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EDITED TRANSCRIPT
ZS.OQ - Q1 2022 Zscaler Inc Earnings Call

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OVERVIEW:

Co. reported 1Q22 revenue of $231m. Expects FY22 revenues to be $1.00-1.01b and non-GAAP EPS, assuming approx. 150-151 fully-diluted shares, to be $0.50-0.52. Also expects 2Q22 revenues to be $240-242m and non-GAAP EPS, assuming approx. 150 fully-diluted shares, to be approx. $0.11.

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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the Zscaler First Quarter 2022 Earnings Call. (Operator Instructions) Please be advised that this call is being recorded. (Operator Instructions)

I would now like to hand the conference over to your host today, Bill Choi, VP Investor Relations and Strategic Finance. Please go ahead, Mr. Choi.

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

Good afternoon, everyone, and welcome to the Zscaler Fiscal First 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 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 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 risks and uncertainties, 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 December, Nasdaq Investor Conference, Barclays Global TMT Conference, BMO Growth and ESG Conference.

Now I'll turn the call over to Jay.

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

Thank you, Bill. Building on our incredible momentum from last year, we had an exceptionally strong start to fiscal '22. In Q1, we delivered 62% of revenue growth and 71% billings growth while generating record operating profits and free cash flow. We are again seeing strong revenue growth across all verticals, customer segments and geographies with over half of our revenue coming from outside the U.S. We recently achieved a significant milestone of surpassing $1 billion in annual recurring revenue while continuing rapid growth.

In my recent dialogues with hundreds of CISOs and CIOs, 8 out of 10 are looking to phase out legacy network security in favor of zero trust architecture due to increasing cybersecurity risks and accelerating digital transformation initiatives. I will highlight 2 main reasons why enterprises are selecting Zscaler over legacy solutions.

One, we saw a more than 300% year-over-year increase in sophisticated threats hidden in SSL-encrypted traffic. A large number of them are ransomware attacks and most would bypass next-gen firewalls, which aren't designed to inspect encrypted traffic at scale. We are the only cloud provider with a proxy architecture designed to inspect SSL-encrypted traffic at scale to deliver better security.

This year, our cloud has blocked more than 20 billion threats hidden in encrypted traffic.

Two, by connecting users only to applications and not to the network, a core principle of zero trust architecture, we eliminate lateral threat movement hence, reducing ransomware attacks such as the Colonial Pipeline breach. In contrast, firewalls and VPNs connect users to the network, enabling lateral threat movement. It is clear from our growth and enterprise wins that architecture matters, and zero trust security can't be built on legacy network security architecture. This gives us long-term advantage.

Turning to the quarter. Let me discuss 2 factors that drove our performance. One, we saw continued strength in new and upsell bookings of over $1 million in annual value. We drove 87% year-over-year growth in customers exceeding $1 million in ARR, ending with over 220 of these customers.

Two, the expansion down market to enterprise segment organizations with 2,000 to 6,000 employees is scaling, and it remains our fastest-growing segment. With increasing contribution from the enterprise segment, the total number of customers who pay us more than $100,000 per year is up 53% year-over-year to over 1,600. Our 71% billings growth this quarter speaks to the commitment that customers are making to our Zero Trust Exchange platform. As we have noted before, the purchase of ZIA is often the first step to adopting our platform. Let me share a couple of ZIA-driven deals.

A Fortune 50 insurance company purchased ZIA transformation bundle with cloud firewall and sandbox, plus DLP and CASB for data protection, to secure 170,000 employees and affiliated agents working from anywhere. This customer wanted to secure and fast access to Internet and SaaS applications, particularly Microsoft 365 and Teams. Connecting to Zscaler's nearest edge cloud where we have direct peering with hundreds of application providers, their users are seeing a 75% improvement in response time.

Next, a leading defense industry integrator purchased ZIA for 200,000 users plus workload protection for Internet traffic. Our ZIA platform, which recently achieved FedRAMP high-ready status, will help them meet many requirements for CMMC, a cybersecurity standard for defense contractors. Zscaler is consolidating their several point products, simplifying the network, enforcing consistent cyber policy across multiple business units while

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reducing operational costs. We believe these large deals show that we are the only multi-tenant zero trust platform meeting the needs of major enterprises to transform the legacy hub-and-spoke network and castle-and-moat security.

With customers shifting to the cloud, more 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 public cloud. Here are a few examples.

A Fortune 500 banking customer signed a 4-year commitment for 3 key pillars of our platform. Their existing ZIA contract was upgraded to include cloud firewall, sandbox, DLP, CASB and browser isolation. They also purchased ZPA for all 100,000 employees to implement app segmentation without having to implement legacy network segmentation. In addition, ZDX was purchased to identify and help remediate application, network or endpoint issues to ensure great user experience and employee productivity regardless of their location. This deal more than tripled the customer's annual spend with us. Having adopted full portfolio for user protection, we are now discussing zero trust security for workloads with this customer.

