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ADBE.OQ - Q4 2023 Adobe Inc Earnings Call

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## OVERVIEW:

Company Summary

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

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

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## PRESENTATION

### Operator

Good day, and welcome to the Q4 and FY 2023 Adobe Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Jonathan Vaas, VP of Investor Relations. Please go ahead.

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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 Chair and CEO; David Wadhvani, President of Digital Media; Anil Chakravarthy, President of Digital Experience; and Dan Durn, Executive Vice President and CFO. On this call, which is being recorded, we will discuss Adobe's fourth quarter and 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, December 13, and contains forward-looking statements that involve risks, uncertainty and assumptions. Actual results may differ materially from those set forth in these statements. For more information on those risks, please review today's earnings release and Adobe's SEC filings.

On this call, we will discuss GAAP and non-GAAP financial measures. Our reported results include GAAP growth rates as well as constant currency rates. During this presentation, Adobe's executives will refer to constant currency revenue growth rates, unless otherwise stated. Reconciliations between the 2 are available in our earnings release and on Adobe's IR 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. Q4 was our first ever \$5 billion quarter, a new record for the company. Adobe achieved revenue of \$5.05 billion, representing 13% year-over-year growth. GAAP earnings per share for the quarter was \$3.23 and non-GAAP earnings per share was \$4.27, representing 28% and 19% year-over-year growth, respectively.

Q4 was the culmination of another record year for Adobe, achieving \$19.41 billion in revenue, which represents 13% annual growth. GAAP earnings per share in fiscal 2023 was \$11.82 and non-GAAP earnings per share was \$16.07, both representing 17% year-over-year growth. We exited the year with \$17.22 billion in RPO. Our strong performance reflects the mission-critical role our products play in a digital-first world, incredible product innovation and exceptional execution.

Adobe Creative Cloud, Document Cloud and Experience Cloud have become the foundation of digital experiences, starting with the moment of inspiration to the creation and development of content and media to the personalized delivery and activation across every channel. Adobe's mission of changing the world through personalized digital experiences and our delivery of foundational technology platforms set us up for the next decade of growth. We take pride in being one of the most inventive, diversified and profitable software companies in the world.

We believe that every massive technology shift offers generational opportunities to deliver new products and solutions to an ever-expanding set of customers. AI and generative AI is one such opportunity, and we have articulated how we intend to invest and differentiate across data, models and interfaces. We have delivered against this strategy and are pleased that a number of our groundbreaking innovations, including our Firefly models and integrations across Creative Cloud, Liquid Mode and integrations across Document Cloud and AI services in our Real-time Customer Data Platform and integrations in Experience Cloud are now seeing tremendous usage by customers.

We remain excited about the strategic opportunity with Figma to jointly advance product design, accelerate collaborative creativity on the web and redefine the future of creativity and productivity. We continue to engage with the European Commission, the Competition and Markets Authority in the U.K. and the U.S. Department of Justice as they conduct their regulatory reviews. The EC has provided a preliminary statement of objections, and the CMA has issued provisional findings of competition concerns. We strongly disagree with these findings and are responding to the respective regulators.

As per their current time lines, the EC's decision deadline is February 5 and the CMA's is February 25. While the DOJ does not have a formal time line to decide whether to bring a complaint, we expect a decision soon. I'll now turn it over to David to discuss the momentum in our Digital Media business.

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

Thanks, Shantanu. Hello, everyone. In Q4, we achieved net new Digital Media ARR of \$569 million and revenue of \$3.72 billion, which grew 14% year-over-year fueled by innovation in both our Creative and Document businesses. Starting with Creative Cloud. Global demand for content is accelerating and continues to be a tailwind for the business. Creative Cloud remains the creativity platform of choice for creators across imaging, photography, design, video, web, animation and 3D.

Our rapid pace of product and AI model innovation is empowering a wide and growing base of individuals, students, creative professionals, small business owners and enterprises to create and monetize amazing content more quickly and easily than ever before. We were thrilled to come together in person with thousands of creators at Adobe MAX in Los Angeles and at our MAX event in Tokyo, with millions more from our community engaging with us online. We reached a record 300 million social interactions in the month following MAX.

Q4 was a record quarter for Creative Cloud, achieving \$3 billion in revenue, which grew 14% year-over-year. Net new Creative Cloud ARR was \$398 million. Business highlights include strong digital traffic resulting from product innovation, social engagement and our continued product led growth efforts, which drove record new commercial subscriptions in the quarter. The general availability of our generative AI Firefly models and their integrations across Creative Cloud drove tremendous customer excitement with over 4.5 billion generations since launch in March.

The release of 3 new Firefly models, Firefly Image 2 model, Firefly Vector model and Firefly Design model, offering highly differentiated levels of control with Effects, Photo Settings and Generative Match. We also introduced Generative Credits as part of our Creative Cloud subscription plans. The general availability of Photoshop Generative Fill and Generative Expand, which are seeing record adoption. They're already among the most used features in the product.

Advances in Adobe Illustrator with the introduction of Text to Vector beta, enabling users to generate icons, scenes, subjects, patterns and gradients. Adobe Premiere Pro advances include a significant performance improvement in the time line for faster and smoother editing, new color preferences and improved tone mapping. Premier Pro is now natively integrated with Frame.io offering faster content sharing and collaboration. The combination of Adobe Express and Firefly is enabling everyone from creative pros to beginners to quickly move from ideation to task-based workflows in Express, dramatically expanding our reach and widening our top of funnel.

