Zoom Q3 FY23 Earnings - Prepared Remarks

Slide 1 – Zoom Q3 FY23 Earnings

Tom McCallum, Head of IR

Thank you, Kelcey.

Hello everyone, and welcome to Zoom's earnings video webinar for the third quarter of FY23. I'm joined today by Zoom's Founder and CEO, Eric Yuan, and Zoom's CFO, Kelly Steckelberg.

Slide 2 – Use of non-GAAP financial measures

Our earnings press release was issued today after the market closed and may be downloaded from the Investor Relations page at investors.Zoom.us. Also, on this page you'll be able to find a copy of today's prepared remarks and a slide deck with financial highlights that, along with our earnings release, include a reconciliation of GAAP to non-GAAP financial results.

Slide 3 – Safe Harbor statement

During this call we will make forward-looking statements, including statements regarding our financial outlook for the fourth quarter and full fiscal year 2023; our expectations regarding financial and business trends; impacts from macroeconomic developments and the Russia-Ukraine war, our market position, opportunities, growth strategy and business aspirations; and product initiatives and the expected benefits of such initiatives.

These statements are only predictions that are based on what we believe today, and actual results may differ materially. These forward-looking statements are subject to risks and other factors that could affect our performance and financial results, which we discuss in detail in our filings with the SEC, including our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q. Zoom assumes no obligation to update any forward-looking statements we may make on today's webinar.

And with that, let me turn the discussion over to Eric.

Slide 4 – Zoomtopia

Eric Yuan, Founder and CEO

Thank you, Tom! And thank you everyone for joining us today.

Earlier this month, we hosted our first fully hybrid Zoomtopia using Zoom Events and it was great! We unveiled new innovations like Zoom Mail and Calendar, which enable users to frictionlessly navigate across their email, calendar and other Zoom products all within the same client.

At Zoomtopia, many of our customers highlighted how they use our expanding platform to do more in the world of flexible work. At our first partner connect event, we hosted hundreds of channel partners, who are excited about working with us to drive adoption of the Zoom platform globally. And our developer partners showcased add-on apps that connect interrelated workflows to the Zoom client.

As global organizations adapt to how, when, and where work happens, human connection remains paramount. Zoom is purpose-built to make all kinds of connections possible, effective, and meaningful. We have launched more than 1,500 features and enhancements on the Zoom platform this year, advancing how people connect with each other, their organization, and their customers—ultimately, opening the doors wide for creativity and collaboration.

Of course, even as we celebrate our innovations and customers, we still face the backdrop of a challenging macroeconomic environment. We continue to see FX pressure and heightened deal scrutiny for new business, but remain focused on delivering happiness to our customers by innovating our platform and expanding our go-to-market capabilities.

Zoom provides a full suite of communications solutions at an attractive total cost of ownership that enables teams to do more with less. Our new products like Zoom Contact Center and Zoom IQ for Sales enable revenue-generation and drive productivity. The continued strength of our Enterprise growth is a testament to how the value-proposition of our platform resonates with customers even in tougher economic environments.

As we enable customers to drive greater efficiency, we also are focusing on our own efficiency. We have always been judicious with investments, prudent about spending, and we have commanded robust margins since our IPO, so this is not a major shift for us. We will continue to drive innovation, customer value and platform expansion, balanced with an increasing emphasis on efficiency and profitability.

Slide 5 – Customer wins highlight the power of the platform

We continued to see strong traction with customers spending greater than $100k in trailing 12 months revenue, which was up 31% year over year. What's more, these customers are increasingly seeing value in buying the whole platform, with thousands of customers already buying Zoom One packages. From an industry perspective, the largest deals came from tech, media and financial services, and we also had notable wins in retail, transportation and pharma.

On the tech front, let me first thank Qualtrics, the leader and creator of the Experience Management category, for expanding their partnership with us. Qualtrics recently upgraded to Zoom One Enterprise, which provides the full power of the Zoom platform to their users and allows them to make meaningful connections with meetings, team chat, whiteboard, phone, and more in one offering. We are delighted to offer Qualtrics a broad set of communications products integrated into one secure and easy-to-use platform.

