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ADBE.OQ - Q1 2023 Adobe Inc Earnings Call

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## OVERVIEW:

Co. reported 1Q23 revenue of \$4.66b and 1Q23 GAAP diluted EPS of \$2.71. Expects FY23 GAAP EPS to be \$10.85-11.15 and non-GAAP EPS to be \$15.30-15.60. Expects 2Q23 total Co. revenue to be \$4.75-4.78b, GAAP EPS to be \$2.65-2.70 and non-GAAP EPS to be \$3.75-3.80.

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

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

**Jonathan Vaas** *Adobe Inc. - VP of IR*

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

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## PRESENTATION

### Operator

Good day, and welcome to the Q1 FY 2023 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.

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### 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 first quarter fiscal year 2023 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, March 15, and contains forward-looking statements that involve risks, 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 constant currency rates. During this presentation, Adobe's executives will refer to constant currency growth rates, unless otherwise stated. Reconciliations are available in our earnings release and on Adobe's Investor Relations website.

Adobe Summit is just around the corner in Las Vegas at the Venetian Convention and Expo Center beginning on Tuesday, March 21. Following the Day 1 keynote, we will host a Q&A session with financial analysts and investors in attendance at 11:30 a.m. Pacific Time. Audio of the event will be broadcast live, and the replay will be available on Adobe's IR website. More details about Summit and the agenda are available at [summit.adobe.com](https://summit.adobe.com).

I will now turn the call over to Shantanu.

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

Thanks, Jonathan. Good afternoon, and thank you for joining us. Adobe had a strong Q1, driving record revenue across our Creative Cloud, Document Cloud and Experience Cloud businesses. We achieved \$4.66 billion in revenue, representing 13% year-over-year growth. GAAP earnings per share for the quarter was \$2.71, and non-GAAP earnings per share was \$3.80.

Digital is reshaping how we connect and engage with the world around us. Our performance demonstrates the critical role that Adobe products are playing in fueling the global digital economy, empowering everyone everywhere to imagine, create and bring any digital experience to life. We're executing against our strategy to unleash creativity for all, accelerate document productivity, and power digital businesses, delivering on our innovative product road map and engaging a growing universe of customers, from individuals to small businesses to the largest enterprises.

Given the recent news reports, I wanted to provide an update on the process and timing of our pending acquisition of Figma. We remain excited about the opportunity to advance product design, accelerate collaborative creativity on the web and redefine the future of creativity and productivity. The potential combination continues to be well received by customers, industry analysts and partners. In addition, we are preparing for integration as we work through the regulatory process. From the outset, we have been well prepared for all potential scenarios while realistic about the regulatory environment. We have completed the discovery phase of the U.S. DOJ second request and are prepared for next steps, whether that is an approval or a challenge. Adobe remains confident in the facts underlying the case. And based on current process timing, we believe the transaction continues to be on track for a close by the end of 2023.

It goes without saying that our Q1 success demonstrates that we continue to be ruthlessly focused on executing against our immense opportunities, independent of this combination.

David, over to you.

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

Thanks, Shantanu. Hello, everyone. We're living in a visual, digital-first world where content creation and consumption are exploding and where consumers, students and businesses need to create content that stands out and elevates their online profiles. As a result, more and more people are turning to Creative Cloud, which remains a preeminent destination for creativity across imaging, design, video, illustration and animation, as well as new media types like 3D and augmented reality. We continue to see strong demand for our flagship applications, including Photoshop, Lightroom, Illustrator, Premiere Pro and Acrobat and are excited about the traction we're getting with Adobe Express.

Q1 was a strong quarter for Creative Cloud. We achieved net new Creative ARR of \$307 million and revenue of \$2.76 billion, which grew 13% year-over-year. Q1 highlights include strong growth in top-of-funnel traffic, which resulted in healthy new demand for creative cloud applications across all routes to market and customer segments globally, from individuals to SMBs, to large enterprises.

Increased demand and mobile adoption in imaging with products like Photoshop and Lightroom. Lightroom mobile is now the default photo editor for the high-end photo editing experience on the Samsung Galaxy S-23 Series.

Continued momentum for Premiere Pro, After Effects and Frame.io, which are leaders in video editing and collaboration. Over 2/3 of films at Sundance, as well as Oscar winners "Everything Everywhere All at Once" and "Navalny", were edited with our video products.

Rapid adoption of Substance 3D by brands such as Amazon, Burberry and Louis Vuitton. The Substance 3D team was honored with a technical Oscar in recognition of 3D capabilities that are making popular films such as Spider-Man, Star Wars and Blade Runner 2049 possible.

Acceleration in our Adobe Stock business driven by the demand for high-quality imaging, vector, video and 3D content.

Momentum for Adobe Express with significant year-over-year growth in monthly active users across segments such as students, small businesses and creative professionals. We are actively driving adoption of both new users and existing Creative Cloud subscribers who are now using Express when they want speed and ease, and we look forward to an imminent release of a dramatic upgrade with enhanced performance, collaboration functionality and new authoring capabilities for video and mixed media.

Exciting introduction of new products, including our beta releases of Character Animator and Adobe Podcast. Adobe Podcast is a web-based, AI-powered audio recording and editing app, perfect for the growing podcast industry. It makes every recording, even those done on your phone in busy spaces, sound like they were recorded in a studio.