Next, in a new logo win, a Fortune 100 insurance customer purchased ZIA Transformation Bundle and ZPA for all 30,000 employees to pursue their cloud-first strategy. With cyber protection as a major requirement, this customer only considers a proxy architecture to perform SSL inspection at scale and rejected firewall-based architectures. ZPA will eliminate the attack surface, hiding the thousands of private applications behind our Zero Trust Exchange. Hence, they can't be discovered, exploited or DDoS-ed. We are consolidating at least 3 vendor point products, materially reducing complexity and operating cost.

Our integration with CrowdStrike and Microsoft was also an important consideration for them.

Next, one of the powerful use cases for ZIA and ZPA is to accelerate M&A integration with significant ROI. An existing European-based Global 500 manufacturing customer purchased ZIA Transformation Bundle for 30,000 employees of the newly acquired business and ZPA for 50,000 users to accelerate the M&A integration. The legacy approach to providing access to private applications post acquisition requires integrating 2 complex corporate networks, which they expect to take 18 months or more without having to connect 2 corporate networks. Zscaler's approach provided secure access to SaaS or private applications across both companies in weeks, saving time and money. After having disrupted perimeter-based security for users with our Zero Trust Exchange, we are bringing zero trust to workloads with Zscaler Cloud Protection. Let me highlight a few ZCP wins.

An existing ZIA and ZPA state government customer purchased workload segmentation for over 4,500 workloads, along with ZDX and CASB for their 28,000 employees. This was a 7-figure annual contract value driven by our emerging products. Implementing zero trust for workloads will reduce their cyber risk by achieving microsegmentation without doing legacy network segmentation.

Moving on to our workload posture offering. We are seeing increased interest from customers in CSPM for configurations and CIEM for entitlements. During the quarter, a tech company bought CSPM for over 9,000 workloads and a software enterprise bought CIEM for 5,000 workloads. Our workload communication offerings powered by ZIA and ZPA technology is building momentum with additional customer wins in the quarter. For example, a health care customer purchased workload communication for 3,500 workloads, and a financial services customer purchased it for 1,000 workloads.

When you look at these wins, our success starts with true zero trust architecture, which is the opposite of firewalls and VPNs. Our Zero Trust Exchange is the largest in-line cloud security platform in the world, processing over 200 billion transactions per day, which doubled in the last 18 months and is preventing more than 7 billion security and policy violations per day. This massive amount of traffic provides us 300 trillion signals per day to feed our machine learning and AI engines, resulting in superior threat protection and better detection of user and application traffic anomalies.

This network effect is a big competitive advantage for us. Each of our 150-plus data centers receives a continuous stream of more than 200,000 unique security updates every day. This can't be done with a single tenant VM-based architecture that legacy security vendors are running on public clouds and calling SASE. This is only possible with a purpose-built, highly scalable cloud that Zscaler built from day 1. I'm very proud of our pace of innovation that delivers value to our customers. Let me share a few stats for the quarter.

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ZIA delivered 29 Agile releases, and ZPA delivered 44 Agile releases. Each product pillar delivered scores of new features and enhancements. Our Threat Lab Security Research team discovered and delivered over 495,000 new advanced threat indicators and signatures to our global cloud. In addition, our cutting-edge security research scientists discovered and reported 18 new zero-day vulnerabilities. These are testimonials of the sophistication and scale of our research team. A great platform combined with a great research team enables us to deliver great cyber protection to our customers. Let me highlight some of the significant features we delivered in Q1.

We enhanced our out-of-band CASB to support additional SaaS applications. We see more customers buying our CASB along with ZIA and replacing their existing CASB point product. We added optical character recognition technology to our DLP offering, addressing data loss problem for images in files like PDFs. This feature, combined with previously released Exact Data Match and Index Data Match technology, makes us the leading data protection platform. We integrated our recently acquired Smokescreen Active Defense technology with ZPA, making it easier for customers to deploy and manage it from a single console. The pace of innovation for our newer pillars like ZDX and ZCP is accelerating.

For example, one of the most demanded ZDX features is real-time performance monitoring for Zoom and Microsoft Teams, which we delivered by working closely with Zoom and Microsoft through API integration. We added over 150 features to ZDX in the past 12 months, delighting our customers.

One customer said, and I quote, "We now have unprecedented visibility into the environment. We can respond faster and forecast where we may have issues and address those areas before they become a problem."

I want to highlight another increasingly important area: helping our customers achieve their ESG goals. Our highly efficient cloud replaces hundreds of thousands of on-prem appliances and eliminates the need to buy more in the future, resulting in the significant decrease in the energy, resources and carbon emissions associated with building, transporting, powering and cooling them. As you may have seen from a recent press release, our cloud platform now uses 100% renewable energy.

