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ZS.OQ - Q3 2025 Zscaler Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Thank you for standing by and welcome to the Zscaler's third-quarter fiscal year 2025 earnings conference call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. (Operator Instructions)

I would now like to hand the call over to Ashwin Kesireddy, Vice President, Investor Relations and Strategic Finance. Please go ahead.

Ashwin Kesireddy - *Kesireddy - Vice President, Investor Relations & Strategic Finance*

Good afternoon, everyone, and welcome to the Zscaler third-quarter fiscal year 2025 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, annual recurring 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 following conferences: Bank of America Global Technology Conference on June 5, FBN Virtual Technology Conference on June 6, BMO Virtual Software Conference on June 9.

Now I'll turn the call over to Jay.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Thank you, Ashwin. Our strong Q3 results demonstrate growing demand for our platform and continued improvement in our sales productivity. More customers are adopting Zscaler's comprehensive solutions with platform-wide deals for our Zero Trust security. Driven by the strong demand, we achieved two significant milestones. First, we achieved our best Q3 with TCV bookings of over \$1 billion. And second, our remaining performance obligations, or RPO are now nearly \$5 billion.

New logo ACV had strong growth of over 40% year over year. Total new ACV was up double digits year over year once again in the quarter. Our annual recurring revenue, or ARR, was approximately \$2.9 billion representing the third straight quarter of 23% year-over-year growth. We remain on track to reach \$3 billion or more in ARR by the end of this quarter.

We are proud of achieving these strong topline results at scale while delivering strong profitability. Our year-to-date fiscal '25 revenue growth of 24% combined with our free cash flow margin of 28% resulted in Rule of 52 performance, while many SaaS companies struggle to achieve Rule of 40 performance, we have exceeded this industry benchmark for each of the last 21 quarters.

Moving on to discussion of our platform, I am very pleased to share that our platform now secures over 50 million users and other significant milestones. This milestone gives us several competitive advantages. First, more users deliver powerful network effect and strengthen our market leadership. Zscaler's Zero Trust Exchange platform sits in line for enterprise communications. Every time we secure a user from a new attack, we apply that protection for all users of our platform, creating a flywheel for improving security.

The magnitude of this effect is staggering. Last year alone, our exchange processed over 100 trillion transactions, blocked over 60 billion threats, and enforced over 5 trillion policies. This unique network effect differentiates Zscaler from other vendors trying to pursue this market segment and delivers unparalleled cybersecurity to our customers. Hence more and more enterprises are selecting Zscaler as the partner of choice.

Second, more users mean more high-quality data for our AI solutions. The millions of users, workloads, and IoT/OT devices on our platform result in over 500 billion transactions, generating over 20 petabytes of high-fidelity data per day. As you know, AI is only as good as the data that powers it, and I believe we have the best data. There are two unique aspects to our proprietary data. One, it's vast quantity, and two, it's high fidelity, both of which we utilize to train our models and deliver highly effective AI solutions.

Third, the large volume of proprietary data I just talked about empowers us to deliver cutting-edge solutions for security operations. By leveraging our data fabric technology and correlating our logs with third-party data, we have introduced exposure management and threat management solutions which deliver a new level of actionable insights for our customers' security operations.

Leveraging our scale, we're building new security operations solutions, co-pilots, and agentic AI solutions that will be showcased at our upcoming Zenith Live conferences. With our Zero Trust Exchange platform, we fundamentally transform cybersecurity from firewall-based model to Zero Trust architecture. Firewall-based security creates trusted and untrusted networks. Once a user or a threat actor gets on the trusted network, they

are then blindly trusted and can move unchecked across the enterprise network. That is what makes ransomware and other cyberattacks so dangerous.

With Zscaler Zero Trust architecture, there's no concept of trusted networks. Every user, every workload, every IoT/OT device, and every AI model is untrusted. With Zero Trust, we connect only the authorized party to the authorized application. While legacy vendors are attempting to cobble together disjointed point products and calling it a platform, we are constantly expanding our core Zero Trust Exchange by integrating new functionality to solve more and more of our customers' security concerns.

Our industry-leading capabilities are recognized by our customers, partners, and leading third-party analyst firms. Of note, I am thrilled to share that Gartner once again recognized Zscaler as a leader in the SSE Magic quadrant, extending our status as a leader in the MQ for user security for over a decade.

Moving on to the macro environment, customers remain cautious about their IT spending due to ongoing economic uncertainty. While customers are still prioritizing cyber and data protection, return on investment and the value delivered remain important to customers. A couple of quarters ago, we launched our cost takeout program to help customers identify and eliminate legacy security and networking products such as firewalls, VPNs, VDIs, and more. We are seeing great success with our program as more and more customers are embracing it to reduce cost and complexity while improving security.