Our Enterprise segment comprises not only large publicly-traded corporations, but also many private companies of all sizes, who see great value in enhancing their Zoom implementations by moving towards our full UC platform. Let me give you a few examples:

I'd like to thank Vensure Employer Services, a privately-owned professional employer organization, for placing their trust in Zoom. In Q3, they added 5,500 Zoom Phone seats and 650 Zoom Contact Center seats demonstrating the promise they saw in adopting a modern, integrated solution for their teams to interact.

Let me also thank Chime Solutions, for establishing, and already expanding, their partnership with Zoom, which includes Zoom One and Zoom Contact Center. Founded with an unwavering focus on bringing jobs and opportunities to underrepresented communities, Chime Solutions delivers high-touch contact center solutions for mid-sized companies and Fortune 500 corporations.

After seeing how well Zoom Contact Center addressed many of their customer's needs and gaining confidence in Zoom's ability to deliver innovation at a rapid pace, they decided to replace their legacy solution with Zoom Contact Center. Executing our innovation roadmap for Contact Center will give us the opportunity to further enhance our partnership with Chime Solutions in the quarters and years to come.

I also want to thank G-P, the number one SaaS-based Global Employment Platform, for choosing Zoom Phone to transform their communication systems and support employees across their organization. G-P understood the value of our integrated platform of communication products from their experience using Zoom Meetings, Zoom Webinars, Team Chat and Zoom Rooms.

G-P ultimately opted for Zoom Phone, as the missing piece in their UC stack, in order to improve their customers' experience, while also enjoying the savings benefits of a cloud-based PBX solution integrated into a full communications platform. Also, I'd like to add that G-P is Zoom's global expansion employment partner and has played a critical role in our growth strategy, giving us the agility and speed to enter new markets quickly.

Again, thank you Qualtrics, Vensure, Chime Solutions and G-P, and all of our customers worldwide.

And with that I'll pass it over to Kelly.

Slide 6 – Continued top-line expansion with positive trends in Enterprise and Online

Kelly Steckelberg, CFO

Thank you, Eric. Let me now turn to the quarter's results and guidance.

In Q3, total revenue came in at $1.102 billion dollars, up 5% year over year and 7% in constant currency. This result was approximately $2 million dollars above the high end of our quarterly guidance.

The growth in revenue was primarily driven by strength in our Enterprise business, which grew 20% year over year and represented 56% of total revenue, up from 49% a year ago. We expect Enterprise customers to comprise an increasingly higher percentage of total revenue over time. From a product perspective, we had strong growth in Zoom Phone coupled with contributions from Zoom Rooms and other products.

At Investor Day earlier this month, we introduced a new metric: Online Average Monthly Churn. In Q3, this metric continued to improve to 3.1%, from 3.7% in Q3 of FY22 and 3.6% last quarter. We are pleased that this metric has now returned to pre-pandemic levels.

Slide 7 – Strong growth with new and existing Enterprise customers

The number of Enterprise customers grew 14% year over year to approximately 209,300. Our trailing twelve month Net Dollar Expansion rate for Enterprise customers in Q3 came in at a healthy 117%.

We saw 31% year-over-year growth in the up-market as we ended the quarter with 3,286 customers contributing more than $100,000 dollars in trailing twelve months revenue. These customers represented 27% of revenue, up from 22% in Q3 of FY22.

Slide 8 – Double-Digit Americas growth but macro headwinds in ROW

Our Americas revenue grew 11% year over year. EMEA continues to be impacted by the stronger dollar, the Russia-Ukraine war, and Online performance, which combined led to a decline of 9% year over year. APAC, also impacted by the stronger dollar, declined 3% year over year.

Slide 9 – Q3 FY23 expenses and margins

Now turning to profitability, I will focus on our non-GAAP results, which exclude stock-based compensation expense and associated payroll taxes, acquisition-related expenses, net litigation settlements, net gains or losses on strategic investments, undistributed earnings attributable to participating securities, and all associated tax effects.

Non-GAAP gross margin in Q3 was 79.5%, an improvement from 76.0% in Q3 of last year and 78.9% last quarter. The sequential improvement was mainly due to optimizing usage across the public cloud and our increasing number of co-located data centers. Given this, we expect our full year gross margin to be approximately 79%.

Research and development expense grew by 59% year over year to approximately $108 million dollars. As a percentage of total revenue, R&D expense increased to 9.8% from 6.4% in Q3 of last year, reflecting our ongoing investments in expanding Zoom's product portfolio and delivering on our customers' evolving needs. We expect to exit the year in the range of 10 to 12% of total revenue, consistent with our long term target.

