer Journey Analytics.

Strong adoption of Adobe Experience Manager for unified content management demonstrating Adobe's leadership in helping businesses effectively manage their content supply chain from creation through delivery. Tremendous growth in demand for partner and Adobe professional services,

underscoring the urgency for implementation and value realization. And key customer wins, including Audible, Anthem, Bank of Nova Scotia, Humana, McDonald's, Stellantis and Toyota.

Reinforcing our leadership position, Adobe continued to receive strong industry analyst recognition, including being named #1 by Gartner for both the Marketing sub-segment of Customer Experience and Relationship Management and Digital Experience Platforms. We were also named a Leader in the inaugural IDC MarketScape for Worldwide Retail and CPG Customer Data Platforms and the IDC MarketScape for Professional Services.

Looking ahead, our category-leading solutions, strong pipeline and tremendous scale through our partner ecosystem position us to deliver personalization at scale across every industry and drive strong growth in the second half.

Dan, over to you.

Daniel J. Durn - Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations

Thanks, Anil. Today, I'll start by summarizing Adobe's performance in Q2 fiscal 2022, highlighting growth drivers across our businesses, and I'll finish with financial targets. Adobe delivered a strong quarter, surpassing our issued Q2 financial targets in an uncertain macro environment.

On the top line, we grew revenue by 14% year-over-year or 15% in constant currency. While making long-term growth investments, we delivered operating margins of 35% on a GAAP basis and 45% on a non-GAAP basis, continuing to be one of the most predictable and profitable growth companies in technology.

We have three strategic businesses growing into massive addressable markets with differentiated products used by hundreds of millions of individuals every month. In addition to our established businesses, we are delivering innovations and new offerings that will drive transformational growth in the future.

Q2 business and financial highlights included: record revenue of \$4.39 billion, GAAP diluted earnings per share of \$2.49 and non-GAAP diluted earnings per share of \$3.35, Digital Media revenue of \$3.20 billion, net new Digital Media ARR of \$464 million, Digital Experience revenue of \$1.10 billion, cash flows from operations of \$2.04 billion, RPO of \$13.82 billion exiting the quarter and repurchasing approximately 1.9 million shares of our stock during the quarter.

[In our Digital Media segment, we achieved] 15% year-over-year revenue growth [in Q2, or 16% in constant] currency. We exited the quarter with \$12.95 billion of Digital Media ARR. We achieved creative revenue of \$2.61 billion, which represents 12% year-over-year growth or 14% in constant currency. We added \$357 million of net new Creative ARR in the quarter, a sequential increase of 13% from Q1.

Second quarter Creative growth drivers included continued strength in acquisition, engagement and retention across our customer segments; momentum in the small and medium business segment, where our Team's offering continues to drive new customer acquisition; demand for our flagship products, including Photoshop, Illustrator and Premiere; mobile applications, where our ending ARR grew greater than 30% year-over-year exiting the quarter; Adobe Stock, where we saw strong book of business growth across organizations and new customers; and momentum in new businesses with strong growth in Frame.io as well as our Substance offerings, which grew ending ARR greater than 60% year-over-year exiting the quarter.

Adobe achieved Document Cloud revenue of \$595 million, which represents 27% year-over-year growth or 28% in constant currency. Document Cloud continues to be our fastest-growing business given the relevance and importance of PDF to knowledge workers around the globe. We added \$107 million of net new Document Cloud ARR in the quarter.

Second quarter Document Cloud growth drivers included continued strength in acquisition, engagement and retention for Acrobat across our customer segments; momentum in the small and medium business segment and the reseller channel, continuing to drive new Document Cloud subscriptions; continued growth of searches online for document actions, funneling millions of new customers into our document franchise through

Acrobat web; strength in mobile with ending ARR growing greater than 40% year-over-year exiting the quarter; and strong adoption of Acrobat with integrated Sign capabilities within organizations of all sizes. Our Document business also had a strong quarter in sales of Acrobat perpetual licenses.

Turning to our Digital Experience segment. In Q2, we achieved revenue of \$1.10 billion, which represents 17% year-over-year growth or 18% in constant currency. Digital Experience subscription revenue was \$961 million, representing 18% year-over-year growth.

