Zscaler Q2 2025 Earnings Call – March 5, 2025

Forward-Looking Statements

Unless otherwise noted, all numbers presented will be on an adjusted, non-GAAP basis. Reconciliation of GAAP to the non-GAAP financial measures is included in our earnings release.

This document contains forward-looking statements that involve risks and uncertainties, including, but not limited to, statements regarding our future financial and operating performance, including our financial outlook for the first quarter of fiscal 2025 and full year fiscal 2025. There are a significant number of factors that could cause actual results to differ materially from statements made in this document, including but not limited to: macroeconomic influences and instability, geopolitical events, operations and financial results and the economy in general; risks related to the use of AI in our platform; our limited operating history; our ability to identify and effectively implement the necessary changes to address execution challenges; risks associated with managing our rapid growth, including fluctuations from period to period; our limited experience with new products and subscriptions and support introductions and the risks associated with new products and subscription and support offerings, including the discovery of software bugs; our ability to attract and retain new customers; the failure to timely develop and achieve market acceptance of new products and subscriptions as well as existing products and subscription and support; rapidly evolving technological developments in the market for network security products and subscription and support offerings and our ability to remain competitive; length of sales cycles; useful lives of our assets and other estimates; and general market, political, economic and business conditions.

Additional risks and uncertainties that could affect our financial results are included under the captions “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” set forth from time to time in our filings and reports with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the fiscal quarter ended July 31, 2024, filed on June 7, 2024, as well as future filings and reports by us, copies of which are available on our website at ir.zscaler.com and on the SEC’s website at www.sec.gov. You should not rely on these forward-looking statements, as actual outcomes and results may differ materially from those contemplated by these forward-looking statements as a result of such risks and uncertainties. Additional information will also be set forth in other filings that we make with the SEC from time to time. All forward-looking statements in this document are based on information available to us as of the date hereof, and we do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

CEO Commentary

Our outstanding Q2 results demonstrate the improvements in our go-to-market execution against a backdrop of growing customer demand for our platform. Billings accelerated in Q2, and revenue grew by 23% year-over-year, with both metrics coming in above the high-end of our guidance. Our go-to-market investments are resulting in increased sales productivity, double-digit New and Upsell business growth, and lower sales attrition. I expect sales productivity to continue growth in the second half, driven by ongoing success of our go-to-market initiatives and growing number of ramped sales reps. Our Annual Recurring Revenue or ARR grew 23% year-over-year in Q2 to over $2.7 billion dollars, and our Net Retention Rate or NRR improved to 115%. With our growing pipeline and better sales productivity, I expect us to achieve $3 billion dollars or more in ARR by the end of the fiscal year.

Q2 was also a strong quarter for profitability with 36% growth in operating profit driving 2 percentage points improvement in operating margin to nearly 22%. Free cash flow margin was also a Q2 record of 22%. Driven by strong revenue growth and free cash flow margin, we operated above Rule of 45, placing us in the rarefied category of large publicly traded SaaS companies that are growing rapidly at scale.

Zscaler pioneered Zero Trust architecture which enables our customers' workforces to securely access applications wherever they reside. Prior to Zscaler, enterprises relied on firewall and VPN-based security which allowed attackers to exploit their vulnerabilities, and move unchecked across corporate networks. Many vendors are marketing SASE built on SD-WANs, which only worsens the growing issue of ransomware attacks. We have gone far beyond SASE by pioneering our Zero Trust Exchange built on true Zero Trust architecture, which eliminates lateral propagation of threats and dramatically reduces attack surface. Building upon our success in securing users, we expanded our platform to secure workloads, IoT/OT devices, B2B users, B2B systems, and more. Today, we are elevating the concept of Zero Trust to a new standard that we call "Zero Trust Everywhere".

