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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Zscaler Third Quarter 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, to Bill Choi. Please go ahead.

Bill Choi *Zscaler, Inc. - VP of IR*

Good afternoon, everyone, and welcome to the Zscaler Fiscal Third Quarter 2020 Earnings Conference Call. On the call with me today are Jay Chaudhry, Chairman and CEO; and Remo Canessa, CFO. Please note that we have posted our earnings release and a supplemental financial schedule to our Investor Relations website.

Unless otherwise noted, all numbers we talk about today will be on an adjusted non-GAAP basis. You will find a reconciliation of GAAP to the non-GAAP financial measures in our earnings release. For historical periods, the GAAP to the non-GAAP reconciliations can be found in the supplemental financial information.

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, remaining performance obligations, income taxes and earnings per share. 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, including but not limited to the duration and impact of COVID-19 on our business, the global economy and the respective businesses of our customers, vendors and partners. 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.

I would also like to inform you that management will be attending the following upcoming virtual investor conferences: Cowen's TMT Conference tomorrow, Bank of America's Global Technology Conference on June 3, Baird's Consumer Technology & Services Conference on June 4, and the Morgan Stanley Thematic Conference on Zero Trust Architectures on June 25. Presentations for these events will be webcast, and the links will be available on our Investor Relations website.

Now I will turn the call over to Jay.

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

Thank you, Bill. And thank you for joining us. I hope everyone is staying healthy and safe during these unprecedented times. Our thoughts and prayers are with those who have been impacted.

As you saw in the earnings release, we delivered very strong results for the third quarter, and we are increasing our guidance for fiscal 2020. We've built the right cloud-native security platform for the cloud world, and the digital transformation market driving our business is further accelerating. Combined with our improved sales execution, we are capitalizing on the market opportunity to take Zscaler beyond $1 billion in annual revenue.

Zscaler was founded on the belief that in a cloud and mobile world, a user must be able to securely access any application from anywhere, on any device. In the new work-from-anywhere economy, fulfilling this vision is even more critical because almost all users are now outside the corporate network, where traditional perimeter-based security becomes irrelevant. To protect their employees working from home, our customers are using Zscaler Internet Access or ZIA to provide secure access to their Internet and SaaS applications, and Zscaler Private Access or ZPA for zero-trust access to internal applications. Combined, ZIA and ZPA enabled our customers to work securely from home literally overnight as quarantine orders went into effect around the globe.

We saw exceptional strength in our ZPA service with over 10x growth in usage during the quarter. Many new and existing customers deployed hundreds of thousands of new ZPA users. Our employees worked around the clock to support these deployments in a matter of weeks or even days. Even with this unprecedented traffic growth, our Net Promoter Score or NPS reached a world-class level, more than twice the average NPS of SaaS companies.

I personally received many e-mails from customers about the positive impact Zscaler made on their business by enabling them to continue their operations.

Let me quote a couple of them. CISO of a large insurance company in U.S. said, quote, "Zscaler's deployment was executed to near perfection. We quickly secured 10,000 users. Kudos to Zscaler for such great tech and people," unquote. CIO of a high-tech company in U.K. said, I quote, "Without doubt, I now consider Zscaler acquisition to be one of the most timely and beneficial services I have purchased in 25 years of working in IT," unquote.

I spoke to over 100 CXOs this past quarter, and most of them believe COVID-19 is accelerating the digital transformation and resistance to change is dissipating.

Zscaler was born in the cloud, for the cloud, and as a result, we seamlessly transitioned to work from anywhere. We are focused on ensuring the health and safety of our employees around the globe while we are successfully engaging and supporting our customers virtually. For example, we are leveraging modern tools like virtual whiteboarding to conduct interactive architectural workshops.

Now let me discuss our performance for the third quarter. Our revenue grew 40% and billings grew 55% year-over-year. We also delivered very strong growth in operating profits and free cash flow. We saw broad strength across verticals with notable strength in financial services.

From a product perspective, we had strong growth in both ZIA and ZPA, but a standout performance in ZPA, which contributed 43% of new and add-on business compared to approximately 20% in the first half of fiscal 2020. ZPA is a natural purchase for existing ZIA customers, which had a positive impact on our net retention rate of 119%.

Gross margins were slightly lower as we temporarily increased our use of public cloud to handle the significant growth in ZPA traffic. We are moving this increased traffic to our data centers in coming quarters and expect gross margins to improve. Remo will speak more about our gross margins in his section.

As I mentioned earlier, many new and existing customers deployed hundreds of thousands of new ZPA users in the quarter. A

Europe-based global conglomerate added more than 200,000 users in 3 weeks across 185 countries; a U.S.-based insurance company deployed 30,000 users in 1 week; an oil and gas company enabled over 27,000 users in 10 days; and an India-based financial services company enabled 11,000 users in only 2 days.

