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ZS.OQ - Q3 2024 Zscaler Inc Earnings Call

EVENT DATE/TIME: MAY 30, 2024 / 8:30PM GMT

OVERVIEW:

Company Summary

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PRESENTATION

Operator

Hello, and thank you for standing by. Welcome to Zscaler third-quarter 2024 earnings conference call. (Operator Instructions)

I would now like to turn the call over to Ashwin Kesireddy, Vice President of Investor Relations and Strategic Finance. Sir, you may begin.

Ashwin Kesireddy - Zscaler Inc - Vice President, Investor Relations & Strategic Finance

Good afternoon, everyone, and welcome to the Zscaler third quarter fiscal year 2024 earnings conference call. On the call with me today are Jay Chaudhry, Chairman and CEO; and Remo Canessa, CFO.

Please note we have posted our earnings release and a supplemental financial schedule to our Investor Relations website. Unless otherwise noted, all numbers we talk about today will be on an adjusted non-GAAP basis. You will find the reconciliation of GAAP to the non-GAAP financial measures in our earnings release.

I'd like to remind you that today's discussion will contain forward-looking statements, including, but not limited to, the company's anticipated future revenue, calculated billings, operating performance, gross margin, operating expenses, operating income, net income, free cash flow, dollar-based net retention rate, future hiring decisions, remaining performance obligations, income taxes, earnings per share, our objectives and outlook, our customer response to our products, and our market share and market opportunity.

These statements and other comments are not guarantees of future performance, but rather are subject to risk and uncertainty, some of which are beyond our control. These forward-looking statements apply as of today, and you should not rely on them as representing our views in the future. We undertake no obligation to update these statements after this call.

For a more complete discussion of the risks and uncertainties, please see our filings with the SEC as well as in today's earnings release. I also want to inform you that we'll be attending the Bank of America Global Technology Conference in San Francisco on June 5.

Now I'll turn the call over to Jay.

Jagtar Chaudhry - *Zscaler Inc - Chairman of the Board, Chief Executive Officer*

Thank you, Ashwin. We delivered an outstanding quarter, with all metrics exceeding our guidance, and I'm very pleased to increase our full year guidance based on our strong performance.

Revenue in Q3 grew by 32% year-over-year, and billings grew by 30%. Our \$1 million-plus ARR customers increased 31% year-over-year to 523, and we ended the quarter with over 50 customers with \$5 million-plus in ARR. Our disciplined approach to growth is reflected in our operating profit, which nearly doubled year-over-year, and our operating margin reached a record 22%.

I'm also pleased to report that we had our first quarter of GAAP profitability on a net income basis for Q3. Our strong performance was driven by continued demand for our Zero Trust Exchange platform, which we purpose built to secure communication among users, workloads, and devices. We expect demand to remain strong as an increasing number of enterprises are planning to adopt our platform for better cyber and data protection.

Zero trust security remains a top initiative for IT teams as legacy castle-and-moat firewall-based security is ineffective in the new world of cloud and AI. Our Zero Trust Exchange, processing over 400 billion transactions and preventing billions of security and policy violations per day, provides superior security to our customers. For example, last calendar year, our platform prevented over 2 billion phishing attempts, up 60% year-over-year. The cyber and data protection capabilities of our platform are resonating with customers, and we are accelerating the expansion of our core platform with innovations across multiple pillars.

We recently introduced the industry's first AI-powered Copilot for ZDX, our digital experience monitoring solution. This helps simplify and automate detection and resolution of performance issues. We added two significant products to our data protection pillar: one, data security posture management, or DSPM, to discover, classify, and protect sensitive data in public clouds; and two, GenAI app security to provide deep visibility and granular controls for GenAI apps.

We introduced Zero Trust network segmentation, which expands our platform to local area networks inside branches, campus, and factories. We expanded our AI cloud solutions by introducing unified vulnerability management to enable customers to proactively identify critical vulnerabilities.

We will continue our rapid platform expansion with organic innovations as well as strategic acquisitions. We recently acquired two early-stage innovators: Avalor and Airgap Networks. Avalor's data fabric ingests, normalizes, and unifies data across enterprise security and business systems to dynamically prioritize vulnerabilities based on holistic risk. This innovative data fabric will combine data from our 400 billion daily transactions with over 150 third-party data sources to add various context to provide better understanding of risk for timely mitigation. As a result, customers can get real-time actionable insights and operational efficiencies, improving their overall security posture.

For securing customer branches, campuses, and factories, we continue to innovate. Our Zero Trust branch solution released last year enables each branch office, campus and factory to be treated like a Starbucks, which means there is no lateral threat movement as the branches are not on the corporate network, and there is no need for firewalls as branches are no longer exposed to the internet. With the Airgap acquisition, we are taking branch security to the next level as we are introducing the industry-first Zero Trust segmentation inside branches, campuses, and factories for servers and IoT/OT devices. This eliminates the need for legacy fiber-based segmentation for east-west traffic.

We talked about our \$72 billion market opportunity in the past. Our recent acquisitions and other innovations increase our market opportunity by several billion dollars as they extend our platform into new adjacent markets, including vulnerability management, security operations, and branch security.