Second quarter Digital Experience growth drivers included strong growth in our Adobe Experience Platform business, or AEP, with Real-Time CDP revenue more than doubling year-over-year; increasing customer interest and pipeline generation for new applications built on AEP, including Real-Time CDP, Customer Journey Optimizer and Customer Journey Analytics; success with Workfront where average deal sizes grew greater than 35% year-over-year; continued customer demand in Content and Commerce with significant new customer acquisition in Adobe Experience Manager as a Cloud Service; enterprise demand for Adobe professional services, driving customer success and new implementations across our solutions and strength in retention rates during the quarter, driven by product differentiation and our focus on delivering customer value.

Our strategy of enabling enterprises to activate first-party data to provide personalization at scale in real time is resonating with customers, driving our continuing Digital Experience growth. In Q2, we continued to focus on making disciplined investments to drive growth, including marketing campaigns and headcount additions in our R&D and sales organizations. We're pleased with our success in talent acquisition during the quarter in a competitive market.

Adobe's effective tax rate in Q2 was 21% on a GAAP basis and 18.5% on a non-GAAP basis. The increase in the GAAP tax rate is primarily due to the lower-than-expected tax benefits associated with stock-based compensation and geographic mix of earnings. RPO exiting the quarter was \$13.82 billion, growing 13% year-over-year or 15% year-over-year when factoring in a 2% foreign exchange headwind.

Our ending cash and short-term investment position exiting Q2 was \$5.30 billion, and cash flows from operations in the quarter were \$2.04 billion. In Q2, we repurchased approximately 1.9 million shares at a cost of \$800 million. We currently have \$9.5 billion remaining of our \$15 billion authorization granted in December 2020, which goes through 2024.

We will now provide Q3 targets as well as an update on the annual targets we provided in December, factoring in the following four items. First, in March, we stated that as a result of lower-than-expected tax benefits associated with stock-based compensation, our effective tax rates would increase in fiscal 2022.

Second, in March, we outlined the impact of the ongoing war in Ukraine and our decision to cease all new sales in Russia and Belarus, resulting in an expected \$75 million revenue impact on our Digital Media business. Third, as a result of the continued strength of the U.S. dollar, we are now factoring in an incremental FX headwind of \$175 million across Q3 and Q4 revenue. And fourth, while demand for our products remains strong, we now expect the second half of the fiscal year to show more pronounced summer seasonality in Q3 in the enterprise business with a stronger sequential increase in Q4.

As a result, for Q3, we are targeting total Adobe revenue of approximately \$4.43 billion, net new Digital Media ARR of approximately \$430 million, Digital Media segment revenue growth of approximately 13% year-over-year or 16% in constant currency, Digital Experience segment revenue growth of approximately 12% year-over-year or 14% in constant currency, Digital Experience subscription revenue growth of approximately 13% year-over-year or 15% in constant currency, tax rate of approximately 22.5% on a GAAP basis and 18.5% on a non-GAAP basis and GAAP earnings per share of approximately \$2.35 and Non-GAAP earnings per share of approximately \$3.33.

For fiscal year 2022, we're now targeting total Adobe revenue of approximately \$17.65 billion, net new Digital Media ARR of approximately \$1.90 billion, Digital Media segment revenue growth of approximately 12% year-over-year or 17% on an adjusted basis, Digital Experience segment revenue growth of approximately 14% year-over-year or 17% on an adjusted basis, Digital Experience subscription revenue growth of approximately 15% year-over-year or 19% on an adjusted basis, tax rate of approximately 21% on a GAAP basis and 18.5% on a non-GAAP basis and GAAP earnings per share of approximately \$9.95 and Non-GAAP earnings per share of approximately \$13.50.

In summary, I'm pleased by the way Adobe executed in Q2. We are driving growth across Creative Cloud, Document Cloud and Experience Cloud, with momentum in our established businesses and early success in our new initiatives. As a result of our disciplined operating model and focused execution, we were able to dramatically reduce the expected impact of increased tax rates and FX headwinds on our EPS. The investments we're making today in people, products and marketing will enable us to drive strong growth for years to come, and we are on track for another year of record revenue and operating cash flows.

Shantanu, back to you.

Shantanu Narayen - Adobe Inc. - Chairman & CEO

Thanks, Dan. We are proud of our strong Q2 performance across Creative Cloud, Document Cloud and Experience Cloud. Adobe remains one of the greatest places to work in the industry, and I want to thank our employees for their relentless dedication.

This quarter, Forbes named us a top employer for college graduates, and we were ranked on their list of America's Best Employers for Diversity. I'm thrilled to welcome our largest cohort of interns and university graduates this summer.