Additionally, to help our customers unlock more cost savings, we launched a new purchasing program in Q3 called Z-Flex. Z-Flex allows customers to flexibly scale their adoption of our platform to meet the constantly evolving organizational demands for cyber and data protection. Customers can seamlessly adopt scale and change modules based on agreed pricing, which simplifies the procurement process. Since its recent launch, Z-Flex's commitments contributed over \$65 million in TCV bookings.

To give you an example, an existing Fortune 500 technology customer made a multi-year commitment under the Z-Flex program, increasing their ARR by over 40% to approximately \$19 million. As part of the Flex commitment, the customer added managed threat hunting, micro segmentation, identity threat detection, Gen AI protection, and several data security modules. This win also demonstrates our growing capabilities in the SOC and Zero Trust Cloud. I expect the contribution from Z-Flex to grow meaningfully in the next fiscal year.

Moving to products, we're seeing significant growth drivers in three categories: Zero Trust Everywhere, Data Security Everywhere, and Agentic Operations. Each of these categories is growing significantly faster than our overall ARR, and their combined ARR is approaching \$1 billion.

Let me cover each of these categories in more detail. On our last earnings call, we introduced Zero Trust Everywhere, which highlights our unique ability to take Zero Trust security beyond users, Zero Trust for cloud workloads and Zero Trust for branches. In Q3, 59% of customers who bought Zero Trust Branch were new logo customers. Many of these new logo customers are starting the Branch journey by securing a small number of branches, which creates significant upsell opportunities for us.

We are enhancing our Zero Trust Branch functionality with several innovations. For example, In Q3 we launched our new unified appliance for Branch that brings together Zero Trust Branch connectivity and Zero Trust Device segmentation into a single plug-and-play appliance. This solution dramatically simplifies Branch infrastructure, eliminating the need for SDVAN, firewall, NAC, and legacy segmentation. I expect Zero Trust Branch to be a significant growth contributor in fiscal '26.

Another key pillar of our Zero Trust Everywhere strategy is Zero Trust Cloud, which enables secure communication from workload to workload and from workload to the internet. Initially, our customers leverage Zero Trust Cloud to secure a small number of workloads to get comfortable with this innovative approach that requires no east-west firewalls, no north-south firewalls, no virtual private networks, no access routes, and no direct connects.

Now we're seeing larger deals for Zero Trust Cloud to secure a larger number of workloads resulting in acceleration of Zero Trust Cloud ARR. To share an example, an existing financial services customer made their initial purchase of cloud workload protection to secure all their internal

workload traffic. This is an impressive seven-figure ACV land deal for workload protection. We are seeing tremendous success as more customers are becoming Zero Trust Everywhere enterprises by embracing Zero Trust for users, branches, and cloud.

Last quarter we shared our goal to triple the number of Zero Trust Everywhere customers from over 130 to over 390 by the end of fiscal '26. I'm pleased to share that we ended Q3 with over 210 Zero Trust Everywhere enterprises, which is over 60% quarter-over-quarter growth. With a strong momentum, we remain on track to achieve our target.

The second category driving our growth is Data Security Everywhere. We have the most comprehensive data security capabilities to secure all types of data, whether structured or unstructured, data in motion or data at rest, and data across all channels including Gen AI apps, web, email, endpoints, SaaS, DSPM, and more. Our comprehensive data security capabilities are resonating with customers and helping us win large deals.

To give you an example, in a seven-figure ACV deal, an existing Fortune 50 automotive customer added an endpoint DLP module and privileged remote access or PRA while expanding Zero Trust users with more ZPS seats. This customer now has six of our eight data security modules including inline DLP, SaaS security, cyber isolation, data isolation, classification encryption, and endpoint DLP. With this deal, the customer's annual spend with us increased by over 50% to well over \$10 million.

Historically, data security was an important consideration for data-heavy regulated industries such as finance and healthcare. With the increasing adoption of Gen AI and SaaS applications, data security is now becoming important to all industries. To give you an example, in a seven-figure ACV deal, a new logo, Fortune 100 food and beverage company, adopted Zero Trust users and multiple data security modules.

Moving to Agentic Operations, our third category of growth. Our Agentic Operations are expanding rapidly in two areas: IT Ops and SecOps. For IT Ops, we delivered ZDX Copilot last year as an embedded feature in our ZDX Advanced Plus package. Since the launch of ZDX Copilot a year ago, bookings for ZDX Advanced Plus grew over 70% year over year to nearly \$75 million.