Moving on to our AI innovations. We are developing multiple AI-powered applications, including Risk360, Business Insights, Unified Vulnerability Management, and more. We are training our AI security models with the vast amounts of data generated by over 400 billion daily transactions on our platform to deliver superior threat detection. We are leveraging AI to automatically classify data and enforce policies for better data loss prevention. We have delivered GenAI app security to enable secure use of AI apps by our customers.

Our GenAI app security delivers: one, visibility into the AI services used by employees; two, policy control, which allows different user groups to access only approved AI services from the thousands of such services; and three, enforcement of data protection policies to prevent sensitive data from leaking to public AI services. We will be showcasing these and other innovations that combine the power of Zero Trust with AI at our Zenith Live User Conference in June.

Organizations are relying on Zscaler to continue to innovate as threat actors are evolving and posing new challenges by frequently exploiting firewall and VPN-based security architecture. Recently, hackers exploited a zero-day vulnerability of a leading next-gen firewall and a vulnerability of a leading VPN. Such exploits put organizations at risk as attackers can move laterally on the flat networks created by legacy firewalls.

These shortfalls in legacy security will continue to be exploited until enterprises embrace Zero Trust architecture and phase out firewalls and VPNs. Zscaler's Zero Trust architecture eliminates lateral threat movement, which dramatically improves security posture of organizations. Our differentiated Zero Trust and proxy-based architecture is foundational to delivering superior security.

Let me give you a few examples. After experiencing a catastrophic cyber-attack last year, a large financial services new logo customer purchased our ZIA data protection and ZDX pillars for 25,000 users in a seven-figure ACV multiyear deal. This customer wanted Zero Trust architecture, and hence excluded the current firewall vendors from consideration. Our superior architecture and strong data protection capabilities were key to winning this deal. As the customer said, Zscaler's CASB, EDM, and OCR technologies are amazing. Zscaler just works.

In another example, an existing global manufacturing customer, after learning about a major VPN vulnerability, rolled out Zscaler to 100,000 devices in just three days. Subsequently, the customer increased their purchase of Zscaler for users, including ZIA, ZPA, ZDX, and data protection, in a seven-figure ACV deal, increasing their ARR by over \$5 million. This customer also made an initial purchase of Zero Trust for branch and our advanced Privileged Remote Access solution, which speaks to customers' growing interest in our broader platform.

Customers are also purchasing more of our platform to eliminate legacy tech debt and consolidate multiple point products while simplifying IT operations and improving user experience. Let me highlight two upsell deals that illustrate this. After making an initial purchase last year, a Global 100 financial services customer significantly expanded the purchase of Zscaler for users in a seven-figure ACV deal for over 64,000 users. Despite having years of relationship with a legacy firewall security vendor, it chose Zscaler. This customer is consolidating multiple point products, including Secure Web Gateway, VPN, and VDI. We work closely with one of our GSI partners on this large project. This deal is an example of us working with GSI partners to expand our market opportunity.

In another upsell win, a large APJ-based financial services customer signed a seven-figure ACV multiyear deal for 10,000 users, buying most of our platform services. In addition to expanding their purchase of Zscaler for users, they purchased our Zero Trust for workloads, Zero Trust for branch, and AI cloud solutions. Our emerging products contributed nearly a third of the ACV value of the deal.

I'm very pleased to share that we are seeing strong customer interest in our emerging products, which contributed nearly a quarter of our new and upsell business this quarter. Here are a few examples. In an eight-figure ACV deal, a Fortune 500 technology customer expanded their purchase of Zscaler for users and made their first purchase of Zero Trust for workloads and our AI cloud solutions. With this purchase, the customers' total ARR increased over 5x to more than \$10 million. This was also our largest workload protection deal to date, representing seven figures in ACV.

I'm thrilled to see our recent innovations in workload protection receiving increased traction. We closed several deals for our AI cloud solutions, including Risk360 and Business Insights, with customers across multiple verticals, including broadcasting, consulting, insurance, and many more. CISOs get inundated with lots of security alerts and signals that don't help them take specific actions based on risk. Customers are buying Risk360 as it provides them with the overall risk score of the organizations, the factors contributing to risk, and the actionable recommendations to reduce risk.

For a Zero Trust branch, one of the largest retailers in Europe who initially adopted ZIA, ZDX, and data protection last year expanded their deployment in a seven-figure upsell deal to include the full suite of Zscaler for Users and Zero Trust SD-WAN. Zero Trust SD-WAN, which will be deployed at their regional locations, contributed about a quarter of the ACV value of this deal.

Next, in the federal vertical, we are proud to be serving 12 of the 15 cabinet-level agencies, and we continue to pursue new and upsell business opportunities across the federal market to help them adopt Zero Trust architecture as mandated by the President's executive order. To give an example, in a seven-figure upsell win, an existing cabinet driver agency increased the purchase of ZIA and ZPA by over 50%, significantly increasing the ARR of this already \$10 million-plus customer.

Next, let me give you an update on our progress in the Department of Defense or DoD segment. DoD has a requirement to implement Zero Trust with the technologies and solutions that work best for individual military services and departments. I'm thrilled to share that we signed a seven-figure ACV deal with a DoD branch this quarter. In this planned deal, the customer made an initial purchase of Zscaler for Users to protect 50,000 users. With our proven Zero Trust architecture, this latest DoD deal demonstrates that we are well positioned to capture the large cybersecurity opportunity at the DoD.