Key customer wins in the quarter include Accenture, BBC, Disney, IBM, Infosys and Nintendo.

Our innovation engine continues to fire on all cylinders to reimagine the future of creativity. Last October, we previewed some of Adobe's Generative AI technology at MAX. We have been hard at work training Adobe models on our proprietary datasets, creating APIs, envisioning new services and integrating all these capabilities into our existing applications as a creative co-pilot. These innovations are developed and deployed in alignment with Adobe's AI ethics principles of accountability, responsibility and transparency. Stay tuned for some exciting announcements slated for next week in conjunction with Adobe Summit.

Digital documents are powering productivity at home and at work, whether users are filing a tax form, submitting a sales contract, requesting feedback on a marketing campaign or completing an online bank transaction. Adobe Document Cloud is a leader in digital documents, redefining how people view, edit, share, scan and sign documents across desktop, web and mobile.

In Q1, Document Cloud had record revenue of \$634 million, which represents 16% year-over-year growth and strong net new ARR of \$103 million, with ending ARR growing 22% year-over-year in constant currency.

Q1 highlights include continued demand for PDF with outstanding growth in documents opened in the Acrobat Chrome extension and a new integration that will make Acrobat Reader the default PDF viewer in Microsoft Edge for over 1 billion Windows users; significant growth in monthly active users for Acrobat web driven by search volume for PDF-related verbs and a continually optimized funnel to our web offering; continued proliferation of Acrobat driven by demand for integrated functionality such as Share for Review for collaboration and Adobe Sign for e-signatures; outstanding increase in API transactions as our ecosystem and business customers continue to customize and integrate document services; strong demand across all routes to market and customer segments globally, from individuals, to SMBs, to large enterprises; key customer wins include Bank of Montreal, HP, JPMorgan Chase, Ministry of Defense of Netherlands, Samsung and Verizon.

Given the strong Q1, the demand for our products and our innovation road map, we're pleased to raise our FY '23 Digital Media net new ARR target.

I'll now pass it to Anil.

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

Thanks, David. Hello, everyone. During the 2022 holiday season, e-commerce drove a record \$211 billion, with 38 days of \$3+ billion in daily spend, according to the Adobe Digital Economy Index. Companies across B2B and B2C need an integrated Customer Experience Management platform that empowers them to anticipate and meet the expectations of their customers. Today, digital is especially critical in enabling companies to drive profitable growth by delivering engaging and efficient customer experiences across the entire funnel, and Adobe is uniquely positioned to power experience-led growth.

Experience Cloud offers a comprehensive portfolio of products that span the entire experience lifecycle, from marketing planning and workflows, to data insights and activation, to content and commerce and customer journeys. Built natively on Adobe Experience Platform, our Real-Time CDP provides businesses with actionable customer profiles, leveraging data from online and offline channels to deliver personalized experiences at scale.

In Q1, we continued to drive strong growth in our Experience Cloud business, achieving \$1.18 billion in revenue. Subscription revenue was \$1.04 billion, both representing 14% year-over-year growth.

Petco is a great example of a B2C company leveraging Adobe's comprehensive set of products to create and deliver engaging experiences. Petco uses Creative Cloud to create content and Experience Cloud, including Real-Time CDP and Adobe Journey Optimizer, to orchestrate personalized experiences across their pet care ecosystem, including veterinary care, grooming, training and insurance.

On the B2B side, Qualcomm is harnessing Experience Cloud to deliver personalized experiences and improve marketing performance as well as Creative Cloud and Document Cloud to accelerate content velocity across its business lines.

Additional Q1 highlights include high retention rates and strong demand for services, demonstrating our customers' focus on long-term value realization; strong growth in Adobe Experience Platform and our native applications, inclusive of Real-Time CDP, Adobe Journey Optimizer and Customer Journey Analytics; momentum for Workfront, which is powering workflows to help teams around the globe collaborate and launch campaigns with ease and efficiency; significant wins over single product competitors in Analytics, Content Management and CDP that underscore Adobe's differentiation; leadership in industry analyst reports, including the Forrester Wave for Digital Intelligence Platforms, the Forrester Wave for Cross-Channel Marketing Hubs and Gartner's Magic Quadrant for Digital Experience Platforms; a significant number of transformational deals, including Accenture, Carnival AIDA, Costco, IBM, MetLife, Paramount, Pfizer, S&P Global, TD Bank and Tim Hortons.

The Digital Experience business had a strong start to the year. Enterprises are focused on driving revenue growth through digital channels while increasing the productivity of their investments in customer experience and marketing. Experience Cloud is uniquely positioned to help enterprise customers across the world unlock profitable growth.

Next week, we are excited to host Adobe Summit, the world's largest digital experience conference. It's our first time coming together in person in Las Vegas since 2019, and we'll be joined online by tens of thousands of customers, partners and developers from around the world. In addition to unveiling exciting new technology innovation across Experience Cloud, we will host inspirational C-level executives from several companies at the forefront of the digital economy.

I'll now pass it to Dan.

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**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 Q1 fiscal 2023, highlighting growth drivers across our businesses, and I'll finish with financial targets.