Demand for our category-defining products and services continues to grow. We're innovating at rapid speed for new and existing customer segments accelerating our leadership in established categories and seeing strong momentum for our newer initiatives. Our strategy remains to focus on long-term growth initiatives while delivering world-class profitability. Our business fundamentals and market tailwinds are strong, and I've never been more confident in our ability to execute on the \$205 billion market opportunity ahead of us.

I will now turn it back over to Jonathan.

Jonathan Vaas - Adobe Inc. - VP of IR

Thanks, Shantanu. Adobe MAX, our Creativity conference, will take place during the third week of October this year in Los Angeles. On day one at MAX on Tuesday, October 18th, we plan to host a financial analyst meeting. Invitations, including discounted registration information, will be sent to our analyst and investor e-mail list later this summer. More information about the event can be found online at max.adobe.com.

We would now be happy to take your questions. (Operator Instructions) Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we will go to our first question from Kirk Materne of Evercore ISI.

Stewart Kirk Materne - Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst

Congrats on the strong results. Shantanu and Anil, I was wondering if you guys could just talk a little bit about the type of conversations you're having with your enterprise customers these days given the macro backdrop. Are you seeing any hesitancy to spend? Obviously, you guys are keeping your full year guidance despite all these headwinds. But I was also just curious if there's any change in kind of the type of deals. Is it more smaller deals but more deals? Or is the product mix changing at all on the Experience Cloud side? I was just wondering if you could give us some color on that because that obviously remains a very primary concern for folks these days.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Thanks, Kirk. Yes, we are pleased with what we saw in the quarter. In the conversations that we're having, both Anil and I would first say, that the interest level in executives all around the world is very high. Unlike last time, I would say, right now, the focus is also a lot on execution. So a lot of the investments that people have made in digital, they recognize that given how critical the imperative is to engage with customers digitally. So we're actually pleased both Adobe as well as if you look at the entire systems integrator and partner network, they are finding that there's a lot of demand for implementation on Adobe products.

I think the other part of the conversation that you all have with enterprise CEOs right now is they all recognize it's an uncertain time, and that's the conversation that we have. But despite that uncertain macroeconomic environment, the thing that all of them recognize is that digital is a priority. And they really want to continue to have conversations with us as to how they can do digital.

I'll have Anil maybe add a little bit of what he's seeing across different verticals as well. But the importance of digital remains undiminished.

Anil S. Chakravarthy - *Adobe Inc. - President of Digital Experience Business*

Yes. Thanks, Shantanu. Just to add a little bit on the vertical color. We were really pleased with some of the wins we had in Q2. If you look at automotive and what we had with Daimler over in Europe, however, we continue our strength in sports, media and entertainment with NFL, which is using the Real-Time CDP for personalization at scale across their fan base and in health care, where we had a really important win with CVS, that was a great validation of all the HIPAA readiness we built into our platform.

So that opens up a big market opportunity. So we were really pleased with those wins. And as you said, digital continues to be a priority, and we are seeing that in the pipeline for the second half.

Operator

And Kirk, did you have anything further?

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

No, that was it. I'll keep to my one-question limit.

Operator

And we'll go next to Brent Thill of Jefferies.

Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Dan, I was curious if you could just comment on the more pronounced summer seasonality, what are you seeing this year versus perhaps in past years?

And just a quick follow-up on the numbers. The net new ARR guide was down in Q2 to Q3. And I think last quarter, you said it would be up. Did we misinterpret what you said last quarter? I just want to make sure you clarify that.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Yes, Brent, the way I would describe it is we had a strong first half, and we actually continue to see a strong demand for our unique solutions. And all of our new initiatives as well as the established businesses are doing well. I guess what we are also paying attention to is what we all read as part of the macro environment.

And when I look at what we expect for our second half, the confidence remains undiminished. The question really for us is timing. And maybe we're being a little cautious as it relates to what happens given the summer seasonality, as you know, Brent, better than most is sort of the July and August. So as it relates to our second half pipeline, the confidence remains undiminished. And we're just maybe a little cautious as it relates to timing.

In terms of what we had said in March, you're right, we had sort of alluded to the fact that we would have expected some sequential increase. Clearly, we had a strong Q2. But that's part of the reason why we wanted to give a little bit of color and be transparent on how we see it. And as you noticed, we reaffirmed the \$1.9 billion for net new ARR for the year.