For a customer to be "Zero Trust Everywhere" they need:

- Zero Trust Users, where users are untrusted and never put on the corporate network;
- Zero Trust Cloud, where workloads are untrusted and can communicate only through our exchange; and
- Zero Trust Branch, where branches, factories, warehouses or IoT/OT devices are islands of their own

Our mission is to create a Zero Trust Everywhere world. With the upcoming hardware refresh cycle, CXOs are increasingly looking for ways to eliminate their legacy security stack, including firewalls, VPNs, SD-WANs and more. We are leaning into the opportunity presented by the refresh cycle with surgical field campaigns to educate our customers on how they can leapfrog to "Zero Trust Everywhere" and free themselves from firewalls and other legacy appliances forever. I'm happy to share that we are seeing initial success from these campaigns. As of the end of Q2, we surpassed 130 enterprises that have become "Zero Trust Everywhere", and my mandate to our teams is to triple that number in the next 18 months.

One of the core solutions of "Zero Trust Everywhere" is Zero Trust Branch, which is seeing tremendous customer interest. Let me share a customer example:

- An existing Global 2000 manufacturing customer, purchased our Zero Trust Branch in a 7-figure deal, adding to their ZIA and ZPA commitments. This customer is leveraging Zscaler to secure all their critical manufacturing sites, eliminating the need for firewalls, NACs, expensive switches and routers at these sites. Next, we are working with this customer to upsell Zero Trust Cloud, to put them on the path to become "Zero Trust Everywhere".

In another example:

- A large communications equipment company purchased our Zero Trust Branch to phase out their existing SD-WAN. We are excited to work with this customer to help them realize better security and operational simplicity of our platform.

Zero Trust Branch is also helping us win new logo customers. In Q2, 57% of customers who purchased Zero Trust Branch are new logo customers.

Moving on to large customer metrics, our $1 million dollar plus ARR customer count again grew 25% year-over-year. In one large customer win:

- A new logo Fortune 50 energy company adopted our Zero Trust platform to secure 25,000 users with ZIA and ZPA, and made initial purchases of both - Zero Trust Branch and Zero Trust Cloud - in a 7-figure deal. This deal showcases how customers are adopting our broader platform, including workloads and branch, in land deals. By embracing Zscaler as the platform of choice for their security transformation, the customer is eliminating firewalls, SD-WANs, legacy Secure-Web Gateways, VPNs and more, thus improving their security while lowering cost and complexity.

I'm also pleased with the momentum in our data protection pillar, which experienced over 40% year-over-year growth in net new ACV. We see two key drivers of this strength:

- **One, consolidation of point products and operational simplicity of data protection.** We have the most comprehensive data protection platform which secures all types of data - whether structured or unstructured; data in motion or data at rest; and data across all channels, including web, email, endpoint, SaaS, cloud workloads, and more. These capabilities are packaged as various modules to provide flexibility to customers to adopt at their own pace. To give you an example:
    - A Global 2000 retail company that had three data protection modules in the last fiscal year, adopted three new additional modules in Q1 of this fiscal year, and significantly expanded data protection to all users across all their six modules in Q2. This 7-figure upsell deal nearly tripled the annual spend of this already million-dollar plus ARR customer. The customer chose Zscaler to drive what in their words is the most significant transformation project in their network and security history.

With too many data protection point products in their environments, customers are forced to manage multiple policies for multiple products. In contrast, Zscaler customers use a common set of policies that can be seamlessly implemented across all data protection modules, resulting in rapid deployment and lower operational overhead. For example:

  - In a 7-figure upsell deal, an existing Global 2000 financial services customer significantly expanded their data protection purchases for 100,000 users. This upsell drove a 65% increase in the annual spend of this already million-dollar plus ARR customer.

As of the end of Q2, over 85% of our $1 million dollar plus ARR customers have 2 or more data protection modules, and 65% have 3 or more modules. We expect this module adoption to continue to grow.

