EDITED TRANSCRIPT
ADBE.OQ - Q2 2023 Adobe Inc Earnings Call

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OVERVIEW:

Company reported cash of $2.14 billion, cash of $6.60 billion.

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PRESENTATION

Operator

Good day, and welcome to the Q2 FY '23 Adobe Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Jonathan Vaas, Vice President 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 Chair and CEO; David Wadhwani, 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 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, June 15, 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 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.

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 an outstanding quarter, achieving record revenue of $4.82 billion, representing 13% year-over-year growth. GAAP earnings per share for the quarter was $2.82, and non-GAAP earnings per share was $3.91. Our results demonstrate strong demand across Creative Cloud, Document Cloud and Experience Cloud with particular strength in Digital Media ARR.

Adobe's mission to change the world through personalized digital experiences is more critical than ever as digital continues to rapidly transform work, life and play. Our groundbreaking innovations, including the new Adobe Express; the launch of Firefly, our family of creative generative AI models; co-pilot functionality in our creative applications, including Photoshop and Illustrator; AI-powered advancements in Acrobat; a new Product Analytics solution; and the latest capabilities in Real-Time CDP are empowering an ever-expanding customer base to imagine, create and deliver standout content and experiences. We're executing against our strategy to unleash creativity for all, accelerate document productivity and power digital businesses.

Every disruptive technology has presented exciting opportunities for Adobe to innovate and increase our addressable market opportunity. This has been true for cloud computing, mobile and AI. We have delivered hundreds of AI innovations through Adobe Sensei such as Neural Filters in Photoshop, Liquid Mode in Acrobat and Customer AI in Adobe Experience Platform. Our ongoing R&D investments have enabled a rapid development and deployment of Firefly, our generative AI technology. We believe generative AI will drive both further accessibility and adoption of our products.

Our generative AI strategy focuses on data, models and interfaces. Our rich data sets across creativity, documents and customer experiences enable us to train models on the highest quality assets. We will build foundation models in the categories where we have deep domain expertise, including imaging, vector, video, documents and marketing. We are bringing generative AI to life as a copilot across our incredible array of interfaces to deliver magic and productivity gains for a broader set of customers. Since its launch in March, Firefly has captured the imagination of the world with over 0.5 billion generations, and we're just getting started.

Our Digital Experience business is powering personalized customer engagement for companies around the world, enabling them to drive experience-led growth. We're delivering an innovative product road map and integrating Sensei GenAI services across Experience Cloud. Last week, we hosted a successful EMEA Summit with tremendous excitement from thousands of customers and partners reinforcing that digital is a critical imperative across industries. Adobe's category leadership and mission-critical products will continue to drive our growth.

For FY '23, we now expect Creative Cloud and Document Cloud to end the year ahead of our previously issued revenue and ARR targets and Digital Experience to be slightly below our previous annual target given the current enterprise spend environment. As a result of our groundbreaking innovation and continued execution, we are pleased to raise total Adobe annual revenue and EPS targets.

David, over to you.

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

Thanks, Shantanu, and hello, everyone. Adobe has long had a mission to unleash creativity for all; and today, this is more possible than ever through the power of AI. The introduction of the new Adobe Express and Firefly will go down as a seminal moment in our creative history. These innovative products and our generative AI copilot in our flagship applications will extend our leadership in core creative categories such as imaging, design, video, illustration, animation and 3D as well as attract an increasingly expansive global audience.

In Q2, we achieved net new Creative ARR of $354 million and revenue of $2.85 billion, which grew 14% year-over-year. We could not be more excited about our generative AI road map that will make Adobe products more accessible to an even larger universe of people while dramatically enhancing productivity for existing customers.

Firefly is attracting tremendous customer interest and is highly differentiated in the market. It is being directly integrated into our product workflows as a copilot to accelerate ideation, exploration and the end-to-end production process. Business and innovation highlights include the beta release

REFINITIV

of Firefly, Adobe's pioneering family of creative generative AI models and Adobe.com/firefly, a destination that allows users to generate and refine content. Firefly's first model is trained on Adobe Stock images and other openly licensed content designed to generate commercially viable, professional quality content.

Firefly-powered capabilities seamlessly integrated into Photoshop are catalyzing a new era of creative power and precision. The viral response to Photoshop's new Generative Fill copilot has been extraordinary across social media platforms. Users have now generated over 0.5 billion assets on the Firefly website and in Photoshop, making these 2 of our most successful beta releases in company history.

Building on this innovation, earlier this week, we announced Generative Recolor in Illustrator, which will similarly serve as a generative AI copilot to millions of designers to iterate and transform vector art. We also released an all-new Adobe Express with Firefly generative AI capabilities that revolutionizes how everyone, from students to small business owners to marketers in large organizations, creates and shares standout content. Adobe Express brings the magic of our technology from Photoshop, Illustrator, Premiere and Acrobat to combine power and precision with speed and ease. The response to the public beta, in particular, the groundbreaking video editing capabilities, has been overwhelmingly positive.

The Enterprise version of Adobe Express and Firefly will empower every employee in an organization to participate in the creation of content, campaigns and websites in conjunction with Experience Cloud. New AI-powered text-based editing and automatic tone mapping in Premiere Pro makes video editors more productive.

An expanded Frame.io platform that now supports collaboration across PDFs and images, in addition to video, increases the value of Adobe's cross-cloud Content Supply Chain solution. A major Lightroom mobile update that instantly allows you to access photos from Apple iCloud and the Android Gallery empowers our growing base of mobile-first and mobile-only users.