ZDX Copilot helps lower the mean time to resolution of service tickets and its capabilities are becoming a key differentiator for us. To give you an example, an existing US-based large healthcare customer purchased ZDX Advanced Plus for 140,000 users in a seven-figure ACV deal. ZDX Copilot was an important consideration for this win.

Moving on to the second area of Agentic Operations, SecOps, where we have several modules including Risk360, Business Insights, Unified Vulnerability Management, Identity Threat Detection, and Cyber Asset Attack Surface Management, or CAASM. Our SecOps solution, built on the data-fabric technology we acquired last year, is gaining traction and it drove over 120% year-over-year growth in SecOps ACV.

To share a customer example, an existing US-based healthier customer purchased Unified Vulnerability Management for 400,000 assets in a seven-figure ACV deal. The customer told me that UVM gave them an accurate asset inventory within two hours, which is a dramatic reduction from the six months it would have taken them otherwise. We will continue to expand our SecOps solution. The acquisition of Red Canary will allow us to expand into SOC categories of managed detection and response, or MDR, and threat intel. We expect to close this transaction in August 2025.

In addition to developing AI-powered solutions, we are enabling customers to safely adopt AI. Our Gen AI data security module is enabling enterprises to securely use public Gen AI apps such as Microsoft 365 Copilot, Deep Seek, ChatGPT, and more. In Q3, many customers, including an existing Global 2000 tech company, a leading fleet management company, and a large federal customer and more purchased our Gen AI data security module.

In addition to securing public AI apps, we are introducing solutions to secure customers' private AI apps such as AI models, chatbots, and inference engines. We're expanding the functionality of our Zero Trust Exchange with an LLM proxy to analyze prompt queries to detect and prevent prompt injections and other malicious activities. And analyze responses to prevent data leakage and enforce the right access. I believe these cutting-edge innovations will position Zscaler to be a market leader in the AI security space.

Our customer obsession, employee dedication to our mission, and our customers' trust in our platform are driving us to deliver innovations that solve our customers' most-critical security challenges. With a strong go-to-market machine and strong momentum in Zero Trust Everywhere and AI security, I am more excited than ever about our continued growth to \$5 billion or more in ARR.

No, 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.

Revenue was \$678 million up 23% year over year and up 5% sequentially. From a geographic perspective, America's represented 54% of revenue, EMEA was 30%, and APJ was 16%. Our annual recurring revenue, or ARR, exiting Q3 was approximately \$2.9 billion. ARR growth was approximately 23% year over year. Remaining performance obligations for RPO grew 30% from a year ago to \$4.978 billion. Current RPO was approximately 48% of the total RPO.

Total calculated billings grew 25% year over year to \$785 million. Our unscheduled billings comprised of new upsell and renewal billings grew in the high 20% year over year, driven by increasing customer demand for our platform. Our calculated current billings grew 24% year over year. We ended Q3 with 642 customers with over \$1 million in ARR and 3,363 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 114%.

While good for our business, our increased success in selling bigger bundles, selling multiple pillars from the start, and faster up sales 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 the factors I just mentioned.

Turning to the rest of our Q3 financial performance, total gross margin of 80.3% compares to 81.4% in the year-ago quarter. Our total operating expenses increased 5% sequentially and 21% year over year to \$397 million. Operating margin of approximately 22% was comparable year over year. Our free cash flow margin was 18%, including data center CapEx at 11% of revenue. We ended the quarter with approximately \$3 billion in cash, cash equivalents, and short-term investments.

As a reminder, our convertible debt reaches final maturity in July. We intend to settle the outstanding convertible debt in cash and equity in Q4. Also, we'll use \$675 million in cash in Q1 of fiscal '26 for the acquisition of Red Canary, which we announced on May 27.

Next, let me provide our guidance for Q4 and full-year fiscal 2025. As a reminder, these numbers are all non-GAAP. For the fourth quarter, we expect revenue in the range of \$705 million to \$707 million reflecting a year-over-year growth of approximately 19%. Gross margins to be 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 \$152 million to \$154 million. Net other income of \$16 million. Earnings per share in the range of \$0.79 to \$0.80, assuming a 23% tax rate and 164 million fully diluted shares. Based on our strong Q3 performance, we're increasing our full-year guidance across all metrics.

For the full-year fiscal 2025, billings in the range of \$3.184 billion to \$3.189 billion reflecting a year-over-year growth of approximately 21% to 22%. Revenue in the range of \$2.659 billion to \$2.661 billion reflecting the year-over-year growth of approximately 23%. Operating profit in the range of \$573 million to \$575 million. Earnings per share in the range of \$3.18 to \$3.19 assuming a 23% tax rate and approximately \$163 million fully diluted shares.

