Zoom Q1 FY24 Earnings - Prepared Remarks

Slide 1 – Zoom Q1 FY24 Earnings

Tom McCallum, Head of IR

Thank you, Kelcey.

Hello everyone, and welcome to Zoom's earnings video webinar for the first quarter of FY24. 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 second quarter and full fiscal year 2024; our expectations regarding financial and business trends; impacts from the macroeconomic environment, our market position, opportunities, go-to-market initiatives, 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 – Zoom acquires Workvivo to bolster the employee experience offering

Eric Yuan, Founder and CEO

Thank you, Tom! Thank you everyone for joining us today. As we continue to execute on the strategic focuses, which I shared with you last quarter, we are grateful for the support, feedback and trust that we have received from our customers and investors.

Last month, we closed our acquisition of Workvivo, which we are super excited about. Workvivo is a modern employee communication and engagement platform. Their solution combines a social intranet and employee app into one central hub, forming the heart of a company's digital ecosystem.

Incorporating Workvivo's feature-rich technology into our all-in-one collaboration solution will allow us to offer Zoom customers a unified platform that keeps knowledge workers and frontline employees informed, engaged, and connected throughout the workday, regardless of in-person, remote, or hybrid work style.

According to Enterprise Apps Today, communicative employers have mobile workers who are 5 times more productive and feel 3 times less burned out. The Workvivo team is working hard to capitalize on this opportunity and is 100% aligned with our culture of delivering happiness to customers and employees. We are so excited to join forces with Workvivo and help our customers raise the bar for employee communication and engagement.

Slide 5 – Expansion of ZoomIQ and partnership with Anthropic are core to our AI strategy

Last quarter, we reiterated our strong positioning in AI, and highlighted our expanded vision to see generative AI permeate and elevate productivity across our portfolio. In Q1, we made considerable progress towards that vision.

We outlined our approach to AI is to drive forward solutions that are federated, empowering and responsible. Federated means flexible and customizable to businesses' unique scenarios and nomenclature. Empowering refers to building solutions that improve individual and team productivity as well as enhance the customer experience. And responsible means customer control of their data with an emphasis on privacy, security, trust and safety.

At Enterprise Connect, we unveiled ZoomIQ's new set of in-beta features leveraging generative AI to support Chat and Email compose, and meeting summary. We are also building new features to summarize long chat threads, catch up tardy meeting participants on what they missed, and brainstorm in Whiteboard.

Last week we announced our strategic investment in Anthropic, an AI safety and research company working to build reliable, interpretable, and steerable AI systems. Our partnership with Anthropic further bolsters our federated approach to AI by allowing Anthropic's AI assistant, Claude, to be integrated across Zoom's entire platform.

We plan to begin by layering Claude into our Contact Center portfolio, which includes Zoom Contact Center, Zoom Virtual Agent, and now in-beta Zoom Workforce Engagement Management. With Claude guiding agents toward trustworthy resolutions and powering self-service for end-users, companies will be able to take customer relationships to the next level.

Slide 6 – Customer wins highlight the power of the platform

Now moving on to some of our customer wins.

I would like to thank Major League Baseball. MLB has long used the power of the broader Zoom Platform to strengthen its connection to fans and teams. And this quarter we expanded our relationship by launching a first-of-its-kind partnership that leverages Zoom Contact Center to enhance real-time replay reviews and deliver increased transparency to baseball fans. By introducing Zoom technologies into operations on and off the field, MLB strives to create an engaging and unique experience for its fans and teams.

I would like to thank Virginia Tech for expanding our relationship by adding more than 10,000 Zoom Phone seats as well as Zoom Contact Center to their Zoom Meetings deployment. We brought responsiveness, reliability and regulatory compliance to this large expansion and Virginia Tech will leverage Zoom's unified communications platform to build a next-gen solution integrated across meetings, phone and contact center, to serve the entire university community.

I would also like to thank Vensure Employer Services, which has grown its workforce significantly the past few years through hiring and M&A. In Q1, Vensure expanded their existing footprint with us by adding approximately 10,000 Zoom Phone Seats and 800 Zoom Contact Center seats as well as our AI-powered Zoom Virtual Agent and Zoom IQ for Sales. It is so exciting to see customers leverage our natively integrated Phone plus Contact Center solutions and invest in our next generation AI-enabled products across their businesses.

