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EDITED TRANSCRIPT

ZS.OQ - Q1 2021 Zscaler Inc Earnings Call

EVENT DATE/TIME: DECEMBER 02, 2020 / 9:30PM GMT

OVERVIEW:

Co. reported 1Q21 revenue of \$142.6m, non-GAAP net income of \$20m and non-GAAP EPS of \$0.14. Expects FY21 revenue to be \$608-612m, non-GAAP operating profit to be \$55-57m and non-GAAP EPS to be \$0.37-0.38. Expects 2Q21 revenue to be \$146-148m, non-GAAP operating profit to be \$11-12m and non-GAAP EPS to be approx. \$0.07-0.08.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Zscaler First Quarter 2021 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 first speaker today to Mr. Bill Choi, Senior Vice President, Investor Relations and Strategic Finance. Thank you. Please go ahead.

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

Good afternoon, everyone, and welcome to the Zscaler Fiscal First Quarter 2021 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.

Starting in fiscal 2021, we are excluding stock-based compensation-related payroll taxes in our non-GAAP presentation. The GAAP to the non-GAAP reconciliations for historical periods 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, future hiring decisions, 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 presenting at the following upcoming events: Credit Suisse Technology Conference tomorrow; UBS Global TMT Conference on December 7; Barclays Global TMT Conference on December 10; our annual Zenith Live Cloud Summit for the Americas and EMEA will be held virtually next week, and for APJ, the following week.

We encourage everyone to register and view our summit. We also invite you to attend a 1-hour product Q&A session specifically for investors and financial analysts on Wednesday, December 9. The presentations for these events will be webcast, and the links will be available on our Investor Relations website.

Now I'll turn the call over to Jay.

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

Thank you, Bill. First of all, I hope all of you and your families are healthy and safe. I'm proud of our strong results and an exceptionally strong start to fiscal '21 in our first quarter.

We delivered 52% growth in revenue and 64% growth in billings, while also generating record operating profits and free cash flow. I believe our financial results demonstrate Zscaler's pivotal role in enabling our customers' digital transformation journeys, which are accelerating at a pace never seen before.

Our visibility and business momentum remains strong, and we are pleased to increase our fiscal year guidance. I believe the market is coming to us, and we are investing across our organization to capture a significant share of a large and growing opportunity.

I would like to thank the Zscaler team and our partners for their tireless efforts and commitment to our customers' success. I'm also pleased and excited to welcome Chris Kozup to the Zscaler team as our new Chief Marketing Officer.

Let me highlight 3 factors that drove our strong performance in the quarter. One, building on our growing traction with large enterprises, we closed a record number of 7-figure ACV deals. The majority of these wins are 3-year commitments to provide the foundation for application, network and security transformation. In particular, I am pleased with our increasing wins in the financial services vertical, which is now embracing the cloud, and their Office 365 deployments have become an important catalyst for us.

Two, our optimized go-to-market engine is driving significant velocity including a strong pace of new logo acquisitions. I'm very pleased with the performance across all geos. Last year, we doubled down on our investment in our sales organization. We scaled our sales enablement team and built a repeatable and metrics-driven process, which is giving us better visibility into our business and ultimately, resulting in a strong and growing pipeline.

These efforts are also bearing fruit in 2 big ways: one, our newly hired sales reps are contributing at a faster pace; and two, our sales productivity is higher than a year ago despite a high percentage of ramping sales reps.

Three, the power of our Zero Trust Exchange platform is resonating with CXOs. Our platform is comprised of 4 key pillars, with each enabling a critical element of the transformation: ZIA to secure direct access to Internet and SaaS; ZPA for zero trust access to private applications; Zscaler Digital Experience, or ZDX, to deliver user experience or work-from-anywhere, cloud workload segmentation to protect applications.

An increasing share of our sales is coming from initial platform purchases by new customers and also growing upsell to existing customers, which is driving a record 122% net retention rate. I believe, in the current challenging environment and in the post-COVID economy, Zscaler will be the go-to platform for vendor consolidation, cost savings, increased user productivity and better cyber protection.

We are excited about our mission to make the cloud safe for business and enjoyable for users. We enable our customers to increasingly use the Internet as their corporate network and replace legacy perimeter-based security with zero trust security. As the CIO of a Zscaler customer told us, "We ended up with the security posture that's better than when we had a complex network and network security. And have a user experience that's materially better."

As we look forward to the next few years, we are focused on driving broader adoption of our 4 major cloud solutions, which together, maximize the value for our customers' digital transformation. From presales to deployment and customer success, we've built a sophisticated sales machine to sell value, and deliver measurable outcome at the CXO level.

We continue to scale our organization as the market increasingly moves our way. We will continue to build our ecosystem of technology and channel partners, which are contributing to overall sales velocity and expanding our reach across our total addressable market. Additionally, we are demonstrating our value to customers through an increased focus on thought leadership and demand generation programs.