The family of generative capabilities across Express, including Text to Image, Text Effects, Text to Template and Generative Fill are driving adoption of Express and making it even faster and more fun for users of all skill levels. Express now comes pre-installed on all new Chromebooks, making it accessible to students, educators and anyone using Chrome OS. Continued strength in Adobe Stock, which had its best year ever, driven by accelerating demand for high-quality image, vector, video and 3D content.

Creative Cloud, Express and Firefly integrations with Adobe GenStudio, enabling ideation, creation and stakeholder collaboration as part of their overall content supply chain. Strong mid-market and enterprise adoption driven by upsell to Creative Cloud offerings with Firefly. Key customer wins include CyberAgent, Deloitte, Discovery Communications, Nexstar Media, Pepsi, Publicis, and the United Nations. We are thrilled with the momentum we're seeing in the Creative business following a year of unprecedented innovation. Customer excitement around Firefly integrations across our applications has been great to see with community engagement, social interactions and creative marketing campaigns driving organic brand search volume, traffic and record demand.

While we started rolling out new Creative Cloud pricing in select geographies in November, the primary driver of growth continues to be new paid subscriptions across our routes to market. We are excited to build on this momentum as we enter FY '24.

Now turning to Document Cloud. Digital documents are essential enablers of our personal and professional lives. Document Cloud is a leader in digital documents, powering all common document actions, including editing, sharing, reviewing, scanning and signing. Document Cloud innovations are advancing accessibility, comprehension, productivity, automation and security in document workflows across web, desktop and mobile. In Q4, we achieved Document Cloud revenue of \$721 million, growing 17% year-over-year. We added a record \$171 million of net new Document Cloud ARR, with ending ARR growing 23% year-over-year in constant currency.

Business highlights include: Acrobat Web growth, which continues to be an incredible source of customer acquisition with monthly active users up over 70% year-over-year; a surge in usage of link sharing for stakeholder collaboration around PDF files, which increased 400% year-over-year, creating a viral growth loop that is bringing tens of millions of users into the Acrobat ecosystem. This is a great example of how we are scaling our PLG motions; strong demand for Acrobat on mobile with MAU surpassing 100 million users in Q4. Liquid Mode has now served over 1 billion files to customers, demonstrating how indispensable this technology has become on mobile devices.

Adobe Acrobat to Express workflows, making it even easier to import, edit and enhance documents to create visually stunning PDFs. Key enterprise customer wins include Alshaya, Bank of America, Department of Veterans Affairs, Mastercard, State Farm Auto Insurance and Volkswagen. Much like the Creative business, we expect generative AI to deliver additional value and attract new customers to Document Cloud. Acrobat's generative AI capabilities, which will enable new creation, comprehension and collaboration functionality have already been rolled out in a private beta. We expect to release this in a public beta in the coming months.

It's been an extraordinary year for the Digital Media business, with the introduction of hundreds of transformative innovations that are reshaping the future of creativity, productivity and digital experiences. Capping this year's many accolades, Time Magazine recognized Adobe Liquid Mode, Photoshop Generative Fill and Generative Expand among the Best Inventions of 2023. I'll now pass it to Anil.

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

Thanks, David. Hello, everyone. Digital experiences are indispensable for every business in every category, enabling companies of all sizes to engage and transact with customers around the world. Adobe's Holiday Shopping Report, which analyzes trillions of data points, found that both Black Friday and Cyber Monday sales hit record highs of \$9.8 billion and \$12.4 billion, respectively, jumping 7.5% and 9.6% from last year. We predict that holiday 2023 spend will exceed \$221 billion in the U.S. alone.

Adobe Experience Cloud is optimally positioned to capitalize on this massive global opportunity. Companies across B2C and B2B are turning to Adobe Experience Cloud as the platform to accelerate experience-led growth. Our leading solutions spanning data insights and audiences, content and commerce, customer journeys and marketing workflow empower businesses to drive customer demand, engagement and growth while simultaneously delivering productivity gains.

Our comprehensive set of applications, including Real-time CDP, are built natively on our highly differentiated Adobe Experience Platform, providing companies with a unified profile of each of their customers to deliver personalized real-time experiences at scale.

Generative AI accelerates our pace of innovation across the Experience Cloud portfolio, enabling us to build on our capabilities to deliver personalized digital experiences. Our efforts are focused in 3 areas: one, augmenting our applications with an AI Assistant that significantly enhances productivity for current users and provides an intuitive conversational interface to enable more knowledge workers to use our products; two, reimagining existing Experience Cloud applications like we did with Adobe Experience Manager; and three, developing entirely new solutions built for the age of generative AI, like Adobe GenStudio.

In Q4, we continued to drive strong growth in the Experience Cloud business across our enterprise and mid-market customers, achieving \$1.27 billion in revenue. Subscription revenue was \$1.12 billion, representing 12% year-over-year growth. Business highlights include: strong momentum with Adobe Experience Platform and native applications, inclusive of real-time CDP, Adobe Journey Optimizer and Customer Journey Analytics. AEP had its first \$100 million quarter of net new business in Q4 and exited the year with a greater than \$700 million annualized book of business.

Release of Adobe GenStudio, an end-to-end solution that brings together best-in-class applications across Creative Cloud, Express and Experience Cloud with Firefly generative AI at the core to help brands meet the rising demand for content. GenStudio provides a comprehensive offering spanning content ideation, creation, production and activation. We are seeing tremendous interest in GenStudio from brands like Henkel, Pepsi and Verizon and agencies like Publicis, Omnicom and Havas as they look to accelerate and optimize their content supply chains.

Reimagine customer experiences with the all-new Adobe Experience Manager Sites that enable businesses and developers to quickly test and optimize web content, deliver fastest possible page load times and maximize SEO rankings, lighthouse scores and conversion. Adobe was recognized as a leader in over 25 industry analyst reports this year, including the Gartner Magic Quadrant for Digital Experience Platforms, B2B Marketing Automation Platforms and Multichannel Marketing Hubs.