As part of this effort, we have a cross-functional team with oversight from the Board to drive our sustainability strategy. Zscaler has never been stronger, and I believe we have an incredible opportunity in front of us. We have our sight set on the next milestone: growing our ARR to $5 billion. I believe the key to sustained growth in our next stage is to accelerate the broader adoption of our platform, our Zero Trust Exchange platform, with 4 major pillars provides a comprehensive foundation for securing and improving application access in the world of cloud and mobility.

With ZIA and ZPA, we have proven our success implementing zero trust for users. Our next immediate opportunity is to bring zero trust to workloads powered by the same core ZIA and ZPA technology. As we shared in our deal highlights, we are seeing solid traction with ZDX and ZCP, the newest growth vectors for the company. We are seeing increasing average revenue per customer, and we estimate a 6x growth opportunity on upsell with our current customers. From presales to deployment and customer success, we have a sophisticated sales machine to sell value and deliver measurable outcomes at the CXO level.

Over the next several years, our innovation engine will further build out the breadth and depth of our platform, extending our already substantial technology lead. We are also pursuing some very exciting opportunities to extend zero trust to operational technology, or OT, systems with manufacturing leaders like Siemens.

In summary, we are very excited about our future, and we believe we are still in the early innings of a significant market opportunity to accelerate secure digital transformation. 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 Jay mentioned, we are pleased with the results for the first quarter of fiscal 2022. Revenue for the quarter was $231 million, up 17% sequentially and 62% year-over-year. On a year-over-year basis, revenue growth accelerated in the quarter driven by strong business activity. ZPA product revenue was 16% of total revenue.

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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%. Our investments in APJ are bearing fruit with greater than 100% revenue growth in that region. Our total calculated billings grew 71% year-over-year to $248 million with billings duration at the high end of our 10- to 14-month range. We had several customers choosing to pay upfront for their multiyear contracts. As a reminder, our contract terms are typically 1 to 3 years, and we do not offer any special incentives for upfront payments.

We're also pleased to report 68% year-over-year growth in short-term billings. I would note that both billings and revenue benefited from a $1.5 million one-off deal in the quarter. Remaining performance obligations, or RPO, were $1.71 billion as of October 31, up 97% from 1 year ago. The current RPO is 50% of the total RPO. Our strong customer retention and ability to upsell the broader platform have resulted in a high dollar-based net retention rate, which was above 125% in the quarter and higher than the 128% we reported last quarter. As we have discussed before, this metric will vary quarter-to-quarter and it's not a metric we manage our business towards. We focus on growing our net new business without incentivizing differently between new or upsell. We have a strong base of large and growing enterprise customers, which provides us with significant opportunity to upsell our broader platform.

Considering these factors, we believe NRR above 125% is truly outstanding for us. We had 224 customers paying us more than $1 million annually, up 87% from 120% in the prior year. The continued strength in this metric speaks to the strategic role we play in our customers' digital transformation initiatives. We also added over 550 customers paying us more than $100,000 annually, ending the quarter at 1,616 such customers.

Turning to the rest of our Q1 financial performance. Total gross margin of 80.6% was approximately flat quarter-over-quarter and down 50 basis points year-over-year. Our total operating expenses increased 17% sequentially and 69% year-over-year to $162 million. Operating expenses as a percentage of revenue increased by approximately 3 percentage points from 67% a year ago to 70% in the quarter, primarily due to increased hiring, higher compensation expenses, investments in Smokescreen and Trustdome businesses we acquired in the second half of last year and a partial return of T&E.

Operating margin was 10% and free cash flow margin was 36%, which benefited from the timing of CapEx spend. We continue to expect CapEx as a percentage of revenue to be high single digits for the full year. We ended the quarter with over $1.58 billion in cash, cash equivalents and short-term investments. Please note that net other income includes an $800,000 loss primarily related to the change in value of our assets denominated in euro and British pound as the U.S. dollar strengthened. To minimize such impact going forward, we recently implemented a hedging program for our balance sheet. As a reminder, we primarily transact sales globally in U.S. dollars. And several quarters ago, we put in place a hedging program for international operating expenses. For income taxes, our tax expenses primarily represent international taxes paid to foreign jurisdictions we do business in.

For several APJ countries, there's a withholding tax on sales made to customers in those countries. As our APJ business has grown significantly in recent quarters, the withholding taxes were $1.5 million in Q1.

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 second quarter of fiscal 2022, we expect revenue in the range of $240 million to $242 million, reflecting 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're more focused on time to market and growth rather than optimizing for gross margins. Operating profit in the range of $20 million to $21 million; net loss and other income of $100,000; income taxes of $4 million; earnings per share of approximately $0.11, assuming 150 million fully diluted shares.