At our recent Virtual CXO Summit series, we hosted 6 events that drew over 400 CXOs and IT leaders to discuss secure digital transformation. Many CXOs shared with me that the current work-from-home environment, while temporary, has helped them realize that zero-trust architecture is the future, and it can be implemented easily and rapidly. COVID was a catalyst in changing the mindset and shaking off inertia, resulting in a reduced need for educating customers about the value of the Zscaler architecture over legacy approaches.

Inbound customer requests have greatly increased, and we're becoming an integral part of a growing number of larger transformation projects. We continue to see more customers buying ZIA and ZPA together, which enables a true transformation with direct and seamless access to SaaS applications or applications in your data center or the public cloud.

For example, a global manufacturing company purchased our transformation bundle plus DLP and CASB for 45,000 users and ZPA for 25,000 users. Drivers for this deal were network and security transformation. They had a traditional hub-and-spoke network for 300 manufacturing facilities, which were slowing their adoption of cloud applications such as WebEx, Office 365 and Workday. A next-gen firewall vendor tried to sell its hybrid offering, but failed to meet the security and performance requirements, including SSL inspection. Interestingly, this initiative was part of a 5-year managed services RFP where all 6 system integrators and service providers bid Zscaler.

We are seeing customers increasingly migrate away from their large installed base of legacy on-prem, gateway and security appliances to pursue direct-to-cloud architecture. In one new customer win, a Fortune 50 retail customer, replaced a legacy web gateway with ZIA for cybersecurity and data protection.

This customer purchased ZIA professional bundle plus CASB, sandbox and DLP for 45,000 users. Security was a major requirement, and only a proxy architecture with SSL inspection was considered. This deal was a good example of Zscaler leveraging our tech partners, where CrowdStrike became the end point security provider and Microsoft the identity provider.

I'm very pleased with our growing success with the financial industry, where adoption of cloud is accelerating. A Fortune 100 financial services company purchased our transformation bundle with advanced DLP and CASB for 18,000 employees to overcome capacity issues with their security appliances when they deployed Office 365. Firewall-based technologies were ruled out due to strict security requirements for SSL inspection and DLP with exact data match.

As these 3 deals show, our comprehensive data protection offering within ZIA has been gaining traction as customers are concerned about data leakage with employees working from anywhere. Our new out-of-band CASB is helping us displace CASB point products and increase our deal size. The most common themes in our customer wins are to increase user productivity, reduce business risk, simplify IT and reduce cost. The Zscaler platform enables this by consolidating and eliminating point products.

Moving on to ZPA. Our customers view ZPA as the foundation for the architectural shift to zero trust access for private applications. Our platform eliminates the Internet attack surface of customers' applications, resulting in reduced business risk. ZPA is the clear market leader with proven maturity and scalability. We are supporting hundreds of large enterprises in the complex, multi-cloud environment.

Let me highlight 2 ZPA deals in the quarter. First, a global bank with headquarters in Europe needed to scale its remote access after the legacy VPN and VDI became a performance bottleneck and a security concern. Their IT team had to cope with over 4,000 trouble tickets per month from users having issues with their connectivity. This customer purchased ZPA for over 100,000 employees to deliver a seamless, always-on experience. While the immediate objective for this deal was to replace legacy VPN, ZPA was selected to implement zero trust architecture by establishing an application-level policy where users connect to specific applications, not to a network.

In another deal, a Fortune 500 tech company purchased ZPA to accelerate M&A integration. After 1 year, 6,000 employees at the acquired division were still using 2 laptops with separate VPNs to 2 separate networks. Integrating 2 complex corporate networks can take 12 months or more. ZPA is the elegant solution to this problem.

Without having to connect to corporate networks, ZPA provides secure application access across both companies in weeks. Purchasing our high-end ZPA offering, the customer is leveraging ZPA's multiple identity support to accelerate deployment. The customer plans to use ZPA as a standard solution for future M&A, a core strategy for growth at this customer. In addition to ZPA, the customer purchased ZDX for 6,000 users to quickly troubleshoot issues and increase employee productivity.

To close my business review, I will touch on some early success with our new emerging products. There is an accelerated market shift towards work-from-anywhere, which aligns with our platform and emerging products like ZDX. We had a number of ZDX wins in the quarter, including an upsell with a European bank for 40,000 employees. This customer has ZIA for all employees, and it was frictionless to turn on ZDX to get end-to-end visibility and resolve performance issues.

We also had wins for our CSPM offering, giving us additional opportunities for growth. Our emerging products are increasing our overall competitive differentiation. For large enterprises who want network and security modernization, we believe we are the only cloud-native, multi-tenant platform that meets their needs.

Zscaler is the largest in-line cloud security platform in the world. We are processing more than 140 billion transactions daily, while preventing 7 billion security incidents and policy violations. Deployed across more than 150 data centers, our Zero Trust Exchange platform was built from the ground up for the secure access service edge or SASE framework. Building a cloud-native architecture with full security and minimal latency is very hard, and running a massive in-line global cloud with 5 nines of availability is an order of magnitude harder.

As the world moves to SASE framework and zero trust architecture, some of you have asked about competition and why others can't build a cloud-native platform like Zscaler? Well, the answer lies in the architecture, which is like the foundation of a building that supports everything.

