

Rev/Employee: \$297.98 k
Number of Employees: 2,020
Avg ROIC: -17.86%
Packaged Software

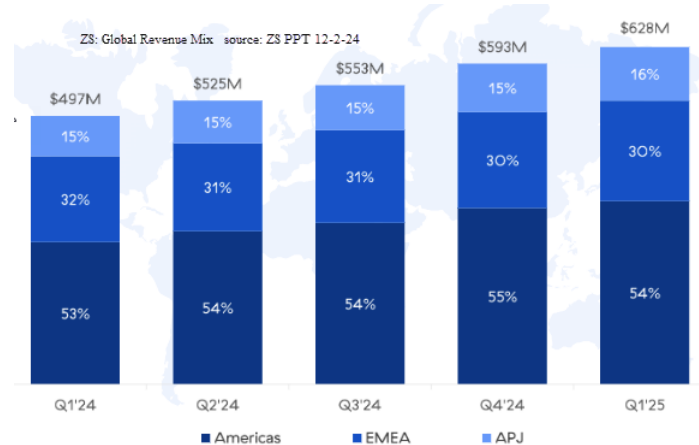
ZS: Reducing Lateral Network Risk

Zscaler's Chairman & CEO Jay Chaudhry (67) is refreshing his senior team and continuing to execute well, though not as quickly as Wall St. Analysts might like. The CEO made a substantial investment in luring his President of global sales, Mike Rich, over to ZS last year and his longtime CFO Remo Canessa (67) is retiring later this year when a successor is found. Canessa has served as the CFO for 8 years and the Board is conducting a formal search for his successor. We think investors can look forward to continued strong growth and unusually thick operating margins under Chaudhry who co-founded Zscaler with his IIT, Varanasi classmate Kailash Kailash in 2007. Kailash remains at the firm as the Chief Architect but is not a Director. Management's incentive plan is well aligned with Investor's interests and ZS's impressive growth has more than absorbed the substantial dilution from large stock grants to Chaudhry and CRO Rich in recent years. Like a good founder, Chaudhry has long minimized his cash pay from ZS while maximizing his equity stake. We think the Board would benefit from some new faces but like that it has set a sunset on a dilutive "evergreen" feature in the executive pay plan.



Management Update: Jagtar "Jay" Chaudhry has consistently focused his firm on profitable growth in the enterprise sector of the market. See our earlier [CEO Profile on Chaudry here](#).

On the Company's Q1 '25 earnings call, CEO Chaudhry succinctly described his firm's value proposition "...hackers are finding new ways to exploit the limitations of legacy castle and moat security to launch an increasing number of sophisticated attacks. Such attacks often start with exploitation of firewall or VPN architecture. These traditional security solutions enable threat actors to move laterally on the corporate network and compromise the entire organization. To make up for the flawed architecture, legacy security vendors are offering disjointed point products under the pretext of a platform. This increases cost and complexity for customers." As CEO, Chaudhry has invested in keeping the firm's "Zero Trust" architecture current and on the leading edge while prudently trimming operational expenses periodically and avoiding the SG&A bloat that afflicts some of his competitors. See an old but good [video on the CEO's entrepreneurial story here](#). We think ZS and CRWD remain two of the most attractive potential strategic acquisitions in a consolidating industry. One fiduciary question for investors is whether Chaudhry will consider selling the firm as it approaches its 20th anniversary or if another executive, including his son-in-law [Raj Krishna](#), who works at Zscaler as the SVP for new initiatives, may be destined to continue the family dynasty which controls over 38% of the voting power in ZS. Zscaler has hired a new CTO, Chief Product Officer, and new Chief Revenue Officer in the last 2 years. We like that CEO Chaudhry did not hesitate to correct a bad hire after only 9 months in 2023, replacing Karl Soderland (recruited from PANW) with current Chief Revenue officer Mike Rich (from ServiceNow). Rich has been aggressively adding quota carrying salespeople to build on the firm's land-and-expand revenue model and delivering good sales traction. ZS growth, particularly with larger enterprise accounts, has been impressive. Through Q1 '25, sales are up about 30% Y/Y with Enterprise accounts (>\$1M ARR) representing about 28% of that growth in the TTM. Currently, ZS has over 65 customers spending over \$5 million per year, 585 customers spending at least \$1 million, and 3,170 customer spending over \$100k annually. Mike Rich's formal title is as the President of Global Sales which suggests he also could be a potential successor to the CEO in future years. Rich brings a strong resume and rolodex having previously served as the President, Americas at ServiceNow where he worked for 12 years (2011 to 2023). Mike Rich holds a BA from the University of California, Santa Barbara. We also note that co-founder and Chief Architect Kailash may have clarified his retirement plan recently with the hire of two seasoned executives.