In the Forrester Wave for Digital Experience Platforms, which was published last week, Adobe received the highest scores for strategy. Key customer wins include Alshaya, Coca-Cola, EY, IBM, Marriott, Riyadh Air, Santander Brazil, Sony, Southern Graphics, Unilever, Vanguard and Verizon. In our conversations with these and other customers around the world, C-level executives are continuing to prioritize experience-led growth as a critical business imperative despite ongoing budget scrutiny.

Adobe Experience Cloud is well-positioned to keep winning with innovative products that power end-to-end customer experiences and enable companies to simultaneously drive growth and profitability. We are looking forward to continuing our leadership and momentum into 2024. I'll now pass it to Dan.

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

Thanks, Anil. Our earnings report today covers both Q4 and FY '23 results. What a year 2023 was. Fueled by a deep understanding of our customers, product innovation and outstanding execution, we delivered strong financial results and world-class margins, positioning the company for years of continued growth.

In FY '23, Adobe achieved record revenue of \$19.41 billion, which represents 10% year-over-year growth or 13% growth in constant currency. GAAP EPS for the year was \$11.82 and non-GAAP EPS was \$16.07, each growing 17% year-over-year.

FY '23 business and financial highlights included: Digital Media revenue of \$14.22 billion; net new Digital Media ARR of \$1.91 billion; Digital Experience revenue of \$4.89 billion; cash flows from operations of \$7.3 billion; RPO of \$17.22 billion exiting the year; and repurchasing approximately 11.5 million shares of our stock during the year at a cost of \$4.63 billion.

In the fourth quarter of FY '23, Adobe achieved revenue of \$5.05 billion, which represents 12% year-over-year growth or 13% in constant currency. GAAP diluted earnings per share in Q4 was \$3.23 and non-GAAP diluted earnings per share was a record \$4.27, growing 28% and 19% year-over-year, respectively. Q4 business and financial highlights included: Digital Media revenue of \$3.72 billion; net new Digital Media ARR of \$569 million; Digital Experience revenue of \$1.27 billion; cash flows from operations of \$1.6 billion; adding approximately \$1.5 billion to RPO in the quarter, our highest sequential quarterly increase ever; and repurchasing approximately 1.8 million shares of our stock.

In our Digital Media segment, we achieved Q4 revenue of \$3.72 billion, which represents 13% year-over-year growth or 14% in constant currency. Our net new ARR in Q4 was \$569 million, which was a quarterly record in constant currency, and we exited the quarter with \$15.17 billion of Digital Media ARR. We achieved Creative revenue of \$3 billion, which represents 12% year-over-year growth or 14% in constant currency. And we added \$398 million of net new Creative ARR in the quarter. Driving this performance was strong customer acquisition throughout the quarter as well as strength during the peak holiday shopping weeks.

Fourth quarter Creative growth drivers included: individual subscriber growth fueled by targeted campaigns and strong web traffic; a strong quarter for Creative Cloud All Apps subscriptions across customer segments and geographies with particular strength in emerging markets; sales of CC single apps, including a strong quarter for imaging and photography offerings; continued growth of our Frame.io offering and Adobe Stock, which capped off its best year ever in terms of net new ARR; customer demand in education, driven by back-to-school purchasing as well as migrations to full-priced offerings by graduating students entering the workforce; and typical Q4 strength in the enterprise, including significant upsell of our new Firefly and Express offerings.

Adobe achieved Document Cloud revenue of \$721 million, which represents 16% year-over-year growth or 17% in constant currency. We added a record \$171 million of net new Document Cloud ARR in the quarter. Fourth quarter Document Cloud growth drivers included: Acrobat subscription demand across all customer segments, routes to market and geographies; continued strength of our free-to-paid funnels, including Reader on the desktop and Acrobat web; strong performance of our collaboration services, including PDF link sharing and Sign, which are virally bringing new users to the Acrobat ecosystem; an outstanding quarter for Acrobat Mobile as a result of increased proliferation, usage and conversion; and year-end seasonal strength in SMB and enterprise.

Turning to our Digital Experience segment. In Q4, we achieved revenue of \$1.27 billion, growing 10% year-over-year or 11% in constant currency. We achieved subscription revenue of \$1.12 billion, which represents 12% year-over-year growth. Fourth quarter Digital Experience growth drivers included: strong year-end bookings across solutions with particular strength in North America; continued success closing multi-solution transformational deals with large enterprises; momentum with AEP and native applications, with the FY '23 exiting book of business growing greater than 60% year-over-year; strong net dollar retention for early adopters of AEP, demonstrating the value enterprises are realizing from our real-time data platform and integrated offerings; and strength across our Data & Insights, Content and Workfront solutions and growing customer interest and pipeline for our new GenStudio solution.

We drove world-class operating margins in Q4 and throughout fiscal 2023 by making disciplined investments in R&D, marketing and sales. And we're pleased that we grew EPS faster than revenue. Adobe's effective tax rate in Q4 was 18% on a GAAP basis and 18.5% on a non-GAAP basis, in line with our expectations. RPO exiting the quarter was \$17.22 billion, growing 13% year-over-year.

Our ending cash and short-term investment position exiting Q4 was \$7.84 billion. And cash flows from operations in the quarter were \$1.6 billion after making a previously discussed payment in the quarter of \$826 million of U.S. federal taxes that we deferred from the second and third quarters of FY '23.