Continued momentum with our ecosystem of strategic partners drives awareness of our products and top-of-funnel for Adobe. Google announced that Adobe Firefly will be a premier generative AI partner for Bard, powering text-to-image capabilities. NVIDIA and Adobe announced that we will collaborate on Generative AI optimizations across hardware and software. Apple highlighted how Lightroom will empower users to edit photos on the Vision Pro VR headset at WWDC. Momentum across routes to market and customer segments, including key enterprise customer wins: EY, Government of the Philippines, NVIDIA, Omnicom, TAFE New South Wales and WPP.

Our generative AI offerings represent additional customer value as well as multiple new monetization opportunities. First, Firefly will be available both as a stand-alone freemium offering for consumers as well as an enterprise offering announced last week. Second, copilot generative AI functionality within our flagship applications will drive higher ARPUs and retention. Third, subscription credit packs will be made available for customers who need to generate greater amounts of content. Fourth, we will offer developer communities access to Firefly APIs and allow enterprises the ability to create exclusive custom models with their proprietary content. And finally, the industry partnerships as well as Firefly represent exciting new top-of-funnel acquisition opportunities for Express, Creative Cloud and Document Cloud. Our priority for now is to get Firefly broadly adopted, and we will introduce specific pricing later this year.

Now turning to the Document Cloud business. PDF has become the de facto standard for the world's unstructured data, and businesses of all sizes are turning to Adobe to help streamline and automate document-based workflows. Adobe Document Cloud offers a comprehensive set of ubiquitous products to accelerate document productivity across every device by seamlessly integrating PDF services into Acrobat.

In Q2, we achieved Document Cloud revenue of $659 million, growing 14% year-over-year. We added $116 million of net new Document Cloud ARR with ending ARR growing 22% year-over-year in constant currency. Business and innovation highlights include: significant growth in Acrobat web monthly active users, driven by searches for Acrobat verbs and further accelerated by an explosion of PDF consumption through our Chrome and Edge extensions; viral adoption of PDF collaboration services, which are both increasing active use among existing users and creating a growth loop to bring new users into the Acrobat ecosystem; mobile momentum across both App Store downloads as well as documents consumed in Liquid Mode; new workflows between Acrobat and Express allow users to integrate documents seamlessly into their creative process. Express now has full fidelity PDF import and editing, which allows users to make documents visually stunning; momentum across routes to market and customer segments, including key enterprise customer wins: Boston Consulting Group, Cushman & Wakefield, Novartis, T-Mobile and WPP.

REFINITIV

Today marks the 30th anniversary of Acrobat, a significant milestone that is both inspiring and humbling. PDF and Acrobat are more relevant today than ever before. We are incredibly proud of how PDF continues to transform the world of digital documents, powering communication and productivity for billions of people every day, and we know that the best is yet to come.

The pending acquisition of Figma will further expand our addressable market, and we have been delighted to hear from customers, partners and industry analysts who are excited about the benefits that the combination will unlock. We continue to engage in conversations with the Competition and Markets Authority in the U.K., the European Commission and the U.S. Department of Justice as they conduct their regulatory reviews. And given the merits of the case, we believe the transaction should close by the end of 2023.

Adobe's Digital Media business is on a roll. We're rapidly delivering groundbreaking innovations across Creative Cloud and Document Cloud. Our increasing breadth of offerings is reaching a broader universe of customers, and our incredible go-to-market strength and proven data-driven operating model are propelling the growth of both our emerging and established businesses. Given the momentum, we are raising our net new Digital Media ARR and revenue targets for fiscal '23.

I'll now pass it to Anil.

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

Thanks, David. Hello, everyone. In Q2, we continued to drive strong growth in our Experience Cloud business, achieving $1.22 billion in revenue. Subscription revenue was $1.07 billion, representing 14% year-over-year growth. Customer interest in the digital experience category remains high. Last week, we were excited to spend time with thousands of customers and partners at EMEA Summit. Businesses of all sizes and industries around the world are increasingly relying on digital channels to engage customers and deliver experience-led growth, and they are turning to Adobe as their trusted partner on that journey.

Adobe Experience Cloud offers the most comprehensive set of solutions for content and commerce, data insights and audiences, customer journeys and marketing workflows. Built natively on Adobe Experience Platform, our Real-Time Customer Data Platform provides businesses with a single view of their customers' data across every channel. Real-Time CDP now delivers over 600 billion predictive insights each year, and customers are creating over 30 trillion audience segments every day.

Experience Cloud is now used by 87% of Fortune 100 companies. For example, Prudential Financial uses our cross-cloud offerings to power its end-to-end customer experience management workflows, from creating high-impact content with Creative Cloud and Express to delivering personalized customer experiences at scale with Adobe Experience Platform. In addition, Prada is using Real-Time CDP and Journey Optimizer to connect digital and in-store customer experiences in real time while reimagining shopping experiences using Substance 3D.

Our vision for Experience Cloud is to deliver personalized experiences at scale, and the power of generative AI accelerates our ability to do that. We are delivering Sensei GenAI innovations to reimagine the work marketers do and how they do it. With Sensei GenAI as their copilot, marketers can generate audiences with high precision and design tailored customer journeys for these audiences. They can activate personalized campaigns for their audiences with on-brand visual content created with Adobe Express and Firefly and compelling offers generated by Experience Cloud applications leveraging real-time customer profiles in AEP. Conversational natural language interfaces powered by Sensei GenAI will make it significantly easier for any marketer to derive insights from Customer Journey Analytics and apply these insights in real time to optimize their campaigns. These are just a few of the transformational innovations that Sensei GenAI is bringing to Experience Cloud.