Free cash flow margin to be approximately 25.5% to 26%. With a large market opportunity and customers increasingly adopting the broader platform, we'll invest aggressively to position us for long term growth and profitability.

Now, I'd like to turn the call back to Jay.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Thank you, Remo. Before moving on to Q&A, I am happy to share the appointment of Kevin Rubin as our new Chief Financial Officer. Remo will remain in an advisory capacity until the end of this fiscal year to ensure a smooth transition.

I'm very excited to have someone with Kevin's strong background and experience join Zscaler. Kevin has over two decades of experience as a CFO of multiple technology companies. I firmly believe his recent eight-year tenure as the CFO of a data analytics company will be crucial to Zscaler in our next phase of growth, which will be driven in large part by the combination of Zero Trust and AI security. I'm thrilled to have Kevin on board and our leadership team and I look forward to working with him.

Kevin, welcome to Zscaler.

Kevin Rubin - Zscaler Inc - Chief Financial Officer

Thank you, Jay. I'm incredibly excited to be joining Zscaler, the leader in cloud security. I believe with its expanding platform, Zscaler is well-positioned to benefit in an increasingly AI-driven enterprise security market. With my background in data analytics, I am strongly aligned with Jay's vision of leveraging the high-volume, high-fidelity data of Zscaler's platform to deliver pioneering security innovations for the age of AI. I look forward to being part of our growth to \$5 billion in ARR and beyond, and I look forward to working with our customers, partners, employees, investors, and analysts.

Jay, back to you.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Thank you, Kevin. Operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ittai Kidron, Oppenheimer & Company.

Ittai Kidron - Oppenheimer & Co., Inc. - Analyst

Thanks and nice results, guys. And Remo, thank you, and Kevin, good luck. Great to connect with you again for the third time. So congrats and good luck to you on that.

Jay, a lot of great, interesting things happening. So great to see a lot of good momentum here with products and customers. I guess I wanted to get your perspective on salesforce focus. And what I mean by that is you have a portfolio that's expanding at warp speed. You have a new purchasing mechanism through Z-Flex.

How do you get people -- how do you get customers focused? How do you get salespeople focused and make sure that things stay on track and more specifically with regards to Z-Flex, which is a clearly a program that should do well for you, it's done well for many others, help me think about the scope of usage of this. Is this going to be available to everybody? What is the bottleneck in making this available to everybody tomorrow?

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Yeah, Ittai, thank you, great set of questions. So first of all, expanding platform at a rapid pace creates interesting challenge and opportunity for sales team. We have been working on it for the last three or four years. As we started the notion of take-off teams for newer product areas. For example, data protection has a take-off team for quite some time and with the acquisition of Red Canary, we're requiring actually a seasoned go-to-market team that knows how to sell so solutions, and this essentially can act as our SecOps specialist team that work closely with our larger Zscaler go-to-market engine.

So we are really using call it a two-tier model. A broad sales team is covering all products and they are account-centric, account-focused and then some of the take-off teams are more experts in some of these new product areas so they can cover the products of interest to them. So having done it for the last few years, we're pretty comfortable, and we know how to scale it.

Second question was Z-Flex. It evolved out of the questions our customers have been asking for. As the platform has gotten bigger and bigger, multiple choices and many times, they wanted the flexibility to try some modules. They wanted to be able to swap one with other. So this is the kind of flexibility you're giving them. And it's also pretty accretive on pricing, so they don't have to go through a procurement cycle every time they want a new product.

Now this is a relatively new program. As we mentioned, we got a great start. In the first quarter itself, in Q3, we had \$65 million plus in TCV booking for this program. But we will start with larger customers that expand to the next level. There's nothing holding it back, but we like to be prudent, test things, learn it and expand from there.

Operator

Mike Cikos, Needham.

Mike Cikos - Needham & Company LLC - Senior Analyst

Great, thanks for taking the questions guys and congrats on the announcement to Kevin and Remo to you as well.

I wanted to cycle back. It really sounds like macro trends you saw in April and May were a relative non-event versus some of the more mixed data points we've gotten for companies that are on a fiscal quarter end. Can you just tackle that a little bit more from the macro side of the house. What are you guys seeing as far as increased scrutiny or increased hesitation versus is it a relative non-event just given the momentum that you guys have from a product and go-to-market side? Thank you.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

I'll start then Remo can add on. We did not see a softer April. This may be because we are not in the business of selling security appliances. Overall, spending environment remains challenging, macro is still tight, and we continue to see large deals scrutiny. Our budgets are tight in general for IT, but for cyber, it's a little easier because cyber is a bigger priority.

