REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ZS.OQ - Q2 2022 Zscaler Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 24, 2022 / 9:30PM GMT

OVERVIEW:

Co. reported 2Q22 revenue of $256m. Expects FY22 revenue to be $1.045-1.050b and non-GAAP EPS assuming approx. 149-150m fully diluted shares to be $0.54-0.56.

CORPORATE PARTICIPANTS

Bill Choi *Zscaler, Inc. - Senior Vice President, Investor Relations and Strategic Finance*

Jay Chaudhry *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Remo E. Canessa *Zscaler, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Alexander Henderson *Needham & Company, LLC, Research Division - Senior Analyst*

Andrew James Nowinski *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Brian Lee Essex *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Daniel J.W. Park *Canaccord Genuity Corp., Research Division - Associate*

Fatima Aslam Boolani *Citigroup Inc., Research Division - Director & Co-Head of Software Research*

Gray Wilson Powell *BTIG, LLC, Research Division - MD & Security and Analytics Software Analyst*

Hamza Fodderwala *Morgan Stanley, Research Division - Equity Analyst*

Joel Fishbein *Truist Securities, Inc., Research Division - Research Analyst*

Jonathan Blake Ruykhaver *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Joshua Alexander Tilton *Wolfe Research, LLC - Research Analyst*

Keith Frances Bachman *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Matthew John Swanson *RBC Capital Markets, Research Division - Associate VP*

Patrick Edwin Ronald Colville *Deutsche Bank AG, Research Division - Research Analyst*

Roger Foley Boyd *UBS Investment Bank, Research Division - Associate Analyst*

Tal Liani *BofA Securities, Research Division - MD, Head of Technology Supersector & Senior Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Zscaler Second Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I will now like to hand the conference over to your speaker today, Mr. Bill Choi, Senior Vice President of Investor Relations and Strategic Finance. Mr. Choi, the floor is yours.

Bill Choi - *Zscaler, Inc. - Senior Vice President, Investor Relations and Strategic Finance*

Good afternoon, everyone, and welcome to the Zscaler Fiscal Second Quarter 2022 Earnings Conference Call. On the call with me today are Jay Chaudhry, Chairman and CEO; and Remo Canessa, CFO. Please note that [we released] our earning release and a supplemental financial schedule on the 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, 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 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. We will upload a copy of today's prepared remarks to the IR website when we move to the Q&A segment of the call.

I would also like to inform you that we'll be attending the following upcoming events in March: Berenberg Thematics Software Conference on March 2, JMP Securities Technology Conference on March 7 and Wolfe Research virtual software conference on March 23.

Now I'll turn the call over to Jay.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Thank you, Bill. I'm pleased to share our strong results for fiscal Q2. We continue to see strong demand for our Zero Trust Exchange platform as our customers embrace the cloud. We delivered 63% year-over-year revenue growth and 59% billings growth, while also generating over 50% growth in operating profits and free cash flow. Public SaaS companies are happy to get to rule of 40, while we have been exceeding the rule of 70 for the last 12 months, validating our strong execution in pursuing our large market opportunity.

Our continued investment in scaling our engineering and go-to-market machines is yielding the best revenue growth we have had in 3 years, even as we surpassed $1 billion in annualized revenue. We plan to keep on making substantial investments across the company to continue our rapid pace of innovation and growth. What we deliver with our platform is critical to our customers' highest priorities. This is reflected in our deal sizes, which are increasing due to our success with large enterprises who are buying more of our expanding platform with a significant growth in the number of new logo and upsell customers for orders with over $1 million in annual value. We now have over 250 customers exceeding $1 million in ARR, an increase of 85% year-over-year. Business momentum for our Zero Trust Exchange is strong due to the market need for a modern security architecture in the world of cloud and mobility.

Our flagship ZIA offering has been growing very well as we continue to expand our cyber and data protection services. ZPA has emerged as our second flagship offering, supporting millions of users and the majority of our Global 2000 customers. We are the clear market leader in zero trust application access with proven maturity and scalability. With ZIA and ZPA, we had demonstrated our success implementing zero trust for users.

Our next immediate big opportunity is to bring zero trust to workloads, in our ZCP pillar, powered by the same core ZIA and ZPA technology. In addition, our ZDX pillar is enabling a highly productive workforce, and it is seeing strong demand. In a single integrated cloud platform, our Zero Trust Exchange provides secure any-to-any connectivity for users, applications, workloads and IoT and OT systems regardless of their location.

While many vendors claim to offer a platform because they bought a bunch of point products that are very hard to integrate, no one comes close to the capabilities of our cloud native extensible platform. We will continue to invest in engineering, customer support, marketing and sales to accelerate the growth of our new products while keeping the strong momentum on our flagship products. We believe we are in a sustained high demand environment. We have a large and expanding market opportunity powered by our customers' digital transformation journeys, which continue at a place never seen before.

According to IDG's recent State of the CIO report, the top CEO mandate for IT in 2022 is to upgrade cybersecurity to reduce business risk. Whether it is supporting remote work, or enabling new digital customer and employee experiences, IT leaders must ensure that business operations are agile, resilient and secure. Given the explosion in ransomware and high-profile data breaches, IT leaders are looking to phase out castle and moat security to adopt zero trust architecture to unlock the full promise of digital transformation. It is clear from our growth in our large enterprise wins that architecture matters.