Q1 was a strong start to the year for Adobe. I know the macroeconomy is on every investor's mind right now, and you can see the resilience and diversification of Adobe's business in our financial results. Businesses today are prioritizing investments in order to maximize returns and impact, both to drive their top line and to deliver operational efficiency. And individuals are looking to create content that enables them to connect and stand out across digital platforms. In this environment, the demand for our products continues to be strong as our solutions are mission-critical to customers in a world where digital content and engagement drive the global economy. Our product differentiation, engine of innovation and data-driven operating model are continuing to drive Adobe's growth.

We have a world-class balance sheet, industry-leading margins, a strong cash flow profile and a proven track record. I can't think of a company that's better positioned as we continue to innovate in our core business and create and scale emerging businesses to drive profitable growth.

In Q1, Adobe achieved record revenue of \$4.66 billion, which represents 9% year-over-year growth or 13% in constant currency.

Business and financial highlights included GAAP diluted earnings per share of \$2.71 and non-GAAP diluted earnings per share of \$3.80, Digital Media revenue of \$3.40 billion, net new Digital Media ARR of \$410 million, Digital Experience revenue of \$1.18 billion, cash flows from operations of \$1.69 billion, RPO of \$15.21 billion exiting the quarter and repurchasing approximately 5 million shares of our stock during the quarter.

In our Digital Media segment, we achieved Q1 revenue of \$3.40 billion, which represents 9% year-over-year growth or 14% in constant currency. We exited the quarter with \$13.67 billion of Digital Media ARR.

We achieved Creative revenue of \$2.76 billion, which represents 8% year-over-year growth or 13% in constant currency, and we added \$307 million of net new Creative ARR in the quarter.

Q1 Creative growth drivers included new user growth, fueled by customer demand and targeted marketing campaigns, which drove increased web traffic in the quarter; adoption of our Creative Cloud All Apps offerings across customer segments and geographies; students graduating from our education segment into the creative professional job market; continued strength in upselling our new Acrobat CC offering, which includes integrated Sign capabilities; licensing of individual applications, including a strong quarter for our imaging and photography offerings; momentum in high-growth businesses, such as Substance and Stock, where we had a tremendous quarter generating new business, and with Frame, which we are successfully cross-selling into our video customer base; and a fast start to the year selling into our large enterprise accounts.

Adobe achieved Document Cloud revenue of \$634 million, which represents 13% year-over-year growth or 16% in constant currency. We added \$103 million of net new Document Cloud ARR in the quarter.

Q1 Document Cloud growth drivers included continued growth of Acrobat web, demonstrating the success of our product-led growth strategy; strength in conversion and retention rates of our Acrobat mobile customers; demand for Acrobat subscriptions across all customer segments; success generating new customer demand for Acrobat Sign in SMB and the mid-market; and strength in the enterprise, driving seat expansion for our Acrobat business.

Turning to our Digital Experience segment. In Q1, we achieved revenue of \$1.18 billion and subscription revenue of \$1.04 billion, which represents 12% year-over-year growth or 14% in constant currency.

Q1 Digital Experience growth drivers included success closing numerous transformational deals with large enterprises that are choosing Adobe to be their end-to-end CXM platform to drive personalization at scale; momentum with our AEP and native applications, with the book of business growing more than 50% year-over-year; strength with our Content and Workfront solutions, as our content supply chain strategy is resonating with customers; renewal rates of our enterprise customers that continue to be strong; and sales execution across multiple geographies.

Turning to the income statement and balance sheet. In Q1, we continued with our strategy of making disciplined investments to drive growth while identifying cost-saving opportunities to drive earnings.

Adobe's effective tax rate in Q1 was 22% on a GAAP basis and 18.5% on a non-GAAP basis, in line with our expectations. For fiscal 2023, Adobe's management is adopting a fixed long-term projected non-GAAP tax rate to assess and report on operating results, which we believe provides a clear view of Adobe's financial performance. The fixed long-term non-GAAP rate considers our current operating structure, existing tax positions, legislation and available forecast information. This rate is based on a 3-year projection and may be adjusted for changes in the future.

RPO exiting the quarter was \$15.21 billion, growing 10% year-over-year or 13% when factoring in a 3 percentage point FX headwind.

Our ending cash and short-term investment position exiting Q1 was \$5.65 billion, and cash flows from operations in the quarter were \$1.69 billion. Over the past year, we completed a thorough review of our short-term investments and marketable securities to ensure we are prepared for the current environment and with a bias towards the higher end of the investment-grade spectrum. Adobe does not hold substantial assets or securities at Silicon Valley Bank or any regional bank.

In Q1, we entered into a \$1.4 billion share repurchase agreement, and we currently have \$5.2 billion remaining of our \$15 billion authorization granted in December 2020, which goes through the end of fiscal 2024.

In light of the strong start to the year and momentum across our business and factoring in the macroeconomic environment, for Q2, we're targeting total Adobe revenue of \$4.75 billion to \$4.78 billion, Digital Media net new ARR of approximately \$420 million, Digital Media segment revenue of \$3.45 billion to \$3.47 billion, Digital Experience segment revenue of \$1.21 billion to \$1.23 billion, Digital Experience subscription revenue of \$1.06 billion to \$1.08 billion, tax rate of approximately 21.5% on a GAAP basis and 18.5% on a non-GAAP basis, GAAP earnings per share of \$2.65 to \$2.70 and non-GAAP earnings per share of \$3.75 to \$3.80.