And even in cyber, the two areas that are high and priority for our customers, Zero Trust architect is one, and securing use of AI is two. If you project involves one of these two security offerings and you can actually do some cost savings, the deal can get done. We are able to do all these things together. That's why it has been a good quarter for us.

Overall, we have been working closely with our customers to reduce their costs and become a strategic partner and this ends up translating into ARR over time. I can tell you this week alone, the three customers who talked to me and they said, oh, Jay, I'm becoming a third time customer for you. That's relationship. That's what we're proud of. Remo?

Remo Canessa - Zscaler Inc - Chief Financial Officer

Not much to add, Jay, other than to call out our sales organization, Mike Rich has been on board now for about 1.5 years and has really built a strong sales organization really to go after the large enterprise. As you remember, Mike came from ServiceNow. We are emulating ourselves towards ServiceNow model where we're trying to get deeper into accounts into strategic large accounts. I think that's a call out to our go-to-market organization as well as our sales organization.

Operator

Brad Zelnick, Deutsche Bank.

Brad Zelnick - Deutsche Bank - Analyst

Great, thanks so much, and I echo my congrats all around. I mean, this is -- these are really refreshing results and congrats on everybody's new appointments and Remo, it's been a pleasure.

I wanted to circle back to Z-Flex because it really speaks to the strategic platform-style relationship customers want to have with you. But from your perspective, Remo, can you walk us through how are these structured? What's the typical duration and the accounting of these deals? And do you maybe foresee a future where billings might no longer be the right metric to measure Zscaler's momentum and success? Thank you.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yes. I'll take the first part, which is, is billing going to be the right metric and let Jay answer the rest.

We talked about it. We're going to go to ARR in fiscal '26. So you're going to see a change from billing to ARR. I think that's really big for Zscaler because it gives us the opportunity really to sell more deeper and more products and really work with our customers related to when they can adopt our products. So I believe going through an ARR metric is the right metric going forward. And I think the Z-Flex program gives us a lot of flexibility to continue to sell across our entire platform. Jay?

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Sure. So the Z-Flex program came out of our customers' desire to buy more but not having to go through negotiations and procurement every time. For example, take data protection. There are eight-plus modules in this single product line itself, and many times the customer says, here are three or four things I'm interested in, but I'm not sure. I'm ready to buy all four, or I'm not sure I can deploy all four if I bought them right now.

So being able to give them flexibility to try and test and they can swap one versus the other, so ability to swap, ability to add some more at a predetermined pricing without having to go through procurement cycles are some of the main benefits they're getting. So as these things are being done, they're being done across the strategically we're delighted and the duration of the contracts is moving. We used to do most of the deals three years we're seeing more and more deals becoming four years and five years.

Operator

Saket Kalia, Barclays.

Saket Kalia - Barclays - Analyst

Okay, great. Hey, guys, thanks for taking my question here and echo my congrats to Kevin and Remo on your next steps.

Jay, maybe for you, I was wondering if you could just dig into Red Canary a little bit more and maybe more specifically whether you sort of view this as an extension of Zero Trust that accelerates that path to \$5 billion in ARR or whether this is something that adds to that and broadens the platform.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Yes. So when I talk to customers of when I tell them from day one, we had on North Star, Zero Trust architecture, which expanded from users, partners, suppliers, to workflows, to branches, and everything. And as we did more and more, the customers would often talk to me and say, this is wonderful, and you got the most logs I have. And then I have to feed these logs to third-party solutions, pay them again for storing them. And doing some stuff with them. Should you naturally expand in that space and provide me a close feedback so things discover in your security operations solutions can be fed back to Zscaler Zero Trust Exchange.

Those are the discussions over the past several years that took us to move in that direction. Our first foundational step we took in distraction was last year when you acquire Avalor. Avalor basically brought the notion that you no longer need to build a massive data lake and pay for it. You should have data fabric which synthesizes the logs and creates a subset of meaningful information that has contacts and an entity relationships.

So now Red Canary brings a number of interesting things for us to move in that direction at a faster pace so we can kind of accelerate our vision of becoming a leading player. They have highly talented and experienced detection and tech intel engineers. That's a very important. Two, to my surprise, they had developed a very sophisticated agentic AI technology for reasoning and workflow. And this is being used today. It's not using it to support a large number of customers.

Now I can take their agentic technology be combine it with the Zscaler data fabric, things accelerate by many, many months for us, and they also have a good sales team that can help us acting as a take of team for Zscaler. So these two things together, the accelerate our overall growth but it is expansion of the platform for us.