Despite legacy vendors marketing claims, true zero trust security can be built on legacy network security architecture. As I have highlighted before, there are 2 reasons why enterprises are selecting Zscaler. One, we are the only proven cloud security provider with a proxy architecture that inspects TLS encrypted traffic at scale to deliver superior security. We connect users to applications and not to the network, eliminating lateral threat movement. This is a core principle of zero trust architecture that can't be achieved by next-gen firewalls or cloud VPNs.

Let me discuss some of our Q2 deal wins that highlight the advantages of our Zero Trust Exchange. I will start with a big ZIA event. A Fortune 100 professional services customer initially purchased our ZIA transformation bundle plus CASB and DLP and ZDX for 125,000 employees working from anywhere. This quarter, they added 175,000 ZIA seats to secure all 300,000 employees.

With a cloud-first strategy and mission-critical client-facing data at stake, they selected our proven scalable platform with a global footprint needed to support their business in over 150 countries. With 93% of their Internet traffic encrypted, TLS inspection was a major requirement, and the customer only considered a proxy architecture.

Next is a new logo customer that started with ZPA as part of a strategic initiative to transform their IT infrastructure. This Global 50 manufacturer, headquartered in Europe, purchased ZPA for 200,000 users to implement zero trust secure. ZPA will eliminate their attack surface, protecting thousands of private applications behind our Zero Trust Exchange. Hence, their apps can't be discovered, exploited or DDoS-ed. We are replacing their firewall-based VPNs that allow lateral threat movement. A global systems integrator partner who is implementing the overall transformation project played a major role in driving the Zscaler win, an example of the channel leverage we are creating with our investments in our SI partners.

As the shift to the cloud accelerates. Customers are buying ZIA and ZPA together, enabling a true transformation with direct and seamless access to SaaS and private applications, whether on-prem or in the public cloud.

Let me highlight several such deals. In a new logo win, a Fortune 50 insurance customer signed a 4-year commitment for ZIA, ZPA and ZDX to securely enable 65,000 employees working from anywhere or comprehensive cyber and data protection, they purchased the high-end transformation bundle plus CASB, advanced DLP and SSPM, or SaaS security posture management, which is like CSPM for SaaS. Fast user experience and superior cybersecurity were the key factors for our win.

In another new customer win, a Fortune 500 fintech company that had grown through acquisitions signed a nearly 5-year commitment to up-level security and simplify IT. They purchased ZIA transformation plus CASB and DLP as well as ZPA and ZDX for 60,000 employees. This consolidates 7 different security point products and accelerates the closure of the 24 data centers. Moreover, ZPA also shortens new employee onboarding to a few days from 2.5 months. It also eliminates the need many of the employees had for 2 laptops to access 2 separate networks.

I'm also excited about our success selling security transformation in new countries. A Global 500 manufacturer headquartered in Mexico purchased ZIA and ZDX for over 18,000 users and ZPA for 14,000 users. This is our first 7-figure annual deal in Latin America, a region where we recently started making investments.

Next, M&A is an elegant use case for the Zscaler platform. In an upsell deal, a diversified industrial conglomerate with over 20 operating companies that previously purchased ZIA transformation bundle added ZPA for 16,000 users to accelerate M&A integration and reduce business risk. Without having to connect 2 corporate networks with legacy firewalls, which could have taken 14 months or more, our Zero Trust Exchange provided secure access to applications across both companies in weeks, saving time and money.

This customer purchased a high-end ZPA bundle with integrated browser isolation to enhance data protection. They also bought our deception technology to intercept bad actors who may have infiltrated the network. This latest purchase more than doubled their annual spend with us.

Next, let me highlight customers purchasing all 4 pillars of our platform. In a new logo win, a Global 2000 leader in technology products purchased ZIA transformation with DLP and CASB, ZPA and ZDX for 11,000 employees and ZCP workload posture for 6,000 workloads in multi-cloud environment.

As we accelerate the digital transformation, the CIO's top priority was to eliminate the risk of legacy VPNs and lateral threat movement while ensuring the best user experience.

They put ZDX to the test by asking us to troubleshoot poor Microsoft 365 experience of an executive traveling in Europe. ZDX mapped the entire network path over the Internet in real time, isolating specific issues and allowing the customer to quickly resolve the issue and improve the user experience. This proof of value led to the quick ZDX purchase. I believe that, over time, every ZIA and ZPA customer will embrace ZDX as workforce productivity is one of the highest priorities for a CIO.

Lastly, I'm happy with our early success in expanding our routes to market via cloud marketplaces. First, with AWS and now with Azure. Let me highlight 2 Azure marketplace deals.

First, an existing Global 200 pharma customer with headquarters in Europe purchased ZPA for all 87,000 employees, enabling zero trust access to the private apps posted in hybrid cloud environments. This purchase was done with just a couple of mouse clicks, and it doubled their annual spend with us.

Second, a new Fortune 500 customer in the energy industry made a 3-year 8-figure commitment for ZIA, ZPA and ZDX for all 23,000 employees. We will continue to invest in cloud marketplaces as a new channel to revenue.