- **The second key driver for data protection growth is the increasing adoption of GenAI.** With the widespread use of GenAI, all enterprises in all industries are confronting the risk of data loss to public-AI apps such as Microsoft 365 Copilot, DeepSeek, ChatGPT and more. This is elevating the importance of data protection across all customers, and customers are purchasing our solution to gain visibility into public-AI apps and prevent data loss. For example, in Q2, many customers purchased data protection to securely adopt Public-AI, including:
  - A Global 2000 Hospitality company,
  - A Global 2000 Technology company,
  - A Global 2000 Manufacturing company, and more.

In addition to securing the use of public-AI apps, we are investing to deliver solutions to secure customers' private-AI apps, such as LLM and SLM models, chatbots, and inference engines. We are expanding the functionality of our Zero Trust Exchange with an LLM proxy to analyze prompt queries and results in real time, to detect and prevent prompt injections and other malicious activities.

We are also utilizing AI to make our products even better and deliver more value to customers.

Less than a year ago, we introduced "ZDX Copilot" which leverages popular AI models like Gemini to deliver operational efficiency and faster resolution of end-to-end user performance issues. We offer ZDX Copilot in our "ZDX Advanced Plus" package. Following the launch of ZDX Copilot, bookings for "ZDX Advanced Plus" grew by over 45% to nearly $50 million dollars, demonstrating the growth potential of AI-powered products. Building on this success, we are taking ZDX to the next level by leveraging ZDX's Agentic AI technology to automate root cause analysis and expand IT workflow integrations for faster remediation and reduced resolution times.

We are also leveraging AI in many other areas including:

- Automated data classification
- image classification

- zero-day vulnerability detection and prevention
- App segmentation,
- IoT/OT device discovery, and more

Our newly introduced AI-Analytics solutions, including Risk360, Unified Vulnerability Management, Business Insights, and others, continue to drive strong growth, and ACV from AI-Analytics nearly doubled year-over-year.

To further accelerate the development of our AI solutions, we recently hired Phil Tee as our EVP of AI Innovations. Phil was the cofounder of an AI-driven enterprise software company that provided intelligent monitoring solutions for DevOps and ITOps. In his role, Phil will lead an incubation group focusing on AI innovations to drive cutting-edge advancements in Agentic AI to further transform our business and accelerate growth.

AI is everywhere around us. The release of DeepSeek-R1 highlights the advancements in model training which can make GenAI capabilities more widely available. Someone called it Jevon's paradox, which I agree with. In fact, I think this is the "Internet moment" of AI which will drive rapid adoption of AI in every aspect of our lives and will create a greater need for better security. Zscaler is very well positioned to protect our customers.

At the World Economic Forum in Davos, I met CEOs of several Global System Integrators or GSIs. We are seeing a sea change in GSI engagements compared to a year ago as an increasing number of them are embedding Zscaler into their network and security transformation practices. Several GSIs and strategic national partners now consider Zscaler as one of their top strategic partners, just like Microsoft and Salesforce. In Q2, GSIs played a critical role in helping us close several deals. For example:

- We partnered with Cognizant to close a 7-figure new logo deal with a Global 2000 insurance customer who purchased Zscaler for Users for 23,000 employees.
- In another example, a large GSI helped us close a 7-figure deal with an existing million-dollar plus Fortune 500 health care customer. This customer purchased our ZIA, ZPA and Data Protection solutions for more than 100,000 users, which increased their annual spend with us by over 350%.
  I'm pleased to see that GSIs are leaning in, working closely with Zscaler, and dedicating resources to drive growth.

Next, let me highlight the progress in our federal vertical. All of you are aware of the highly publicized efficiency measures taking place under the new administration in the United States. Incumbent security vendors cannot save costs for our government, but Zscaler can and does by eliminating multiple legacy security products, including firewalls, VPNs, NACs, DLPs, VDIs, and more. Simply put, we offer better security at lower cost. Having landed in nearly all the cabinet level Federal agencies and with significant upsell opportunity still remaining, we are well positioned to benefit from the government's efficiency measures.