Business and innovation highlights include: strong demand for Adobe Experience Platform and native applications with our book of business now exceeding $500 million. This quarter, we unveiled new capabilities in Real-Time CDP that will enable brands to scale first-party data with look-alike audiences, significantly accelerating the delivery of personalized experiences. Real-Time CDP is used by global brands across industries, including DICK'S Sporting Goods, General Motors, Henkel, Major League Baseball, ServiceNow and TSB Bank; the launch of Adobe Product Analytics, which combines customer journey insights with product analytics to drive a new level of product-led growth; a comprehensive Content Supply Chain solution that connects content creation and delivery across Experience Cloud and Creative Cloud to help enterprises effectively manage their content demands. We're working with partners, including Accenture, IBM, Omnicom and Publicis, to scale the delivery of Content Supply Chain to

REFINITIV

our joint customers; strong demand for Workfront as it rapidly becomes a solution of choice for teams to plan, orchestrate and launch personalized campaigns at scale; global availability of Adobe Mix Modeler to provide marketers with an AI-powered, self-service solution to accurately measure campaigns across paid, owned and earned channels; new AI innovations in Adobe Experience Manager that provide real-time content performance data and predictions on which content will perform best by audience segment; leadership in industry analyst reports, including the IDC Marketscape for Retail Commerce Platforms and a Positive rating in Gartner's annual assessment of Adobe's enterprise strategy; key customer wins, including DSV, ICICI Bank, JPMorgan, Kroger, Omnicom, Royal Canin, ServiceNow, T-Mobile and Volkswagen.

While overall demand is strong and win rates remain healthy, as we enter the second half, we are seeing some projects being pushed out in the current enterprise spend environment, which we have reflected in our updated annual targets. In a world where digital has become the predominant channel to reach and engage customers, Adobe is uniquely positioned to keep winning with innovative products that power end-to-end customer experiences and enable enterprises to simultaneously drive growth and profitability.

I'll now pass it to Dan.

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

Adobe's Q2 results demonstrate strong demand across a diverse portfolio of products, from individuals buying through digital channels to the world's largest enterprises. While we grow existing businesses and deliver world-class profitability, Adobe continues to incubate and invest in groundbreaking new technologies that will change how people work and democratize access to our tools. I couldn't be prouder of how Adobe has navigated the current environment and position the company to win.

In Q2, Adobe achieved record revenue of $4.82 billion, which represents 10% year-over-year growth or 13% in constant currency. Business and financial highlights included: GAAP diluted earnings per share of $2.82 and non-GAAP diluted earnings per share of $3.91; Digital Media revenue of $3.51 billion; net new Digital Media ARR of $470 million; Digital Experience revenue of $1.22 billion; cash flows from operations of $2.14 billion; RPO of $15.22 billion exiting the quarter; and repurchasing approximately 2.7 million shares of our stock during the quarter.

In our Digital Media segment, we achieved Q2 revenue of $3.51 billion, which represents 10% year-over-year growth or 14% in constant currency. We exited the quarter with $14.14 billion of Digital Media ARR, growing 15% year-over-year in constant currency. We achieved Creative revenue of $2.85 billion, which represents 9% year-over-year growth or 14% in constant currency. We added $354 million of net new Creative ARR in Q2, with strong digital demand for our offerings throughout the quarter.

Second quarter Creative growth drivers included: new user growth across geographies, customer segments and creative offerings driven by targeted campaigns and promotions and utilizing insights from our data-driven operating model; strong traffic and conversion on Adobe.com; single app subscriptions, including a strong quarter for imaging driven by "Everyone Can Photoshop" campaign; strong growth in photography driven by accelerated demand for Lightroom mobile; another strong quarter for Adobe Stock and other emerging businesses with exiting ARR for both Frame.io and Substance growing greater than 50% year-over-year in constant currency; continued success rolling out our new Acrobat CC offering integrated with Sign capabilities; and success in the enterprise as our Creative and collaboration solutions continue to see strong adoption.

Adobe achieved Document Cloud revenue of $659 million, which represents 11% year-over-year growth or 14% in constant currency. We added $116 million of net new Document Cloud ARR in the quarter, crossing the $2.5 billion milestone with exiting ARR growing 22% year-over-year in constant currency.

Second quarter Document Cloud growth drivers included: strong subscription demand for Acrobat with integrated Sign capabilities across customer segments and geographies, driven by targeted offers, DDOM insights and our "Acrobat's Got It" campaign; success monetizing new customers through the Acrobat web funnel with monthly active users growing greater than 50% year-over-year as our product-led growth strategy continues

REFINITIV

to perform well; strength in Acrobat mobile downloads, conversion and engagement with Liquid Mode usage up over 40% year-over-year; and strength in the enterprise driven by seat expansion. This quarter, perpetual sales accounted for less than 5% of Document Cloud revenue.