Next, let me give you an update on our go-to-market organization, where we continue to make great progress. First, to capture the strong demand for our platform and to scale our business to \$5 billion in ARR and beyond, we appointed Mike Rich as our Chief Revenue Officer in Q2. Mike hired key leaders in Q3, and he now has his full management team in place. The quality and caliber of Mike's leadership team is exceptional. I'm very pleased with the progress of our sales hiring, particularly at the leadership level. With the right leaders in place, we are now focused on increasing the pace of hiring quota-carrying reps.

Second, as I mentioned last quarter, we are evolving our sales motion from opportunity-centric to account-centric. The eight-figure ACV deal with a Fortune 500 technology company that I called out earlier is an example of the success of this new sales motion. We engaged closely with this customer to recommend the best solution for now and the future. We look forward to working with them as they are fully embracing digital transformation and Zero Trust security.

In conclusion, we are on a mission to take our platform everywhere so customers can benefit from better security, simplified IT operations, and improved user productivity. We are one of the few vendors that deliver tangible cost savings as we eliminate multiple legacy point products. The last three decades of the security industry have been centered around firewalls, which are no longer effective in today's cloud, mobile, and AI world.

I believe the next three decades will be defined by Zero Trust architecture. We have the right platform and the right team to delight our customers and capture a large and growing market opportunity. I'm excited about the journey ahead and look forward to sharing at Zenith Live how Zscaler is combining the power of Zero Trust with AI to power the future of secure digital transformation.

Now I'd like to turn over the call to Remo for our financial results.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Thank you, Jay. Our Q3 results exceeded our guidance on growth and profitability, even with ongoing customer scrutiny of large deals, the changes in our sales organization, and higher than expected sales attrition in the quarter.

Revenue was \$553 million, up 32% year-over-year and up 5% sequentially. From a geographic perspective, Americas represented 54% of revenue, EMEA was 31%, and APJ was 15%. Our total calculated billings in Q3 grew 30% year-over-year and remained flat sequentially at \$628 million. Our

calculated current billings grew 29% year-over-year. Our remaining performance obligations, or RPO, grew 27% from a year ago to \$3.824 billion. Current RPO was approximately 51% of the total RPO.

We ended Q3 with 523 customers with greater than \$1 million in ARR and 2,922 customers with over \$100,000 in ARR. This continued strong growth of large customers speaks to the strategic role we play in our customers' digital transformation journeys.

Our 12-month trailing dollar-based net retention rate was 116%. While good for our business, our increased success in selling bigger bundles, selling multiple pillars from the start, and faster upsells within a year can reduce our dollar-based net retention rate in the future. There could be variability in this metric on a quarterly basis due to the factors I just mentioned.

Turning to the rest of our Q3 financial performance. Total gross margin of 81.4% compares to 80.8% in the prior quarter and 80.2% in the year ago quarter. On a year-over-year basis, gross margin benefited by approximately 60 basis points from a change in accounting attributed to the longer useful life of our cloud infrastructure. As mentioned on our previous earnings call, beginning fiscal 2024, we extended the depreciable, useful life of our servers and network equipment in our cloud infrastructure from four to five years.

Moving on, our total operating expenses increased 2% sequentially and 21% year-over-year to \$328 million. We continue to generate significant leverage in our financial model, with operating margin reaching 22%, an increase of approximately 680 basis points year-over-year.

Our free cash flow margin was 22%, including data center CapEx of approximately 6% of revenue. We ended the quarter with over \$2.2 billion in cash, cash equivalents and short-term investments.

Moving on to guidance for Q4 and full year fiscal 2024. As a reminder, these numbers are all non-GAAP. For the fourth quarter, we expect revenue in the range of \$565 million to \$567 million, reflecting year-over-year growth of 24% to 25%; gross margins of 80%; operating profit in the range of \$107 million to \$109 million; net other income of \$17 million; income taxes of \$11 million; earnings per share in the range of \$0.69 to \$0.70, assuming 165 million fully diluted shares.

For the full year fiscal 2024, we're increasing our guidance as follows: revenue in the range of \$2.14 billion to \$2.142 billion, reflecting year-over-year growth of approximately 32%; calculated billings in the range of \$2.603 billion to \$2.606 billion or year-over-year growth of approximately 28%; operating profit in the range of \$422 million to \$424 million, which reflects up to 490 basis points of operating margin improvement compared to last year; income taxes of approximately \$32 million; earnings per share in the range of \$2.99 to \$3.01, assuming approximately 161 million fully diluted shares. We expect our free cash flow margin to be in the low to mid-20% range.

We will give specific F2025 guidance on the next earnings call, but I'd like to mention that the increased spend on the data center CapEx, which we had originally planned for F2024, is now planned for F2025.