As a result of the strong performance in Q1 and trajectory of the business, we are raising our fiscal 2023 net new ARR and EPS targets. For fiscal 2023, we are now targeting Digital Media net new ARR of approximately \$1.70 billion, GAAP earnings per share of \$10.85 to \$11.15 and non-GAAP earnings per share of \$15.30 to \$15.60.

In summary, I'm pleased with our strong top line and bottom line execution in Q1, demonstrating the momentum we've established for the year. Our strong engine of innovation, combined with our operational rigor, are driving profitable growth and position us well to capture the massive growth opportunities at our doorstep.

Shantanu, back to you.

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

Thanks, Dan. Adobe's Q1 results underscore our strong momentum and the significant opportunities we have across our businesses. We're thrilled to be back in Las Vegas for Adobe Summit next week. In addition to unveiling several new innovations across Experience Cloud, Creative Cloud and Document Cloud, we will share how we are building on our decades of AI leadership to deliver generative AI technologies that redefine creativity and customer experiences. We look forward to seeing you there.

Adobe's employees around the world motivate us to continuously raise the bar and create the future. This quarter, we were named to Glassdoor's Best Places to Work, Bloomberg's Gender-Equality Index for the fifth year in a row; and the CDP A List, which recognizes leadership and environmental impact. Our renowned brand, mission-critical products, and vast base of customers create an unmatched advantage that will fuel our growth.

Thank you, and we will now take questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And we'll take our first question from the line of Brad Zelnick with Deutsche Bank.

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

Congrats on a really strong start to the year. Dan, your guidance explicitly embeds assumptions for the macro environment. Can you share with us what those are and how those assumptions might have changed from a few months ago when you last guided?

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

Yes. Thanks, Brad. There's really no change in our view in the macro environment. I think we're pretty clear, at the time we set our annual guidance, the environment that we're in. We see the environment that others see. I think you can see that the company is performing really well against that

backdrop. So we feel good about how we're situated, the way in which we're engaging with customers and its broad diversified performance across that environment. And so we like how we're set up, but there's really no change to the assumptions underlying the macro environment. We see the same environment that others do.

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**Operator**

And we'll take our next question from the line of Alex Zukin with Wolfe Research.

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

So maybe just what do you think is the driving force behind -- so many companies are talking about longer sales cycles, difficulty closing business. You had an outstanding quarter, specifically within the Enterprise. So maybe what's driving those macro headwinds for others that you're not seeing, or your resiliency specifically?

And then on the topic of metrics, every metric was strong as we looked at revenues, RPO, Digital Media ARR, operating margins. But maybe just can you talk about deferred revenue in the quarter? Anything there that was a headwind? Because it did look like free cash flow was a little bit lighter than what we were expecting.

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

I'll take the first, Alex, and then maybe Dan can speak to the second. I mean I think, as Dan said, when we look at the macroeconomic situation, and you can see strong companies actually refer to this across the board, whether it's consumers, whether it's small and medium businesses, whether it's enterprises globally, I think the reality is that digital for them is an imperative. And really for companies that have innovative solutions, it's a tailwind. I think what a lot of companies are focused on is the message that enterprises are certainly sharing, is that if the prior focus was growth at any cost, certainly, they're looking for more profitable growth. And I think if you look at our solutions on the Creative, Document or Enterprise side, we help them. We help them with growth, but we help them with profitable growth and engaging with customers.

The second thing I would say is that there's a large TAM here. And so I think our job in this environment is making sure that we have an even larger pipeline that we go address and attract because there may be some difference in the closure rates. But I think if you look at it in aggregate, our job is looking at it and saying how do we differentiate ourselves.

I think the one thing also I would say, Alex, is that a lot of the companies that have single product offerings, I think they are probably seeing more headwind because a certain company may not put one part of what they offer as a priority. And I think a lot of the companies are looking at it and saying, "If we're engaging in digital, we might change our focus from content management to the implementation of the customer data platform," or there might be a focus more on campaigns or ensuring that the advertising spend, the attribution associated with it. So I think the team has executed against continuing to try and drive a large opportunity.

The other thing I think we feel good about is the fact that both Summit as well as in the U.S. and U.K., we're looking forward to being in person because we can engage more in person with them. So hopefully, that gives you some color of why perhaps the stronger companies are showing more macro strength than other companies.

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

And Alex, I'll jump in on the second part of the question. As we think about RPO being up 13% year-over-year on a constant currency basis, you think about the underlying performance of deferred revenue, unbilled backlog, it's a very similar profile across both of those dimensions of the RPO. If you think about cash flow, the one thing I would point to, we all know that there's been a change in the tax regulation around capitalization



of R&D expenses. We signaled, at the time we set our annual targets, that we would see a step-up in cash taxes starting this quarter, and that's really what you see profiling through operating cash.

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

Perfect. Congrats.

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**Operator**

(Operator Instructions) We'll take our next question from the line of Keith Weiss with Morgan Stanley.

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

A really nice quarter. I think my question is actually a deep dive into the prior 2 questions. Dan, maybe digging a little bit into sort of what Brad was asking, we are, like from a market perspective and an investor perspective, worrying about these kind of incremental impacts like Silicon Valley Bank and other bank failures. And you're seeing continued like reduction in head count from big shops like Meta on a go-forward basis. So I think the market is getting incrementally worried about the underlying kind of macro impacts.