Turning to our Digital Experience segment. In Q2, we achieved revenue of $1.22 billion, which represents 12% year-over-year growth or 14% in constant currency. Q2 subscription revenue was $1.07 billion, which represents 11% year-over-year growth or 14% in constant currency. Second quarter Digital Experience growth drivers included: strong demand for our Adobe Experience Platform and native applications, including Real-Time CDP, Customer Journey Analytics and Adobe Journey Optimizer. In Q2, subscription revenue for AEP and Apps grew more than 60% year-over-year; strength in Content and Commerce with AEM as a cloud service seeing significant book of business growth in Q2; customer interest in our Content Supply Chain solution. The value proposition of seamlessly connecting content creation workflows to customer experience management is resonating with enterprises and is driving accelerated growth for Workfront and our Content solutions; continued value realization from our solutions leading to strong retention across our customer segments; and momentum selling transformational deals to large enterprises adopting our platform and end-to-end suite of applications, including T-Mobile and Omnicom.

Adobe's effective tax rate in Q2 was 21.5% on a GAAP basis and 18.5% on a non-GAAP basis, in line with our expectations. RPO exiting the quarter was $15.22 billion, growing 10% year-over-year or 13% when adjusting for a 3% FX headwind. Our ending cash and short-term investment position exiting Q2 was $6.60 billion, and cash flows from operations in the quarter were $2.14 billion.

In Q2, we entered into a $1 billion share repurchase agreement, and we currently have $4.15 billion remaining on our $15 billion authorization that was granted in December 2020 and goes through the end of fiscal 2024.

In light of the momentum across our business and factoring in current macroeconomic conditions and summer seasonality, for Q3, we're targeting: total Adobe revenue of $4.83 billion to $4.87 billion; Digital Media net new ARR of approximately $410 million; Digital Media segment revenue of $3.55 billion to $3.57 billion; Digital Experience segment revenue of $1.21 billion to $1.23 billion; Digital Experience subscription revenue of $1.08 billion to $1.10 billion; tax rate of approximately 21.5% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of $2.82 to $2.88; and non-GAAP earnings per share of $3.95 to $4.

Given the company's performance in the first half of the year and our relentless focus on driving disciplined profitable growth, we're raising our annual fiscal 2023 targets for EPS and net new Digital Media ARR. We are also raising our total Adobe revenue target for fiscal 2023 with Digital Media ahead of our previously issued targets and Digital Experience slightly lower.

For fiscal 2023, we're now targeting: total Adobe revenue of $19.25 billion to $19.35 billion; Digital Media net new ARR of approximately $1.75 billion; Digital Media segment revenue of $14.10 billion to $14.15 billion; Digital Experience segment revenue of $4.85 billion to $4.90 billion; Digital Experience subscription revenue of $4.30 billion to $4.35 billion; tax rate of approximately 21.5% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of $11.15 to $11.25; and non-GAAP earnings per share of $15.65 to $15.75.

In Q4, we expect to see year-end strength in customer demand for Digital Experience and Digital Media solutions. Our updated targets for fiscal 2023 demonstrates solid operating margin expansion in the second half as compared to the second half of fiscal 2022.

In summary, I'm extremely pleased with Adobe's performance in the first half of the year. Few companies are capable of delivering strong top and bottom line growth in a challenging environment, while at the same time, delivering game-changing innovations that will drive the next decade of growth. These innovations are generating strong customer demand for our products, shaping fiscal 2023 to be another wonderful year for Adobe.

Shantanu, back to you.

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

Thanks, Dan. Our strong Q2 results underscore our momentum and the significant opportunities we have across our business. I'm proud of how our employees around the world continue to raise the bar, create the future and live our purpose. We continue to invest in hiring new college grads and interns to bring the best and brightest talent to Adobe.

It's an incredibly exciting time at Adobe. Demand for our category-defining products and services continues to grow. Our innovation engine is delivering Adobe magic for an expanding set of global customers, and our strong execution is enabling us to address a massive market opportunity. 2023 is going to be another phenomenal year for Adobe as we continue to deliver top line growth and margins while investing in fundamental technologies that expand Adobe's success for decades.

Thank you. We will now take questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from Michael Turrin with Wells Fargo Securities.

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

Nice job on the results. I mean, obviously, I think starting point is with Firefly. We've been fielding a number of questions just on how this alters the size of the market. You had some useful commentary both on monetization and your views on the market. But can you just add some context around early demand signals and how you're expecting this to show up both on the user side of the market and just the overall velocity of content generation?

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

Sure. Happy to talk about that. We're really excited, if you can't tell on the call, about Firefly and what this represents. The early customer and community response has been absolutely exhilarating for all of us. You heard us talk about over 0.5 billion assets that have already been generated. Generations from Photoshop were 80x higher than we had originally projected going into the beta and obviously, feel really good about both the quality of the content being created and also the ability to scale the product to support that.

And we have seen incredible social buzz. The Photoshop community is doing what it always does and is using the product, both Firefly and Photoshop, in ways that we didn't even think of when we were initially building the feature set. So it's great to see all this organic development and buzz coming up.

And as we talked about, we're also excited about what this means from a business opportunity perspective. On the retention side, we think the value that we add in the flagship applications are going to be great for existing users. In terms of top of funnel, we think that this helps us reach billions of new users because it makes the act of creating more accessible. With regard to conversion, we are very excited about what this can mean for new user onboarding, both Photoshop and Illustrator and also in Express. It makes the onboarding of new customers especially early success far more achievable for them.