Q3 was a transitional quarter for our go-to-market team, and I believe we did an outstanding job navigating through it. Although our attrition was higher than we expected, as Jay mentioned, we had a strong quarter hiring, particularly at the sales leadership level. We are now focused on increasing the pace of hiring quota-carrying reps. We believe the combination of our existing sales team with these new hires will result in a much stronger go-to-market organization. That said, new hires will take time to ramp to full productivity, which we believe will result in a few points of headwind to our total billings growth in F2025.

With our customer obsession, expanding platform, and strengthening sales teams, we're well positioned to continue to gain share in a large and growing market for us.

With that, operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Matt Hedberg, RBC Capital.

Matt Hedberg - RBC Capital Markets - Analyst

Great. Thanks for taking my questions, guys. Congrats on the quarter. Really, really nice to see the results in obviously a difficult selling environment. I guess, Jay, I think one of the questions that we often get from investors is around security consolidation. And I think you gave a lot of great anecdotal evidence around success of newer products and sort of the traction you're seeing there.

Can you just expand upon that and just talk a little bit more about the role of Zscaler in broader consolidation? Because it certainly feels like customers want to do more with less. And just how strategic is Zscaler in that initiative?

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Of course, Matt. Thank you. Customers do want consolidation and simplification of lots of point products, but they want to do it along best-of-breed platforms. They don't believe in a single vendor offering, the entire, what I may call, God security platform, okay?

Our customers are moving a bunch of, from point product, the whole DMZ, demilitarized zone, goes away. So we are playing a big role in consolidation. We're taking out lots of firewalls, VPNs, and that's all lots of savings from. That's why we're able to justify the sale of our platform, by taking out a lot of products.

Now customers do want two or three tiers of security. That's why, often, it's Zscaler for in-line, an EDR vendor and an identity vendor. But the notion of selling ELA bundle, everything doesn't go well. More and more CIO and CFOs are scrutinizing shelves that's being bought. So consolidation is happening, we are playing a big role, but it's focused selected consolidation, not a point-blank, give me everything type of stuff.

Operator

Saket Kalia, Barclays.

Saket Kalia - Barclays - Analyst

Okay. Great. Hey, guys, thanks for taking my question. And I echo my congrats on the quarter. Jay, maybe I'll make my question for you. I think we all know your views on firewall-based SASE solutions, but I'm curious how you're faring competitively against the smaller competitors here that are maybe more purpose-built SASE solutions.

And do you feel like the market's view here on pricing is changing at all as we see more of those purpose-built SASE competitors enter the market? The results certainly won't indicate so, but I just want to hear your view on sort of that part of the competitive landscape.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Sure. Thanks, Saket. So yes, small SASE vendors. As you know, we play in the large entrust market. We don't really see some of these small SASE vendors that are so-called purpose-built. A lot of those purpose-built vendors come from taking firewall-as-a-service into a network together and all that type of stuff.

Part of the challenge I have with the SASE thing is that it says SD-WAN plus SSE. My customers, my CISOs, believe that SD-WAN enables lateral threat movement. So where we are headed, we think SD-WAN has to go away. It will be replaced with Zero Trust SD-WAN. That's the new market segment we are pioneering. So we will keep on driving innovations.

Sometimes investors think that SASE or SSE is a static market. They often ask the question, Jay, aren't these guys going to catch up with us? Of course they're trying to catch up and do what we did four years ago, but we've done another two years ahead, two years ahead. In the cyber space, it's a race, and we keep on innovating at a faster pace. And I don't think smaller SASE vendors or firewall vendors will be able to catch up with us.

Operator

Alex Henderson, Needham.

Alex Henderson - *Needham & Company Inc. - Analyst*

Great. Thank you very much, and it's great to see you guys executing against a tough environment here. But I was taken back by a little bit of the commentary around the higher attrition in your sales organization even as you're bringing in a lot of additional new salespeople and sales leadership.

So can you talk a little bit about the mechanics of why that is occurring? Is that a reflection of a change in policy? Is it a change in skill sets that the firm thinks it needs? What has caused that attrition? And should we be sanguine when we're hearing that you're seeing accelerating people departing the firm?

Jagtar Chaudhry - *Zscaler Inc - Chairman of the Board, Chief Executive Officer*

So Alex, with the departure of our COO, we saw higher attrition in Q3 than expected, but we expect it to stabilize in Q4. It's a combination of factors, including skill set. But I'm very pleased with how well the GTM transition is progressing. With the hiring of key leaders in Q3, Mike now has full management team.

As you know, we have a great brand, we are a destination for top talent with the right leaders in place. We have accelerated the pace of hiring quota-carrying reps in Q4. Our high-caliber leaders are attracting and finding seasoned reps, and they will play a key role in making us successful to take us from \$2 billion to \$5 billion. Remo?

Remo Canessa - *Zscaler Inc - Chief Financial Officer*

Yes. I mean it's a great question, Alex. So the attrition is, you got to keep in mind, it's both voluntary and involuntary attrition. As Jay mentioned, with Mike Rich coming on board, he's hired his entire leadership in his first quarter here, his first full quarter. Our focus now is going to be increasing the pace of hiring for quota-carrying sales reps.

Just to give you some color, in the first month, which is of this quarter, which is May, we've hired comparably the same amount of reps that we hired in all of Q3. So what you want to do is you've got to get your leadership in place, because that leadership is going to drive the makeup of the sales and go-to-market organization.