Remo, do you want to add?

Remo Canessa - Zscaler Inc - Chief Financial Officer

Yes. I mean just on the financial information on the transaction. It is valued at \$675 million plus equity for employees. As Jay mentioned, we expect it to close in August of 2025. And we expect it also to be largely neutral to our FY26 consensus operating margin.

A big portion of Red Canary's ARR is concentrated in certain segments that are not strategic to us. So through the post-close integration process, we expect to retain approximately half of the \$140 million ARR you may have seen. We will share more details on this on the next call in our Q4 call.

Operator

Shrenik Kothari, Baird.

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

Yeah, thanks for taking my question. Again, congrats, on great execution. Looking forward to working with you, Kevin.

So in terms of the Z-Flex, definitely looks like that's helping broader adoption of multiple of deals. As you said, Jay, with the emerging product categories growing 5%. You also cited Gen AI as a key demand driver. Can you tell us a little bit about what kind of attach rates are you seeing there? And if it's driven by Flex, any sense of percentage of sort of wins, which explicitly citing this Gen AI-related risk, Copilot category as the buying catalyst? Appreciate it.

Jay Chaudhry - *Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board*

Yes. So Gen AI is becoming more and more important to our customers. And our solutions in three areas: First has been security use of public AI. We have been actually offering that solution for quite some time now. And even Microsoft 365 Copilot security is part of that. And this is the first area. We are bundling that solution along with our advanced-data-protection module because the number one use of this is protect the data.

Secondly, securing use of privacy AI models and applications our customers are building. Here, we have been building an LLM proxy that can analyze on queries and to detect any bad things like from injections and the restaurant stuff and can also inspect responses. So that's the second area.

The third area is Agentic Operations in IT operations categories, our security operations category. And this area, we started building a couple of years ago, you saw on Risk360 AI, you saw unified vulnerability management that we acquired Avalor and the Red Canary is going to help us accelerate that area as well. And they're using a bunch of agentic AI technology, which is very healthy.

So we don't see traction. And if you look at the numbers of growth, it's starting with small numbers, but it's pretty impressive growth so far.

Operator

Roger Boyd of UBS.

Roger Boyd - *UBS Equities - Analyst*

Great, thanks for taking the questions and congrats to you both as well. Maybe, Jay, just on branch connector. I think the metric that continues to impress me is that you have nearly 60% of customers adopting branch connector over the past few quarters that are effectively new to Zscaler.

What are your thoughts on what's going right there? The role that branch connector is playing in new customer wins, particularly as you continue that success with some of these cost takeout ROI sales programs against maybe some legacy network equipment? Thanks.

Jay Chaudhry - *Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board*

Yes. Our branch connector is now packaged as plug-and-play fine which actually is helping customers because they plug and play that things happen. And now we have also embedded or integrated [airgap] technology to do so trust segmentation for devices. If the two together are doing very well, now frankly, the degree of interest that customers have taken in this area has exceeded my expectations.

As you heard, I mean 59% of customers have purchased Zero Trust Branch, our new logo customers. That's pretty impressive. And I think it's going to get better. I was talking to a customer recently who was testing our Branch appliance I was looking for deploying it for about 100 branches. And one staff testing went through, he said, oh, I should be doing for all 1,000 branch.

This is pretty remarkable. Obviously, we need to keep on executing. But it just tells you the pain customers have, having a bunch of firewall, boxes, DSCP, and they have free lands, and all this stuff. Our goal is to eliminate all of that stuff. The Branch has nothing more than two things: Zscaler appliance and a switch and of course, the WiFi is turned on. So very, very excited about it.

Operator

Tal Liani, Bank of America.

Tal Liani - BofA Global Research - Analyst

How are you? One day they're going to learn how to pronounce my name, so.

So we're entering second half of the year with scheduled billing very high. And the question we always ask ourselves because of the new competition in SASE is how much of the growth is because of scheduled billing? And how much of the growth is because of new products that are beyond ZIA, ZPA. So the question is, can you break down the strength this quarter?

And the reason why I'm asking it is because I see that NRR that was high about 1.5 years ago, declined and then slightly and recovered last quarter went down again this quarter sequentially. So the question is, what were the trends in ZIA, ZPA versus the trends in other products. Sorry for the long-winded question. And if you can give some kind of outlook, some discussion of the outlook of the new products and how you expect them to perform and contribute to revenues? Thanks.