Operator

And we'll go next to our question from Brad Sills of Bank of America.

Bradley Hartwell Sills - *BofA Securities, Research Division - Director, Analyst*

I wanted to ask about Creative Cloud Express. You mentioned some new features here, imaging, video, editing for Acrobat. It seems to me like those are -- would be considered typically premium features. Is there any change in strategy with Creative Cloud Express as to where you see that playing in different segments of the market?

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

Yes. Thanks for the question. First of all, we're really thrilled with the reception of Creative Cloud Express -- Adobe Express into the market. And frankly, it's been a lot of fun for us because it's a product that everyone at Adobe can also be using. It's amazing to see the creativity coming out of finance and legal, for example.

As a reminder, just to sort of up level for a second, we've been focused on the communicator and creator economy ecosystem for years. In fact, we believe that we're the largest provider of creative tools to professionals and communicators on the back of our core products. So I want to just make sure people recognize that the core products are playing to this incredibly large market.

Where we see Express filling in is that Express is additive and broadens the reach in that new communicator base because of exactly what you're saying, the freemium business model, the zero-friction onboarding. It's clearly showing that we're able to attract millions of new users into the franchise. And we're able to do it very efficiently by optimizing how we onboard customers from search terms that typically were not ones that we focused on in the past. We also look at the ability to onboard those users and differentiate the offering with the integration of these amazing features that we get from the desktop applications like Adobe Magic. And all of this helps differentiate what we're doing with Express.

And if we take a step back and look at it from a business perspective, we feel very confident that Adobe Express and the way we actually pull people into that funnel is additive to the market opportunity that we're playing. So we are really emphasizing the ability to add more capabilities there and differentiate there.

I do also want to remind folks that Express is also available to core Creative Cloud customers. And by integrating some of those features into Express, we're enabling workflows between the core Creative Cloud products and also Express, and we believe that's going to have a strong retentive value on the core base. And we just had, in fact, a great quarter with very strong retention for Creative Cloud as well.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Brad, maybe if I were to add, I think the team is actually having a lot of fun with all these cool features. To your point, they're showing some incredible stuff as part of the quick actions. But if you look at the depth of what they have, I mean, there is so much behind the scenes that we will be able to monetize. But clearly, the focus is on usage right now, as David said. It's been fun.

Operator

We'll go next to Alex Zukin of Wolfe Research.

Aleksandr J. Zukin - *Wolfe Research, LLC - MD & Head of the Software Group*

I guess maybe just a 2-parter. The first one, we've talked, I think, a lot about pricing tailwinds during last quarter in terms of the impact for the year. And I guess can you help us just quantify the impact that you're anticipating for Q3 and Q4? Because it does look to start ramping here pretty meaningfully.

And then, Shantanu, I guess maybe just for you, with respect to the strategic approach to M&A and kind of what's on the horizon given the changing valuation paradigms in the market, how important is either a large strategic M&A to the growth profile of the business versus tuck-ins?

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

I'm happy to -- go ahead, Shantanu.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

I think as it relates to your M&A question and then David can certainly answer the other one. Clearly, valuations, to your point, have changed quite a bit. And the first thing I'll start off by saying is we're really pleased with our portfolio. If you look at some of the new initiatives, and we've touched on that, whether it's Adobe Express, whether it's the Real-Time CDP, Customer Journey Analytics, what we are doing with things on the web, including PDF, we feel really good. I do feel, Alex, that there are going to be a number of small single-product companies that are probably not going to survive what's happening. And the valuation sort of multiple changing is actually, I think, good for a larger company like Adobe.

So it doesn't feel like we need anything, but we'll always be on the lookout for things that are additive, that are adjacent and that will provide great shareholder value. And our metrics associated with ensuring great technology, great cultural fit and adjacency remain. But we have so much going on within the company that we're excited about our current portfolio. Clearly, things will be more reasonable in terms of M&A as well.

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

And on pricing, Alex, you're right. We did sort of introduce a modest price increase to a portion of our customer base in Q2. The new prices were in market for about a month and drove a little under a \$10 million of benefit, which is exactly what we were expecting. And as you can see, is a very small part of the \$464 million that we drove in Q2.

Customer reaction overall to this has been good because we've added so many new features since the last price update that it's been very positive overall. And in fact, if we get asked anything by analysts, it's why we didn't make a bigger price increase. And the reality there is we're primarily focused on adding millions of new users. We are a growth business. We want to continue to grow the user base. And we believe that with the initiatives we have around both the core and the new products, we want to run the business through acquisition of new users, engagement and retention.