It introduces new offers with Adobe.com/firefly as a destination that we can monetize and everything that we talked about at Summit last week around what this can be as an enterprise-grade offering. And of course, with all of this, we have an opportunity to sell subscription credit packs for upsell opportunities. So if you net all that out, we see an ARPU opportunity. We see a net number of users opportunity and also because of retention, an LTV opportunity.

REFINITIV

Now we expect all of this to play out over many years. We're very focused right now on user acquisition. None of this, we expect to impact our Q3 numbers. And we'll start to see some of it in Q4, but we don't expect it to be material. But as I mentioned, we expect to see it ramp over the next few years. And we'll share more specifics of this in the months ahead.

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

Clearly lots to be excited about there.

Operator

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

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

Okay. Great. Congrats on a great quarter. David, maybe for you. I want to zero in on that point around Firefly and generating billions of potential users in the years ahead. Obviously, still very early with Firefly but -- as well as Adobe Express. But I'm curious, what are you seeing with Adobe Express and the ability for Firefly to generate some of the demand or pull through some of that demand for Express, both on the consumer side and the enterprise side.

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

Yes. Very excited on both fronts. As you may have seen, we had a beta release of Express last week. And this is a massive update to Express. In fact, it's a brand-new product effectively built from the ground up, and we believe this is the product for everyone to use. The response has been absolutely incredible. Broad-based feedback has been overwhelmingly positive, as you mentioned, because of the integration of Firefly but also how Firefly is able to integrate directly into the user flows and the user journeys for utilization and generation of video content, also for PDF integrations so people are able to bring in and build end-to-end workflows to generate amazing marketing collateral with PDF.

We've seen CC users, existing subscribers for CC very excited about the workflows that we've introduced with both Illustrator and Photoshop. Illustrator users are able to take their Illustrator output, bring it into Express, add animation and push it out to social. Photoshop users are taking their corpus of Photoshop templates, and they're making that the foundation for easy editing and sharing for their marketing organizations.

And that's really been sort of an incredible vote of confidence from everyone that we've seen using the beta, which has also driven the announcements we had last week, specifically around Express and Firefly packaged together for enterprises. And the interest that we've seen coming out of the announcement in terms of enterprise interest and pipeline generation associated with that has been terrific. And what we're particularly excited about that is it brings our clouds together.

So Creative pros are able to create in Photoshop and Illustrator and our other flagship applications. Marketers are able to take that content and edit it more quickly in Express. Both of these are orchestrated through Workfront and Frame.io and they're pushed into AEM, so really a core part of our Content Supply Chain. It really feels like an inflection point for Express as well.

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

And Saket, maybe if I were to add 2 things to that. First, I think on the consumer side, with the new Express, if you can imagine it, you can do it. And so I think it's really powerful. And within an enterprise, much like Acrobat, we want every enterprise employee to now have a combination of both Acrobat and Express.

Operator

And our next question will come from Kirk Materne with Evercore ISI.

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

Congrats on the quarter. I guess, one, it's probably for David again. David, I was just kind of curious when you think about the enterprise part of the Digital Media business. How, I guess, prepared are customers from a content perspective and the data perspective to take on some of the generative AI capabilities that you guys are bringing to market? And I'm sure this blends into Anil, too, on the Adobe Experience Manager. But I was just wondering if you guys could talk about the data aspect of this and how that interplay might help, frankly, both sides of the Digital Media and the Digital Experience businesses.

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

Sure. I'll say a few words and then hand it off to Anil as well. So as we've talked about, Firefly, from the beginning, has a few core principles. The first is the quality of output, right? So text, we have capability of text imaging, text-to-text effects. We have vectors in there now. We're working on video design, 3D generation as well. So we have a series of all this incredible content that we think will be cornerstone of everything needed for enterprise content velocity.

The second thing is that we're building it in a way that we can integrate into existing workflows. We've already started to announce integrations into Photoshop and Illustrator and Express. You'll also start to see us continue those integration points, but you'll also start to see us integrate it more directly into the Digital Experience workflows as well.

Third is that, and perhaps most importantly, we've also been able to -- because of the way we share and are transparent about where we get our content, we can tell customers that their content generated with Firefly is commercially safe for use. Copyrights are not being violated. Diversity and Inclusion is front and center. Harmful imagery is not being generated. So we're able to give them that confidence and also, as part of our enterprise plans, give them indemnification for the content that's being created. So those things, I think, fundamentally help them engage that.

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

Just picking up on what you said. I think if you look at Express and Firefly and also the Sensei GenAI services that we announced for Digital Experience, comes at a time when marketing is going through a big shift from sort of mass marketing to personalized marketing at scale. And for the personalization at scale, everything has to be personalized, whether it's content or audiences, customer journeys. And that's the unique advantage we have. We have the data within the audience -- the Adobe Experience Platform with the real-time customer profiles. We then have the models that we're working with like Firefly. And then we have the interfaces through the apps like Adobe Campaign, Adobe Experience Manager and so on.

So we can put all of that together in a manner that's really consistent with the data governance that people -- that customers expect so that their data is used only in their context and use that to do personalized marketing at scale. So it really fits very well together.

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

Maybe just given how much excitement we have around this, Kirk, 3 quick things. The first is it really allows for us to, within a company, have every marketer participate in the production and delivery of content. And so agility for an enterprise is great.

Second thing maybe I'll add to what both Anil and David said, we can now create custom models. So think of it, if you're a company like Coke or a company like Disney and you want to create these campaigns where you want to try out different things, the Firefly model can be customized for them. And that in conjunction with what we have with Express and AEM really allows it to be tailored for that particular company.