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CTO Syam Nair joined in May 2023 from Salesforce.com where he had been the EVP of Engineering and spent 6 years. Nair is responsible for 3 core products: ZIA for Internet Access; ZPA for Private Access; and ZDX for Digital Experience. We particularly like ZS' role in helping to secure the Microsoft 365 applications of OneDrive, SharePoint, and the new ZDX Copilot module is interesting in securing large language model AI apps in terms of access, inputs, and permissions. CTO Nair holds a BSc and a Master's in Computer Science from Goa University, India, and an MBA from Indiana University. There is also a new Chief Product Officer, Adam Geller, who joined late last year and is a former SVP at Palo Alto Networks (2013-20) and an alumnus of Exabeam (2020-24), and Verisign (2001-10) with a BSc from Cornell University. Of more immediate interest is the replacement of retiring CFO Remo Canessa this year. The CFO's exact retirement date is unknown and the firm has hired a headhunter to conduct a formal search process. CFO Canessa will leave his successor a strong set of books with an EBIT margin of 21% and FCF running at about 46%. On the Q1 '23 call in December (July Fiscal Year), the CFO told investors that, "We continue to generate significant leverage in our financial model, with operating margin of approximately 21%, an increase of about 330 basis points year-over-year. Our free cash flow margin was 46%, including data center CapEx of approximately 3% of revenue. We ended the quarter with over \$2.7 billion in cash, cash equivalents and short-term investments" and he guided, "...for the full-year fiscal 2025, we expect billings in the range of \$3.124 billion to \$3.149 billion, reflecting a year-over-year growth of 19% to 20%. We expect our first half mix to be approximately 39.3% to 39.5% of our full-year billings guide; revenue in the range of \$2.623 billion to \$2.643 billion, reflecting a year-over-year growth of 21% to 22%."