But you guys went the other way. Like in Q1, you're taking up your net new ARR additions for Digital Media. So can you walk us through specifically, is there anything mechanical or sort of tactical, if you will, that gives you guys the confidence that like, even with the heightened kind of volatility that we're seeing out there, that you guys feel comfortable in Q1 taking up that full year guide? And then on the other side of the equation, on the free cash flow, can you just specify for us and you can give us a sense of kind of where those cash taxes are going to go over time just to help us kind of tune in our model?

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

Yes. So let me take them in reverse order. In terms of cash taxes, there's a 5-year amortization period around the capitalization of that R&D. So you'll see a pretty dramatic cash tax step-up initially. But over that 5-year amortization period, it will converge on the reported tax rate. And so that's the general profile, and that's why you see the significant step-up in Q1 just starting that process now.

In terms of the environment we're in, clearly, the company is performing well. You see the diversification of our business. That's across geographies, industry sectors, product portfolio. The company is just performing well at a broad base way. On the strength of that performance and the momentum we have, the visibility we have into the full year, we think it's the prudent thing to set expectations with investors in a way that reflects what we see as the opportunity in the company-specific performance.

When I take a step back and I think about what is driving that differential performance in this environment, I think our products are mission-critical to our customers. We are on the critical path of them generating revenue. But as the world goes digital and those investments are prioritized, not only do we help companies drive top line growth but we help them with the underlying productivity gains that go with that. It is why customers in this environment are prioritizing around things that we sell to enable their success. It addresses top line performance as well as underlying profitability of our customers. So being on the critical path, being mission-critical to customers, we think this is the type of environment where the power of Adobe and the performance of the company gets to shine.

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

Yes. And I'll just add a little bit specific to Digital Media. The foundation of the growth that we have, we still feel a very significant tailwind even in this market. Shantanu talked about the strength of the enterprise business. Every business needs to be a digital business. Digital content is fueling the global economy. That's true for smaller organizations and individuals as well.

If you look at the creator economy, we're seeing more people come in to start to create their own personal online brands. So we saw a very strong digital funnel. As well, we had the highest traffic that we've ever had come to adobe.com. And even in small, medium businesses, the part of their business that they need to invest most in is the digital channel, as Dan was talking about.

You look at that diversity, you then layer on the diversity of the growth drivers that we have in the business, whether it's new user acquisition, whether it's upsell of existing users, whether it's retention rates, whether it's new businesses like Substance or Stock or the pricing and packaging opportunities that we have. Every one of those levers has been very productive for us.

In terms of primary growth driver, it is and always has been new user acquisition. It is, by far, the biggest contributor. And a lot of the PLG work that we've done over the last year or 1.5 years is contributing to not just top of funnel but also conversion of that top of funnel.

In terms of upsell and migration, we've been investing for a decade or more in education, and we have a very efficient channel now where students that graduate effectively upgrade and migrate into full-priced offerings. That drove a very strong Creative Cloud individual all apps quarter for us.

Retention, we've been doing a lot of work in retention through PLG, but we've also been driving a lot of utilization of Adobe Express as part of the Creative Cloud business. All of that combined makes for a very strong retention rate.

New businesses, we talked about Substance and Frame having outsized growth, and of course, the pricing and packaging work that we've been doing, all along continues to contribute to that, both for CC and Acrobat CC/DC as a whole.

So looking ahead, all of these drivers and these levers are intact, and we have lots of opportunities going forward as well.

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

And maybe just putting it all together, if you look at it and say that, hey, we did \$410 million in Q1. We're targeting \$420 million of net new ARR in Q2. The question you would have asked us if we hadn't done this was what are you signaling about the second half of the year. So I think it's a way of showing that the momentum is there in the business.

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**Operator**

And we'll take our next question from the line of Jake Roberge with William Blair.

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**Jacob Roberge** - *William Blair & Company L.L.C., Research Division - Analyst*

Congrats on great results. I just want to double click on that pension commentary you called out in several areas of the business during the prepared remarks. Is there anything specific that you're doing differently in this period of macro uncertainty that's driving those results? And have you started to see Express help at all with retention metrics as customers know the tier that they can actually graduate down to?

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

Well, for a couple of years right now, we've been really focused on what we've called in the past the data-driven operating model and really being pretty focused on driving the business both with the narrative and the number. And so I think as we continue to, as David mentioned, have different products, he's really focused on how we're acquiring them, how are we engaging them, what's the usage, how do we make sure they're getting value for the product, how do we continuously tell them about what's new.

And then I think as David has come in and introduced the notion of product PLG, I think that part has also really started to reflect in making sure that customers know that we're building products and features that are relevant for the pain points that they have. So I would say the underlying

business, while they are sort of the digital imperative, I wouldn't underestimate the incredible execution that the team continues to do on that or in DX. I mean how do you look at the solutions we're selling? How do you understand cross-sell? How do you understand upsell? And I think the hours and hours of work that goes in is sometimes not appreciated, but I'm incredibly respectful and appreciative of what the teams have done. So a lot of execution is, I think, the short answer.

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**Operator**

And we'll take the next question from the line of Brad Sills with Bank of America.