I also wanted to just clarify that, that entire go to market is completely aligned already within the company. And so we have one enterprise sales force calling on them across Express, Creative Cloud as well as Experience Cloud solutions.

Operator

And our next question will come from Alex Zukin with Wolfe Research.

Arsenije Edward Matovic - *Wolfe Research, LLC - Research Analyst*

This is Arsenije on for Alex Zukin. Alex is flying right now, but he says it's good to see who the true AI winners are. So now to my question. The DM business continues to outperform in an impressive way. Can you talk to some of the underlying levers and stack rank what is driving the strengths. Whether it's demand for content, uptake of newer products or cross-selling success, can you help unpack the layers of success you're seeing? And then just on gen AI, you have announced new offerings with Generative Fill and more recently, Generative Recolor. As you are seeing kind of the traction you are getting online within the creative community, how is it helping inform you about where the greatest monetization opportunity is?

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

Sure. Yes, I'll -- first of all, thanks for the question. Yes, we feel like we're off to a great start for the first half of the year. And as we look at it, the strength was very broad-based. Traffic to Adobe.com and top of funnel was strong, frankly, all quarter long. And it's clear that our messaging is resonating well with a broader and broader set of audiences that we can reach.

Second, we saw strong conversion. Our product-led growth investments that we've been making for some time now are starting to pay dividends. Adobe.com is an area we've focused for a long time. We continue to see improvements in terms of customer journey work and conversion. And we've more recently been investing much more significantly in product-led growth motions in our core flagship applications like Photoshop and Acrobat as well. And we've been leveraging a lot of Anil's Digital Experience products that allow us to do personalization at scale in terms of in-product experiences there.

And then lastly, it feels like we've really started to see some good inflection in our mobile applications. In particular, Acrobat on mobile and Lightroom mobile performed very well this quarter as well. In addition to that, as Dan mentioned in his opening comments, the emerging products like Substance and Frame continue to grow very nicely and really sort of slipstream into the Content Supply Chain conversation that we're having with enterprise customers.

And frankly, enterprise demand for content creation continues to grow. Anil said last week at EMEA Summit that our customers are expecting it to grow 5x in terms of content creation over the next few years. We continue to see more pull for creative apps. And also, we're starting to see enterprises invest much more in Acrobat penetration into their accounts. So they really want more people to have Acrobat from Adobe. So that's just to name a few things. Things are shaping up great for the year, and we're very excited about the direction of the business.

Operator

And our next question will come from Mark Moerdler with Bernstein Research.

Mark L. Moerdler - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

Congratulations on the strong quarter and the updated guidance. Dan, can you give us some color on how gen AI is going to impact margins? Especially you've -- 0.5 billion assets created just in the beta, the potential for substantial gen AI, once this is all launched, is going to be enormous. How should we think about that?

REFINITIV

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

Yes. Thanks for the question, Mark. As I reflect on the company's journey, we've got a long history of driving strong profitable growth. We deliver the innovation and the top line progression, but we do it in a very disciplined way, which drives margin and cash flow for investors. I see this playing out in a similar fashion.

These are real investments. They're material investments we're making to unlock the magic of the Adobe technology platform and seamlessly integrating it across the product portfolio. When we think about the cost drivers, we think about training. We think about inference. We think about storage costs. The company is ruthlessly prioritizing how we're spending and what projects we're investing in to create a spend envelope to bring this technology to life in a very rapid fashion.

You can see the discipline at play. We've been at this for several quarters. You see the strong print from a profitability standpoint in Q1. We followed through with a strong print again in Q2. And as we look into the back part of the year, again, you're seeing second half year-over-year, second half-over-second half showing an uptick from a profitability standpoint.

So we're going to continue to stay focused on being very disciplined, how we prioritize what we do and don't do and make sure we create the right kind of spend envelope for this technology as we bring it to life. I think it's an end statement for us at the company and what we've done for a very long time here, drive innovation, drive strong top line growth and do it in a very profitable way that's cash flow generative and value creative for investors.

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

Yes. And just I'll add a little bit on to that because we've been working very closely between our engineering organization and the finance organization on a number of levers to make sure that we're managing and keeping discipline and cost front of mind. The first is the model training itself. There are a number of things the team has been doing to optimize our ability to train larger models more efficiently.

The second is post-training inference optimization. There's a lot of, I think, cutting-edge work coming out here, both in terms of research and the work we're doing around things like pruning and distillation and quantization that make the inference execution much more efficient. Third is, as we've talked about in the past, we're working with folks like NVIDIA to make sure that the hardware and software advances go hand in glove, and we're leveraging more and more compute pathways that are on the chip itself. Four is user experience, making sure that as we expose these things to users, we do it in a way that drives more efficiency in the back end. And of course, the big unlock longer term is about hybrid generative approaches. So how do we move more of this computing to the desktop as well? That'll be a major cost benefit down the road. But it's a significant effort and a lot of work to do, and we take it very seriously.

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

And Mark, I just wanted to add, in addition to all of that great work that we're doing on saving costs, I'm more excited about the top line growth that this is going to cause for us.

Operator

And our next question will come from Tyler Radke with Citibank.