Pay & Incentives: The Board says that it benchmarks executive pay versus a reasonable IT Software industry peer group that includes: CRWD, OKTA, and PANW, but we think the structure of the incentive plan is still quite unusual given the sheer size of the equity grants to the CEO and new head of sales in recent years. To his credit, CEO Chaudhry is paid a deminimus salary of just under \$24k, and does not receive annual cash bonuses. For many years, Chaudhry has taken almost no cash and only participates in the firm's long term equity incentive plan. The Board has awarded their Chairman & CEO with periodic, but large, grants that are typically in substantial chunks separated by 3-4 year time periods. We like the heavy performance orientation of the equity grants, which vest on ARR targets, but also note their dilutive impact through the years that tempers the share price. In 2023, the CEO's LTIP award was worth \$57.7 million but he did not receive any grant in 2024. We don't think he is likely to receive another grant until 2026. The CEO's equity LTIP award was a 80/20% mix of performance vesting PSUs and time vesting RSUs. CFO Ranessa and the SVPs are each paid a \$450k salary. Last year, the CFO's total pay was worth about \$7.1 million. The CFO and SVPs annual cash bonuses are based on 3 good operating growth metrics: 40% EBIT, 30% Calculated Billings (revenues + deferred revenues), and 30% GAAP Revenues. No bonuses are paid for metrics below 80% of target and the bonus payouts are calculated (and paid) every six months, keeping everyone very focused on current results. Last year, the CFO and SVP's averaged a cash payout of ~108% of salary and all cash bonuses have a maximum payout of 150% of salary. The senior management team's long term equity LTIP is comprised of time-vesting RSUs and ARR performance vesting PSUs. The RSUs vest in 16 equally weighted quarterly tranches over 4 years. The PSUs vest based on 4 year targets for ARR growth of \$4 billion. We think the ARR targets are suitably aggressive with fiscal 2024 PSU targets set at approximately 200% of fiscal 2023 ARR. In the case of sales head Mike Rich, his actual pay was somewhat different as he was paid \$550k in cash as a "consultant" for about 5 weeks of work in the fall of 2023, then received a \$550k cash signing bonus when he formally joined as an employee in November of '23, and then pro-rated bonus payments totaling \$375k for fiscal year 2024. ZS paid CRO Rich an initial signing package worth about \$35 million to join the firm. In addition to his salary, CRO Rich received a series of RSUs, PSUs, and option grants just after he joined in December 2023. His initial RSU award was worth \$21.2 million and his PSU award was worth \$7.8 million. The PSU award will vest in 3 equal tranches upon achieving ARR targets of \$3 billion, \$4 billion and \$5 billion. CRO Rich also received 50k ZS options at a strike of about \$198/share that vested 25% last month and now monthly for the next 3 years.

Equity Ownership: The CEO is required to beneficially hold at least 5x his salary in stock and the SVPs at least 3x. In Chaudhry's case, the CEO's actual beneficial stake is about 56 million shares (38%). Chaudry directly owns



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about 18% and is a trustee of a series of trusts that own about 19.3%. Early employee Ajay Mangal personally owns about 9% of the firm and he is also the designated trustee for the Chaudry family's stake (mostly via his CJCP and CSK trusts) which has a stake of about 29.3 million shares. Neither man has been a material seller in the last year, with CEO Chaudry netting proceeds of only \$2 million since January 1, 2024 and Mangal netting about \$8 million.

We see the CEO's comfort with such a large personal equity stake as a confidence factor in the firm's IP and technology. Departing CFO Canessa's beneficial stake is about 228k shares after estate preparation sales during the last year, netted him about \$8.5 million in proceeds since January 1, 2024. 9 year General Counsel Robert Schlossman also has net proceeds of about \$8 million during the same time period and beneficially owns about 115k shares now. Among institutional active share investors, American Century Investments holds about 2.9 million shares or 1.9%, Voya Investment Management holds 1.9%, and First Trust Advisors holds 1.5%.

Fiduciary & Other: As Chairman & CEO, Jay Chaudhry presides over a classified (3 year terms), well qualified, but aging Board. We also note that it is unusual with a co-founder serving as both the Chairman & CEO, that the Board also says it does not see the need for an independent Lead Director. At the AGM held on January 10th, we note favorably that shareholders approved the Board's recommendation to sunset an "evergreen" feature in the stock incentive plan that refreshed the available shares to 5% of the then outstanding shares every year. That feature will now end in fiscal 2028. David Schneider (56) is the only person on 8 person Board under 63 years of age. Schneider is a partner at Coatue Management (since '21) and the former head of sales at ServiceNow. James Beer (63) is the former CFO of Atlassian, McKesson, and Symantec. Directors Scott Darling (68,) and Andrew Brown (61, former CTO of UBS) have each been on the Board since 2016 and 2015 respectively. Director Charles Giancarlo (66) is the CEO of Pure Storage and has been on the Board since 2016. He is an alumnus of Silver Lake and Cisco and is also a major shareholder of ZS with a stake of about 360k shares. Director Karen Blasing (68) Chairs the Audit Committee and has been on the Board since 2017. Blasing is the former CFO of Guidewire, Force 10 Networks, and Nuance Communications. PwC is the firm's Auditor and was paid fees of about \$5 million last year.