As Jay mentioned, the go-to-market organization that we have, I feel very, very good about it. I feel outstanding, quite frankly. The work that's being done, the people that we're bringing on board and the direction we're going, I think, is absolutely outstanding.

Jagtar Chaudhry - *Zscaler Inc - Chairman of the Board, Chief Executive Officer*

Yeah. And if I may say, I think I'm very pleased with the transition is part of the plan to bring Mike on board to get to account base selling.

Operator

Brad Zelnick, Deutsche Bank.

Brad Zelnick - Deutsche Bank - Analyst

Great. Thank you, guys, so much for taking the question and congrats, especially on all the emerging product success that you're having. Jay, I wanted to follow up on Saket's question because I think some investors are concerned about intensifying competition in your core market, not just amongst specialized SASE players but some of the bigger ones as well. And I know Zscaler has always distinguished itself, first and foremost, on its architectural advantage, Zero Trust Exchange, et cetera. But what can you share with us to help appreciate the durability of that advantage?

And maybe for Remo, what quantitative metrics can you share, whether it's win rates, pricing trends, sales cycle times or anything else that can help us gauge the competitive environment? Thank you.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

So first of all, starting with, as we have said, architecture matters. It's like going from traditional car to electric car. Most of the large vendors are trying to build upon what they have, and we don't believe they'll ever get there, okay? So that's just the architectural.

Number two, the market functionality in this area is not static. It's moving and it's evolving. You recall when we went public six years ago, our platform was relatively small. Look at how much it has expanded. And that's only just for users. It's a big market for workloads. You saw a number of deals we talked about where workload is taking good traction. Then there are trillions of IoT/OT devices. We are the right platform, we are expanding in that area.

In fact, part of the reason we did Airgap acquisition was to expand into IoT/OT inside the campus, inside the plant, to do Zero Trust segmentation, which typically has been done by firewalls. And look at the data protection. That area has exploded. Nobody comes close to doing data protection as well as we do. So functionality is number two.

The third thing I believe will keep us ahead in the long run is speed of innovation. You're seeing how well we have innovated, how fast we've innovated. Rest assured this is not going to slow down.

The last point I'll make in this area that I'm extremely proud of -- more proud of than any of our financial stuff, is a net promoter score of 7. Happy customers buy more. I'll share one interesting snippet. A few months ago, I counted CXOs I have worked with who have bought Zscaler for more than once from us. This is Fortune 1000 companies. That number I came was 285. So all this stuff makes me very confident and proud. Remo?

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yeah. From win rate basis, they continue to be very high, so no change in win rates. Pricing trends, we're really not seeing anything from a pricing trend perspective. It just remains relatively constant. I think what that speaks to is basically the strategic nature of our platform and what we do for our customers.

And also sales cycles, we talked about our sales cycles for large deals are 9 to 12 months. We've mentioned a few quarters ago that they're moving more towards that 12 month. Really no change there either.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

If I may add a little bit on the pricing pressure, Remo. Of course, there is some pricing pressure, but we are focused on value selling. When we are able to go in and say, we aren't able to take a X million dollar worth technology, and we'll do it so much in Q1, so much in Q2, so in Q3, we are able to secure pretty good pricing. That's the point I want to make. The market scrutiny is there, but my team is doing a good job in showing value to our customers by eliminating lots of point products.

Operator

Roger Boyd, UBS.

Roger Boyd - UBS Economics - Analyst

Great. Thanks for taking the questions. Remo, I know you're not guiding to F2025, but you did suggest that the attrition you're seeing in the third quarter here would be a few points impactful to growth next year. I don't think we'll comment on that, but wondering alternatively, if you can just talk about your growth versus profitability framework.

In the past, you've talked about biasing towards margin expansion under a certain level of growth. But the message I'm hearing right now, it sounds like you feel pretty confident about rehiring under the new sales leadership. You're also verging on GAAP profitability. A lot of moving parts, but just any thoughts on how you're thinking about that growth versus profitability framework from here would be great. Thank you.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yeah. I'll focus in on the growth versus profitability and also the GAAP profit. I think that hits most of your points. From my perspective, Zscaler is perfectly positioned with our platform in its early stages in this emerging market, where we're expanding basically our product base. So from my view and Jay's view, we will still continue to invest on top line growth.

You saw, in Q3, our operating profitability on a non-GAAP basis was 22%. When we went public, we said our operating profitability target was 20% to 22%. We hit 22%. I am not concerned about operating profitability. The model basically will increase profitability naturally as the business slows down. So there's no reason, really, to focus on operating profitability and, really, the name of the game right now is to continue to invest and build that top line growth.

From my perspective, also on a GAAP profitability, we got the GAAP profitability in Q3 primarily related to stock-based compensation going down to 22% of revenue. That 22% of revenue relates to a reversal of PSUs for certain executives who left the company. So going forward on GAAP profitability, we will get to GAAP profitability, but I don't want to make any projections of when that's going to happen.