Remo Canessa - Zscaler Inc - Chief Financial Officer

That's a lot of questions. I'll try with a few hopefully, Jay can pick up where I missed. Q3 unscheduled billings was a 28% growth year over year. So that is outstanding. Scheduled billings growth in Q3 came as expected. It was in the low 20% range. The unscheduled billings in Q4 and the guidance that we gave is 25% growth year over year.

So the business is doing very well, and it's consistent to what we said at the beginning of the year when we called out scheduled versus unscheduled billings, it's pretty much worked up almost exactly what we said. So we're really proud of how we communicated that to the street and how the performance is happening in the second half of the year.

Related to the NRR rate, it is 114%, but that is outstanding. So from my perspective, we only looked, we've said this before, we only look at it once every quarter, right now from what we're talking to our investor call. The key thing, I think, is that if you look at what we have and the platform that we created and the expansion of the emerging products, we've talked about that the emerging products is expanding. So we're expecting emerging products to be in the mid-20% to high-20% range for this year.

And the reason for that is that we're expanding the products. Those are all new products that come out, DSPM, Gen AI, and the DLP products. So I think Jay called out, we're a technology company. We're an innovation company. I mean we are at the size that we have a very large revenue and recurring revenue and RPO. But at the heart, Zscaler is a technology company at the support front to continue to really, I think, exploit this market as no other company can. Jay?

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Yes. I mean, look, all our metrics are exceptionally strong. unscheduled billing is strong, even new ARR -- sorry, new logo ARR. New logos grew 40% year over year, so very proud of all areas. And I can only number you talk about NRR, be kind of the bigger platform we sell, the sooner we sell the next thing, but the lower our NRR. That's why you kind of ignored NRR, but look at other metrics.

Operator

Andrew DeGasperi, BNP Paribas.

Andrew DeGasperi - *BNP Paribas - Analyst*

Thanks for taking my question. Just on a separate line of thought, our checks found that Zscaler could benefit greatly from the Federal business. And I know it's not a big contributor of revenue today, but we've heard that it's not really being impacted by the cuts that the administration is making. And in fact, there could be some ramp up there. Are you seeing the same thing? Or are you still optimistic about that line of revenue?

Jay Chaudhry - *Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board*

So Fed for us was in line with our expectations this quarter. And sure, there's some uncertainty in the business. But Fed wants we've got cost, the biggest cost in the security space is firewall and C-type of vendors and if I can go and take a lot of cost on of it by the moving of lot of those products, it actually works in our favor. Remo?

Remo Canessa - *Zscaler Inc - Chief Financial Officer*

And also for our guide for Q4, we're not expecting a significant strength with Fed. As Jay mentioned, we are well-positioned. These are very large contracts, which take time. We're in 14 of the 15 cabinet agencies. But again, right now, as I said, as Jay mentioned, came as expected in Q3, and we're not expecting any significant quarter in Q4 for Fed.

Operator

Andrew Nowinski, Wells Fargo.

Andrew Nowinski - *Wells Fargo Securities, LLC - Analyst*

Thank you for taking the question and congratulations Kevin on joining Zscaler. And Remo, it's been a pleasure working with you as well. I wish you well.

I wanted to ask about the new growth categories at a higher level. Thank you for providing some of those new metrics for it. I think it was over \$1 billion already in ARR across the three new growth categories you called out. But it looks like ZIA and ZPA were part of Zero Trust Everywhere. So I'm wondering what's making up the difference between the \$1 billion in the new growth categories of ARR that you generated versus the 2.9% in total? And then what's the growth rate of those sort of non-emerging products look like? Thank you.

Jay Chaudhry - *Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board*

Okay. So that's good. That's clarified, three main buckets, Zero Trust Everywhere. So here, we're basically making sure the customers were having Zero Trust users, Zero Trust Branches, Zero Trust Cloud, all areas together. And this is where these customers were about 130 and we more than doubled it or went to 210, sorry. And we plan to go to 390. So that's a subset of customers. That's number one.

And we are actually seeing a 60% quarter-over-quarter growth in the area. It's a growth factor that matters quite a bit. 60% is impressive. The data security ethic. We have been talking with to securities quite some time. Last quarter, we shared that we crossed \$350 million in ARR in that, and it's still growing faster than the total company ARR.

And third area is the relatively newer area. This is our AI solution business on our security operation, IT operation, This is where some of the 360 Unified Vulnerability Management type of solutions come in. And we saw in ZDX Advance Plus which actually uses some of the Zscaler with Copilot technology, you've seen 70% year-over-year growth in that area. And the products, the younger products that fall in the security ops bucket and ACV were over 120%. So from all angles, these three products are doing very good, amazing growth and approaching more than \$1 billion.

Operator

Shaul Eyal, TD Cowen.