In Q4, we entered into a \$1 billion share repurchase agreement, and we currently have \$2.15 billion remaining of our \$15 billion authorization granted in December 2020. As a reminder, we measure ARR on a constant currency basis during a fiscal year and revalue ARR at year-end. FX rate changes between December of 2022 and this year have resulted in a \$160 million increase to the Digital Media ARR balance entering FY '24, which is now \$15.33 billion and is reflected in our updated investor data sheet.

Factoring in the momentum across our businesses and current expectations for the macroeconomic and foreign exchange environments, for FY '24, we are targeting: total Adobe revenue of \$21.30 billion to \$21.50 billion; Digital Media net new ARR of approximately \$1.9 billion; Digital Media segment revenue of \$15.75 billion to \$15.85 billion; Digital Experience segment revenue of \$5.275 billion to \$5.375 billion; Digital Experience subscription revenue of \$4.75 billion to \$4.80 billion; tax rate of approximately 18% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of \$13.45 to \$13.85; and non-GAAP earnings per share of \$17.60 to \$18.00.

As a reminder and as is customary, these targets do not reflect our planned acquisition of Figma. We expect normal seasonality throughout the year with a seasonal step down for new business into the first quarter, sequential growth from Q1 to Q2, typical Q3 summer seasonality and a strong finish to the year in Q4. We expect our cash tax rate to improve sequentially in FY '24 by 2 percentage points as the amortization of previously capitalized R&D increases our deductions next year for tax purposes, benefiting our operating cash flows next year.

For Q1 FY '24, we're targeting: total Adobe revenue of \$5.10 billion to \$5.15 billion; Digital Media net new ARR of approximately \$410 million; Digital Media segment revenue of \$3.77 billion to \$3.80 billion; Digital Experience segment revenue of \$1.27 billion to \$1.29 billion; Digital Experience subscription revenue of \$1.14 billion to \$1.16 billion; tax rate of approximately 18% on a GAAP basis and 18.5% on a non-GAAP basis; GAAP earnings per share of \$3.35 to \$3.40; and non-GAAP earnings per share of \$4.35 to \$4.40.

While the implied operating margin for Q1 is up sequentially, we expect a typical seasonal margin stepdown starting in Q2 as a result of the annual merit increases and disciplined investments to drive growth.

In summary, I couldn't be prouder of the company's performance in FY '23 and the momentum we're carrying into 2024 across Creative Cloud, Document Cloud and Experience Cloud. Our strategy, scale, speed of execution and profitability position us for years of sustained success. Shantanu, back to you.

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

Thanks, Dan. In addition to our financial accomplishments, we are proud to once again be recognized for our industry leadership. Content Credentials and Adobe's approach to responsible AI were recognized by Fast Company as one of the year's breakthrough innovations. We were again named to the Dow Jones Sustainability Index. Glassdoor listed Adobe as one of the Best Places to Work. And Interbrand ranked us in the top 20 Best Global Brands as a rising brand for the eighth year in a row.

Digital remains a massive tailwind as content demand and consumption continues to grow and businesses of all sizes are focused on transforming their customer experiences. Adobe is incredibly well-positioned to lead and capitalize on this opportunity, thanks to our innovative road map, expanding global customer base, strong brand and the best employees in the world. Our fiscal '24 financial targets reflect our confidence in continuing to drive strong top line growth and world-class profitability. I'm more certain than ever that Adobe's best days are ahead of us. Thank you, and we will now take questions. Operator?

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We'll take our first question from Kash Rangan with Goldman Sachs.

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### **Kasthuri Gopalan Rangan** - *Goldman Sachs Group, Inc., Research Division - Head of Software Coverage*

Congrats on the quarter, and happy holidays. Shantanu and team, I'm wondering, going into 2024, it definitely feels like the economy's in stable footing. And in general, the software metrics are all improving as this year unfolded and very different from going from '22 to '23, yet your DM ARR guidance is not the same as how you started last year but you got the benefit of Generative AI, tailwinds from the economy, you've got pricing and Firefly.

Can you just help us understand, if you isolate for those factors, what has gone into your guidance? Because it seems like if we exclude the optionalities that you have, including the tailwinds in the economy, that, that guidance looks like it's very conservative. And maybe that's the right thing to do but just wanted to understand your thought process.

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

Yes. Thanks, Kash. I mean certainly, really thrilled with what a phenomenal year we had across all aspects of the business, whether it was the \$5 billion quarter, \$5 billion book of business now in DX exiting and certainly, Digital Media ARR performance. Let's -- if you reflect, I mean, you talked about the guidance that we gave at the beginning of '23 and '24.

If you recall, we actually had guided to \$16.50 million first, then we upped it, as you know, to \$17.50 million and ended with \$19.13 million. And so to your point, on the execution front, we've delivered some great innovative products. We've expanded the customer base with new products like Express and Firefly. We're certainly focused on surfaces and making sure all of our flagship products are available across all surfaces. And so we do have multiple growth drivers to your point, and we are focused on monetizing the opportunity.

I mean I would say we take our guide very seriously. The other way of looking at it, Kash, is it's our highest annual guide ever in terms of what the guide we've issued. It's our highest Q1 guide ever. And we want to go, again, execute against this large opportunity and have another record year. So we're feeling good. The momentum is certainly there in the business, but we take our guidance at this point of the year very seriously.

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### Operator

We will take our next question from Keith Weiss with Morgan Stanley.

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

I think this is in a similar vein to what Kash was trying to get at but maybe a little bit more focused on Q4 in particular. When we look at the Digital Media net new ARR adds in Q4, it looks like you had a very, very strong Document Cloud, record quarter, like you were saying. Really strong year-on-year growth in those net adds. Creative Cloud, where we actually saw a price increase and we have all the excitement on Firefly, that was actually down on a year-on-year basis.