Enterprises trust Zscaler over cloud imitators and new entrants because we have a true zero trust architecture and have over 10 years of operational experience running the largest security cloud in the world. Our Zero Trust Exchange processes over 210 billion transactions in line and prevents more than 7 billion security and policy violations per day, providing our customers an unmatched network effect for superior security. To flawlessly run the world's largest security cloud with 5-nines of availability requires more than security expertise. It requires networking expertise and the ability to control the traffic paths.

As Zscaler was born as a cloud company and has been operating an in-line cloud since 2008, we have gained this expertise over time. There's no compression algorithm for years of experience. This expertise will become even more important as we address hundreds of millions of workloads and billions of OT/IoT devices.

Let me share an example of our cloud operations differentiation. Microsoft extended direct fiber connectivity from the major data centers to ours because of the volume of traffic that flows between Zscaler and Microsoft. This direct connectivity enables us to deliver higher reliability and performance than the traditional Internet exchange peering approach. This is a validation of our scale and the criticality of our services to our mutual customers.

Another example of delivering great availability and high performance is our integrations with Microsoft and Zoom. With API-based integration for Teams and Zoom, we proactively identify and resolve performance issues for these latency-sensitive apps, without which user collaboration is disrupted and business productivity is lost. Our proven track record, running the world's largest in-line security cloud, makes Zscaler the obvious and trusted partner of choice, but enterprises need to securely access mission-critical applications.

Let me also talk about our recognized market and innovation leadership. Zscaler pioneered the zero trust architecture. And over time, our platform subsumed functionality of multiple point products into our secure web gateway foundation. As the market evolved and customers migrated towards a platform approach such as Zscaler, Gartner expanded the scope of their secure web gateway MQ to include functionalities such as CASB, ZTNA, digital experience monitoring and browser isolation and renamed it SSE or security service edge.

After 10 consecutive years of being named a leader in Gartner's MQ for secure web gateway, we were again named a market leader for SSE. Many of you are aware of SASE. So how are SASE and SSE related? SASE framework is the combination of SSE and WAN Edge. SSE has all the security capabilities built on zero trust architecture and is independent of the type of network. WAN-Edge, which is generally SD-WAN, provides connectivity to an SSE cloud.

Importantly, zero trust security is implemented in the SSE cloud, not in the WAN-Edge. As the category leader in SSE with the widest and deepest offerings, Zscaler is the go-to platform for vendor consolidation, cost savings, increased user productivity and better cyber protection.

And as our market opportunities expand, we are promoting 2 strong leaders to continue scaling Zscaler. We're expanding Amit Sinha's role to President of the company. Amit will continue to lead our engineering and cloud operations teams while also assuming broad responsibilities for expansion of our platform into new areas. We are also promoting Dali Rajic to Chief Operating Officer. Dali will continue to lead our global sales organization, while also assuming broader responsibilities for interlocking among sales, marketing, business development and transformation teams to further enhance the customers' life cycle journey.

In their new roles, Amit and Dali will be responsible for driving further growth, operational excellence and collaboration across Zscaler as we continue the path towards our next milestone of $5 billion in ARR. To enable our customers' ever-growing digital transformation aspirations, extend our market leadership, our entire organization is focused on attracting and developing talent and creating a culture that rewards innovation at all levels.

We added approximately 1,000 employees globally in the last 6 months and have over 4,000 employees who are energized by our shared mission to create a hyperconnected digital world in which the exchange of information is always secure and seamless. In today's competitive hiring market, Zscaler is a destination for top talent. We are proud of our Glassdoor rating, which is among the highest in the industry. Zscaler has never been stronger, and I believe we have a large and growing opportunity in front of us.

Now I would like to turn over the call to Remo for our financial results.

Remo E. Canessa - *Zscaler, Inc. - CFO*

Thank you, Jay. As Jay mentioned, we are pleased with the results for the second quarter of fiscal 2022. Revenue for the quarter was $256 million, up 11% sequentially and 63% year-over-year. On a year-over-year basis, revenue growth accelerated in the quarter, driven by strong business activity. ZPA product revenue was 17% of total revenue. From a geographic perspective, we had broad strength across our 3 major regions. Americas represented 51% of revenue, EMEA was 35% and APJ was 14%. APJ continues to be our fastest-growing region with revenue growth of 116%.

Our total calculated billings grew 59% year-over-year to $368 million, with billings duration near the midpoint of our 10 to 14 months range. We are also pleased to report 61% year-over-year growth in short-term billings. Remaining performance obligations, or RPO, were $1.95 billion as of January 31, growing 90% from 1 year ago.

The current RPO is 50% of the total RPO. Our strong customer retention rate and our ability to upsell the broader platform have resulted in a high dollar-based net retention rate, which was again above 125%. We had 251 customers paying us more than $1 million annually, up 85% from 136 in the prior year. The continued strength in this metric speaks to the strategic role we play in our customers' digital transformation initiatives. We added over 560 customers in the past 12 months, paying us more than $100,000 annually, ending the quarter at 1,751 such customers.