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

I wanted to ask about that top of funnel activity that you've been generating here with Communicator and the Consumer segment with Creative Cloud Express, the success you're seeing there. Some exciting new announcements coming here, it sounds like on Creative Cloud Express enhancements here. Could we interpret that to mean that perhaps you're pivoting more towards upselling those customers to some of these newer features and offerings that are coming with Creative Cloud Express, away from that top of funnel activity that you've been very successful with thus far?

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

Yes. As Shantanu talked about, it's a holistic process. First of all, we've, over the last couple of years, spent a lot of time with product-led growth. What that gives us is confidence that when people come to Adobe.com and they get into the products, they're going to have a great onboarding experience. They're more likely to convert, and they're more likely to stay, which then starts to give us more confidence and growth in terms of improving what has already been world-class in terms of lifetime value.

As that happens, we've been running more targeted campaigns with things for Photoshop and Acrobat and Illustrator, as an example, that are more targeted to the growth activities and the landing pages in the products themselves. And we've actually been connecting all of our outbound marketing activities with landing pages in the products themselves. So we have been able to really increase our demand efforts and the ROI associated with that to bring more traffic to top of funnel.

In addition to that, we have been investing a lot in growth loops. So people are able to now, when using the products, actually share the content out to stakeholders. Those stakeholders are able to look at that content, but also become top-of-funnel opportunity for us. If you look at Acrobat Web, as an example, we've seen a massive increase in terms of Acrobat Web usage driven by things like share for review. So that drives more top of funnel for us.

And then third is partnerships. We've been working very closely with Microsoft, as an example. We've announced that Reader, as an example, will be the default PDF viewer in Edge, which now gives us access to over 1 billion users on Windows-based devices. So it's a cacophony of these activities that ultimately results in strong top of funnel. And then, as we talked about, it's really about the hard work and the data to drive personalized experiences at scale, leveraging a lot of Anil's DX business and products to drive users all the way through to conversion.

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**Operator**

And we'll take our next question from the line of Michael Turrin with Wells Fargo Securities.

**Michael James Turrin** - Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

Great. One of the things that stood out is you mentioned wins over single-product competitors and a few key areas on the Digital Experience side. Can we go a bit deeper into that as this environment and some of what's happening on the private company side, maybe presenting opportunities you're now able to take advantage of? I'd just be curious here a bit more on maybe both the DX and DMe side, just what's happening there.

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

Yes. Let me start on the Digital Experience side. We have a broad and comprehensive portfolio, and it's integrated with the Adobe Experience Platform. So from a customer perspective, they get the best of both worlds. They get those best-in-class applications, whether it's Content and Commerce, Customer Journeys or Data Insights or workflow, marketing workflow, and they get the benefit of integration with the Adobe Experience Platform and the native apps that we've built there.

So that's a powerful combination. It helps to really address what Shantanu was talking about, which is how do you keep growing through your digital channels and you get the revenue growth but you also get the benefit of getting efficiency through consolidation. And that's where we believe we really shine as customers are looking at their overall stack. Similar to what they have done in other aspects of their IT enterprise architecture, they're looking at who is my go-to platform that I can really standardize on and I'll build around, and so we are getting the benefit of that choice.

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

And on the DMe side, we look at just all the energy in the market around single-product players, whether it's a mobile app, whether it's a web app or whether it's this excitement, incredible excitement, that we have as well around generative AI, really as focused on driving top of funnel because it's driving a lot of awareness of creativity and the things that people want to do. And ultimately, as they leverage those apps, as they see themselves as more accretive, they inevitably end up at our doorstep going forward.

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**Operator**

And we'll take our next question from the line of Kash Rangan with Goldman Sachs.

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

I just want to pick up there where I think David talked about the excitement with generative AI; anybody that wants to jump in. What does this mean for Adobe? Is this just somewhat substitutive for all the opportunity that you have? Or is it somewhat incremental or massively incremental? And how does Adobe monetize generative AI? Is this something that you can create a separate SKU or charge more? I'm curious to get your thoughts quantitatively and qualitatively.

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

Yes, Kash, I think there was about 3 or 4 questions but all related, so happy to take those really quickly. Nicely played. First of all, this is really about increasing the total number of users, we believe, very strongly. As we talked about at MAX, this is about enhancing human creativity, not replacing it. And ultimately, whether you're an individual solo-preneur SMB or enterprise, we're hearing the same thing, which is that you need to create more content than you're able to create today.

And so this really plays well into our core strength. As you know, we've got a decades-long focus on AI, things like neural filters and object selection. And hundreds of other features have been based on AI for us. And they've increased creativity, and they've increased productivity, and they've

helped people keep up with the demand for content. They've also made it easier for people to onboard into the experiences. And so we've been able to broaden the opportunity for people to start leveraging and using our core products.

We've now been able to leverage the hundreds of people that are in our research organization and really target them towards generative technology, which we believe is a huge step forward, leveraging all the work we've done, but a huge step forward going forward. And we and everyone else in the industry are still in the early innings.

So to give you a sense of where we're going, at MAX, we talked about our vision for effectively not just creating content but really engaging and embedding it in the existing workflows to create a creative copilot, we refer to it as. And since then, we've been very hard at work at creating our own model. And the model that we're focused on is around output quality. So it's about best-of-breed generative AI, but combining that with the Adobe magic that we've talked about over the years and all of the technology we have that takes images and makes them better. And so the output quality, we think, is going to be differentiated.