We are seeing the attach rate of ZPA increase in our deals, but we still have a very large opportunity for upsell in the future as only 32% of our Global 2000 customers have purchased ZPA. Ultimately, we believe all employees need ZPA as internal applications migrate to the public cloud, and COVID-19 is accelerating this adoption. ZPA is much more than a VPN replacement. Customers are buying ZPA to implement a zero-trust network approach or what Gartner calls ZTNA, which advocates that network security can no longer be done in a perimeter-less world. Hence, users should not be connected to the network, but only to specific applications. While many enterprises purchased VPN appliances from their legacy VPN vendors in the past couple of months, I believe those were tactical purchases. In the world of zero trust, there's no place for firewalls and VPNs since they are network security devices and traditional networks are disappearing.

Our new customers are increasingly purchasing ZIA and ZPA together as both are needed to enable employees to work from anywhere securely with great user experience.

For example, a fintech customer purchased our Transformation Bundle plus DLP, in-line and out-of-band CASB and browser isolation for 40,000 users and ZPA for 25,000 users. This Fortune 500 company was increasingly using cloud applications like Office 365, but their multi-vendor appliance-based security stack was a bottleneck that was hurting user performance and business agility. The deal started as a legacy web gateway replacement, but our sales team successfully demonstrated the value in transforming their network and security to deliver great user experience, superior security at a very attractive return on investment. With Zscaler, they are consolidating 4 different vendors and eliminating more than 8 point products including secure web gateway, next-gen firewall, sandbox, DNS, DLP, CASB and SSL inspection. Moreover, our cloud-native architecture scales to meet any surges in their traffic that had overwhelmed their security appliances. In addition, their new zero trust approach will enable the company to quickly integrate mergers and acquisitions, which is a core growth strategy for them.

Next, let me talk about ZIA, which we believe is also accelerating due to COVID-19. ZIA protects employees working from home as they access SaaS applications and the Internet. Without ZIA, enterprises must use legacy VPN to route traffic to the corporate data center first, then out to the Internet, back to the data center, and finally back to the user. No wonder this results in poor user experience. And we all know that VPN, even a cloud-based VPN, puts users on the corporate network and represents a major cyber risk. Last quarter, our ThreatLabZ security research team uncovered well over 0.5 million COVID-19-specific threats and protected our customers from them.

Let me highlight a few of ZIA deals. A major U.S. bank was experiencing performance issues with an incumbent web gateway that could not meet the traffic requirements of Office 365 and was due for a refresh. And this partner-led deal, the customer purchased our Transformation Bundle plus DLP, CASB and browser isolation for 23,000 users and will retire the legacy proxy solution along with a few other security point products. The customer expects this project to yield an ROI exceeding 100% and a payback period less than 12 months, while adding critical capabilities like SSL inspection at scale, cloud firewall, and best-in-class DLP as DLP is becoming important in the world of cloud and work from anywhere. While SD-WAN was an important consideration for this deal, with COVID-19, the focus shifted to deploying Zscaler right away to protect users working from home and visit SD-WAN in the future.

With similar goals, a Fortune 500 financial services company, an existing customer, upgraded their 50,000-user subscription from Business to Transformation Bundle. This is another example of a sizable deal that was driven by 2 of our new products: out-of- band CASB and browser isolation.

These examples illustrate that many of our customers are buying our high-end ZIA bundles and additional product modules.

Lastly, a European public sector customer purchased our Transformation Bundle and DLP for 100,000 users. They needed to replace a recently purchased so-called "cloud security service" from a legacy next-gen firewall vendor. After taking 10 months to onboard 14,000 users, they had to stop their deployment. Since security was important for this customer, they needed to inspect SSL traffic. While this virtual firewall could ostensibly inspect SSL, it could not do so at any meaningful scale. When their single-tenant cloud service failed, the

vendor offered to replace it with on-prem firewall appliances. Since Zscaler was natively designed as a full SSL proxy, our customers can inspect encrypted traffic at scale without impacting user experience, leading to better security and reduced business risk. This customer also purchased ZPA for 30,000 users with plans to expand in the near future.

As this last example shows, architecture matters for a cloud security platform that must sit in line to inspect traffic and enforce policy. Single-tenant architecture, whether deployed as appliances or as virtual machines in a public cloud, will only work if enterprises settle for poor security by not inspecting SSL traffic. As I have said before, you can't create a Netflix service by stacking thousands of DVD players in the cloud. We believe Gartner strongly validated our platform and vision when they published a new approach for security named Secure Access Service Edge or SASE. While many imitators claim to be SASE, they conveniently forget to mention that Gartner identifies SSL inspection as a key requirement of SASE architecture. We believe our 10-year track record of running a massive in-line cloud that has to be highly reliable and available, makes Zscaler the safe and the best choice when enterprises need to securely access mission-critical applications.