Turning to the rest of our Q2 financial performance. Total gross margin of 80.4% was approximately flat quarter-over-quarter and down 90 basis points year-over-year. Our total operating expenses increased 13% sequentially and 62% year-over-year to $183 million. Operating expenses as a percentage of revenue of 72% were similar to a year ago, even as we made ongoing investments in Smokescreen and Trustdome businesses we acquired in the second half of last year and with a partial return of T&E.

Operating margin was 9% and free cash flow margin was 12%. We continue to expect CapEx as a percent of revenue to be in the high single digits for the full year. We ended the quarter with over $1.61 billion in cash, cash equivalents and short-term investments.

Now moving on to guidance and modeling points. As a reminder, these numbers are all non-GAAP, which excludes stock-based compensation expenses and related payroll taxes, amortization of debt discount and amortization of intangible assets. For the third quarter of fiscal 2022, we expect revenue in the range of $270 million to $272 million, reflecting a year-over-year growth of 53% to 54%, gross margins of 79%. I would like to remind investors that a number of our emerging products, including ZDX, Workload Segmentation and CSPM, will initially have lower gross margins than our core products because we are more focused on time to market and growth rather than optimizing them for gross margins.

Operating profit in the range of $19 million to $20 million. As noted before, we have more in-person events starting this quarter, including customer events, conferences and our internal midyear sales events. Net loss and other income of $100,000, income taxes of $4 million, earnings per share of $0.10 to $0.11, assuming 149 million to 150 million fully diluted shares.

For the full year fiscal 2022, we are increasing our revenue guidance to a range of $1.045 billion to $1.05 billion or year-over-year growth of 55% to 56%, increasing calculated billings to a range of $1.365 billion to $1.37 billion or year-over-year growth of 46% to 47%, increasing our operating profit to a range of $95 million to $98 million, increasing our earnings per share to a range of $0.54 to $0.56, assuming approximately 149 million to 150 million fully diluted shares. Please note that our share count guidance includes dilution from our convertible debentures based on the existing treasury method of accounting.

With a large market opportunity and customers increasingly adopting the broader platform, we're committed to investing aggressively in our company. We see a window of opportunity to extend our first mover advantages in this fast-growing market, which will have positive long-term impacts. We will balance growth and profitability based on how our business is growing but we'll continue to prioritize growth, which we believe is in the best interest of our shareholders, employees and customers.

Operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Andrew Nowinski of Wells Fargo.

Andrew James Nowinski - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Great. Congrats on a nice quarter this afternoon, gentlemen. I'd like to start off with a question on the impact from the Russia-Ukraine conflict. So at the start of the COVID pandemic, you clearly saw some new momentum with ZPA as more employees were forced to work remotely. I'm wondering if the Russia-Ukraine conflict has had a similar effect, creating any new demand for your solutions. And whether it's from companies in the region or even outside of Ukraine that might be concerned with the ensuing cyberattacks that could be launched.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Andrew, it's a little bit early to tell the impact, but our customers are concerned. There's higher cyber threat sensitivity. I was talking to a CXO from Germany earlier today, and he actually opened the call I had with him with this topic. And customers want to make sure they're secure. And one of the things we think is going to help us directly is ZPA, which can hide the attack surface. If you can't see something, you can't attack it. And ZIA becomes more important for all the in-line protection. Our research team is seeing signals of increased reconnaissance activity that's increasing for the past few weeks. We have a 100 person research team, and we're making them available as a resource to our customers.

Operator

Our next question comes from the line of Matt Hedberg of RBC Capital Markets.

Matthew John Swanson - *RBC Capital Markets, Research Division - Associate VP*

Yes. This is Matt Swanson on for Matt Hedberg. Jay, first of all, incredibly impressive to be able to find and hire 1,000 people over the last 6 months in this environment. But when you kind of think about 1 of every 4 Zscaler employees being new to the company, could you just talk about how you're managing that growth? And also given the expanded draft of the products and the more multicolor sales, how we should think about the ramp time for adding new sales head count?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Well, thank you, a multipart question. So first of all, let me start by saying that we are very pleased that we have been able to do good hiring in this tough hiring environment because we are a top destination for top talent. So hiring is obviously the starting point. Part two, I think we are doing a number of things that need to be done to make sure these people can be easily incorporated in the company. And in the past, we talked about a very strong enablement team, a number of boot camps for training we do and buddy systems realigned. So a number of things are doing to make sure these people are becoming part of it. And the results we have shown over the past 2 years show that in this COVID environment, we have been able to do a good job in making them productive.

Remo, next part.

Remo E. Canessa - *Zscaler, Inc. - CFO*

From a head count perspective, we called out last quarter, that we had an outstanding quarter for field quota adds. We had an equally great quarter also in Q2. So our plans are to really push growth. We see this as a huge market opportunity. We're going to continue to do that, and we're going to continue to hire across the company.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

The only comment I'll add next to it is it's not just RSMs that matter for us. our top-down strategic sales process requires solution architects, we have transformation team of CIOs, CISOs and CTOs. They all play an important role, and we're doing well across the board in hiring.