And this is the first time since 2018, we've seen Creative Cloud net new ARR below \$400 million. And I think that's the surprise for investors, was a negative surprise for investors that we're trying to figure out. Was there something dragging the Creative Cloud side of the equation this year or a tough comp from last year or something that explains why the price increases and all the positive momentum and innovation out of Adobe MAX isn't translating into net new ARR growth for Creative Cloud in particular?



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

Yes, happy to take that, Keith, David here. So first of all, as you mentioned in the DME business, we're really excited about the results for '24, over \$1.9 billion in net new ARR, obviously well above the guide. We see an expanding base of customers and a lot of momentum coming from Gen AI as you noted. As part of this, we delivered -- what we delivered in Q4 was net new ARR, was a record net new ARR in constant currency.

Now specific to your question on Creative Cloud momentum and how to interpret the numbers that you see there, underlying all of this is very strong momentum because we delivered a record Creative Cloud new commercial subscriptions number in the year. So that is really the foundation and the base of customers coming in and really benefiting from not just what we get in this quarter but also how we build on that going forward. So it really sets us up well for FY '24.

As you look at the numbers for Creative Cloud ARR, net new ARR in the quarter, you have to look at it relative -- Q4 FY '23 relative to Q4 FY '22, as you mentioned. You need to consider that FY '22 had 2 pricing actions that accrued to Creative Cloud that are much lower now in Q4 FY '23. So if you normalize for the impact of the pricing that rolled off and the pricing that came on, Creative Cloud net new ARR in Q4 grew on a constant currency basis.

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

And Keith, just to punctuate the 2 points that David said, first, it was a record for Creative ARR as it related to subscriptions in Q4 of 2023. And Creative ARR would have grown if you had backed out the pricing. So the business continues to be extremely healthy, to your point.

**Operator**

We will take our next question from Alex Zukin with Wolfe Research.

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

I guess maybe looking at next year, as we look at how much of the renewal base in Creative Cloud is potentially up for that type of the pricing uplift, and as we look at Acrobat, specifically the AI functionality that you're releasing into public beta, how should we think about the tailwind to both Creative Cloud from pricing and to Document Cloud specifically from an AI product monetization perspective for '24, for calendar '24?

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

Yes, happy to take that, Alex. A lot packed into that question, so let me try to tease it apart. Let me first start with the question around FY '24 and the impact of pricing. Before we jump straight into that, I do want to take a bit of a step back and just remind everyone that Digital Media ARR is a mix of a few things: new subscriptions, which, as I mentioned, we had a record number of new subscriptions in Q4; upsell and cross-sell, which is transitioning people to higher plans from the plan that they're on; and then lastly, offer optimization.

And as you've noted in the last couple of years, we've really been broadening the number of offers we have all the way down from free price points to the All Apps price points. But even beyond that, we now have capabilities to sell add-ons to All Apps as well. And of course, all of this does include the pricing increases that you had mentioned where we've added more value.

I do want to just stress because I know there's a lot of attention on the pricing impact that we always have seen and continue to believe that the primary growth driver for ARR will be new subscriptions in '24. So that's why we're so focused on the top of funnel and new customer acquisition.

But specific to your question on pricing, you need to consider a few things: first, our recently announced pricing changes will impact less than half the Creative Cloud base so that was a very specific question you asked. Hopefully, that gives you the answer. But it also leaves us the opportunity

to price in new value in the years ahead as we move forward. Second, the impact will be more visible in net new ARR in the back half of FY '24 as we lap the previous pricing actions that I was talking to Keith about from last year and as we roll out the pricing over the next few quarters. So the second half of FY '24, we'll see more visibility into the benefits of that to net new ARR.

Third, given that we're rolling out these prices across plans and across geos incrementally over the year, the benefit to ARR will actually be spread across FY '24 and FY '25. And fourth, if you really want to sort of sharpen your pencil, the pricing impact on ARR in '24 is actually lower than the pricing impact was in '23 to Creative Cloud. So hopefully, that gives you a sense.

But again, it comes back to this, is why we're so excited about the momentum we're seeing in new subscriptions, which really bodes well for the business this year and in the long term. Hopefully, that gives you a pretty good sense on that. And then really quickly on Document Cloud, we're thrilled with the performance of Document Cloud. A lot of that comes down to our core strategy, which has been around integrating the desktop, the web and mobile into a single ecosystem and really driving the monthly active usage of Document Cloud up through all of the product-led growth motions we have and converting people on the back end of that.

What we're really excited about as we bring the AI assistant to market, which, by the way, as I mentioned, is now in private beta, expect it to come out in the next few months as a public beta and then GA later in the year. But what we're really excited about there is being able to not just service the paid Acrobat base with that but also start to bring that to the free reader base. So lots of opportunity and excitement for the year ahead for Doc Cloud as well.

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#### Operator

We will take our next question from Kirk Materne with Evercore ISI.

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

Congrats on the quarter and happy holidays. David, I guess I'll go back to you again. In the commentary, you all talked about enterprise strength and specifically upselling of Firefly and Express in your enterprise customer base. Can you just give us some more, I guess, qualitative color on what those discussions are like?

Are they lead, is this part of the reason you're seeing sort of an uptick in new subscriptions in the enterprise in particular? And then on Express, can you just talk again about sort of what you're seeing in terms of leading indicators of that being an enterprise product that can continue to expand into fiscal '24?

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

Yes. Maybe I'll start, and then Anil can add because this does cross over our 2 businesses. So with Firefly and Express, very excited about the momentum that we continue to see. You heard that we crossed 4.5 billion generations now. So we continue to see really, really strong adoption and usage of it, partially as a stand-alone business but also integrated into our Photoshop and Illustrator and these existing workflows.