We recently crossed a milestone of processing over 100 billion transactions per day, which we believe allows us to provide an unmatched network effect for better security for our customers.

Let me now discuss the tremendous progress we have made in our go-to-market initiatives to implement a repeatable and scalable process for world-class sales execution. I believe our consultative sales approach played a major role in our success this quarter. It enabled us to maintain a high level of engagement with our customers and prospects in the current virtual environment.

Last quarter, I said that we were making good progress based on key leading sales indicators. Let me give you a few examples of our progress in Q3. We hired a record number of field sales reps, and we're continuing to attract high-level talent. We built out strong sales leadership at the regional director, regional VP and area VP levels. We increased sales productivity. We generated strong pipeline. And we recruited cloud-focused channel partners to drive further sales leverage. I could not be happier with our progress, and we believe this quarter's strong results are a proof of our ability to execute our sales strategy.

Moving on to products. As we discussed previously, we have 4 new product offerings that are generally available this quarter. CASB, Browser Isolation, Zscaler B2B, and Zscaler Digital Experience or ZDX. As I mentioned in my deal highlights, our CASB and Browser Isolation products are beginning to generate revenue. As we have indicated before, we anticipate these new products will add to our growth in fiscal 2021 and beyond.

Our cloud security platform protects users' access to any application from anywhere. Our next opportunity is to expand into protecting applications and data in the cloud. We are pursuing this opportunity in 3 areas: one, with out-of-band CASB, we are providing comprehensive data protection for SaaS applications; two, with the acquisition of Cloudneeti and its Cloud Security Posture Management, or CSPM functionality, we now provide data protection to public cloud workloads, which is an emerging security market segment; three, with today's announcement of the acquisition of Edgewise Networks, we are extending zero-trust protection to east-west traffic within a public cloud or data center. With Edgewise, we can provide a zero-trust approach for machine-to-machine and process-to-process communications. Edgewise discovers individual micro services and their legitimate communication patterns, and using AI and machine learning algorithms, automatically creates and enforces authorized process-to-process communication to provide application segmentation. This is a far superior approach than legacy network segmentation for security.

With our existing and new products, we believe Zscaler is the most comprehensive cloud security platform, and these additional products will expand our already large market opportunities. Now I'd like to turn over the call to Remo for our financial results.

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

Thank you, Jay. As mentioned, we had a very strong third quarter. Revenue for the quarter was $110.5 million, up 9% sequentially and 40% year-over-year. From a geographic perspective, for the quarter, Americas represented 51% of revenue, EMEA was 40% and APJ was 9%.

Turning to calculated billings, which we define as the change in deferred revenue for the quarter plus total revenue recognized in that

quarter. Billings grew 55% year-over-year to $131.3 million. As a reminder, our contract terms are typically 1 to 3 years and we primarily invoice our customers 1 year in advance. Remaining performance obligations or RPO, which represents our total committed noncancelable future revenue, was $654 million on April 30, up 31% from a year ago. The current RPO is 56% of the total RPO and grew 36% year-over-year.

I'd like to call out 2 dynamics that impacted our billing and contract duration. We are offering shorter commitments and invoicing periods for customers needing help with their business continuity requirements for COVID-19; and in China, and Japan, free access to ZPA for 3 months. The overall impact of these initiatives to our billings and RPO was relatively modest, with billing duration approximately flat year-over-year and with contract duration down slightly. We also had a higher mix of upsell business, which typically have shorter contract and billing duration as it often co-terminates with the existing contract.

Our strong customer retention and ability to upsell have resulted in a consistently high dollar-based net retention rate, which is 119% for the quarter and benefited from increased adoption of ZPA with existing customers. This compares to 118% a year ago and 116% last quarter. As we've highlighted, this metric will vary quarter to quarter. While good for our business, our increased success in selling bigger Transformation Bundles, selling both the ZIA and ZPA from the start, and faster upsells within a year can reduce our dollar-based net retention rate in the future. Considering these factors, we feel that 119% is outstanding.

Total gross margin was 80%, down 2 percentage points sequentially and year-over-year. This decline is primarily due to ZPA traffic growing over 10x during the quarter. We supported this surge in demand by augmenting the use of AWS and Azure, which run at significantly higher cost compared to our data centers. We decided to prioritize helping our customers get ramped quickly rather than managing our cloud infrastructure to optimize our gross margins. We are working to reduce the use of public cloud and increase the capacity in our data centers over the next 3 quarters, but we expect some pressure on gross margin in the near term. We expect overall gross margins to be 76% to 77% in Q4, 78% in the first half of fiscal 2021, and we expect to return to our 80% target in the second half fiscal 2021. We feel it is important to continue to invest in our cloud and infrastructure to drive top line revenue growth.