Operator

And next, we have the line of Alex Henderson of Needham.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Great, thanks, and let me also extend my compliments to an outstanding quarter. You guys really, against a very tough comp, really delivered superb results. I was hoping you could talk a little bit more in the terms of hiring around the capacity expansion within your sales organization. To what extent you've delivered on the prior hiring, say, a year ago, getting to quota and where we are on the current hiring, getting to when you think they'll get to quota and what your expectations are for CY '22 for staffing increases in sales capacity. Is it reasonable to think that it could be another year of 50% capacity growth?

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes, I'll take it. So from a quota perspective, we are seeing people getting ramped quicker, but they're on full quota after 1 year. So that hasn't changed at all. Regarding sales capacity, I don't want to give percentages out. What I'd like to say is that there's a huge market opportunity, and we see it. So we will continue to build sales capacity in our model. The one thing that we did call out in the last quarter and the quarter before. If we're growing over 30% on the top line revenue, you can expect less than 300 basis points operating margin expansion.

Our view is that this is a huge market opportunity and you're right, Alex. These results for a company of our scale are outstanding. They're absolutely outstanding. But you've got billings growth at 59%. You've got short-term billings growth at 61%. And you look at a model that's got tremendous leverage in a market that's, in my opinion, huge. We're going to continue to really focus in on that top line and invest in our business. And we're very confident that we have the best product and a huge market opportunity.

Operator

Next, we have the line of Hamza Fodderwala of Morgan Stanley.

Hamza Fodderwala - *Morgan Stanley, Research Division - Equity Analyst*

Remo, if I could direct my question to you first. I mean Jay mentioned a lot of great things about the demand environment, about some of the secular tailwinds that you guys are seeing, larger deal sizes. If I look at the billings growth and 59% growth at this scale is obviously very impressive, it was a little bit below sort of the usual seasonality in the 70% type billings growth that you guys were doing over the last 4 quarters.

So I'm just curious, when we think about billings at this scale, is there anything that we should be mindful of in terms of seasonality going forward? Or anything that was perhaps one-time-y a year ago or last quarter when we think about billings growth in relation to revenue growth over the next 4 quarters?

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes. I mean a lot of questions there. Let me try to answer it. So 59% billings growth, as you mentioned, is absolutely outstanding. If I take a look at Q2, if there's one area that didn't perform at the level that we bought it would, it was federal. Federal was low single digit of our new and upsell business. Now why is that? It's just the budget constraints, basically. So our feeling is that federal will be a big portion or a substantial portion of our business. We got the FedRAMP certification. Also, we've built up a strong team with the relationships. So -- but to call out one thing in the quarter that I would say was -- didn't come in as we expected would be federal. It was low, low single digits.

Regarding billings and revenue as we go forward, hard to say. It all depends on our really top-level growth. Like I mentioned before, with Alex, it's a huge market opportunity, absolutely huge. We feel we're well positioned. We're seeing the traction with our customers. I believe we had 251 customers greater than the $1 million ARR, which is growth rate 85% over the prior year. Our customers bigger than $100,000 ARR was like 1,750. So substantial growth also year-over-year, I think it's like 500 customers or something like that or 550. The market is there, and we feel we have the solution.

And again, from my perspective, the results that we put up were outstanding results. And again, the key thing for investors is that we're going to continue to invest in top line growth in the business. We see no reason to slow it down. We'll be cognizant related to operating profitability. But you're all aware, the SaaS model with 80% gross margin, getting to operating profitability, high operating profitability, it's not a difficult thing. Really trying to take advantage of this market is what we're after.

Operator

And next, we have Joel Fishbein of Truist.

Joel Fishbein - *Truist Securities, Inc., Research Division - Research Analyst*

Congrats on the great execution. I guess this is for Jay and Remo. You've been pretty successful in terms of cross-selling a lot of the different products and obviously, deal sizes are going up pretty dramatically. I'd love to get your take on how ARPU per seat has been trending.

And then a second part of that is, how is it being able to sell into different parts of an organization since the products affect, obviously, different parts of an organization? That would be helpful as well.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

I can start. In my prepared remarks, I covered so many deals where ZIA, ZPA, ZDX worked together and a number of deals with all 4 product pillars were bought. So we're actually very happy with the traction we're seeing. You've seen over the past couple of years that ZIA, ZPA common together has become a fairly -- a common thing. And on ZDX for the last 1 year has becoming more and more common, we've seen lots and lots of customers buying ZDX because without this, you can't troubleshoot if something goes on wrong somewhere. And ZCP is becoming an interesting seating opportunity for us because that's an early market for the workloads, and we are positioning ourselves well to grow it. So we feel very good about the cross-selling. Remo can give further color to it.

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes. I mean the ARPU is definitely increasing, and we'll be giving information on that on an annual basis. New versus upsell in the quarter was 45% new and 55% upsell. So a good quarter, balance between new and upsell for us.

Operator

And next, we have Gray Powell of BTIG.

Gray Wilson Powell - *BTIG, LLC, Research Division - MD & Security and Analytics Software Analyst*

Great, thanks for taking the question, and, yes, congratulations on a strong quarter. So I know a lot of people are focused on billings as the primary metric. But if I'm doing my math correctly, it looks like current RPO grew about 80% this quarter. Pretty close to 83% last quarter and well above your 63% revenue growth rate. So just curious, what do you think we should be looking at as the best leading indicator for future revenue growth? And should it converge to RPO trends over time?