Again, the focus is on top line growth and also maintain operating profitability. For modeling purposes, one of the things I didn't comment on but I'll comment on now, think about operating profitability going up slightly in F2025. Not a lot. Again, our focus is growth, and as long as we feel we're making the right investments to really exploit this market and increase shareholder value, we're going to continue to do that. So a very, very slight increase in operating profitability is what you should think about F2024 versus F2025.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

And investments in two big areas: keep on innovating at a faster and faster pace, building some of the disruptive technologies that we are so proud of; number two, keep on investing in go-to-market.

Operator

Ittai Kidron, Oppenheimer & Company.

Param Singh - *Oppenheimer & Co., Inc. - Analyst*

Hi, thank you. This is Param Singh on for Ittai Kidron. First of all, I want to understand your 4Q guidance a little bit. If I just go back the last couple of years, your year-to-year growth rate doesn't change much from 3Q to 4Q, but there's a significant deceleration in your 4Q guide this time. I just want to understand, is there something that I'm missing outside of, say, a little bit of conservatism for higher sales attrition that maybe people are not thinking about right now?

Remo Canessa - *Zscaler Inc - Chief Financial Officer*

Thank you for the question. Number one, we like being prudent. So that's number one. Number two is Q3 was a very, very strong quarter for us. We beat the basically consensus on a top line basis by 8%. And also fourth quarter of F2023, we called out that we had a large \$20 million deal. So it's a tough compare from a billings perspective going into -- tough compare for '24 versus '23. And you got the last point. The attrition did play into it also.

Operator

Eric Heath, KeyBanc.

Eric Heath - *KeyBanc Capital Markets Inc. - Analyst*

Again, just really strong results and acceleration in pretty difficult compares, so great to see. Jay, I mean, look, the macro environment is pretty tough. So I'd be curious to hear some of your perspective more on the topic and just hear what customers' willingness to do transformational projects like SASE are at the moment, especially when they're -- they do seem to be hitting the pause button in other areas.

Jagtar Chaudhry - *Zscaler Inc - Chairman of the Board, Chief Executive Officer*

Yeah. So macro remains tough. Deals scrutiny remains high, but it's two things that are helping us: one, CIOs, CISOs and Boards remain very worried about cyber with all the ransomware attacks. So if you play a critical role in minimizing cyber threats, as we do with Zero Trust architecture to minimize lateral movement, we get attention and engagement with C-level. But if then you can show the CXO that you're going to do this cyber initiative and you're going to save X million dollars, you get more attention. So those two things are helping us build a strong engagement and pipeline.

Even if you do that, the next hurdle is you need to convince the CFO that actually the savings can be done. They're being more scrutinizing, show me savings quarter by quarter by quarter. We have a strong business value assessment team; we engage with the C-level early on and we show those benefits.

Think of this way. How many cyber companies are out there that can actually show tangible savings? You think a firewall company will show savings? No, they want to still protect their firewalls. They don't want to do cannibalization. We can cannibalize. We can actually take out all the firewalls and VPNs and that media can out the world.

So it's a good opportunity. We just want to make sure we have the high caliber seasoned salespeople who can engage with C-level and drive all these initiatives. And that's why I'm so excited about that leadership under Mike and the sales team. We are expanding and growing.

Operator

Joseph Gallo, Jefferies.

Joseph Gallo - Jefferies - Analyst

Hey guys, thanks for the question and really nice results, especially in looking at broader software. Jay, how should we think about the sustainability of these growth numbers? And then as you look out over the next 12 to 18 months, where are the biggest upside drivers to the top line model? Is it the sales force ramping? Or is the new products? And then congrats on that quarter of new business coming from emerging. How should we think about that next year? Thanks.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Sorry, the first one was sustainability of what?

Joseph Gallo - Jefferies - Analyst

Sustainability of growth, and what the biggest upside drivers are.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

The biggest upside. So you mentioned three points here. It's kind of interesting. One is, obviously, sales force matters. It makes a big difference. So the initiative we're going through with sales force, making sure more and more our salespeople are able to engage at the C-level, consultative, combined with our GSI initiatives, is obviously a big, big opportunity for us.

Then you talked about emerging products. They're very good. They are actually evolving. They're taking. They're giving us the results a bit more, but if you want to ask me what's going to give us the biggest numbers in terms of dollar-wise, when emerging start from a small number, they don't move the needle.

What's going to move the needle from product point of view, ZPA has a strong growth. We still expect ZPA to give strong growth. Zscaler Digital Experience has grown significantly. It will move the needle next year, and the data protection portfolio has become significant. It's pretty sizable. And if you ask me, almost every Zscaler customer over time should have our own data protection because once we're sitting in line for traffic inspection, we are the natural vendor to be doing data protection and that's an area for growth. Plenty of product offerings.

The two areas, new area that can really change things quite a bit for us, Zero Trust segmentation, is the acquisition of Airgap. It's a new market we're entering to so far. We stayed up to the branch. We never went inside the branch. We left the -- these best firewalls alone. Now we're going in there, not with a better firewall, but without a firewall doing Zero Trust segmentation.

And Avalor opens a whole range of opportunities, and Zenith Live will talk more about that. But very, very bullish in the product portfolio. But once you combine your amazing portfolio with a great go-to-market team, you get excellence.

Operator

Fatima Boolani, Citi.