Turning to operating expenses. Our total operating expenses increased 11% sequentially and 35% year-over-year to $79.6 million, and decreased as a percentage of revenue to 72% compared to 74% last year. Sales and marketing increased 6% sequentially and 35% year-over-year to $52.6 million. We had 2 midyear regional sales kickoffs in February for training and team building that represented $2.3 million in expenses. The year-over-year increase is due to higher compensation expenses and investments in building our teams and go-to-market initiatives offset by lower T&E.

R&D was up 20% sequentially and up 39% year-over-year to $17.1 million. The increase is primarily due to continued investments in our team to enhance our product functionality and innovate new products.

G&A increased 22% sequentially and 26% year-over-year to $9.9 million. The growth in G&A includes investments within our teams, compensation-related expenses and professional fees including acquisition-related expenses.

Our third quarter operating margin was 8%, which compares to 8% in the same quarter last year.

Net income in the quarter was $9 million or non-GAAP earnings per share of $0.07.

We ended the quarter with $391 million in cash, cash equivalents and short-term investments and no debt. Free cash flow was positive $9 million in the quarter.

Before moving on to guidance, I'd like to share a few additional thoughts related to COVID-19 that may be informative. Though we are not yet able to accurately predict the long-term impact of the pandemic, we did not experience a negative impact to our top line results from COVID-19 this quarter. We attribute this to our focus on large enterprises, our recurring revenue model and our market position as customers moved increasingly to the cloud. We had good linearity in the quarter with a strong March and April, and May to date continues to be strong. We have not seen any meaningful pressure on renewals or receivables collections to date due to COVID-19, though the long-term impact on our customers and partners is not fully known. Renewals due in the next 12 to 18 months may face

downward pressure depending on how the economy recovers. Our overall exposure to industries particularly impacted by COVID-19 like transportation, hospitality, retail and leisure where workforce reductions have been announced publicly, is less than 10%.

Now moving on to guidance, which incorporates these observations. A reminder, these numbers are all non-GAAP which excludes stock-based compensation expenses, amortization of intangible assets, facility exit costs and any associated tax effects.

For the fourth quarter, we expect revenue in the range of $117 million to $119 million, reflecting year-over-year growth of 36% to 38%. Operating profit in the range of $2 million to $4 million, other income of $1 million, income taxes of $1 million, and earnings per share of approximately $0.02 to $0.03 assuming 140 million common shares outstanding.

For the full year fiscal 2020, we expect revenue in the range of $422 million to $424 million or year-over-year growth of 39% to 40%. Calculated billings in the range of $529 million to $531 million for year-over-year growth of 36%. Excluding $11 million of upfront billings in Q2 of 2019, our updated billings guidance for the fiscal year implies growth of 40%. Operating profit in the range of $24 million to $26 million, other income of $6.4 million, income taxes of $3.5 million, and earnings per share in the range of $0.20 to $0.21 assuming approximately 138 million common shares outstanding.

The acquisitions of Cloudneeti and Edgewise Networks are expected to have an immaterial impact on revenue in Q4 and in fiscal 2021 as they are early-stage companies. The cash purchase price of Cloudneeti which closed in mid-April, was $9 million and the cash purchase price of Edgewise, which closed last week was $31 million. Our plan is to further develop these products and incorporate their technologies into our platform. We expect to incur approximately $2 million in additional operating expenses related to the acquisitions in Q4 and $12 million to $14 million in fiscal 2021. This is incorporated into our Q4 guidance.

Our guidance reflects our plans to invest aggressively in our business to pursue our significant market opportunity. We've been very successful in hiring and onboarding remotely and remain on track to increase our field sales rep headcount by 60% for the full year. We're very pleased with the progress in our go-to-market initiatives, and confident that these investments will build the foundation for long-term growth. In addition, we will increase investments in our technology platform and cloud infrastructure.

Now I'd like to hand the call back over to Jay.

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

Thank you, Remo. In closing, let me state 5 key points that make me excited. One, secured digital transformation, which is the market we are purpose-built to address, is accelerating. Two, as we have seen with SaaS leaders like Salesforce and Workday, architecture matters. Only a cloud-native multi-tenant architecture can enable true transformation. Three, our customers are consolidating and simplifying legacy network and security infrastructure, resulting in significant cost savings. Hence, our value proposition is highly attractive to CFOs and CIOS, especially in today's challenging economic environment. Four, in addition to our ongoing success for delivering comprehensive user protection, our next big opportunity is to expand into protecting applications and data, which we are pursuing through our own internal innovation and targeted acquisitions. Five, we are delivering world-class sales execution, which we believe will drive sustainable long-term growth.