Aleksandr J. Zukin - *Wolfe Research, LLC - MD & Head of the Software Group*

Got it. And sorry, Dan, just maybe just the impact on Q3 that you're anticipating in the guide for net new ARR on pricing?

Daniel J. Durn - *Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations*

Yes. That -- we won't provide that as part of the guide. I think the metrics that David gave you around Q2 give you a good sense of the expected actions that we anticipate going forward.

Operator

And we'll go next to Saket Kalia of Barclays.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Okay. Great. David, maybe just to stay with you, given the questions on macro, I was wondering if we could go one level deeper into the makeup of Creative ARR. We have a very helpful disclosure from Analyst Day, the single-app versus the all-app mix, which is helpful. But how do you think about the mix from maybe consumers versus professionals, if there's a way to break that down because, of course, right now, there are lots of questions just about the health of the consumer.

How do you think about that mix? And how do you think about maybe the defensiveness or the retention rates on both of those different cohorts? Does that make sense?

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

Yes, makes perfect sense. Yes, happy to take that one. So at a high level, we think about the business through, obviously, multiple segmentations. But as you're looking at it, we think about it as enterprise buyers, mid-market and SMB buyers, communicators and consumers. So we have a very broad and diverse portfolio, which has served us very well in the past.

And as you are alluding to, we've been through multiple recessions before. So we have some good insight into how these different cohorts respond to difficult financial times. And overall, we fared very well. Enterprises, we've talked about, you heard Anil and Shantanu talk about content is fueling the digital economy and needing to stay very focused on their digital investments. From a pro market perspective, we have professionals that are making their living using our products. So we feel very good about that offering as well.

From a communicators perspective, where they tend to be either working in departments or small businesses or they're part of this growing movement around the creator economy and they're aspiring to make money or build followers with that, so it's an essential part of their tool set that they're going to do to grow their side hustle and their activities.

And as it relates to the consumer businesses, we've been very thoughtful with pricing there and have very attractive pricing that we think has fared very well for us in the past around through recession. So overall, we think the business is diverse, and we see the business as very resilient.

Operator

And we'll go to our next question from Karl Keirstead of UBS.

Karl Emil Keirstead - *UBS Investment Bank, Research Division - Analyst*

I'd love to ask about the Digital Experience guide. You set it for 14% in the third quarter. That's down about 4 points in constant currency from 18% in May and is the lowest in a bit. I know it's a tougher comp. Is that the issue? Or is there anything else to call out on the DX business?

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Nothing, Karl, to call out. I mean if you look at what our targets are for the year and if you look at it in terms of what we would expect for both subscription and total revenue, we're, in effect, saying exactly the same at the beginning of the year in what's a really tough economic environment. So yes, the interest in our solutions remains strong.

I also wanted to maybe add to a little bit of what David said for Saket. So the consumer sentiment that we continue to hear from banks such as yourselves is that the consumer sentiment actually continues to remain strong, both in the U.S. and in Europe. So I didn't want to have anybody feel like that's not what we are seeing as well.

Operator

And we'll move to our next question from Jay Vleeschhouwer of Griffin Securities.

Jay Vleeschhouwer - *Griffin Securities, Inc., Research Division - MD of Software Research*

I'd like to ask about 2 important attributes of your product-led growth strategy. First, could you comment on the contribution from or expectations for what you call your Application and Intelligent Services. Is that becoming meaningful at this point?

And then secondly, at Summit a couple of months ago and again this evening, we heard multiple examples of integrations within and across your segments, which is longstanding Adobe practice, but we've heard a great to more about that the last couple of years. Could you comment on which of the many integrations you think, either in terms of addressable market or your own sales capacities, might be the most meaningful over the next number of quarters and years?

Anil S. Chakravarthy - *Adobe Inc. - President of Digital Experience Business*

Thanks for the question, Jay. In terms of the Application & Intelligence Services, it fits really well into the portfolio of our Adobe Experience platform-based services. So just to recap, we have 3 major services, the Real-Time CDP, Customer Journey Analytics and the Journey Optimizer. And what we have done is really integrated these intelligent services as part of these applications that run natively on the Adobe Experience Platform. And where that has been extremely valuable to us is we have a broad base of customers through our Digital Experience portfolios. For example, with Adobe Analytics, we have -- that's been the gold standard for a long time on -- for web traffic analysis and trends and insights.