For the full year fiscal 2022, we are increasing our revenue to a range of $1 billion to $1.01 billion or year-over-year growth of 49% to 50%, increasing calculated billings to a range of $1.3 billion to $1.305 billion or year-over-year growth of 39% to 40%. We now expect our first half mix to be approximately 43% to 44% of our full year billings, increasing our operating profit to a range of $90 million to $93 million based on the return of in-person conferences and events, we expect operating margin to decline sequentially in Q3 before improving in Q4; updating earnings per share to a range of $0.50 to $0.52, assuming approximately 150 million to 151 million fully diluted shares.

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Please note that our share count guidance now includes dilution from our convertible debentures.

With a large market opportunity and customers increasingly adopting the broader platform, we are committed to investing aggressively in our company. 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) And our first question comes from Matt Hedberg from RBC Capital Markets.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

Congrats on a really strong quarter. Jay, I want to start with you. You've had a lot of success here recently, and you talked on the call about the path from $1 billion in ARR to $5 billion in ARR. You talked about some of the building blocks, but I wonder if you could put a finer point on how you get there. And do you have -- currently have the products in place to get to that very large goal?

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

The short answer is yes, and let me expand upon it. If you look at our current main products, ZIA, ZPA, which have been our flagship products, there's a fair amount of upsell opportunity to our current base. We are going to share that, with upsell, we could actually take on ARR 6x. Of course, we won't just wait for upsell. We are focused on adding new customers as well.

We have decent penetration on the high end: Fortune 500 companies, 35%; Global 2000, about 25%. That means there's a big market still for us to deploy. And these, especially high-end customers, look for a proxy-based architecture and zero trust architecture.

And then on top of that are our 2 other solutions, zero trust for workloads that has been just coming out early stage; and we are also moving into zero trust for IoT and OT, leveraging the core technologies we have in place. And then on top of that is a newly emerging markets for workload security posture, entitlement, permissions, and the like. And we did a couple of small acquisitions in that area. We're building upon it and growing it.

So I do see security market rapidly changing. We believe all segments that we know today will no longer be there. They'll disappear over time. And we have a lead -- significant lead over others to keep on building more. So I feel pretty comfortable and confident to be able to get to our $5 billion ARR target and beyond.

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

Yes. Just to add just a little bit -- yes, just to add a little bit there. Our SAM is $72 billion. And as we talked about in our Analyst Day, it does not include other areas which we are making investments, so in areas such as 5G or OT, IoT, B2B, B2C. So it's -- and what's interesting is that this market has really changed over the years from what it was even 10 years ago and certainly, 20 years ago, where a lot of legacy, basically, technology exists still today. There's a huge market opportunity.

And one of the things we've done within the company and we've talked about is that we're going to prioritize growth over operating profitability. And one of the areas that we're making significant investment is in our go-to-market. So we've made significant investments in the past. We'll continue to make significant investments.

And in that go-to-market, it's really 3-pronged: you've got sales, you've got marketing, you've got channel. Sales organization, we've been making significant investments in the last few years. You can see the fruits of what our sales organization has done. We've hired recently about a year ago or a little less than a year ago, a CMO, and he's doing absolutely outstanding. And we are making significant investment in channel.

With that also, as we talked about trying to get to or getting to a much larger company, we are going to be making investments throughout the company to build the foundation and the strength and efficiencies. So we're in a unique position and really created, in my opinion, a revolutionary technology with the platform that's created 12 years ago that addresses this market pretty much head on.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

And that's actually a dovetail into the second question. I mean it looks like you guys had a lot of hiring this quarter. Obviously, Q1, I can imagine you want to front-end load some of your hiring. Can you talk about the rep capacity coming out of Q1? And do you -- how do you kind of think about ads throughout the balance of the fiscal year?

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

We're going to continue to add aggressively throughout the year. Our net adds that we had in Q1 was over 450 employees. About half of those ads were in sales and marketing.

From a field quota sales rep perspective, the comment that we made before was that we've hired more field sales reps this year in fiscal '22 versus fiscal '21. We're certainly on pace to do that. And also in Q1, we had a new record quarter for RSM, our field quota sales rep ads. We see Zscaler's a destination.

And so related to your question, how we're going to do going forward, like I said before, we are going to prioritize growth and we're going to hire aggressively, and we're going to try to really go after this market.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

Congrats, guys.

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

Thank you.

Operator

(Operator Instructions) And our next question comes from Gray Powell from BTIG.

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

Congratulations on the strong results. So I know you hit like kind of high-level drivers. I'd just be curious on the product level, what surprised you most to the upside this quarter? Was it more on the core ZIA and ZPA side? Or was it more on the emerging product side of the portfolio?