Fatima Boolani - Citi - Analyst

Good afternoon. Thanks for taking my question. Jay and Remo, I wanted to reconcile the strength in the execution this quarter against the very explicit commentary around higher-than-expected sales capacity attrition. So I'm wondering if you can map back to anything internally that helped drive that outperformance of sales execution in spite of sales capacity departure?

And maybe specifically, if you can update us on how the verticalization efforts you've instituted in the go-to-market organization, how those have been yielding relative to your expectations? Thank you.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

So maybe I can start, Remo, and you come back to it. So first of all, work equalization. It's a journey. As companies grow, they get their companies that are more solution centric. They actually need to be more vertical. We started our vertical journey with the federal markets, then we expanded to threat market and then we recently expanded to healthcare.

And you're going to see some more expansions, but more importantly, you're going to see some more folks' initiatives to accelerate the growth of those markets. It's going very well. And Mike Rich and his team come from a previous company where they actually have gone through the vertical journey. So I'm very comfortable we'll keep on pursuing it successfully.

Your second question was in spite of attrition, good numbers. What's involved? Zscaler is not a point product where the sale depends on the sales reps and SC alone. It's a teamwork. We have told you all along that we required -- we have some very seasoned CXOs who have been former CIO, CISO, CTOs, top of people. We need some architects. We talk about business value assessment. When you have a team like this engaged, the departure of some number of salespeople has a limited impact, and we are doing very well as you saw from our pro forma results.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yeah. I mean, just to add on to Jay, just to also confirm, from my perspective, the execution that we had in the quarter was outstanding, and that's driven, for the entire sales organization, get the new salespeople coming onboard and our existing salespeople. I think one of the things that our execution and the reason that we did well, it really speaks to the strength of Zscaler and our platform and the need of our customers for our service.

As Jay talked -- mentioned, relationships matter. And no company I have ever been in my career has the relationships with CXOs that's been as high and as strategic on a worldwide basis, not even close, to what we have here at Zscaler. That matters, solution architects matters, architectural workshops matter. There's more -- it's really a team that goes into customers with EBCs.

It's really a unique company, and what we talked about when we're going public is that it's not a box sale. And box skills are more, I want to say tactical, let's call it tactical. This is a strategic sell which really takes the understanding in companies at the highest level to make these transformational changes. So I think all of that basically played into our execution --

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

And one more comment I'll make. Our customers view us as a very strategic and mission-critical partner. That being the case, there's a strong engagement, and that's why our overall retention is so high.

Operator

Shrenik Kothari, Baird.

Shrenik Kothari - *Robert W. Baird & Co., Inc. - Analyst*

Yeah. Thanks for taking my question. Congrats on the great quarter. So Jay, you highlighted data protection in the Q&A. And we are also hearing about the increasing need for kind of very comprehensive data protection. It's been a key focus area for us. It seems like it's starting to pay dividends, it's kind of inflecting up now.

So just curious like as overall AI workloads get bigger and the digital and cloud adoption continues to rise across industries. So how do you see like new verticals and potentially new use cases that could potentially expand your TAM and also drive growth in the next year, like thinking next year and beyond?

Jagtar Chaudhry - *Zscaler Inc - Chairman of the Board, Chief Executive Officer*

Yes, the new use case for the new products are definitely increasing our TAM. In fact, if you look at data protection, what it used to be for DLP inline, it's only a piece of it. Data at rest, data sitting in endpoint, data sitting in public cloud, data loss related to SASE security supply chain vendors, its own expanding DSPM, it fills all of that portfolio that expanded our TAM quite a bit.

AI is kind of interesting. It's increasing the TAM itself, but it's also getting embedded in all products. We leverage AI and data protection quite a bit. Workload is growing. We're very bullish about it. A big area of TAM expansion for us is actually Zero Trust for branch. This is where we are. We believe it's a matter of time in three, four years. Everyone will say, are you using traditional SD-WAN or are you using Zero Trust SD-WAN?

We are the only vendor in the market that offer Zero Trust SD-WAN, and copycats will try to kind of follow us in the next three, four years, then we are going to move to the next level. We will talk about TAM probably in coming quarters, but if you ask me to take a guess, Ashwin and I have been debating a little bit, we think we added somewhere in the \$10 billion to \$20 billion on top of \$72 billion we have talked about before.

Operator

Gray Powell, BTIG.

Gray Powell - *BTIG - Analyst*

Great. Thanks for taking the question. Maybe on the go-to-market side. Just anecdotally, we've heard that some of the larger GSIs, folks like Accenture, we just heard that they're fans of Mike Rich. So I'd be curious, what can he do better there that maybe Zscaler was not doing before? Just how can you improve those relationships and drive more growth?

Remo Canessa - *Zscaler Inc - Chief Financial Officer*

Yeah, it's a good point. We highlighted last quarter, three things we'll be doing as Mike's key initiative focus from opportunity centric to account centric being one, GSI has been two and verticals being three. All three are making good progress. And GSI know the value we bring to the table.

We have been doing a number of deals, but as Jay is always impatient and saying not doing enough deals, we need to do more. So, one of the key that's needed for us would be to bring in some more higher caliber leaders in that space. We have added a number of leaders who comes from having worked with GSIs like Accenture and working with cloud providers at billions of dollars of work in the business. So, expansion in expertise and caliber in that area is going to accelerate our business and we are counting on it.