And with Customer Journey Analytics, our enterprise customers can now get a 360-degree view of everything that's happening across the customer journey, whether it's web traffic or through mobile apps, social, call center and so on. And that's where the intelligence services really fit in to really be able to expand the portfolio and drive value from how you segment those into audiences and activate them.

Jay Vleeschhouwer - *Griffin Securities, Inc., Research Division - MD of Software Research*

Okay. And the second part of the question?

Anil S. Chakravarthy - Adobe Inc. - President of Digital Experience Business

If you could repeat the second part of the question, please?

Jay Vleeschhouwer - Griffin Securities, Inc., Research Division - MD of Software Research

Sure. I was trying to get some insights into which of the many integrations that you've done, either within or across your segments, whether it's Digital Media, DX or combinations thereof, you think had, had or will have the most meaningful impact, assuming that not all of these integrations are created equally?

Shantanu Narayen - Adobe Inc. - Chairman & CEO

I'll start off maybe on that particular question, Jay, because one of the areas that we're seeing just tremendous interest is what we are referring to as content supply chain. And both David and Anil can touch on that as well a little bit more. But this notion of people creating campaigns, if you agree with us that the greatest value that we can provide is enabling every enterprise to do personalization at scale, the amount of content that's being created, the amount of content that's being delivered and to understand the efficacy of the campaigns is just absolutely top of mind.

I mean we have a large, large consumer company that has completely consolidated all of their marketing activity to really understand what this content supply chain is. And so the notion of content supply chain and what we can do between our creative applications, the asset management that we deliver, the website and what we are doing with AEM, Experience Manager, that and work front, to be able to do workflow associated with that, that is really resonating with every single customer right now.

Operator

And we will go next to Keith Weiss of Morgan Stanley.

Keith Weiss - Morgan Stanley, Research Division - Equity Analyst

I have a question for Dan, and it's about sort of the guidance philosophy. And I think what a lot of people are trying to get at is understanding holding the Digital Media ARR guide at \$1.9 billion for the full year. Despite the kind of increased seasonality in Q3. Despite the fact -- like The Street kind of gave you a pass. We've already taken our numbers down to like \$1.8 billion. Why keep that risk out there? Why push more risk into Q4? Or why put a high bar out there when -- obviously, it's not in the stock. All the stocks are getting killed here. It's not in our expectations. Like what is it that gives you so much confidence to like keep that number out there?

Daniel J. Durn - Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations

So I guess where I'd start is, if you take a look at where we are in the first half, I would say the performance of the business is really good. We talked about it earlier, conversations with the customers, what we're seeing in data and DDOM and the insights that it gives us, we see strength into the back half of the year. So we're confident in the underlying performance of the business.

And I'd go back to the earlier comments, we see the headlines, we see what others are talking about. And so in an environment like this, maybe we're a little cautious about Q3. I think that's the prudent way to go. But it doesn't take away from the insights we have and the belief we have and confidence in the underlying performance and the strength we see into the second half. And so I think we've taken everything into account, and we've got the right set of targets out there that reflect what we're seeing in the business and how we expect to perform.

Keith Weiss - *Morgan Stanley, Research Division - Equity Analyst*

Got it. And I mean any visibility into what gets better in Q4 that's going to enable that? Because you're looking for net new ARR to go from basically down in the first half of the year to growing in the back half. What -- could you give us any kind of visibility into like what gives you guys that confidence?

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

If you look at the rhythm of how we've managed the business, certainly, you look at what happens with education in Q4, you look at the enterprise which tends to be a seasonally strong Q4, you start to look at what's happening with the emerging businesses that will continue to ramp. And so it's a combination. I think somebody else alluded to pricing, and we'll have a full quarter of pricing as well.

And so when you put all of those together, every Q3 to Q4, we see a seasonal uptick. And if you look at what happened even last year and you look at what the numbers look like, it's something that we're going to go drive.

Operator

And we'll go next to Tyler Radke with Citi.

Tyler Maverick Radke - *Citigroup Inc., Research Division - VP & Senior Analyst*

Yes. I wanted to ask you about the CDP space. I think you talked about your revenue there doubling year-over-year. I guess just a couple of questions.

Number one, how significant is CDP as part of the overall experience business as a growth driver? And two, could you just talk a little bit about the competitive landscape? This is something that Salesforce talked a lot about on their last earnings call. We've seen Amplitude recently launch a CDP. So how do you kind of see all this evolving? And how do you think this plays out?