Finally, I want to thank My Plan Manager, Australia's leading services provider for the National Disability Insurance Program. MPM chose Zoom Contact Center for its attractive Total Cost of Ownership, the deep integration with Salesforce, and the vision and future roadmap for Customer Experience. And our journey did not end with Contact Center. Appreciating the value of the platform, they also decided to standardize on Zoom One. We are so happy to partner with MPM to help them deliver a world-class customer and employee experience to their clients and disability service providers.

Again, thank you MLB, Virginia Tech, Vensure, MPM, and all of our customers worldwide.

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

Slide 7 - Q1 Milestones

Kelly Steckelberg, CFO

Thank you, Eric. And hello everyone. We are pleased that we beat our top-line and profitability guidance in Q1. Here are a few milestones:

- First, our non-gaap gross margin of 80.5% exceeded our long term target;
- Second, after adjusting for the three fewer days in the quarter, our Online revenue was slightly up sequentially;
- And last – the moment you have all been waiting for – Zoom Phone surpassed 10% of revenue in the quarter.

Slide 8 – Continued top-line expansion in Q1 with positive trends in Enterprise and Online

In Q1, total revenue came in at $1.105 billion dollars, up 3% year over year and 5% in constant currency. This result was approximately $20 million dollars above the high end of our guidance.

Our Enterprise business grew 13% year over year and represented 57% of total revenue, up from 52% a year ago.

As I mentioned in the quarterly milestones, our Online business improved meaningfully in the quarter as it benefited from many initiatives including the price increase and buy flow optimization. In addition, we saw Online Average Monthly Churn decrease to 3.1%, from 3.6% in Q1 of FY23, and 3.4% last quarter. We are pleased that this part of our business is stabilizing sooner than expected.

Slide 9 – Growth with new and existing Enterprise customers

The number of Enterprise customers grew 9% year over year to approximately 215,900. Our trailing twelve month Net Dollar Expansion rate for Enterprise customers in Q1 came in at 112%.

We saw 23% year-over-year growth in the up-market as we ended the quarter with 3,580 customers contributing more than $100,000 dollars in trailing twelve months revenue. These customers represent 29% of revenue, up from 24% in Q1 of FY23, and span diverse industries such as healthcare, education, government, and more.

Slide 10 – Growth in Americas, macro headwinds in ROW

As expected we did experience some distraction across the global sales team due to the previously announced headcount reduction and subsequent sales reorganization. Despite the distraction, our Americas revenue grew 8% year over year, while EMEA and APAC declined by 8% and 5%, respectively.

The decline in EMEA was primarily attributable to the outsized impact of the headcount reduction due to local regulations prolonging the process, the Russia-Ukraine War, and the stronger dollar. The decline in APAC was primarily attributable to the stronger dollar.

Slide 11 – Q1 FY24 expenses and margins

Moving on to 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, restructuring expenses, and all associated tax effects.

Non-GAAP gross margin in Q1 was 80.5%, an improvement from 78.6% in Q1 of last year and 79.8% last quarter. We are pleased that we have achieved our long term target as we drove sequential improvement mainly due to optimizing usage across the public cloud and our co-located data centers. For FY24, we still expect non-GAAP gross margin to be approximately 79.5%, reflecting additional investments in new AI technologies.

Research and development expense grew by 25% year over year to approximately $106 million dollars. As a percentage of total revenue, R&D expense increased to 9.6% from 7.9% in Q1 of last year, reflecting our investments in expanding our product portfolio including Zoom Contact Center, AI, and more. Looking ahead, innovation will remain a top priority for Zoom.

Sales and marketing expense grew by 4% year over year to $278 million dollars. This represented approximately 25.2% of total revenue, up from 24.9% in Q1 of last year.

G&A expense declined by 10% to $84 million dollars or approximately 7.6% of total revenue, down from 8.6% in Q1 of last year, as we focused on achieving greater back office efficiencies and savings.

Non-GAAP operating income expanded to $422 million dollars, exceeding the high end of our guidance of $379 million dollars. This translates to a 38.2% non-GAAP operating margin, an improvement from 37.2% in Q1 of last year.