And we're starting to see a lot of interest not just in the context of using it as part of the existing products but also using it as part of the ecosystem within enterprises. So we've been working with a number of customers to not just enable them with Firefly, which is the predominance of the growth that we're seeing in Q4 for enterprise adoption but also have a number of pilot customers already engaged around custom model extensions so that they can bring their own assets and their own content into what Firefly generates.

Second, we're also enabling the ability to expose it through APIs so they can build it into their existing workflows. And third, we're, of course, connecting it and tying it all into Adobe Express, which now also has its own Firefly and additional capabilities like things so that you can not just sort of create content using Firefly but then start to assemble it, start to schedule social posts around it, start to do multi-language translations, that those are all features that are already in there and then create a stakeholder workflow from people working in Photoshop to the marketers

that are trying to post externally. So that's where things get very interesting and exciting in terms of the connection we have with GenStudio and everything that Anil is doing.

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

Just building on that, GenStudio, since we announced it at MAX, we've had a tremendous amount of interest, both from enterprise customers like Henkel and Pepsi and Verizon as well as a number of the agencies as well. And primarily, it goes back to what we discussed at Summit. The demand for content is expected to grow 5x over the next couple of years. And every brand in the world is looking at, hey, how can we speed up the production of quality on brand content?

How can we let a number of other people in marketing, other areas of the company create their own content according to the enterprise standards?

And the combination of what we have in the Digital Experience portfolio, like Adobe Experience Manager and assets, as well as what we have in the Creative Cloud, especially around Express and Creative Cloud, really lets enterprises get that kind of agility and the cost effectiveness of producing content at scale. So that's what we're seeing and we're seeing a tremendous amount of interest for that.

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

And maybe I'll just add a little bit to that, Kirk. I mean I think the exciting thing about what people are doing is they're standardizing on Firefly and the fact that we have responsible generations for the entire enterprise. So the interest level has been around how do we standardize that for all of the image or vector or other generations that they want to do for all the knowledge workers in the enterprise. So really good adoption of Firefly.

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**Operator**

We will take our next question from Karl Keirstead with UBS.

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

I'd like to ask about a different subject, and that's the Creative Express product now that it's being sold in the enterprise. Wondering if you could offer some color on the adoption ramp, the competitiveness versus Canva and whether your plans around driving Express revenues versus driving user adoption have changed at all.

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

Great. Yes, happy to take that. Express is off to a great start. As you remember, we went general availability in August with the latest version of it. It's been getting a lot of very, very positive reaction response. And frankly, since then in Q4, too, we've added a ton of new innovation. Firefly integration started with Text to Image and Text Effects, but we also added Text to Template that will create a fully formed template for you in Generative Fill so you can iteratively change things on the fly.

We now let you draw and paint on the canvas. We've given users much more video support. We've really built an incredible best-of-breed PDF support and workflow with Acrobat in there as well. Some of the other things that now start to bleed into the enterprise also, we've integrated social workflows so that people can schedule their posts.

We've enabled people to do auto translation so you can post in multiple geographies and languages. We've opened up our ecosystem for partner plug-ins and we have now over 50 extensions. And we've added enterprise features like AEM integration and template locking so that the core brand police in an organization can manage and make sure that the brand elements that they don't want changing are locked when you disseminate this more broadly.

What we've seen is really, I think, some very exciting broad-based benefits from this. One is we've seen new trialists coming in, growing very quickly after this launch, which is exciting to see. We've seen education users starting to adopt this very quickly as well. The Creative Cloud paid base has been coming on and growing very quickly in terms of their usage. And then enterprise, as we talked about, from a usage perspective. And again, Express is a core part of how Anil and team are now selling GenStudio.

And last thing is like this is just setting up the momentum for the year to come. We have a mobile release coming out, which will be very exciting for users to be able to use this on the go. We have thousands of people already using that beta. We announced our Chromebooks partnership, so anyone that buys a new Chromebook is going to have this. We have partnerships with folks like Wix for their workflows. We're going to be doing deeper integrations into Acrobat. So we're very excited about where this goes.

That is a long way to answer a very simple question. We want a lot of people using this, so our primary focus continues to be around broadening the top of funnel. Of course, as part of that, we are constantly and continually, as I mentioned, journeying people for upsell and cross-sell opportunities to the paid plan and over to Creative Cloud and other products. But our primary focus continues to be adoption in broad proliferation.

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**Operator**

We will take our next question from Brad Zelnick with Deutsche Bank.

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

This is for Dan or maybe Anil. As we think about the momentum within the DX business, it's great to hear things like the 60% increase in your AEP and native apps book of business, the strong net dollar retention and you talked about overall strong year-end bookings. But what is it maybe about the pipeline ahead, bookings conversion or perhaps other factors that account for the degree of decel that you're guiding for into next year?

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

Thanks, Brad. We are really excited about this massive multiyear opportunity. If you look at any enterprise customers around the world, everybody recognizes the long-term imperative of transforming their customer experiences. And we're seeing that in these transformational deals that we talked about. As you mentioned, for example, with the AEP, our first \$100 million net new business quarter and ending with over \$700 million in our annualized book of business.

With that said, it's definitely we're seeing macroeconomic impact, just like other enterprise software companies are. Every customer looks at the total cost of deploying the software and then what it would take to get the payback and ROI. And as a result, there's definitely some scrutiny and caution there. But that said, if we look at going into next year, we do see the pipeline across both our industry verticals as well as our mid-market customers. And we continue to be the leader in the market, and we did get that recognition from both analysts and customers.

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**Operator**

We will take our next question from Brent Thill with Jefferies.