Anil S. Chakravarthy - *Adobe Inc. - President of Digital Experience Business*

Thanks, Tyler. Yes, let me take the big picture first on what we see with the overall CDP market. First of all, all the interest in CDP is a great validation of the fact that the traditional CRM is not the way to go to build the next-generation customer experience. Some of the data might be there, but you really need to activate the data and construct a rich profile before you can activate that.

So if we look at the CDP market, what we see is, from our perspective, it's the platform for full customer engagement. And then that involves a number of different components. You look at the data collection that's required, and we built a lot of connectors not only with our apps. We have over 100 connectors out there for the data collection. Then you need to be able to assemble that into a real-time database so that you can make that next best action, the next best offer. We call it personalization at scale to millions of people in milliseconds. And that real-time customer profile needs to be activated.

And third, it then becomes the platform for not just the apps in our portfolio. But then, for example, the integration we have with Dynamics, for example, with customer service or the integration we have with ServiceNow and so on. It needs to become the customer data platform that serves the entire range of customer-facing applications. That's the way we look at CDP. That's what makes it a broad and exciting market. And that's really where we are differentiated. When we talk to customers, and I'll give you the examples of, say, CBS and NFL and so on, they recognize and agree with that vision, and that's why they are betting on us. And most of the players you see do one piece of it and don't really have either the comprehensive nature of the products in their portfolio or the real ability to pull it off in a true real-time manner.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Maybe the one thing I would add to all of that is we have 32 billion profiles right now. I mean, clearly, every customer has their profile kept isolated. So we're clearly the leader as it relates to large companies that have a CDP in the market that's real time.

Operator

And we'll move next to Gregg Moskowitz with Mizuho.

Gregg Steven Moskowitz - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Can you talk about the Express Your Brand program? Obviously, Meta has huge small business reach, but it would be helpful to get your expectations on what this partnership will do for Adobe incrementally.

David Wadhvani - *Adobe Inc. - President of Digital Media Business*

Yes. So happy to do that. It's been -- it's actually a very exciting program for us. So as you know, Adobe Express is predominantly focused on communicators, small, medium businesses as they start to move more online. We've talked a lot about the rise of the creator economy. We've mentioned that there are hundreds of millions of small, medium businesses that are really targeting more online communication and really focused on social media. In fact, in a recent survey, we found that the majority of small, medium businesses actually say that their online presence is more important than their physical presence. And so they need to coordinate and communicate digitally.

And our ability to provide -- with Meta provide all the tools that they need end-to-end to build incredible content that stands out and participate in the online experience that Meta is providing and, of course, also work more broadly across all the other social networks, I think, is a really great opportunity for Meta, for us and certainly for the small, medium business owners that are part of that program.

Operator

We'll go next to Kash Rangan of Goldman Sachs.

Kasthuri Gopalan Rangan - *Goldman Sachs Group, Inc., Research Division - Analyst*

Shantanu and team, this upcoming maybe recession is the one that everybody has been predicting. And the company, as David said, has been through a couple of recessions before.

The company is a very different company today than it was even just a few years ago. What is your best prognosis as to how the portfolio of Adobe products behaves if we are to enter a downturn, not that we wish it? But if we were to enter one, how do you think the portfolio is positioned? And from the financial angle, are you prepared to at all slow down hiring. The beauty of the subscription model is that you still start on hiring and produce nice margin upside, that sort of thing from a financial perspective. But curious to get your thoughts overall on this particular topic.

Shantanu Narayen - *Adobe Inc. - Chairman & CEO*

Sure. Let me first cover your second part, Kash, as it relates to the bottom line. And our philosophy right now, given all of the myriad opportunities that we have is we're planning for the upside. We know how to react to the downside when that happens. I mean look at what's happened with the tax rate and the financial team and the product teams what they were able to do to really address all of that is truly remarkable. I mean we take it for granted at the company, but we've done an amazing, amazing job at continuing to be extremely profitable.

For me, I think when you talk about a recession, the question I ask people is when you look at the 3 things that Adobe does, which is focus on content, focus on automation, focus on customer engagement, I just don't look at any of those and feel like the secular trend for that will change. So there may be some change in the rhythm of that quarter-over-quarter. But the fundamental shift of what we are doing, I mean, Anil talked about this real-time CDP, customer engagement is going to be the only thing that differentiates the business from another business. And the success that we're seeing in health care clearly points to that as well.