Sales and marketing expense grew by 27% year over year to $301 million dollars. This represented approximately 27.3% of total revenue, up from 22.6% in Q3 of last year. We continue to invest judiciously in sales capacity and channel partner expansion.

G&A expense grew by 6% to $87 million dollars or approximately 7.9% of total revenue, in line with 7.8% in Q3 of last year.

Non-GAAP operating income was $381 million dollars, exceeding the high end of our guidance of $330 million dollars, as we continue to thoughtfully prioritize investments. This translates to a 34.6% non-GAAP operating margin for Q3, as compared to 39.1% in Q3 of last year.

Non-GAAP diluted earnings per share in Q3 was $1.07, 24 cents above the high end of our guidance. Due to our share repurchase program, our Q3 weighted average share count has decreased year over year by approximately 4 million shares to 302 million.

Slide 10 – Growing future revenue under contract

Turning to the balance sheet. Deferred revenue at the end of the period was $1.4 billion dollars, up 14% year over year from $1.2 billion dollars.

Looking at both our billed and unbilled contracts, our RPO totaled approximately $3.2 billion dollars, up 32% year over year from $2.5 billion dollars. We expect to recognize approximately 59% of the total RPO as revenue over the next 12 months, as compared to 67% in Q3 of last year, reflecting a shift towards longer term contracts.

As a reminder, our annual seasonality of renewals is front-end loaded and moderates over the rest of the year, reflecting the sequentially smaller renewal base. As such, we expect Q4 deferred revenue to grow at approximately 2 to 3% year over year.

Slide 11 – Strong cash flow and position in Q3

We ended the quarter with approximately $5.2 billion dollars in cash, cash equivalents and marketable securities, excluding restricted cash. Year to date, we have purchased $991 million dollars of our own stock, representing approximately 11 million shares.

We had operating cash flow in the quarter of $295 million dollars, as compared to $395 million dollars in Q3 of last year. Free cash flow was $273 million dollars, as compared to $375 million dollars in Q3 of last year. Our margins for operating cash flow and free cash flow were 26.8% and 24.7%, respectively.

As previously discussed, this year we have seen larger cash outflows from an increase in cash taxes starting in Q2, which relate to the depletion of our NOLs and the lower tax deductions for stock-based compensation caused by the stock price decline. We now expect free cash flow to be at the high end of our range of 1 billion to 1.15 billion dollars. As a reminder, our range assumes that the Section 174 tax legislation requiring capitalization of R&D expenses will be repealed or deferred by Congress by the end of this fiscal year.

Slide 12 – Q4 and Full Fiscal Year 2023 outlook

Now, turning to guidance.

This outlook is consistent with what we are observing in the market today. Specifically, it assumes that our Enterprise business will grow in the low to mid twenties while our Online business will decline approximately 8 percent for the year.

For the fourth quarter of FY23, we expect revenue to be in the range of 1.095 to 1.105 billion dollars, which at the midpoint would represent approximately 3% year-over-year growth, or 5% in constant currency. We expect non-GAAP operating income to be in the range of 316 to 326 million dollars. Our outlook for non-GAAP earnings per share is 75 to 78 cents based on approximately 301 million shares outstanding.

For the full year of FY23, we now expect revenue to be in the range of 4.37 to 4.38 billion dollars, which at the midpoint represents approximately 7% year-over-year growth, or 8.5% in constant currency. This represents a decrease of $15 million dollars from our previous full year guidance, of which approximately $14 million is attributable to the continued FX pressure in Q3 and Q4.

We now expect our non-GAAP operating income to be in the range of 1.49 to 1.5 billion dollars representing a non-GAAP operating margin of approximately 34%, which is an increase of $50 million dollars or one percent, respectively, as compared to our Q2 guidance. Our tax rate is expected to approximate the blended U.S. federal and state rate. Our outlook for non-GAAP earnings per share is $3.91 to $3.94, based on approximately 304 million shares outstanding.

Slide 13 – One Platform To Connect

Zoom remains focused on thoughtfully balancing growth and profitability through platform innovation, customer value creation, and partner ecosystem expansion. Thank you to the Zoom team, our customers, our community, and our investors!