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

I wanted to ask about the Document Cloud strength you saw in the quarter. So the business saw a nice improvement relative to last quarter. If you could just unpack that a bit. And then secondly, as I look at the full year outlook, clearly, a really strong quarter, one of the biggest feats we've seen

in years. As I think about Q4, just kind of the initial implied guide, is there anything to call out any onetime factors around pricing we should keep in mind as we compare the year-over-year decline? Or is that just conservatism?

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

Yes. Maybe I'll talk about the Acrobat business, and then we can get to Q4 after that. So first of all, yes, another great quarter. It was great to see ARR growing 23%. And a lot of this is the basics of PDF demand, right? We've seen this incredible tailwind with demand for PDF continuing to grow. PDF has become the de facto standard for unstructured data. And PDF-related searches continue to grow. And this is, as Shantanu mentioned and I mentioned in the prepared remarks, 30 years after PDF launched. So it's amazing to see how things are going.

We've been investing very heavily in expanding our top of funnel. We have Acrobat Web that's been driving a lot of new users. We've seen good growth directly to Acrobat Web. Acrobat Mobile has also been a source of new opportunity for us. We talked about our extensions in Chrome and Edge. And also, we've mentioned in the past, our partnership with Microsoft to really make Acrobat the foundation -- or PDF and Reader, the foundation of all documents viewed in Edge as well. So that creates an enormous top of funnel for us, and we continue to sort of broaden that.

In addition to that, we've been adding more value directly into the products with a proliferation of signatures and collaboration capabilities. And all of that, combined with our product-led growth motion, is driving strong conversion. So we feel really good about the foundation of that business.

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

And coming to the guide, Tyler, the way I'd think about it is, if we think about the journey to date this fiscal year, we had a strong print in Q1. We had a strong print in Q2. We've got a lot of momentum around this business. As we look into the back half of the year, we see that momentum continuing. We're 2 weeks into Q3. We see that momentum continuing. And as you would expect, we see a strong finish to the year in Q4. And we've got a long track record inside of the company of setting expectations and then executing against those expectations in a way that drives value for investors. And so I think the setup for the back half of the year is no different than that.

Operator

And our next question will come from Matt Swanson with RBC.

Matthew John Swanson - *RBC Capital Markets, Research Division - Associate VP*

Yes. And I'll add my congratulations on the quarter. We've kind of talked from the beginning that a major differentiation point for Firefly is that this is an enterprise-safe generative model. Could you just give us some insights into your customer conversations and really how focused enterprises are around the potential, maybe a copyright or trademark issues that generative could create using other solutions?

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

Matt, maybe I'll take that. It's actually been off the chart, the interest. We just had our summit in London, following the successful launch that we had here where customers even in the U.S. were asking us questions. And I would say there are around 3 areas. All of them had perhaps experimented with other solutions. The moment Adobe came in and said this is both safe and designed for commercially safe as well as we can create the custom models, I think the interest associated with that has been off the charts.

We've already created some custom models where we tweak our core model with assets that people can provide us. And that's also a secret sauce that we're unlocking and the integration of that within each of our products. So frankly, the product's not yet available, but the number of customers who want to sign on in terms of wanting to use it has been one of the most successful launches that we've had. And when I say the product's not ready, all I'm saying is it's not generally available. It's certainly available for them to put through their paces within the company.

Matthew John Swanson - *RBC Capital Markets, Research Division - Associate VP*

Yes. No, that sounds fantastic. We get the users and the CEOs to agree on the same product. That's a good combination.

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

Thank you.

Operator

Our next question comes from Jay Vleeschhouwer with Griffin Securities.

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

Shantanu, at summit, with the Content Supply Chain news, the company pretty much effectuated something that you've been talking about for the last number of years. That is Content Supply Chain. And the question is about the potential business impact. Could you talk about what is fundamentally new or newly required in terms of pipeline development for that broader concept of implementing Adobe product? What you think the impact might be, for example, in your average book of business that you disclosed with your top 2,500 and top 1,000 customers each year at the analyst meeting? And you do seem to be investing still heavily in consulting capacity. So is that part of the development that you're foreseeing necessary for Content Supply Chain?

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

A couple of points, Jay, and then certainly, Anil can add to it. First, I think, is we are a good user case for what's happening. The reality is that with what David talked about as it relates to product-led growth, what the Content Supply Chain really allows us to do is start with a marketing brief that we're putting within workflow, start to create the campaigns, have AEM and our asset management solution be the place where all of these assets are and then deliver them through campaign as well as deliver them through the Adobe Experience Manager on the website.

So I think the interest associated with this is all about trying to say all of the content that we are creating, how do we both make that more efficient as well as understand how we can both globalize, which has been a big driver of why people want this Content Supply Chain. The traditional agencies, I think Anil referred to this. They all have not only, I think, procured our solution for their internal usage, but they're also collectively taking this solution to joint customers. So I think it actually just really beautifully aligns within Anil's enterprise sales motion, how we can go with everything from workflow, which actually had a great quarter, so we continue to see good growth in workflow. So I think it aligns all of our offerings. And there isn't one customer that doesn't want this, partly because of all the additional cost and scrutiny on what the expenses are right now.

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

Yes. We are just so uniquely differentiated across the Creative Cloud and Experience Cloud. And in terms of getting this implemented for customers, as you mentioned, we have now partnerships with Accenture, with IBM, with Omnicom, with Publicis. And all of them are working very closely with us, with our field teams to make sure that the Content Supply Chain gets implemented for every customer across different verticals and geographies, specifically for their needs.