The second thing is around commercial use. There's a lot of complex questions here around copyrights, around diversity and inclusion, about harmful content that's being created. That's something we take very seriously, and we're embedding that into everything we do.

And the third thing is really about workflow integration. Creating an image is just the start. It's not the end. And Adobe is the only player that has a full end-to-end workflow, not just within the products and the tools that we have in the digital media business but also everything that Anil is doing around the content workflow and the content supply chain out to the point of distribution. And in fact, because of this, we're seeing other gen-tech companies wanting to partner with us more and more. And so we feel like we're in a really advantaged position where we're going to come out with our own model and we're going to be partnering with others to make sure that, because of our distribution and the place we play in the market, we can bring a lot of this value to actual fruition. And stay tuned. Next week at Summit, we have a lot of exciting announcements and progress to make there.

And then last to your, I think, fourth or fifth question, monetization. We're very excited about what this means for the business. New user onboarding, we think that, again, if you can start to imagine yourself as creative by using a text prompt, we can take you through that full journey and onboard you into other Adobe offerings. It's also great for retention. We've always seen the more value that gets used in our core offerings, the better the retention rates and the better the LTV. And we think there's upsell opportunity. We do think these are distinct new packages that we can bring to market and upsell people to.

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## Operator

And we'll take our next question from the line of Jay Vleeschhouwer with Griffin Securities.

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

David, for you first, when we spoke at MAX on the subject of monetization, you alluded to Adobe's plans for new pricing and packaging, and you alluded to that this evening. But there was a third ingredient that you also alluded to at the time, which was segmentation, which sounded to me like something that you have success with back in the pre-CC days. And so is this something that you could talk about in terms of your returning to the segmentation techniques of the past that work rather well for the company?

And then for Anil, it's interesting to hear the reference to your competition with single-product companies. That's not a new phenomenon, of course. You've had multi-solution DX portfolio for some time. So would you say, therefore, that the wins or magnitude of the wins against single-product competitors is more pronounced now, it's a larger part of the DX business? And would you say that the investments that you've evidently been making over the last year in consulting capacity has been a critical enabling ingredient for the growth you're now seeing in DX?

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

Yes. So starting with the DME side, Jay, for broad understanding, what we talked about at Adobe MAX was this recognition that since we introduced Creative Cloud 10 or 11 years ago, we have now a much more comprehensive set of capabilities all the way from a freemium model with Adobe Express, all the way to our high-end creative cloud offerings, but also additional capabilities and packages beyond that like Substance and like Frame.io and like Stock that allow people to go beyond what they can do with the core Creative products.

The second thing in addition to that expansion that's happened is that, as we've been driving more with DDOM and more with product-led growth, we are starting to automatically segment customers not necessarily today in terms of what they buy but how they experience the products that they're using already. And so what that leads to is an opportunity. And then going back to all the levers that we have for ongoing growth, there's the opportunity to start segmenting them earlier in the purchase flow into offers and offers that meet their needs and optimize the value to the price in a way that benefits our customers and, of course, also benefits Adobe. So you can expect to see us continuing to play with everything from how we get new users, how we upsell users, how we retain them, new businesses we bring in, but also pricing and packaging to your point.

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

And just to punctuate that maybe a little bit, Jay, I mean the reality is that we actually have different pricing for different devices today, which is completely different. We have web-based pricing for people who come and experience this as a result of a web search that they've made more successfully through Acrobat Web, for example.

And so if the question is when we had things like Design collection or Web collection or Video collection, I mean the reality is that CC All Apps, which actually had a really good quarter, is perceived by people to be the new sort of table stakes for what is happening in Creative, and we think that that's a great offering. And as David said, I mean whether it's Stock or whether it is Substance and our 3D offerings, what we are doing there, those are really perceived to be the differential offerings that are personalized and, for a Photoshop customer, how do we get them to use one of these other offerings. So I think we've done a really good job on that particular front.

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

Yes. From the DX perspective, we obviously started investing in AEP 5 years ago. Now we have lots of examples of customers who are using some of the capabilities like unified profile or the Real-Time CDP and the real-time performance at scale in production. So from a customer's perspective, if they think about a single product, they actually know what an integrated product looks like, and they realize that that's what they would have to build together, build on their own. So I think that's making the choice of going with a product from Adobe, which is already integrated which is also best-in-class application, versus a single product where they would have to put it together. I think that's making the contrast more stark.

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

And there's more scrutiny. Wouldn't you say, Anil? So I think part of what's happening is, as the IT or the Chief Marketing Officer, the Chief Digital Officer is thinking about this holistically, there's more scrutiny around who is the company that can provide us the more comprehensive solutions. So you have seen, Jay, a certain difference in how customers are viewing that, which again plays to our strengths.

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**Operator**

And we'll take our next question from the line of Saket Kalia with Barclays.

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

Okay. Great. Well done in the quarter. I'd love to dig into Figma a little bit, understanding very well that it's still in process. And so David, maybe for you. I know you and the team see the opportunities with products like FigJam in really complementing Creative Cloud. I was wondering if you've seen other opportunities for some of that complementary sort of opportunity as you spend more time with the business.