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

All products actually did well. I mean this was a stellar quarter, whether you look at the product side or you look at the geo side or you look at the market segment side. There are a couple of deals we highlighted in my earnings call. Actually, the big ZIA deals are actually still coming up very strong. Sometimes, people think that ZIA kind of started early. It may be kind of slowing down. But we aren't seeing slowdown in ZIA. ZPA is ramping pretty rapidly, growing pretty fast. And ZDX actually is probably the most sought-after product in the market, especially with Zoom and Teams kind of issues that are almost impossible to decipher and figure out. The big integration we did at a very rapid pace in the past few months, and we announced that publicly a couple of weeks ago. We have with the help of Microsoft and Zoom, both, we did API-based integration.

So across the board, I think it's wonderful, hard to kind of pinpoint one product area.

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

Yes. From a geographic perspective, what I'd like to do is call out APJ. They did absolutely outstanding. And what we've talked about before also, it's one of the areas that we're going to invest more in is in APJ, in particular, Japan. And so if you look at our performance, APJ was very, very strong for us. But as Jay mentioned, across the board, it was an outstanding quarter.

Operator

And our next question comes from Alex Henderson from Needham.

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

Outstanding quarter. I didn't catch a growth rate or a percentage of revenues coming from ZDX or ZCP. If you have one of those, that would be great. My question is predominantly on the commentary about your conversations with the CIO, CTO, CISOs. Clearly, the move to cloud direct for users is taking root aggressively. But at the other side of that coin, it seems pretty clear that applications are simply going to become points in the cloud. And under that scenario, you're the connectivity between both the user to the application and the application to the other applications domain to domain. But in that world, I don't see any reason for there to be an enterprise network.

And so I guess my question is, have you had conversations with people in the enterprise to actually start talking about decommissioning the enterprise network, where the branch home office and data centers simply become islands in the cloud the same way AWS is? Can you talk to whether that vision is penetrating into top management?

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

Yes. It is actually happening. It's real. I mean I can tell you because I've talked to so many customers. I have many customers who don't have any data center. I have many customers who don't have any private network, so to speak. It's all broadband connections coming from their headquarters that ran to us and the like.

Now I would say that most of that has seen in pretty decent-sized enterprises, ranging from about 5,000 to probably 10,000 or 15,000 users. I haven't gone there yet where you're looking at 20,000-, 30,000-person company decommissioning everything. But that's happened. We are seeing clearly the trend moving in that direction.

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

And your other question, Alex, related to the breakout of ZDX and ZCP, we did not give that. What we talked about on the last call is that ZDX and ZCP as a percent of our total new and upsell business for the year would be low teens. We still expect that.

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

Yes. If I may add one more comment, since you talked about network free enterprise, so to speak, not before that we talked about data center free enterprise. I had a customer advisory board meeting today, the 9 CIOs of large enterprises was meeting with us. And one of them said, I have no data center. I have no private network. Now I want to get to a level where I am firewall-free as well, okay? So you see more and more of that. In the world of cloud, there's no room for any firewall. In the data center, they will be there for a while. And it's okay because there's more effort needed to displace them than phasing out the data center and its applications.

Operator

And our next question comes from Patrick Colville from Deutsche Bank.

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

I think it would be correct to echo everyone's congratulations on a, undoubtedly, very stellar quarter. Can I just ask about the headcount adds? I think that was really intriguing commentary, and I guess we'd like to better understand that. So you mentioned 450 net adds in fiscal first quarter. Just can you just help us think about the kind of trajectory through the rest of the year? I mean -- and kind of what you've got baked in the guidance? I mean, should we expect that kind of number again in 2Q, 3Q, 4Q? Or would the kind of glide path be slightly different?

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

Yes. It's a great question. It depends on our performance, quite frankly. If we continue to perform at the levels that we are, as we've talked about, we see this as a huge market opportunity. We're going to invest in this market. And really the major investments that we have are people, getting outstanding employees to work for Zscaler.

So it was a good quarter for us. I mean net adds, as I mentioned, 450. I don't want to give a projection of what we're going to add for the year. But really, the takeaway is if we continue to grow as we are growing, we will continue adding at pace.

Operator

And our next question comes from Sterling Auty from JPMorgan.

Sterling Auty - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So along the lines of the last question, help us understand the trends in customer acquisition costs. So when you look at the net new logos that you added in the quarter, are you actually seeing the cost to acquire those customers going down, going up or staying about the same as what you've seen over the last, let's say, 3 or 4 quarters?

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

That's a great question. Based on our performance that we have and based on our operating profitability, I would say customer acquisition costs are staying relatively the same because we are putting a lot of investment into marketing as well as our sales organization.

On a short-term basis, as we've -- as I've talked about, but again, the contribution margin that we have in years 2, 3 is above 60%. So we're still in that position that we are trying to acquire or bring on board new customers and we're making that investment. As we go forward and as the company matures, that should come down. But right now, that's not our focus. Our focus is to build our top line growth.

