Zscaler, Inc. (ZS)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

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<tbody>
<tr>
<td>52WK H-L ($) : 90 - 35</td>
<td>Suitability:</td>
<td>Q1</td>
<td>0.03A</td>
<td>0.04E</td>
</tr>
<tr>
<td>Market Cap (mil): 10,453</td>
<td>Price Target ($) : Q2</td>
<td>0.09A</td>
<td>0.07E</td>
<td>0.13E</td>
</tr>
<tr>
<td>Shares Out (mil): 137.9</td>
<td>L-Term Rev. Gr Rate Est: Q3</td>
<td>0.07A</td>
<td>0.06E</td>
<td>0.08E</td>
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<tr>
<td>Float (mil): 69.8</td>
<td>L-Term EPS Gr Rate Est: Q4</td>
<td>0.02E</td>
<td>0.09E</td>
<td>0.11E</td>
</tr>
<tr>
<td>Avg. Daily Vol (mil): 3.04</td>
<td>Debt/Cap:</td>
<td>0.0%</td>
<td>0.20E</td>
<td>0.25E</td>
</tr>
<tr>
<td>Dividend ($) : 0.00</td>
<td>ROE:</td>
<td>NM</td>
<td>FY P/E</td>
<td></td>
</tr>
<tr>
<td>Yield (%): 0.0</td>
<td>Outperform Higher Risk Total</td>
<td></td>
<td></td>
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<tr>
<th>Headquartered</th>
<th>IPO/Founded</th>
<th>Jul 2020E</th>
<th>2021E</th>
<th>2022E</th>
</tr>
</thead>
<tbody>
<tr>
<td>San Jose, CA</td>
<td>2018/2008</td>
<td>Revenue (Mil)</td>
<td>423.4</td>
<td>546.1</td>
</tr>
<tr>
<td>Management</td>
<td></td>
<td>% Growth</td>
<td>39.8%</td>
<td>29.0%</td>
</tr>
<tr>
<td>Jagtar S. Chaudhry</td>
<td>Pres., CEO &amp; Chairman</td>
<td>Operating Margin</td>
<td>5.9%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Remo E. Canessa</td>
<td>CFO</td>
<td></td>
<td></td>
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</table>

Company Description

Zscaler, founded in 2008, and headquartered in San Jose, California, is a cybersecurity vendor seeking to mitigate the risk of cyber threats facing enterprises in a cloud-first world. Through its multi-tenant platform, distributed across more than 150 data centers globally, Zscaler enables customers to offload web security to the internet backbone—reducing the need for sprawling on-prem appliance infrastructure or cumbersome MPLS backhauling. Continued innovation over the last several years has allowed the company to expand from a sole cloud-based proxy offering to a cloud-based platform with solutions that span sandboxing, outbound firewall, private access, and data loss prevention.

Investment Thesis

Who is Zscaler? Based in San Jose CA, Zscaler offers a cloud-native security platform in a subscription model. The company was founded in 2008 as an alternative to on-premise security solutions in parallel with the shift to SaaS applications. The Zscaler globally distributed cloud resides in over 150 data centers and is updated over 120K times per day.

Large potential TAM. Management details their total addressable market as ~$20 billion comprised of categories such as URL filtering, branch firewall, DLP, sandboxing, and VPN. Zscaler provides customers an actual ROI given their ability to reduce WAN costs, branch office infrastructure, and improve user experience.

Competitive landscape. Zscaler competes with solutions including Symantec BlueCoat, Cisco Umbrella, and Raytheon Forcepoint (Websense). These competitors offer cloud-based solutions but channel checks indicate these offerings can be less robust, provide less granularity, and sometimes require on-premise hardware.

Cloud-based architecture. Zscaler deploys proprietary software on top of commodity hardware at ISPs and colocations around the world (e.g., Equinix). The company makes use of some third-party providers such as Arista, Juniper, and Super Micro. Cost of revenue includes colocation costs, bandwidth costs and asset depreciation.

Go-to-market. The company utilizes a combination of Service Providers and Integrators and Value-Added Resellers. We view incremental go-to-market resources as an opportunity since some channel partners know the company well and some don't know the company at all.

Pricing. Zscaler charges on a subscription model per user per month ranging from roughly $1-$6. Customers typically sign a multi-year deal upfront. Per Gartner, the typical discount from list price is 35-40% which we view as industry norm. It's increasingly common for a customer to attach every employee to the Zscaler cloud.

Valuation. Our $100 price target is supported by a DCF analysis and implies a CY21E EV/Sales multiple of ~22.4x. This multiple is at a premium to the median for high-growth SaaS peers (~18.5x EV/Sales), which we believe is justified by the company's strong offering and competitive positioning in a growing market.
Risks & Caveats

**Competition.** Competition in the network security market is intense, and Zscaler faces competition from both legacy players and start-ups. Many competitors have better name recognition, larger install bases, broader product portfolios, and larger sales and marketing budgets. Additionally, Zscaler competes in the same labor markets as these competitors for scarce cybersecurity talent.

**History of losses.** Zscaler has incurred net losses and negative cash flow or only minimal non-GAAP income/cash flow in all periods of the company’s history. The company is expected to continue to achieve minimal cash flow and non-GAAP profitability for the foreseeable future. In order to further grow the business, the company will continue to invest heavily in both sales and research and development.

**Macroeconomic risk.** Zscaler is susceptible to macroeconomic risks, as IT customers tend to delay new investments during economic downturns.
Appendix - Important Disclosures and Analyst Certification

Approved on 29 May 2020 10:40EDT/ Published on 29 May 2020 10:45EDT.

Rating and Price Target History for: Zscaler, Inc. (ZS) as of 05-28-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of ZS.

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Zscaler, Inc.
May 29, 2020

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