We are mindful of the terrible toll that COVID-19 is inflicting on the lives of so many people in so many ways, and we hope that we are helping and making a difference to our customers and their employees in these challenging times. We wish everyone good health and safety.

Operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) I show our first question comes from the line of Alex Henderson from Needham.

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

I was hoping you could talk a little bit about the transaction that you won from a next-gen firewall player, cloud architecture. Are you seeing an increased flow of traffic coming at you in your pipeline from people who are having those same type of issues? To what extent have you been able to demonstrate that the architecture really does matter to some of those customers? And is that becoming a funnel of opportunity for you?

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

Alex, thank you for the question. If there were a good amount of installed base, we would be seeing a lot of flow coming in. There aren't that many customers who are using firewall-based cloud security services. The one that has deployed, we are seeing and who are trying to do security with proper SSL inspection are floundering. So in a nutshell, are there lots of customers out there with firewall installed base in the cloud? Not really.

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

Okay. Then let me shift to the second follow-up question, if I could. Clearly, you're driving a cloud direct model. As that happens, you're connecting the user direct to the cloud and then applications are increasingly being driven by Kubernetes in a variety of locations, whether that be AWS, Azure or private cloud. And those start to become points of -- in the cloud, and connectivity to them becomes critical. Are you planning on doing the connectivity into those locations, those points in the cloud? Or are you also planning on going beyond that to the CICD processing and the like, where the image is secured before it goes into production or in run time?

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

So the way we look at app access is, applications whether it's sitting in a data center or in a public cloud or a private cloud, are simply destinations. So with ZPA, any user can access any of those applications. We are independent of how those applications are deployed and where they are deployed. So we are doing that today.

But the more important step we are doing in future as we announced to the acquisition of Edgewise Network is application-to-application communication security, process-to-process communication, which we think is the next big opportunity for us.

Operator

Our next question comes from Andrew Nowinski from D.A. Davidson.

Andrew James Nowinski *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Congrats on the fantastic quarter. I'd like to start with a question on ZPA. So I was wondering if you could give us any color relative to the pricing of ZPA versus ZIA? And what I'm trying to get at is whether you're indifferent in terms of whether customers start with ZPA and then move to ZIA or vice versa?

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

So I will start and Remo can add on. ZIA and ZPA are 2 independent product lines, ZIA to provide secure access to external applications like SaaS and Internet, and ZPA to provide access to internal applications. Customers can start from either side, it doesn't really matter. But since ZIA started very early on with us, so we have a large installed base of customers who started with ZIA, and those happy customers are adding ZPA, but we do see a number of customers starting with ZPA.

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

Pricing is similar. We sell in 3 bundles for each: Pro, Business and Transformation. So the pricing is similar, and the bundles are similar for both products.

Andrew James Nowinski *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Got it. That makes sense. And then just a quick follow-up on your hiring target. I don't know if you mentioned it, but I know you were targeting 60% growth in headcount by the end of the July quarter. Are you still on track to achieve that?

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

Yes. We had a record quarter in Q3 hiring. And we also feel the quality of people they're bringing on board is outstanding. The leadership that we're putting in place throughout the sales organization, for the most part, it's completely in place right now. So now we're filling up the ranks with the field sales reps, but we are planning and expecting to get to the 60% field sales rep growth.

Operator

Our next question comes from Brad Zelnick from Crédit Suisse.

Brad Alan Zelnick *Crédit Suisse AG, Research Division - MD*

Guys, I just first want to say congratulations on the success. Very impressive to see the acceleration in the business and frankly the execution during these crazy times.

And that really leads to my first question for Jay. Jay, can you just talk us through the balance of headwinds and tailwinds from COVID-19 that impacted the business? And if you look out on the horizon longer term, how does this experience change the shape of adoption for Zscaler going forward?

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

Yes. If you look at what COVID has done, it has forced everyone to work from home. It is accelerating digital transformation, and that's a market we were designed to address. So we are getting benefit from COVID-19 as every customer had to work from home. And you saw a number of examples where we enabled so many customers literally overnight or over a week or 2 weeks, so it's helping us.

Now the next question ends up being, what happens after 2 or 3 months? We think the changes that CIOs, CTOs are seeing with transformation, with being able to work from home, they are actually accelerating their transformation. One of the new things they learned during this transition was, "I am working from home. All of my employees are working from home without using my corporate network. Why do I need the corporate network? Why do I need to do this local internet breakout and why do I need to do this SD-WAN transformation?" So a lot of customers are buying into going to the final step of transformation where a user can directly go to any application from anywhere.