Operator

And our next question will come from Keith Weiss with Morgan Stanley.

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Elizabeth Mary Elliott Porter - *Morgan Stanley, Research Division - VP of Equity Research*

Great. This is Elizabeth Porter on for Keith Weiss. Congrats on the strong quarter. And my question is again around generative AI. There's clearly a lot of investment and news across the industry. So are there generative AI capabilities that could become table stakes? And what are the areas that drive real differentiation that is monetizable for Adobe? How do you see this market evolving between those 2 pieces over time where Adobe really solidifies its leadership?

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

Yes. I think, for us, the entire generative AI really is all 3 layers that we talked about. And if you think about our generative AI strategy, it really first starts with do we have unique data that we can use on behalf of our customers for customers. And clearly, both in the creative, in the document space with PDF as well as in the marketing space, the amount of data that we have is a key differentiator because that is going to dictate the models when you want to design this to be commercially safe.

I think the second thing that we're really focused on is in the domains where we have incredible expertise. Whether you consider it imaging or vector or documents or marketing, we are creating our own foundational models. And so when you create the foundation models, you really understand how that works, you understand how you can take it to an enterprise and create a custom model for that.

But I think the real differentiator for Adobe continues to be how does a user get value. And I think it's in the ubiquitous interfaces that we have, whether that's on the marketing side, everything where people are trying to create these campaigns or automate production or create a website or create a mobile app, similarly in documents, which we haven't touched on as much today, how they get the synthesis of the PDF, how they understand the structure of the PDF and clearly, in creative that we've seen, both with Generative Recolor and Adobe Illustrator as well as Generative Fill in Photoshop. As long as we have the interfaces that delight customers and where all this magic comes to life, that's really, I would say, Adobe is differentiated.

And you've seen that. It's not like there weren't other imaging models out there. The fact that we've captured the imagination of the community is a result of how all 3 of these layers really work well for Adobe better than anybody else.

Operator

And that question will come from Brent Thill with Jefferies.

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

Shantanu, a lot of questions around why won't the DX Cloud give the Creative Cloud the [cold] as well. Why are you confident this won't spill over? And given I'm the last question, I'll break the operator's policy and asking one for David on, when you think about just the #1 question we're all getting, will AI reduce the number of seats available to you. Can you just address that? That's the #1 question we continue to get.

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

Great. I'll start with the second, and we can go to the first after that. So Brent, if you take a look at Adobe's history, this is what we do, right? If you look at desktop publishing, if you look at creative imaging, if you look at video editing, the result of Adobe's focus here is always about increasing productivity, increasing the importance of these new workflows, and that has always led to an increase in jobs.

Let's take video editing as an example, right? We lowered the cost of production in video significantly with our work with Premiere and After Effects in Audition. And what that did was it increased the ability for people to create more content. So they didn't take the same -- they didn't create the

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same amount of content with fewer people. What they did was they found new business opportunities. They created more niche content that led to video streaming and personalization, and that created an explosion in the industry around video production.

That's what we do. And we're sitting at a moment where companies are telling us that there's a 5x increase in content production coming out in the next few -- next couple of years. And you see a host of new media types coming out. And we see the opportunity here for both seat expansion as a result of this and also because of the value we're adding into our products themselves, increase in ARPU as well.

Now beyond all of this, in terms of professional video and professional content creation, I should say, there's also a massive opportunity because this catalyzes our ability much more effectively to go after the billions of creators around the world who need things like this to be creative. So we're going to help them also create standout content.

So again, I take a step back and I say we have an opportunity to get more people into the franchise. We have the ability to drive more ARPU through our products, and we have the ability to make people more successful and drive more LTV. So the foundation, I think, is very strong.

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

And Brent, if I understood the question right, I mean, the interest within the DX customer base for what we are doing on Creative Cloud, if you look at both Summits, the interest associated with how these clouds and offerings are working together is actually one of the catalysts that I think will help both the Digital Media as well as the Digital Experience business.

So you're right. I mean we are finding that every customer is saying this is the way for us to really go all the way from when we start to create a campaign all the way to the delivery and understanding the analytics associated with that. And I think the enterprise team has really aligned around this joint selling, and we've created a bill of materials where you can actually have both the Digital Experience as well as the Creative Cloud offerings in it. And I think that's what you're going to see. In the second half, we're going to have a lot more of these combined sales that happen with every enterprise because it helps, as we've been saying, with both the top line and the bottom line.

And since it was the last question, I mean, let me end by saying it was a great first half. We appreciate all the comments that you have made about the quarter. And I wanted to thank the Adobe team for real great execution as well as, again, congratulate, in particular, the Acrobat team for 30 years of amazing innovation.

What I'm most proud of is, if you look at just the last few months in terms of what the company has delivered across Firefly and Generative Fill and Generative Recoloring, what's happening with Acrobat across the web, in Digital Experience, the Adobe Mix Modeler, Product Analytics, what we are doing around Content Supply Chain, the new offerings that are coming for an increasing set of customers that will serve real customer problems I think really all goes well for how we will continue to drive innovation and serve customers well. So I'm really excited about the second half as well as what we're going to continue to do in terms of delivering top line and bottom line growth.

And with that, I'll hand it over to Jonathan.

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

Thanks, Shantanu, and thanks, everyone, for joining the call. I look forward to speaking with many of you soon, and this concludes the event.

Operator

Thank you. That does conclude today's conference. We do thank you for your participation, and have an excellent day.