Operator

And our next question comes from Jonathan Ruykhaver from Baird.

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

Congrats, guys. Really impressive. So Jay, I think you've commented in the past that Workload Segmentation is something that you can really only see the most advanced companies talking about. So obviously, very early stage. But you seem to highlight is going where -- of that capability in terms of zero trust and applying its applications in machines. So I'm just kind of curious how you see that broader adoption this year. Anything to call out in terms of what you see relative to what you were thinking about that maybe 6 months ago?

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

Yes. I mean your question seems to imply microsegmentation, advanced segmentation, which is actually only done by advanced companies. I look at segmentation in 3 buckets. First of all, zero to application -- sorry, user-to-app segmentation. ZPA was designed to naturally do that. So more and more of Zscaler customers are doing it because user is the weakest link. That's one.

Two, actually workload-to-workload segmentation at the workload level or VPC to VPC level, VPC, say, in AWS East to AWS West, we actually do that with our zero trust for workloads, which is powered by ZPA.

And then the third, the most advanced one you started out with, is being able to do microsegmentation. And that's really done only by more sophisticated companies. But we are really driving all 3 levels of segmentation, which is wonderful for our customers and good for our business. Did I answer your question?

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

Well, have you seen any change in that use case, just the adoption of that use case? Or is it pretty steady state?

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

The advanced microsegment -- sorry, the microsegmentation, I think, is growing at a decent rate. But where the customer had no option literally was user-to-app segmentation and our app-to-app or VPC-to-VPC, those are the 2 new areas of pushing and seeing a lot of great interest. Literally coming from having no options, to Zscaler, you can do it so well, so easily. So we will see much faster growth in that segment.

Operator

And our next question comes from Saket Kalia from Barclays.

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

Jay, maybe for you. With just the success of multiple new emerging products, can you just talk about any thoughts you have on new bundling strategies and how those could look? I mean the bundles that you've done with ZIA and ZPA have been so successful in the past. How does that bundling strategy change, if at all, as ZDX and ZCP become bigger parts of the business? Does that make sense?

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

It does. So overall, as you know, we have a deep and broad platform. And we also see CIO, CISOs looking for consolidation. They want solution rather than have to buy many products and put them together. And also, things like ZIA, ZPA, ZDX with a single agent, literally, all 3 products can get turned on pretty easily. So you will see more and more bundling over time.

You're seeing ZIA. In fact, first of all, you see bundling for an -- in ZIA family on business bundle to Transformation Bundle then you saw a ZIA and ZPA coming together. Then you'll see ZIA, ZPN, ZDX coming together. The trend will continue. I think based on different products, probably the timing may be different based on what we learned from the customers.

Operator

And our next question comes from Hamza Fodderwala from Morgan Stanley.

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

Jay, a question for you. Just more broadly on security architecture and the market moving more towards SASE and zero trust network access. I would think that in today's environment where there's obviously supply chain constraints on things like on-premise firewalls that you should be seeing more adoption towards your type of platform. But we're still seeing customers buy on-premise firewalls, right? And I think it's a pretty strong demand environment. So I'm wondering when that tipping point occurs or if that tipping point occurs? And maybe if you can give us some color around the pace of adoption towards SASE and zero trust network activity, where we are in that adoption curve?

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

Yes. It's a good question. Your question reminds me of the question I was asked a few times several years ago. Zscaler is growing so well. Why is Blue Coat still growing so well and selling so well, right? You notice in our shelf here, there's a lot of traffic that goes through the data center. And as that traffic grows, whether you've got a proxy appliance sitting there or firewall since it takes the traffic is you really need to upgrade it and grow it over time. And we saw Blue Coat kind of grew and then suddenly fell off a cliff.

And also, I think it gets very hard to figure out the numbers for actual appliance, the VM, VMware, VMware. It gets very hard to figure out. But I can tell you this, our customers don't want any firewalls in the cloud. Now today, they have some. There's the VMs out there. But as we are talking about new solutions, our customers want a firewall-free cloud world.

Now for the data center, there's lots of complexity. It's kind of being phased out. So we have zero focus in trying to remove any firewalls in the data center. Leave them alone, and they'll become like mainframes over time. Now what is that time? I'm not sure. I can guess into it, but I have 200% conviction that firewall appliances or VMs will go away.

Regarding SASE, I would like to clarify. The SASE has become a buzzword for everyone. Networking guys have highjacked the term because that's so they can attach themselves to SASE. And Gartner had to further clarify it. Gartner said, I can do an MQ for SASE because it is a collection of things. It's like on the kitchen sink. Now they have a new Magic Quadrant coming out, Secure Service Edge, another acronym, SSE. But it is only about security. It is about the functionality of ZIA/ZPA kind of to put together. And for the networking side, there will be a separate stuff.