So we'll navigate it. We have an incredibly experienced management team. We're planning for the upside right now, which is all of our growth initiatives. And we'll react as appropriate. And we are clearly not going to be in denial. But right now, it feels like a very strong time for Adobe to continue to execute against the things that we have on our plate.

Daniel J. Durn - Adobe Inc. - CFO and Executive VP of Finance, Technology Services & Operations

Yes, I just want to build a little bit on the first part of Shantanu's answer. We talked about offsetting some of the headwinds we see. We talked about the increase in tax rate. We talked about the FX headwind into the back half of the year. In Q1, we discussed the impact we were seeing from the war in Ukraine. When we take the FX and the impact we discussed in Q1, that's a \$250 million revenue headwind in the back half of the year. The increase in tax rate is about a \$0.25 a share impact full year. When I net both of those together, we would expect to see about \$0.60 to \$0.70 a share erosion of the earnings power of the company. And to Shantanu's point, it really underscores a philosophy that's underpinned how this company has operated for a very long time.

It's about focused execution. It's about operating discipline, and the fact that the full year targets have come down \$0.20 when the math would suggest it should be much greater than that, just really underscores the power of the model. We're investing for innovation. We're investing to serve our customers, but we're doing it in a very focused disciplined way. And I think that says a lot about who we are as a company.

Operator

And our last question is from Brad Zelnick with Deutsche Bank.

Brad Alan Zelnick - Deutsche Bank AG, Research Division - Head of Software Equity Research and Senior US Software Research Analyst

Excellent. Congrats on a strong Q2. My question is for David. David, we've seen reports of the trial you're running in Canada for a free browser-based version of Photoshop, which I assume is another Express-like offering to build top-of-funnel interest and awareness. Can you share more about the strategy here? And how you think about the balance of more simplified products, creating incremental demand versus competing with more premium SKUs?

David Wadhvani - Adobe Inc. - President of Digital Media Business

Yes, absolutely happy to talk about that. We are very excited about the work we're doing here, frankly, not just with Adobe Express, but with Photoshop, as we mentioned here, with Lightroom as we've done in the past and also with Acrobat. Our focus has always been to take the strength that we have in the desktop and build a multi-surface experience for our customers across desktop, mobile and web.

And as we've done that, we've noticed that web and mobile really represents an opportunity to broaden our audience in a very significant way. And we do that by capturing search traffic and at the point of intent, bringing them into the zero-friction web experience with a freemium model.

And so PS web and what you're seeing there is a step along that journey for our core imaging franchise. And we absolutely anticipate it being a source of funnel opportunity, similar to the way that Acrobat has seen -- Acrobat web as a source of that funnel activity. You see how strong the core Acrobat business is and how it's performing.

We have a version of Acrobat web that's available. We've been able to double traffic to that, and we now have over 50 million monthly active users leveraging Acrobat web, and we use that as a top of -- leveraging Acrobat web on a monthly active basis, and we're able to leverage that and convert that traffic into a real business. We're playing that same playbook now with Photoshop as well, and we expect that to be a very productive opportunity.

Shantanu Narayen - Adobe Inc. - Chairman & CEO

I think if I were to add to that, I mean, really, in effect, what we do is we look at platforms in an unbelievably expansive way. And on any platform, just making sure that we get the magic of our technology and as friction-free way possible is part of what we are continuing to do. And we have an unbelievably rigorous process also of them really understanding how to monetize it. So some of the press releases may be a little bit more sensationalistic in terms of how they announced that, Brad.

But since that was the last question, I just have to say, we're proud of how we're executing against our strategy. I mean everybody would acknowledge that it's an uncertain macroeconomic environment. But we believe that we will continue to win by delivering great innovative products that at the end of the day, delight and ever increasing for our set of customers. We're making some very creative marketing campaigns. We have strong sales and go-to-market motions that are appropriate for the set of customers that we're targeting. And I think with being the best users of our product, which actually gives us tremendous credibility to both innovate at a rapid pace as well as deliver great customer satisfaction and growth to our customers worldwide.

So thank you for joining us. And with that, I'll turn it over to Jonathan.

Jonathan Vaas - Adobe Inc. - VP of IR

Great. Thanks, Shantanu. Thanks, everyone, for joining the call. We look forward to speaking to many of you soon, and this does conclude the event. Thank you.

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