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

Dan, if you could just review the broader assumptions in your guide. I think there's still a little concern from the Street in terms of why you're guiding where you're guiding relative to where the Street was at. And maybe just tying in, Shantanu, to the guide, if you could just give us your top line view of do you feel like the environment is improving. Do you think it's just stabilizing? Just any thoughts in terms of sort of a high level what you think is happening as we go into next year.

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

Yes. So thanks for the question, Brent. When we take a look at the guide, if we think about where we're at, at this point in time as we're looking forward into FY '24, clearly, we see a lot of momentum in the business. The company's engine of innovation has been incredibly strong, and you see the strong financial performance of the company. That's both from a top line standpoint as well as profitability and cash flow standpoint. So clearly, a lot of momentum around the business.

As I think about where we sit today, we printed a 46.4% operating margin. As we look forward into next year, we take into account everything we can see. As Shantanu said, we take the guidance seriously and we set expectations in a prudent way. There's an opportunity to do better than the expectations that we set. Clearly, the company is going to be driving towards that. As we think about the engine of innovation, we think the pipeline is strong. We're going to continue to invest in the drivers of growth. This company is going to orient towards growth.

When I think about the investment profile, not only are we going to be disciplined but we're going to continue to invest in those drivers of growth. On the DX side, Anil talked about AEP and apps, strong book of business, strong growth. We're laying the groundwork and content supply chain with the GenStudio solution, scaling that motion and engaging with customers to go from ideation to creation to activation, delivering new technologies products, AEM sites, incorporating intelligence into those products.

On the DMe side, you can see it across the portfolio, AI Assistant in Acrobat. It's in private beta. It's going to be in public beta in the coming months. You look at Firefly, Express natively and deeply integrating these technologies throughout the product portfolio. There is going to be continual investment as it relates to that innovation. As you think about the momentum exiting this year and as you think about the guide into Q1, you can see that momentum continuing. You've got operating margin up a little bit.

And then throughout the year, as we said at our FA Day and at last year's earnings call, you can see a mid-40s expectation around operating margin for the company as we drive this investment cycle, as we drive leadership in our core markets and are a key catalyst in the trends that are shaping those markets. So again, taking a step back, it nets into account the macro that Anil talked about. Everything we see from a core business standpoint and the investment profile that we're going to drive to lead if there's an opportunity to do better than where we set those expectations, we're certainly going to do it.

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

And maybe just to add to that, Brent, since you asked. First, let me clarify, there's nothing as it relates to the economic indicators that we saw anything that would give us pause for concern. So let me start off by saying that. I think at our investor meeting, we told you that we would expect a strong quarter. I think you would acknowledge we posted some really strong numbers and the momentum continues.

And I think as it relates to Creative Cloud, it's going to be driven by new customer acquisition, which is the engine that's driven the business. And maybe perhaps the sell side looked at some of the pricing and put more of that in '24 than in '24 and '25. And that will spread out and perhaps they put a little bit more in what percentage of the base that impacts. So from my perspective, the good news about Creative is it's being driven by massive new adoption into the platform.

On Document Cloud, really strong results. I think as Dan said, as we put the AI pack on there as well, that should help fuel more adoption. And Digital Experience. I mean I know that Brad also asked that question. I mean, it's great to see the adoption of AEP and apps. I mean, that is clearly the future of digital experiences, driving \$100 million quarter, the \$700 million in the annualized book of business, which I think will reflect the next-generation customer experience architecture.

So we're feeling positive and we're going to go execute against that, Brent. So nothing that we see on the horizon would tell us either from the economic or competition that we're not poised to have another great year. And profitability as well. I mean look at the numbers that we posted, both in terms of Q4 as well as for fiscal '24. And that is -- that does not, in any way, mean that we're not going to invest in all of the cloud and the foundation model. So I feel really good.

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

And then just one thing to add, Brent. If we were here a year ago, the expectations going into the year where FX was going to be a pretty decent headwind to the performance. You see that in the way we've reported our results and then compare it to a constant currency basis. We started with a pretty decent spread between the as-reported numbers in constant currency in Q1. By the time we got to Q4, you saw that spread compress.

As I look forward into FY '24, it's more of a neutral footing to maybe a slight headwind. Too early to really call it with precision, but I see that set up being slightly different and maybe just a slight headwind versus what we were seeing a year ago.

**Operator**

We will take our next question from Jay Vleeschhouwer with Griffin Securities.

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

You noted the strength in RPO in the quarter, including the record sequential increase. Could you talk about how you're thinking about RPO for fiscal '24? Would you expect it to continue to be able to outgrow revenue growth by several points as you did in fiscal '23? And perhaps talk about the ingredients that will continue to drive RPO either by segment or any other considerations that you'd like to talk about in that.

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

Yes. Thanks, Jay. As I pull some of the threads together that we've heard on this call, Anil talked about large transformational deals, being the platform of choice with Customer Experience Management, simultaneously driving top line and bottom line productivity and the investments around driving those are an imperative in the market. We see a similar dynamic with the new technologies that we're bringing to market on the DMe side of the business. We're seeing a strong pull from the enterprise.

And so as I net out that environment and our performance against that opportunity, it goes to produce the type of sequential RPO progression that we saw Q3 to Q4. Every quarter won't be that large, but the backdrop around that dynamic for the company, given the setup we see, it should be another strong year for RPO throughout the year.

**Operator**

We will take our next question from Saket Kalia with Barclays.

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

Congrats on a nice quarter. David, maybe for you. I had a question just on Firefly and the subscription packets. I know that the commercial model for commercial for -- I'm sorry, for Firefly credit packets really just started about 6 weeks ago. Are there any early observations that you've seen just on customers' willingness to add those packets or maybe how they're consuming the initial credit allocation that they get with the Creative Cloud subscription?