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I think there are more customers who want to eliminate the network because it is the network that creates lateral movement and enables ransomware type of attacks. I mean all this stuff is driving on growth. It's helping, but there is a big market out there, there's inertia out there, that's still buying a bunch of these firewall appliances and the like.

Take VPN. We all know that VPN is probably the biggest security hole out there. There's still -- I mean we're replacing lots in that. That's what's fueling ZPA growth, but there's a big market that's still buying VPNs. And we are making progress pretty aggressively. And Gartner and all thinks that in the next about 2.5 years, most of VPNs will be gone. And we think whether a vendor is calling VPN in the cloud by a different name or EVPN, they'll eventually go away, and that's where we will help with zero trust architecture. A long answer, I hope it helped.

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

No, it helps.

Operator

And our next question comes from Brian Essex from Goldman Sachs.

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

Jay, I was wondering if I could maybe just follow up on a few other questions that we've had previously. Considering the investment that you've made in sales reps and sales and marketing over the past few years and particularly you're focused on cross-sell and upsell, I mean I've noticed that the billings are growing over -- looks like they're growing over twice what customer growth is. So maybe if you could put a finer point on how you're investing in particularly your direct sales force to -- or whether you're leveraging your channel to some greater extent to drive yourself towards that 6x growth opportunity from cross-sell/upsell.

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

So first of all, if you look at our growth, we had 85 -- 87% year-over-year growth for our customers with over $1 million in ARR. That's a customer growth number. Now if you look at customers with over $100,000 ARR, that year-over-year growth was about 53%. I think when you look at listed customer numbers, there's some low small customer on the low end and whatnot. Those numbers end up being kind of misleading. So it's good to look at categories. So we are pleased with the growth of customers. Though our bigger focus is just overall ARR growth, our overall bookings growth and the like.

Now for that, as we look at cross-selling, upselling our new logo, we actually do not do any special incentive for one or the other. We have internally debated it quite a bit. But when you've got so many products who sell on your portfolio, for me to motivate salespeople to go for new business and not focus on upsell won't be right. So we have essentially the same compensation.

Now channel is beginning to play a more and more role, especially in the enterprise segment. The bigger the deal, the more you have to engage with them, like the Fortune 500. But when you come to 2,000 to 5,000 or even up to 10,000 users, channel is big new add, more and more value. And channel actually is helping us get new logos because that's one of the big values they had. Did I cover the points you asked for?

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

Yes, you did. That was very helpful. So I appreciate it. And congrats again.

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

Thanks, Brian.

Operator

And our next question comes from Gregg Moskowitz from Mizuho.

Gregg Steven Moskowitz - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

I'll add my congrats on a truly remarkable quarter. Jay, I'm wondering, have you begun to see uptake for ZPA Private Service Edge? And I'm just kind of curious if that's begun perhaps to help you in hybrid enterprise environments such that it might be contributing to the robust overall growth that you're showing.

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

ZPA...

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

Private Service Edge.

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

Oh, yes, Private -- okay. Good. Yes. ZPA Private Service Edge is getting more and more deployed. But just to let you know, we're not trying to make a lot of money on Private Service Edge per se. Most of the money comes from actually subscription fee of users. But what Private Service does is it allows you to implement zero trust for on-prem on the network users. And since people, when they come back to the office, they need to make sure that users and applications are not on the same network. That's where Private Service Edge comes in. We charge a reasonable amount for it, but the biggest amount comes from making sure every user, whether they're in the office or at home, they actually use ZPA. That's really how we look at its growth, and we are very pleased with it.

And also the second factor to drive that would be as more and more applications are in public cloud, like Azure and AWS, they all need to go through ZPA for that. That's where I made the statement in the past that I expect it's a matter of time when every user for our customers will have ZIA, ZPA and ZDX. Three together gives them fast, secure and reliable experience.

Gregg Steven Moskowitz - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

All right. That's great. And certainly well suited for hybrid work environment.

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

Yes. Thank you.

Operator

And our next question comes from Shaul Eyal from Cowen.

Shaul Eyal - *Cowen and Company, LLC, Research Division - MD of Communications, Security and Infrastructure Software and Senior Analyst*

Congrats on the ongoing strong performance. Quick one on my end. Jay, can you talk about the progress you're seeing on the federal front?

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

Yes. On the federal side, we actually are doing quite well. It's growing much faster than our total overall revenue. We expect to benefit from infrastructure plan or during this fiscal year. And that the EO directive that came from Biden administration early on, it's actually helping. We're seeing that federal bodies are actually, should I say, speeding up some of the projects that are stuck out there, it needed 2 things: it needed the right zero trust architecture, which we have; then it needed FedRAMP certification, and we have both of those things. We're the only security vendor with 2 highest FedRAMP certification. And we have a sizable team.