So net-net, we are seeing some good tailwinds. Now the headwind could potentially be the reduction in spend because every company is becoming cost conscious. And that's where actually our story is getting more compelling. Since we do such a great ROI, so CFOs and CIOs are now looking for consolidation of vendors. And this consolidation is around best-of-breed platforms rather than best-of-breed point products. So they like our position that we are not trying to play in 4 different market segments that are totally different, but in a very meaningful segment where we are the zero-trust exchange to connect anything to anything. So net-net, we think this trend of accelerated digital transformation is going to help our business.

Brad Alan Zelnick *Crédit Suisse AG, Research Division - MD*

It makes perfect sense and it would seem to me Zscaler was built for a situation just like this.

Maybe my follow-up just for Remo. The net expansion is a metric that you've been deemphasizing over the last several quarters. And maybe somewhat unsurprisingly at least to us, it's nice to see it tick up significantly in the April quarter. How should we think about it as we look forward? And what are you assuming? I know you've only given us one quarter of guidance. But even as you're formulating your own plan into next year, how are you thinking about expansion of the base?

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

Yes. We've talked about it. And we've deemphasized the net retention rate. However, it stayed pretty consistent for the last 3 years. From my perspective, I don't want to give forward guidance on the net retention rate, but I don't see the composition of our business significantly changing in the near future.

Operator

Our next question comes the line of Daniel Bartus from Bank of America.

Daniel Bartus *BofA Merrill Lynch, Research Division - Research Analyst*

Jay, I just wanted to drill down on your SD-WAN-driven sales and what you're hearing from customers. And I'm thinking, does it make sense that this 3Q may be the trough for your ZIA business that's typically tied to SD-WAN?

And then as we look into the 4Q and beyond, do SD-WAN headwinds potentially persist? Or do you hear that it's going to be a priority as to save money as people kind of trickle back into the offices?

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

Right. That's a question we have been asking a lot of CIOs as we talk to them. As work from home order happened, all network changes got put on hold. They had only one priority, "I need my employees to work from home securely. We truly needed a ZIA kind of product to go to external applications, ZPA for internal applications." So we actually benefit from not even having to deal with SD-WAN because sometimes network transformation can take longer. We expect that as customers go back to the office, they will be revisiting those SD-WAN projects. But it has shown the CIOs, that they don't have to depend upon the network and they can move forward faster with it.

I was talking to a CIO of this very large company, about 100,000 users, who was actually looking at doing the SD-WAN breakout. And now having seen this, he says, "I'll think about it if I need to, but I am finding that I can run my business without worrying about the network."

In IT, things don't change overnight but the emphasis is changing. We think now the shift is happening. It is less focus on network, more focus on access from anywhere.

Daniel Bartus *BofA Merrill Lynch, Research Division - Research Analyst*

Great, great, and that's really helpful. And just quickly Remo, I'm wondering if you can help us break out the strength for ZPA between existing ZPA customers adding more seats and actually adding new ZPA customers?

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

Yes. So the strength in the quarter was ZPA and it was with existing customers. So the growth both in ZIA and ZPA were very good. With the work-at-home initiative, the existing customers quickly purchased ZPA, and ZPA represented close to 40% of our new customers. So the new customer business is historically 50% to 60% mix of the new ACV, but we expect it to return back to the historical mix.

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

Yes, if I may add, ZPA came from 3 sources. One was our existing customers who bought some number of seats of ZPA, which generally have been in the 20%, 30%, 40%, 50% range. So that's one. Second bucket was Zscaler customers who had bought ZIA, were still looking at ZPA but hadn't bought it, and that decision moved on. That became number two. And third was, customers who bought ZIA and ZPA together because they were new logos to us. All 3 contributed to the success of ZPA, while ZIA did very well as well.

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

Yes. As a follow-on also, typically in the past, we've seen a 50-50 mix of new and existing. Over the last several quarters, that mix has been more in the 30% to 50% range. In Q3, it was closer to that lower end of the range.

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

And that's number of customers.

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

And the number of customers.

Operator

Our next question comes from Saket Kalia from Barclays.

Saket Kalia *Barclays Bank PLC, Research Division - Senior Analyst*

Echo my congrats on the quarter. Jay, maybe for you just to change subjects here just for a second. Can you talk about some of the acquisitions here with Cloudneeti and Edgewise? Those are a little different than ZIA and ZPA in terms of displacing sort of an existing vendor, a per user kind of per year pricing model. How do you sort of envision those 2 new acquisitions sort of fitting into the go-to-market for the future?