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

Yes, happy to take that. First of all, I think philosophically, going back to what we said at the investor meeting and at MAX, our primary focus here is to drive usage of the generative capabilities, and you see that with the 4.5 billion images generated. That strategy is working. Secondly, we priced

the generative packs -- sorry, we integrated the generative capabilities and credits directly into our paid plans with the express intent of driving adoption of the paid subscription plans and getting broad proliferation of the ability to use those.

And what we are seeing is heavy usage within those paid plans. I think as we've mentioned in the past, I think I mentioned earlier today as well we -- Generative Fill, for example, in Photoshop, is the fastest-growing feature that we've put into Photoshop in recent memory. So the usage is great. The utilization is great. I don't personally expect generative packs to have a large impact in the short term other than to drive more customers to our paid existing subscription plans.

But what will happen over the course of the year and the next few years is that we will be integrating more and more generative capabilities into the existing product workflows. And that will drive -- and we'll be integrating capabilities like video generation, which will cost more than 1 generation, and that will drive a natural inflation in that market and that will become a driver for growth subsequently.

But this year is really primarily focused on getting people into the right paid plans of our flagship applications or Adobe Express and then drive usage in that sense. And then as that happens, the rest will take care of itself in the years ahead.

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#### Operator

We will take our final question from Mark Moerdler with Bernstein Research.

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

Dan, I'd like to look a little bit. At MAX, we discussed how excited you were on Firefly and how it drives Creative Cloud seat and paid seat adoption. Now that you've had a bit of time in market, can you explain how you think about how this will drive the paid seat growth? Is it how strong it could be?

And should we expect those seats are going to be a lower unit price because they're going to be entry level? Or do you think that will get offset by these higher priced Firefly-driven sales into the enterprise?

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

Yes. Thanks, Mark. I think at the core of bringing this technology to life, as a stand-alone application to drive an ideation part of the process but value in deeply integrating these capabilities into the flagship applications and the workflows that define the creation process, it gives us a lot of surface area with customers and meeting them where they are in their particular needs and use case-specific needs.

And so bringing people efficiently top of funnel, establishing the segmentation across that product portfolio, driving efficiency into the creation process and allowing velocity to enter the ideation, creation, activation and instrumentation of that to really refine how companies engage with customers. So it lays the groundwork for us to touch more customers where they are in the ecosystem, bring them on board in use case-specific way and then take them on digital journeys, which is something the company is very skilled at with our DDOM to cross-sell and upsell over the life of their engagement with our ecosystem.

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

From a product perspective, when you think about it, Mark, for us, the biggest thing that we want to do is how do we further make our products accessible, fun and affordable for increasing set of customers. And I think Firefly is one of those inflection points that will help everybody get over the blank screen fear that they have.

And so first, as you think about Firefly as an ideation and people just coming and want to have creative inspiration, this is whether you're an individual user, whether you're agencies, we're seeing a lot of adoption of Firefly to just start the entire creative process. And that sort of brings them as an on-ramp into Express, which would be the other part.

Express is certainly the introductory pricing, the ability to get millions more into the fold. And the ability right now, it used to be that Express and other offerings in that is to all worry about do I have the right templates? Well, AI is going to completely change that. We have our own models. And so Firefly will allow anybody to take whatever creative idea that they have and make that available. So I think Firefly really helps with the Express offering.

On the Creative Cloud, David mentioned this. I mean if you look at the adoption of that functionality and usage that's being driven, whether it's in Photoshop right now, Illustrator, as we add video, both in terms of providing greater value, and we certainly will, therefore, have the uplift in pricing as well as the retentive ability for Firefly, that's where I think you're going to see a lot of the really interesting aspects of how Firefly will drive both adoption as well as monetization.

And then if you go at the other end of the spectrum to the enterprise, GenStudio, every single marketer that I know and CFO and CMO are all worried about how much am I spending on data, how do I get agility in my campaigns. And the fact that Firefly is integrated into both Express as well as when we do the custom models for them so they can upload their own models and then have the brand consistency that they want. So Firefly really is the fact that we have our own models, a great catalyst for business all across the spectrum.

And the usage and the adoption shows that. In emerging markets, as people there in emerging markets are increasingly used to create variants of content and localization of content, that's where we're also seeing a tremendous usage of these particular technologies. So really exciting.

And then you take the same technology that we have in Creative and think about its impact in both Document Cloud when we do that and the ability to have summaries and have conversational interfaces with PDF, thereby making every single PDF, as David again said, both for communication, collaboration and creation far more compelling. I think you're going to see that same kind of uplift in usage and therefore, monetization on the Acrobat side.

And since that was the last question, I mean, for us, we look at FY '23, and we're really proud of what we were able to accomplish across all spectrums, top line revenue, RPO and driving book of business, Creative Cloud, Document Cloud and Experience Cloud and profitability. And we think '24 is going to be exactly more of the same, which is continuing to drive great innovation, great product growth, great profitability.

Clearly, I think there's been a set of questions around the Digital Media ARR and you know what our take is on that. And we're extremely confident about how that continues to be a growth business. And perhaps the pricing impact was overestimated.

And as we said, this is again a new growth business, and it will be a multiyear pricing benefit for us as we think about the uplift that we have. So we're really pleased. We appreciate you being on the call and like many of you wished us, happy holidays, and we hope to see you soon. Thank you for joining us.

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

Thanks, everyone. Happy holidays. This concludes the call.

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**Operator**

Once again, this concludes today's call. Thank you for your participation. You may now disconnect.

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