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes, that's a great question. And if you take a look at our RPO growth year-over-year, it was about 90% and CRPO growth was 79%. What we've always called out when the RPO growth rates and CRPO growth rates are going just triple digit, we brought back investors that said billings is the best way to look at our business. And when you take a look at RPO and CRPO, they're more sensitive to the timing of large deals, the timing of renewals, contract durations and other specific terms. It's for these reasons that we want -- we feel the people should be looking at billings versus RPO or CRPO. Also, our -- especially when we're in the range of 10 to 14 months. So -- and both in the quarter, our duration was right in the middle of the range of 10 to 14 months.

One thing I'll also call out that investors probably look at is short-term billings growth. Our short-term billings growth was 61%. So I would look at everything as an investor, but from a Zscaler perspective, it's really billings. And if we're in that range, 12 to 14 months, it kind of bounces and then also short-term billings growth. Those are the key metrics. That takes all the noise level, all the things going on with RPO and CRPO out of the equation.

Operator

Our next question comes from the line of Jonathan Ruykhaver of Baird.

Jonathan Blake Ruykhaver - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So you announced last quarter general availability of workload communication. So just kind of curious to hear commentary on adoption trends, expectations around that ramp. And how would you view long-term adoption over time? Will it be somewhat limited to larger organizations, similar to what you've commented on workload segmentation? Or is it a bigger opportunity?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

It's a very good question. Workload segmentation is only 1 piece of the offering. The core, the basic offering is what we call zero trust for workloads. Workloads are a mirror image of users. Like users, they talk to Internet. And like users talk to workloads, workloads also talk to other workloads. So we've taken our disruptive zero trust [to users, the ZIA and ZPA, and applied] (added by the company after the call) to workloads.

So today, what's done to really secure workloads in the cloud? It's largely VM version of firewalls. There's a firewall before you go to the Internet. There's a firewall before you go to another region and so on and so forth. We believe we will disrupt the workload-based security the same way we did it for users with ZIA and ZPA. So it's a massive opportunity.

I highlighted a number of deals where actually multiple products got bought together, including ZCP. Some of these deals included a Fortune 500 semiconductor company, a Fortune 500 financial services company, a global 500 logistics company. Now I would say that customers do start small in the cloud workload area and then they grow with us.

Operator

Our next question comes from the line of Fatima Boolani of Citi.

Fatima Aslam Boolani - *Citigroup Inc., Research Division - Director & Co-Head of Software Research*

Remo, this a question for you on cash flow. We saw the relationship between operating margins and the cash flow margins diverge pretty materially over the course of the pandemic, and we are starting to see that consolidate a little bit. So I'm curious if you can shed some light on how we should think about the free cash flow trajectory from here, particularly in the context of the multiyear commits and large deals that Jay alluded to in his prepared remarks and as you start to do a lot more enterprise and large deal in 7, 8-figure business.

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes. Let me first say, we would like to be prudent with our projections. So keep that in mind. If you take a look at our free cash flow margins in Q1, it was like in the 35%, 36% range of revenue. In fiscal -- or in Q2, our free cash flow margins were 12%, with operating profitability at 9%.

From my perspective, I just think it's just prudent to think about free cash flow being slightly higher, 3, 4, 5 percentage points higher than operating profitability. It is going to fluctuate on a quarter-on-quarter basis. Our Q1s and Q3s are typically our highest quarter for free cash flow. The reason for that is that our Q2 to Q4 is our biggest billing quarters. So you're collecting the cash in Q1s and Q3s.

As we get bigger, we bill typically annually. So -- and that's -- when we talk about billings being a good metric in between that 10 and 14 months, that's what we talk about. Certainly, we could increase free cash flow by doing multiyear billings, but that's not our model. What we try to do is get a multiyear commitment contracts, which we have seen increase. But for free cash flow or billings, we typically say it's 1 year.

Operator

And next, we have Tal Liani of Bank of America.

Tal Liani - *BofA Securities, Research Division - MD, Head of Technology Supersector & Senior Analyst*

I want to ask about billing growth because the stock is going down on lower billing growth than buy-side expectations. So you grew billing around 71%, pretty stable the previous 4 quarters. This quarter, it was much better than guidance, but it was lower than what we've seen the previous 4 quarters. So that's 59%. And then the guidance for the year is 46% more or less.

So the question is how should we think about billing growth? What can you say about this quarter? Why is it lower than previous 4 quarters? And then what's the explanation? Or what are the puts and takes for the following few quarters?

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes. I mean great question. Well, 4 quarters in a row, at this scale, that 70% plus is outstanding. Is that sustainable? It's very hard to sustain that when you get to the size that we are. 59% billings growth is outstanding.

If you take a look at some of the prior quarters, duration plays into that top line billing growth. If you look at short-term billings grow, it was 61%. And so if you go back in prior quarters, you'll see that's -- a 61% short-term billings growth is a pretty good number, a very good number.