And then, Dan, maybe just a quick housekeeping question. Can you just remind us sort of what the revenue overlap looks like with Figma? I believe it's the Adobe XD product specifically where there's overlap, but maybe you could just remind us sort of what that revenue overlap looks like.

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

Yes, Saket, maybe I'll first jump in. I mean I think, just let's remember before they answer, these are 2 separate companies, and so we are operating at arm's length in terms of what they are doing. I think we've shared upfront that the XD revenue is de minimis. And so that's the part that I wanted to get across, and then David can certainly speak to some of the strategic rationale and ideas for what we can do.

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

Yes. So I think there's a ton of opportunity in terms of how we look at the Figma business and figure out Figma opportunity. First of all, as we've discussed, we believe that we can just fundamentally accelerate what they're doing today in product design. We have a global footprint. We are working with a lot of our enterprise customers across the globe. And the feedback that we're getting from these enterprise customers is a lot of excitement about the kind of things we can do by bringing these 2 companies together, to just accelerate, make them more productive in terms of what they want to accomplish and just accelerate everything that they're doing.

The second thing is around taking workflows between Photoshop and Illustrator and Figma and really just operationalizing them in a way that we can bring real-time collaboration capabilities based on the Figma platform to the core disciplines like illustration and video editing and photography and 3D design and more.

And the third is really around the evolution with FigJam, bringing that into the core for productivity use cases. So taking FigJam and integrating it more deeply with things like Acrobat and starting to just recognize that creativity is starting to be the foundation of how new productivity applications need to present themselves. And that whole motion of enabling productivity workers, to express themselves creatively, is where the market is going with the rise of the creator economy. And so we just see a ton of opportunities to integrate the products. We are limited in what we can talk to them about in the moment. But what I can say is everyone, from Adobe employees to Figma employees, to our customers, can't wait for this to close so we can actually get moving on all this.

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**Jonathan Vaas** - Adobe Inc. - VP of IR

Operator, we're just about at the top of the hour. We'll take one more question, please.

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**Operator**

We'll take our next question from the line of Brent Thill with Jefferies.

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

Shantanu, on the DX business, I'm just curious if you could just give us an overview of what you're seeing there. Are you still seeing the big deals? Are you seeing a higher number of smaller transactions? And then can you just talk through the pipeline, just general kind of set up what you're seeing in terms of the overall DX business and in how customers are behaving?

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

Happy to, Brent, and I hope we get to see you next week at Summit because then you'll also get to meet a whole bunch of customers. And Anil, certainly feel free to add. I mean I think we saw some really good transformational deals. I think both Dan and Anil referred to that. And so companies that are looking at Adobe to help them with their entire end-to-end customer experience management, good strength there, Brent. I mean those tend to be ones that we have worked with for many years and some that are really looking at it as strategic. So I would say that segment, the pipeline associated with people who are looking for a comprehensive and integrated CXM solution, is pretty large.

I think as it relates to what we call the solution-led segment as well, which is people who may have our Analytic solutions and want Content solutions or those who have both of those and want Journey Optimizer or Customer Journey Analytics or certainly the Commerce solutions, that's another part of the business where we are making sure that we can upsell. I know Anil, typically at every FA meeting, gives you stats and metrics on how we're making progress. So that is one. Given we have the customer relationship and we have the customer engagement, and we have customer success managers, I think, continuing to penetrate a customer account, that's where also we see pipeline. And that's a pipeline that's driven, frankly, by us.

I think in terms of the geographies, we continue to see strength in North America. I think when you think about EMEA, that remains an area of strength. There are some areas in Asia, some countries in Asia. So our job there, really, Brent, has been how do you drive a large pipeline, understanding that there's going to be different companies that look at this differently in specific quarter. But we are focused on the addressable market.

Anil, I don't know if you have other stuff to add.

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

I think the only thing I would say is I think the themes that we're going to sit on at Summit, personalization at scale, Content Supply Chain, even for customers who are starting with a single product, they like the vision because they know that, that is what is key to driving the digital growth and driving profitable growth. So even if they're starting with one and focusing on value realization, they have their eye on a longer-term road map, and that benefits our relationship with them.

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

And Brent, the other thing I'll say, given this is the last question is, I think at Summit, you'll see some of the themes. I mean, certainly, content has been a theme for us for a long time. Data has been a theme for us for a long time. The focus on customer platform and CDP has been a big one. I think how this spreads its tentacles into the product and PLG, as David has said, so I think we have some exciting things that we'll talk about in that particular space in AI and how AI can help.

So we're not just resting on what we have today as an integrated offering. Really, the innovative product road map across each one of our businesses, what David's been doing in creative, what's happening in documents on the web and mobile devices and what Anil's going to show, I think that's also what gives us a lot of confidence that we're anticipating and solving customer problems. And so it was a strong start to Q1. And based on the product innovation, we really continue to be excited about the opportunity that we have at Adobe, and we look forward to seeing all of you at Summit.

**Jonathan Vaas** - Adobe Inc. - VP of IR

Thanks, everyone, for joining the call. Like Shantanu said, we hope to see many of you next Tuesday at Summit. I look forward to talking to many of you soon, and this concludes the call.



**Operator**

Thank you. This does conclude today's meeting. Thank you for your attendance, and you may now disconnect.

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