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

Yes. So first of all, if you look at overall positioning, Zscaler has been focused on protecting users no matter what they need to access. That's our ZIA, ZPA, Zscaler B2B story. Our next natural step was to protect applications and data in the cloud. So for that, Cloudneeti helps us to protect workloads because misconfigurations and all can cause leakage of data. So that's an important piece for data protection.

And then Edgewise basically extends our story of saying, why should we just stop at connecting users to applications? Why not applications to applications, why not process to process using the same zero-trust approach that disrupts typical network-based security? So that's how they fit.

Now from a pricing point of view, yes, our pricing has been based on the number of users. Now, price will be based on what, workloads, right? There are millions and millions of workloads going out in the cloud. It will be subscription service just like everything else, but the unit of pricing becomes workloads.

Saket Kalia *Barclays Bank PLC, Research Division - Senior Analyst*

Got it. That makes sense.

Maybe for my follow-up for you, Remo, so helpful commentary in the prepared remarks just around duration. Can you just tell us how you're thinking about duration here in Q4, understanding the majority of billings here are annually in advance? You talked a little bit about more co-term business, maybe some shorter commitments as well kind of in a COVID environment. How are you thinking about sort of the duration inside the implied Q4 billings guide?

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

Yes. I really don't see much change in the billing duration in Q4. Our billing duration typically is between 10 and 14 months. And for the last few quarters, several quarters, it's been the lower half of that range. I'd expect the same in Q4.

Operator

Our next question comes from Catharine Trebnick from Dougherty.

Catharine Anne Trebnick *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Data & Internet Protocol Networking*

Congratulations on a good quarter. So in your prepared remarks, you had discussed that you were doing whiteboarding in some of your activities in the sales motion. Can you describe -- every time I talk to investors, I get pushback on how complicated the sales process is for you all: it takes longer, it's a long sales cycle. Could you explain to us or give a sort of background on what that new sales process looks like in COVID-19?

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

Thank you, Catharine. At the core of Zscaler is transformation of the network and applications because you no longer need traditional hub-and-spoke network. So when you try to replace one box of a firewall with a second box of firewall, it's simpler. This box comes out, that box goes in. In Zscaler, we generally need to show them that you don't have to have this hub-and-spoke network and castle-and-moat security model.

So you end up doing this architectural discussion. Now once architects start getting it and understanding it, the life becomes a lot easier because typically we don't go through the typical POCs, proof of concept that compares features and functions. And whiteboarding

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becomes important to show essentially how the network is sitting today, how could it change in Phase 1, Phase 2, Phase 3. So we show them their transmission journey. That's where whiteboarding comes in.

Is it complicated? I won't say it's complicated. I would say it's different than doing the box-centric, POC-centric sale. Here, transformation starts from the C level, and those are generally the first parties we work with. And generally, that C-level really depends upon architects to show them how the architecture changes. So we haven't seen any slowdown in terms of engagement, actually I've been surprised to find that getting meetings with C-level as well as architects in this confined-at-home world is actually much easier. Did I answer your question?

Catharine Anne Trebnick *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Data & Internet Protocol Networking*

Yes, you did.

Operator

Our next question comes from the line of Gray Powell from BTIG.

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

Congratulations on the good results. Yes, I just want to go back to one of the comments you made in the prepared remarks particularly on linearity. So did you guys see any material benefit from emergency spending initiatives to support work from home? And I know you said linearity was strong in March and April, and that May continues to be strong. So I'm just trying to think of the trend line there. Was there any like decel in May? Or just how did May compare to April?

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

Yes. I won't make a specific comment between May and April. What I can say is that linearity in Q3 was better than we've had in prior quarters. We picked up strongly in March with the work from home with COVID-19. We continue to have a strong April. And so we ended the quarter well. And that momentum that we had in Q3 is carrying over into May, and May continues to be strong.

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

Got it. That makes perfect sense. And then just one quick one, so I know you guys mentioned you did some free, I think, it was 90-day trials or promotions on ZPA back in March and April. Just what's your confidence level in converting those into paid customers? And how big should we think of that opportunity, Jay?

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

Yes. As COVID-19 became basically a global pandemic, most of the customers have started with our original pre-offer for their China-based employees converted to paying customers. Some of the customers converted to business continuity program with the shorter commitment period, but many also converted to multiyear commitments with annual billings. So that's proved to be pretty good for us.

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

Just to add on, Remo, we did not have a global trial free program.

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

That's correct.

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

We essentially did it in China early on when things started. And after that, our customers tried to call us and say, "We need to help to get turned on. It's less of an issue of money. It's more of a matter of my employees need to be productive on Monday morning." And we were crazy busy getting our customers online and making sure they work well.

Operator

Our next question comes from the line of Srini Nandury from Summit Insights.