Going forward, you've got our projections. We like being prudent with our projections. The key thing is that we see this as a huge market. And we're going to continue to invest, and we're going to keep on driving that top line numbers. Those numbers are for revenue and billings and short-term billings. And then because the value that you get from driving that top line number, the leverage you get is huge. Because in a SaaS model, with the contribution margin in that 60% range for years 2 and 3, it doesn't take long to get to the operating profitability. So building up your ARR is really, really important in getting that market share and being the dominant player. That's our focus.

Operator

Our next question comes from Mike Walkley of Canaccord.

Daniel J.W. Park - *Canaccord Genuity Corp., Research Division - Associate*

It's Daniel on for Mike. So over the -- over recent periods, you've been working on really improving your sales motion within the enterprise segment. Could you give us some color on how this part of your business trended this quarter? And I guess if you're recognizing some additional wins given the investments you've made so far?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Enterprise segment, which we define as 2,000 to 6,000 employees per company, is progressing very well, and we continue to make significant investments in growing the team. Moving to small enterprises is a natural step for us. It's an attractive market. And it's also a market where channel can play a bigger role, and summit channel program has been helping us quite a bit. So we plan to continue to invest and grow the sales.

Remo, do you want to add anything, too?

Remo E. Canessa - *Zscaler, Inc. - CFO*

Yes. I mean, in the quarter, all segments grew well. But given our strength in large deals during the quarter, the large enterprise did better.

Operator

Our next question comes from Patrick Colville of Deutsche Bank.

Patrick Edwin Ronald Colville - *Deutsche Bank AG, Research Division - Research Analyst*

Can I just double click on the point you made earlier in the call around federal? You called out that federal was only low single digits of new and upsell. Can you just give us a framework to just compare what that was like last quarter or last year so we can get a frame of reference? And can I also just ask, were there any deals that were pushed out or that have subsequently closed after January 31 that you hope -- that we should be aware of?

Remo E. Canessa - *Zscaler, Inc. - CFO*

I'll answer the first part, and Jay can answer the part about the deals. But typically, federal has been mid-single digit. Sometimes, even high single digits. But I don't recall, Patrick, what it was last year. But you can think of federal being mid-single digit on average contribution in our quarterly new and upsell business, and this quarter it was low single digits.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

And in terms of pipeline and deals and all, it is growing. Pipeline is growing. We are well engaged. We're seeing more momentum coming from some of the new memos and initiatives being put in place. We got the architecture. We got the FedRAMP certification. I think one thing remains a little unpredictable is some of the federal budgets and the timings.

Operator

Our next question comes from Keith Bachman of Bank of Montreal.

Keith Frances Bachman - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Just clarification on the question, Remo. You mentioned duration. And if you look at short-term billing, you grew at 61%. It's a little bit of a degradation, call it, 7 points from the previous quarter, but the compare was 6 points higher. So your short-term billings have been pretty steady.

If I look at the January through July quarters of last year, you grew 70-plus percent. But can you just remind me how much that was enhanced by duration so we can normalize for the compare?

And then if I'm allowed to sneak one in, I just wanted to see if you could just talk about NRR trends as you see going through the year. Does it stay steady? Or do you think as you're rolling out new products like ZCP, that those trends actually may improve to facilitate growth?

Remo E. Canessa - *Zscaler, Inc. - CFO*

No problem. I'll just call out 1 quarter that I'm aware of, which is Q3 of last year. Q3 of last year, in that 10- to 14-month range, it was close to that 14-month range in Q3. So that's the duration impact of Q3 of last year, which I can recall.

Regarding NRR, new products. The comment that we made last quarter is that if it's over 125%, we're not going to give out specifically what the NRR is. It was over 125% in the quarter, but our new products are doing well. I mean our new products are doing well, as well as ZPA. And those are pretty big contributors related to that NRR.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

If I may add, we expect NRR to do well. But having said that, it's one of those things we see, the bigger bundles we sell upfront, the lower NRR. Or if we do the first deal today and in 2 quarters, we do the second upsell deal, that doesn't really get picked up in NRR. So happy with NRR. But in the past, we kind of said that we don't really try to focus too much on NRR. That's why we gave you 125% or higher as, as a good indicator.

Operator

And next, we have Brian Essex of Goldman Sachs.

Brian Lee Essex - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Congrats on the results. I guess, Jay, maybe if you could address this one. I know when Dali came on board, a focus of his was increasing deal velocity and also hiring. Well, now you've got -- you're kind of getting larger deals, you have a more mature sales force. So there's some puts and takes there. Maybe any commentary you can provide on sales cycles? And now that you're larger, growing over large numbers with bigger deals, but now with a more mature sales force, how you're managing that dynamic and what those sales cycles look like?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Yes. So it's a good question. So first of all, it is the sales force with all the processes and enablement we put in place has helped us grow exceptionally well over these -- over the past 2.5, 3 years since we put this new motion in place. That's number one.

Number two, I think at that time, we merely focused on the higher end of the market, largely a major MLEs. Now we expanded further down to enterprise as well, which is doing quite well. As you would expect, the sales cycle is lower towards the lower end of the market. It remains fairly high on the high end of the market. It is a transformation sale. It involves CIO, CISO, CTO, multiple parties. But as we go in, we engage, we end up winning big.