Shaul Eyal - TD Cowen - Analyst

Thank you. Congrats Jay, Remo, and Kevin on all fronts. Jay, on Red Canary, there are number of MDR providers, various sites out there. What are the two or three reasons that attracted you specifically to this asset over the others? Is it technology, market reach, clients, revenue scope? Just want to get some additional color. Thank you.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Sure. I mean, this acquisition was driven to make sure we can accelerate our vision to become a leading player in the SOC market. So what are these guys offer? We wanted something complementary to what we've had. What we have in this space is the data-fabric technology that we acquired from April last year.

Number one, we are impressed with the talented engineers, experienced people who are detection and theft intel that's foundation to doing these things. Two, I mentioned earlier, we are impressed with the agentic AI technology for reasoning and workflow they already built and they're using in production.

Lots the companies talk about agentic AI, the 20 startups we looked at in this area, all new agentic AI. You look at how many customers do you have, what is in production, hardly any. This company had real stuff in production. And we can integrate that technology with our platform with expertise that brings to the table. It became very impressive. And then, of course, they also have a go-to-market team that can become a take-off team, a team of specialists to help us take the solution to the market.

Operator

Matthew Hedberg, RBC Capital Markets.

Michael Richards - RBC Capital Markets - Analyst

Hey guys, this is Mike Richards on from Matt. Thanks for taking the question. With the accelerating success across the broader platform here, maybe we could take a step back and talk about how much of that success is driven from the ROI messaging, resonating in this macro versus the go-to-market productivity that that you guys were expecting. And what ending are we in that go-to-market productivity improvement. Thanks for the question.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

It's coming from ROI versus go-to market versus what? Productivity. Okay, great. Okay. Look, all these things in your success generally, there's no single thing that kind of make it happen. It's generally a collection of things that work together. We have a strong go-to-market team that Mike Rich and team have done a great job. Platform has expanded the two together, then being able to show cost savings to bring these things and other magic happens.

Trying to do one thing at a time goes only so far. If you're able to pull it off, great go-to-market, great platform and cost savings, it's wonderful. In fact, lots of people talk about cost savings. How many companies can actually go to the customer today and say, here is my security solution that's going to save you money. It's generally known that security never saves money, okay.

But as Zscaler evolve, we are able to show that they can actually save money by taking out a lot of not only legacy security products, but a lot of legacy networking products as well. That's why the numbers are very impressive. We are very excited about it that this thing has been working for quite some time. It's getting better. And so and the result of that ends up being good numbers and good productivity.

Operator

Gray Powell, BTIG.

Gray Powell - BTIG - Analyst

Okay, great. Thanks for taking the question and congratulations on the good results. So I just maybe had like a higher-level question. I understand the need for customers to rationalize that their spend or like not buy the same product twice. But we've also heard particularly with other security vendors, that some companies have become really aggressive pushing ELAs, and sometimes that ends up creating shelf ware.

So I'd be curious like when you're talking about Zscaler versus the competition, is that something that you see in the market? And if so, how does that feed into your customer conversations and does it actually put you in a better position?

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Customers dislike ELA. They know that ELAs often becomes shelf ware, okay? So we really don't like to push ELA. But our goal is interesting, to say customers are trying to have better cybersecurity and/or cost. And as we go in, we show them journey with fast journey or you can take on these products, these products, these products. And it is a cost and have better user experience and in addition, business agility.

Often customers saying, I want to open a new branch office in two days rather than two months. Please can you make it happen? There's so many M&As happening out there. I never thought there would be so many mergers and integration. Every week, I see a couple of them at least, and they all need Zscaler's solution to be able to bring things together without needing legacy network and security.

So these deals are actually growing our platform. We are really not selling a lot of ELAs. We're selling the platform they need. Offline can salespeople don't really try to push a bigger deal because they can take longer. But the customer says, oh, if I can have more savings, I can do a bigger deal. So we let the deal happen the way it happens.

But our goal is do what's right for the customer, look at them as a long-term partnership. And honestly, one of the -- number one thing I look at from a go-to-market point of view, how well is this going to deployed, how much is not deployed. There's a big focus on that. And I can tell you that Zscaler solutions are very well deployed out there.

Operator

Thank you. I would now like to turn the conference back to Jay Chaudhry for closing remarks. Sir.

Jay Chaudhry - Zscaler Inc - Co-Founder, President, Chief Executive Officer & Chairman of the Board

Thank you for joining us for the earnings call. I look forward to seeing you at one of the many conferences. Thank you again.

Remo Canessa - Zscaler Inc - Chief Financial Officer

Thank you.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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