Srinivas S. Nandury *Summit Insights Group, L.L.C - MD & Senior IT Hardware and Software Analyst*

All right. Congrats on a great quarter.

Jay, you talked about using AWS for some of the processing of the data since you didn't have enough capacity. How does that affect the latency? And more importantly, how long does it take for you to add more capacity to the infrastructure?

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

Add capacity to our infrastructure?

Srinivas S. Nandury *Summit Insights Group, L.L.C - MD & Senior IT Hardware and Software Analyst*

Yes. That's the reason I presume you're using AWS, right?

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

Yes. So the difference is the following. You need to have some hardware sitting in the data centers when you want to add capacity. Then turning on and turning them up and running is not a hard thing at all. Literally, that's a matter of maybe a day or 2. So whatever time it takes, is it takes time to acquire hardware and ship it to a data center, then it gets turned on pretty quickly.

Now as COVID happened literally overnight, I still recall on Thursday, I got a call from very large conglomerate in Europe. They said, "My over 300,000 people need to start working from home on Monday, 14th of March and I'm already using ZIA. I'm still playing around with ZPA, but I need ZPA to turn on by Monday morning." And this is in 2 days' notice, right?

So for us to get our capacity ready doesn't take a whole lot. Shipments and all does take some time. And so it's a good option to be able to use Azure or AWS as we need to increase capacity for a short amount of time. And as we said in our prepared remarks, the gross margin difference can be significant. So we use them as we need them, and then we can dial that down.

Operator

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

Fatima Aslam Boolani *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate Technology-Software*

I hope you're all safe and sound. Jay, maybe a question for you to start. As I zoom out, or as you zoom out rather, and consider your pipeline at a time when organizations are perhaps becoming more measured in what they're spending and whom they're spending with, perhaps slow playing some of the big architectural decisions particularly around SD-WAN, as you had alluded to earlier, I was curious how a lot of these dynamics are or will be impacting your pipeline composition, if I consider some of your traditional demand drivers across competitive displacement, SD-WAN adoption and Office 365 migration?

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

Yes. If I may say, our #1 driver has been digital transformation whether Office 365 or SD-WAN, any of those things have been coming from one core thing. It is very true. Every CIO and CFO is becoming more cost conscious. So the decision is not driven by, "I need to change the architecture." The decision is driven by, "I need to consolidate my multiple vendors, reduce my costs and be ready for digital transformation." If you look at from 2 buckets point of view, consolidations, we do because of a great platform, and architecture readiness gets them there. So we actually see this thing accelerating in many ways especially the network, which generally is the slowest moving part, is becoming less important factor because CIOs have seen business work without using their corporate network. Did I answer your question?

Fatima Aslam Boolani *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate Technology-Software*

Yes. That's super helpful.

And Remo, maybe a question for you. Just as it relates to volumes of large deals in the quarter, you provided some marquee examples in

the prepared remarks of the 200,000-seat win. So I'm curious if there was any outsized or unusually large impact from very large deals in the quarter? And that's it for me.

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

No. I mean there's no real large deal in the quarter. I mean a lot of deals are greater than $500,000.

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

ACV.

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

ACV, which is a great quarter for us, but nothing stands out as a very, very large deal.

Operator

And our last question comes from Shebly Seyrafi from FBN Securities.

Shebly Seyrafi *FBN Securities, Inc., Research Division - MD*

So my question is you're going to have 4 new products ramping in '21. Do you have an estimate roughly what kind of revenue contribution they'll be?

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

Yes. I mean, it's small. It's not going to be material. If you take a look at our ZPA product that we introduced, I'd say it's going to be along those same type of trajectory. A couple of percentage points of our total perhaps in fiscal '21 and then accelerating as we go forward, but clearly immaterial, basically, impact for the products in fiscal '21.

Shebly Seyrafi *FBN Securities, Inc., Research Division - MD*

Okay. And then I know from the number you provided, Americas growth accelerated with my spreadsheet to 39% from 30% growth the prior quarter. And you even had a tougher year-to-year comparison in the Americas. So is this just COVID or are there other factors in the Americas driving this?

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

Yes. So related to the new products, it also relates to new and upsell, not revenue, so just so you're aware of that. Related to the growth in the regions, I can say that all regions did very, very well. For new and upsell, there's no region that did not do well. EMEA, APJ and Americas, all did about the same.

Operator

Thank you. This concludes our Q&A session. At this time, I'd like to turn it over to Mr. Chaudhry, CEO, for closing remarks.

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

Good. All right. Well, thank you for your interest in Zscaler. We wish everyone good health and safety. Look forward to seeing you at our next quarterly earnings call.

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

Great. Thank you.

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

Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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