Non-GAAP diluted earnings per share in Q1 was $1.16, on approximately 304 million non-GAAP diluted weighted average shares outstanding. This result was 18 cents above the high end of our guidance and 13% higher than Q1 of last year.

Slide 12 – Growing future revenue under contract

Turning to the balance sheet. Deferred revenue at the end of the period was $1.4 billion dollars, up 3% year over year from $1.3 billion dollars. This is slightly above our guidance and primarily driven by renewals during our largest seasonal renewal quarter.

Looking at both our billed and unbilled contracts, our RPO totaled approximately $3.5 billion dollars, up 16% year over year from $3 billion dollars. We expect to recognize approximately 59% of the total RPO as revenue over the next 12 months, as compared to 63% in Q1 of FY23 and 56% in Q4 of FY23. The sequential increase in current RPO as a percentage of total RPO was primarily due to shorter contract durations in recent Enterprise deals arising from uncertainty in the macro environment.

We expect Q2 deferred revenue to be down 2 to 4% year over year, which takes into account the recent trend of shorter durations on Enterprise deals and our renewal seasonality, which peaks in Q1 and declines throughout the year.

Slide 13 – Strong cash flow and position in Q1

We ended the quarter with approximately $5.6 billion dollars in cash, cash equivalents and marketable securities, excluding restricted cash.

We had operating cash flow in the quarter of $418 million dollars, as compared to $526 million dollars in Q1 of last year. Free cash flow was $397 million dollars, as compared to $501 million dollars in Q1 of last year. Our operating cash flow and free cash flow margins were 37.9% and 35.9%, respectively.

Due to a net legal settlement expected to occur later this year, we are revising our cash flow outlook for FY24. We now expect free cash flow to be in the range of 1.14 to 1.19 billion dollars. In FY24 and going forward, we expect our smallest cash tax payments to occur in Q1, and largest to occur in Q2.

Slide 14 – Q2 and Full Fiscal Year 2024 outlook

Now, turning to guidance. For Q2, we expect revenue to be in the range of 1.11 to 1.115 billion dollars, which at the midpoint would represent approximately 1% year-over-year growth, or 2% in constant currency. We expect non-GAAP operating income to be in the range of 405 to 410 million dollars. Our outlook for non-GAAP earnings per share is $1.04 to $1.06 based on approximately 307 million shares outstanding. As our Online business is stabilizing, we wanted to give you all some additional one-time color on how we see it playing out in the coming quarters. We expect our Online revenues to be approximately $480 million dollars in Q2 and be relatively flat thereafter in FY24.

We are pleased to raise our top-line and profitability outlook for the full year of FY24. We now expect revenue to be in the range of 4.465 to 4.485 billion dollars, which at the midpoint represents approximately 2% year-over-year growth, or 3% in constant currency. We expect our non-GAAP operating income to be in the range of 1.63 to 1.65 billion dollars representing a non-GAAP operating margin of approximately 37%. Our tax rate is expected to approximate the blended U.S. federal and state rate. Our outlook for non-GAAP earnings per share is $4.25 to $4.31, based on approximately 308 million shares outstanding.

Slide 15 – Zoom publishes second ESG Report

As we look to reignite growth and maintain strong profitability, we are committed to doing so in the right way. We are pleased to have recently issued our second ESG report, which includes additional data regarding our greenhouse gas emissions inventory, and recommits Zoom to achieving 100% renewable energy for our direct operations by 2030. Our core value of Care is as important as ever. It's embedded in how our product fosters emissions reductions, while supporting greater inclusiveness. It is also evident in our corporate and employee giving.

Slide 16 - One platform delivering limitless human connection

You heard it from Eric. We are innovating extremely quickly to bring our customers the immense benefits of generative AI and empower modern collaboration. We are trusted and loved by our amazing and diverse set of customers. And we are fortunate to be one of the most recognized brands in the world.

In Q1, we made some very tough decisions related to team size, structure and incentives that have understandably caused distraction in the short term, but at the same time exemplify our commitment to long-term growth and profitability. With a focus on the future, we have refreshed our mission and vision: "One platform delivering limitless human connection".

Thank you to the entire Zoom team, our customers, our community, and our investors!