And not only that we start, wherever we're going in these accounts, we are so sticky that we keep on upselling and growing. So I'm very confident, very comfortable. Obviously, as numbers are growing bigger, we need to do -- keep on doing the same thing. The market is there. Product portfolio is there. We have no competitive pressure, and it really needs to keep on executing. I think we're doing a good job, and we'll keep on driving. And we have good margins at the gross margin level to keep on investing.

Brian Lee Essex - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Great. Any way to quantify what sales cycles are and how they've trended?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

I would say we haven't come and said they are reduced by x percent, but I would say it's a range that we have always said the lower, smaller deals was 3 to 6 months and bigger are from 6 to 12 months. (inaudible) is getting bigger, probably there's a movement towards the lower side of it. But deals come in many shapes and sizes. So they are all -- but we are -- we have a very rapidly growing pipeline, and our close rates are pretty good as well. So I feel very bullish and comfortable.

Operator

Next question comes from Roger Boyd of UBS.

Roger Foley Boyd - *UBS Investment Bank, Research Division - Associate Analyst*

Wondering if you could talk about -- so first of all, really strong performance out of the $1 million plus ARR cohort. I wonder if you could talk about what you're seeing in that smaller enterprise cohort in terms of competition. And then also what's the recognition of Gartner on their new secure service edge Magic Quadrant means as you go to market with that smaller 6,000 to 2,000 cohort?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Right. It's a good question. So first of all, the MQ is not just the lower market. MQ is across the board, probably more relevant in the larger markets to some degree because larger companies tend to be Gartner customers. But I would say, frankly, I was surprised to see that the 2 CASB vendors listed in the leaders quadrant because we don't see them in the real world out there. So if I were to quibble with the criteria that Gartner used, I believe it was overweight on CASB, which is much easier to build, it's out of band. And it was underweight on secure web gateway, which is foundation of zero trust and much harder to build because it is in line.

In our customer base, we are replacing lots of CASB point products that have been sold over the years. And you look at our platform, it has expanded significantly, ZIA, ZPA, ZDX, ZCP and all.

Now second question related to smaller enterprises, right? There, we do see more vendors in low end of the enterprise than we saw -- when we see on the high end, high-end are very savvy. They rule out actually some of the vendors who don't have the right architecture, and they also look for operational excellence.

Yesterday, I had a call with the CIO of a large financial services company. He wanted to start the discussion by saying this, I see so many vendors that keep on coming and talking about all kind of feature and functionality. And when I talked to their operational experience running the cloud, they don't have much to talk about. Well, they don't because they haven't really done it before.

So operational experience is becoming more and more important as some of these -- you have seen issues for AWS to Azure AD and some of those stuff out there. But on the lower end, we do see firewall vendors, Ciscos of the world, some of the other new entrants. But once we engage and we win almost every time. Typically, in the past, we had less presence in enterprise, but now we are actually engaged in putting more resources in the lower end of the market and winning. It's a growth area for us.

Operator

And next, we have Joshua Tilton of Wolfe Research.

Joshua Alexander Tilton - *Wolfe Research, LLC - Research Analyst*

I kind of just wanted to follow up on the previous competition question, but just a little bit more broadly. Could you possibly kind of just comment on how have your number of at-bats been trending? And how would you characterize your overall win rates across the entire market relative to maybe previous quarters?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Sorry, the first one was how our numbers?

Joshua Alexander Tilton - *Wolfe Research, LLC - Research Analyst*

How are the number of your at-bats been trending? Are you getting more opportunities, less opportunities? How has that been trending over the last couple of months in previous quarters?

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Yes. So first of all, driven by transformation deals, there aren't too many cases where we do have active bake-offs. Even in the security space, people are used to bake-offs off and all. We do less of that because typically, we go in, we help drive transformation, working with the CIO and going down from there. And in case we do have bake-offs, we almost always win to a degree. We don't really track how many wins we expect us to engage and win. The main reason if we don't win a deal, it's because we couldn't really get the thing closed in the quarter. It moved down to the next quarter and the like. So probably deal getting delayed is part of the reason. It's not generally that competitive pressure is kind of hurting our business.

We -- and as we grow more and more platforms -- and the market is shifting fast. It's no longer the days of '90s and early 2000 when it's the same play. I mean look at it 2 years ago, 3 years ago or when we did IPO, ZIA, small piece was a thing. Now ZIA is transformation bundle became a big thing, now, ZIA, ZPA together. So every user could work from wherever.

Then we moved the game to have digital experience being part of the requirements and now workload and whatnot. So as we think on the competitive stuff, we are good. We just need to make sure we keep on hiring and training people to do this top-down strategic sale.

Operator

And that concludes the Q&A portion of the call. I will hand the conference back over to Jay Chaudhry for final comments.

Jay Chaudhry - *Zscaler, Inc. - Co-Founder, President, CEO & Chairman of the Board*

Thank you, everybody, for joining us and your continued interest in Zscaler. I also want to thank our customers, partners and employees who are helping us deliver a strong quarter. We look forward to seeing you at upcoming investor events or to updating you next quarter on our continued progress. Thank you, again.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect, and have a pleasant day.