Outside the US, we continue to make investments to grow our public sector practice, and we are seeing results. For example, In an 8-figure TCV deal, a national government purchased Zscaler for Users to secure the entire government workforce. This is a monumental win for Zscaler and our APJ sales team, and I'm humbled by the trust this nation's government has put in us.

In conclusion, we are entering the second half of the fiscal year with three key drivers.

- **First,** our increasing sales productivity. Sales productivity increased in Q2 driven by strong demand, and I expect productivity to continue to improve in the second half.
- **Second,** we are driving Zero Trust everywhere in our customers. We have launched targeted campaigns to educate our customers on how they can become "Zero Trust Everywhere" and escape the refresh cycle for appliances.
- **Third,** the growing adoption of AI is driving demand across multiple dimensions, including data protection and our AI-powered security products. I fully expect us to benefit from these tailwinds.

As I mentioned earlier, with strong demand for our platform and growing innovations, I expect us to achieve $3 billion dollars or more in ARR by the end of the fiscal year. I look forward to sharing more about our innovations and platform strategy at Zenith Live in June.

CFO commentary

Our Q2 results exceeded our guidance on growth and profitability, even with ongoing customer scrutiny of large deals. Revenue was $648 million, up 23% year-over-year and up 3% sequentially. From a geographic perspective, Americas represented 54% of revenue, EMEA was 30%, and APJ was 16%.

Our Annual Recurring Revenue or ARR exiting Q2 surpassed $2.7 billion. ARR growth was approximately 23% year-over-year. Remaining performance obligations, or RPO, grew 28% from a year ago to $4.615 billion. Current RPO was approximately 49% of the total RPO.

Total calculated billings grew 18% year-over-year to $743 million. Our Unscheduled Billings, comprised of new, upsell and renewal billings, grew over 25% year-over-year. Our calculated current billings grew 19% year-over-year.

We ended Q2 with 620 customers with over $1 million in ARR, and 3,291 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 115%. 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 Q2 financial performance, total gross margin of 80.4% compares to 80.8% in the year-ago quarter. Our total operating expenses increased 2% sequentially and 19% year-over-year to $380 million. We continue to generate significant leverage in our financial model, with operating margin of approximately 22%, an increase of about 200 basis points year-over-year. Our free cash flow margin was 22%, including data center CapEx at 2% of revenue. We ended the quarter with approximately $2.9 billion in cash, cash equivalents and short-term investments.

Next, let me provide our guidance for Q3 and full year fiscal 2025. As a reminder, these numbers are all non-GAAP.
For the third quarter:

- We expect revenue in the range of $665 million to $667 million, reflecting a year-over-year growth of 20% to 21%.
- Gross margins of approximately 80%. I would like to remind investors that we are introducing new products that are experiencing strong growth and are optimized for faster go-to-market rather than margins. This will continue to influence our gross margins. We plan to optimize new products for margins over time as they scale.
- Operating profit in the range of $140 million to $142 million.
- Net other income of $18 million.

- Earnings per share in the range of $0.75 to $0.76, assuming a 23% tax rate and 163 million fully diluted shares.

For the full year fiscal 2025:

- We expect billings in the range of $3.153 billion to $3.168 billion, reflecting a year-over-year growth of approximately 20% to 21%. For Q3, we expect billings growth to continue to improve and encourage modeling 200 to 260 basis points of sequential billings growth.
- Revenue in the range of $2.640 billion to $2.654 billion, reflecting a year-over-year growth of approximately 22%.
- Operating profit in the range of $562 million to $572 million.
- Earnings per share in the range of $3.04 to $3.09, assuming a 23% tax rate and approximately 163.5 million fully diluted shares
- We expect our free cash flow margin to be approximately 24.5%-25.0%.

With a large market opportunity and customers increasingly adopting the broader platform, we will invest aggressively to position us for long-term growth and profitability.