Remo, can you give a color on where we are on...

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

Yes. So for federal, in the quarter, we were mid-single digits of total new sell business. As Jay mentioned, we've made significant investments in the federal sector. The certifications are significant. And as Jay mentioned, we're the only security vendor with the 2 highest FedRAMP certifications.

In addition, we've got a strong team in federal and good partners. So federal takes time, but we feel that we're well positioned in federal. Our pipeline is increasing, and our engagements are very good.

Operator

And our next question comes from Keith Bachman from BMO.

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

Jay, I wanted to ask you about competition, and I want to come at it in a little bit different way and break it in a few parts. In terms of greenfield activities, how often are you seeing -- because of your different architecture, are you essentially doing one-to-one negotiations? Or part B, how much are you seeing the same or different participants? And what I mean by that is there's -- I think most investors assume Palo Alto, but there's also a Cloudflare, Netskope, Menlo, iBoss. Is the field when you're negotiating on particularly new work, is it getting more crowded or less crowded? And then finally, does pricing enter into discussion, particularly for new work?

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

It's a good question. So first of all, as we have driven top-down with CIOs for transformation, it's not typically we go in and say, I will replace this box. I'll replaced at these boxes. It's rarely a one-on-one replacement type of stuff. So we end up driving the agenda from that point of view. And it used to be that for ZIA, we would show them how we can help with secure web gateway and associated products, and Blue Coat would be the starting point for replacement or another web proxy.

Then ZPA became an important piece, now more and more customers are buying ZIA and ZPA together. Now that's a different kind of players out there. So while having an expanded portfolio, when we go in and say, I can provide all access to all applications, no matter where they are, from anywhere, we have ZIA, ZPA. It just fundamentally changes that equation.

Now ZDX being part of the same thing because CIO cares about user performance. So it's not common for us to get into, what do you call it, bake off kind of stuff because it's really not a one-on-one type of replacement.

Now on the lower end of the market, we do see a smattering of players from Cisco, from time to time, firewall guys from time to time, and whatnot. And once we engage, we win. That's why we're seeing our enterprise segment, 2,000 to 5,000 users actually growing pretty significantly.

Regarding pricing. We haven't really seen much pricing pressure. By the time we show the customer, all these point products we can displace, the operational costs and the like, price becomes the least important issue for us.

Operator

And our next question comes from Joshua Tilton from Wolfe Research.

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

Congrats on the strong results. As we just think about the remainder of the year, should we expect any unusual changes to the quarterly calculated billings seasonality maybe compared to prior years as we continue to lap a very, very strong FY '21?

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

Basically, our Q2 and Q4s are our largest quarters. And we talked about the billings being in the first half 43% to 44%. And one thing to keep in mind, I mean, the numbers are getting big. So as numbers get bigger, just keep that in mind related going forward related to your expectation.

Operator

And our next question comes from Erik Suppiger from JMP Securities.

Erik Loren Suppiger - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Congratulations. On the $5 billion commitment, can you -- I understand that you just see within your installed base opportunity to get there. But can you talk a little bit about how you view the timing? If you don't want to set a time frame, can you give us some context in terms of kind of aspirations for how you can build towards that?

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

Yes. I mean it's a great question. Clearly, we're going to try to get there as quickly as we can in a responsible manner. It really comes down to our execution, and it's really hard to give a time frame. We do have internal long-range plan model. And I can tell you that from my perspective and related to what I see related to our opportunity, really the opportunity's there.

The key thing, Erik, is that if we continue to have significant growth, which we had this quarter, 62% revenue growth, we will -- again, we're going to forward lean, and we'll be mindful of our operating profitability. But that's really secondary from our perspective. The comment about contribution margin and the amount that we're spending for the first year, getting new customers, that's critical for us to continue to get those customers.

The contribution margins in years 2 and 3 are 60-plus percent. This is -- I don't want to give a time frame on the call. We are driving aggressively, and we are putting growth over profitability. We'll be mindful of profitability. And the benefit that you've got with Jay and myself, we've seen a lot

of things in our careers, and we've got a pretty good idea of how things are going to kind of work out for us. And when things come up that we need to make decisions, we'll make those decisions. But all our decisions will be made to increase value for our shareholders.

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

Yes. If I may add, I see no external factors today that I'm overly concerned about. I think it's largely our execution that we need to do right to make sure our team doesn't become complacent and arrogant because of success. So hiring people and hiring the right people, right leadership in place the way we have done in the past few years, that's the focus to continue.

Operator

I would now like to turn the call back over to Jay Chaudhry for closing.

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

Thank you all for your continued support and interest in Zscaler. We hope to see you at some of the investment conferences. Thank you again.

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

Thank you.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.