Operator

Joshua Tilton, Wolfe Research.

Unidentified Participant

Hey. This is Patrick on for Josh. Coming back to the competition, we've seen several firewall and VPN based vulnerabilities disclosed from some of your competitors in recent months that offer those solutions. Can you talk about what impact those have had on demand, if any? And then, anything specific to call out in the federal space there as well? Thanks.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Yeah. So it's true. We all have been reading both the vulnerability is coming from some of the leading VPN vendors and some of the fiber vendors out there as well. It has increased demand. The number of engagements we have already closed that came from the VPN vulnerabilities that federal government, CISA issued a directive for, there are number of them in the pipeline. I'm not sure I can give you quantifiable number, but I can tell you it's a meaningful number. Customers now fully understand that whether VPN, on prem or VPN MOS as a cloud service, as a virtual machine is still a VPN and we are replacing a lot of those that becomes a starting point for ZPA. Then they start looking for Zero Trust segmentation and the like.

In the federal government, they used it longer than the public and private sector. But public sector has decided to eliminate all of those VPNs that have been deployed out there. We got a number of active engagements going on. You've seen our federal business is going quite well, very pleased with the progress we're making. And CISA combination are playing an important role. Most of our deals there combine both of them. So any user can access any application from anywhere in Zero Trust fashion.

Operator

Gregg Moskowitz, Mizuho.

Gregg Moskowitz - Mizuho Securities USA - Analyst

Okay, thank you for taking the questions. Jay, workload protection has done fairly well overall, but historically speaking, the deal sizes have been limited. Given the success that you sort of called out in your prepared remarks, do you think we may be at an inflection point for workload protection? Or does the pipeline suggest that we're still a ways off from that?

And then a quick clarification for Remo, if I may, Remo, you mentioned operating profitability going up slightly in F2025. Does that apply to Op margins as well? Or are you saying that we should only expect operating profit dollars to go up slightly? Thanks.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Yeah. In the workload protection, a thing I'm very proud of is nobody in the market talks for Zero Trust communication and workload the way we do, I guess we like to be pioneers out there. We need to evangelize. The debt market is taking off, it has to take off. The deal size in technology type of companies are getting bigger. The deal size in traditional companies are still smaller because the workloads in production are still coming up, but not as fast.

So I do believe it's a matter of time and almost all of Zscaler customers will be buying our workload product and it will bring a big market opportunities. But I think a number of other products that are probably growing faster than this. I don't want to kind of say it's not good. It is very strategic for us. You're working with the customers. It's a matter of time as revenue starts growing at a faster pace.

Remo Canessa - Zscaler Inc - Chief Financial Officer

And Gregg, I was referring to operating profit margin percentage.

Operator

Tal Liani, Bank of America.

Tal Liani - BofA Global Research - Analyst

Hi, guys. Thanks. My question is on NRR. You talked a lot about upsell and new products and ability to expand, but your NRR has declined from 120% to 117% to 116% in the last three quarters. How do you connect it to your comments on new products?

And on the flip side, the contribution of new customers went up to 50% of your growth this quarter. Can you give us a little bit details on the profile, meaning do you go to different verticals, down market to SMB? Is there any color to this growth with new customers? Thanks.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yes. The NRR at 116%, I think, is outstanding. The things that influence NRR, and we've talked about this many times, with our users, basically, we're trying to sell the user platform to our customers. And that includes ZIA, ZPA, and ZDX. So that is going to influence NRR.

Also, customers buying within a year doesn't get captured NRR, because NRR is basically customer that buys this year versus a year later, but if they buy within the year, that can impact NRR. Having said all that, 116% is a really good number, from our perspective.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

And we've said over the past many years, the faster you sell, the lower your NRR, the bigger bundle you sell, the lower. So we look at it as a factor, but it's not the most important factor we track.

Operator

Adam Borg, Stifel.

Adam Borg - Stifel Nicolaus and Company, Incorporated - Analyst

Awesome. Adam Borg with Stifel, thanks for taking the question. Maybe for Jay on the Advanced Plus bundle, I know this is a newer offering, that you talked about a few quarters back and it's a healthy pricing uplift given some of the new AI capabilities. And I was just curious if you could talk more about how that Advanced Plus Bundle is resonating and kind of what percent of the installed base you think this is really addressable to over time? Thanks so much.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Yes. Overall, our customers are buying bigger and bigger bundles. That's why our pricing is -- our ARR is going up because the bigger bundles can take out more products and give them functionality. I'm not sure I have any quantitative data to provide you. But actually speaking, bigger and bigger bundles are happening. If you -- as you listen to our prepared remarks, it's no longer buying bundles for users, along with users, we're selling platforms, selling data protection and quite, often we are beginning to sell AI solutions like Risk360 and the like as well.

Operator

Thank you. At this time, I would like to turn the call back over to Jay for closing remarks.

Jagtar Chaudhry - Zscaler Inc - Chairman of the Board, Chief Executive Officer

Well, thank you for your interest in Zscaler. We look forward to seeing you at some of the upcoming conferences. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect. Everyone have a wonderful day.

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