Our foundation is a multi-tenant architecture built from the ground up for in-line traffic inspection. It delivers over 20 key security solutions, including antivirus, cloud sandbox, cloud firewall, DLP, advanced threat prevention and SSL inspection at scale.

That's extremely hard to build and complex to operate as a cloud service without compromising user experience. It is like the difference between building a simple SaaS application versus a highly complex SaaS platform like an ERP. How many cloud-native ERP systems are you aware of since NetSuite started 2 decades ago? While single dimensional SaaS applications are easy to develop, multidimensional platforms like an ERP and Zscaler are much harder to design, build and operate.

With our business momentum, we are also demonstrating that our strategic sales process and world-class execution are important competitive advantages. First, our consultative sales model identifies the value we can drive for the customers and enables them to fully realize the benefits of digital transformation. This strategic sales process requires top sales talent. I believe we have the best sales team, top to bottom, and we are hiring at a rapid pace. We are now a destination for top talent around the globe.

Second, we are deepening our ecosystem of technology partners, which are contributing to deal wins and adding leverage to our sales model. In addition to our ongoing partnership with Microsoft and CrowdStrike, we have now extended our strategic partnership with VMware to integrate with their SD-WAN solution, and to partner for joint go-to-market engagements. I believe we've built a go-to-market engine that will generate long-term sustainable growth.

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 2021. Revenue for the quarter was \$142.6 million, up 13% sequentially and 52% year-over-year. ZPA revenue was 13% of total revenue.

From a geographic perspective, we have broad strength across our 3 major regions: Americas represented 51% of revenue; EMEA was 39%; and APJ was 10%. Revenue exceeded our guidance due to stronger-than-expected deal activity as the value proposition of ZIA and ZPA is increasingly becoming clear to customers.

Turning to calculated billings, which we define as the change in deferred revenue for the quarter plus totally recognized in that quarter, billings grew 64% year-over-year to \$144.7 million. As a reminder, our contract terms are typically 1 to 3 years. We primarily invoice our customers 1 year in advance.

Remaining performance obligations, or RPO, which represents our total committed noncancelable future revenue, was \$864 million on October 31, up 56% from a year ago. The current RPO is 54% of the total RPO. We had a healthy mix between new and existing customers with new customers contributing over 50% of new and upsell ACV.

Our strong customer retention, ability to upsell, have resulted in a consistently high dollar-based net retention rate, which is 122% compared to 120% last quarter and a year ago. As we have highlighted, this metric will vary quarter-to-quarter. While good for our business, our increased success selling bigger transformation bundles, selling both 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 122% is outstanding.

Total gross margin of 81% increased 2 percentage points sequentially and was comparable on a year-over-year basis. The sequential improvement was driven by migrating most of the ZPA infrastructure to our data centers during the quarter as well as timing of expenses.

While we are pleased with the gross margin performance, I would like to remind investors that a number of our new emerging products, which include ZDX, workload segmentation and CSPM, will be running in the public cloud until we scale them into our own data centers in the future. While in the public cloud, these products will have lower gross margins than our core products. As a result, we expect gross margins to be approximately 79% for the full year in fiscal 2021.

Turning to operating expenses, our total operating expenses increased 11% sequentially and 33% year-over-year to \$96 million. Operating expenses as a percentage of revenue improved by 10 percentage points from 77% a year ago to 67% in the quarter. Sales and marketing increased 12% sequentially and 31% year-over-year to \$64.2 million.

The year-over-year increase was due to higher compensation expenses and investments of building our teams and go-to-market initiatives, offset by lower T&E with our employees working from home. We've been very successful in hiring and onboarding remotely. And we're accelerating our sales and marketing hiring throughout this fiscal year.

R&D increased 8% sequentially and 42% year-over-year to \$20.9 million. The increase was primarily due to continued investments in our team. G&A increased 9% sequentially and 29% year-over-year to \$10.9 million. The growth in G&A includes investments in building our teams, compensation-related expenses and professional fees.

Our first quarter operating margin was 14%, which compares to 4% in the same quarter last year. Net income in the quarter was \$20 million or non-GAAP earnings per share of \$0.14.

We ended the quarter with over \$1.4 billion in cash, cash equivalents and short-term investments. Free cash flow was positive \$42 million in the quarter, which is a meaningful improvement from \$11 million in the prior quarter and \$9 million in the year ago quarter. The strength in free cash flow was driven by strong receivable collections and better underlying profitability in the quarter.

Now moving on to guidance. As a reminder, these numbers are all non-GAAP, which excludes stock-based compensation expenses and related payroll taxes, amortization of debt discount, amortization of intangible assets, facility exit costs and any associated tax effects.

For the second quarter of fiscal 2021, we expect revenue in the range of \$146 million to \$148 million reflecting year-over-year growth of 44% to 46%; operating profit, \$11 million to \$12 million; other income of \$800,000, net of interest payments on the senior convertible notes; income taxes of \$1.25 million; and earnings per share of approximately \$0.07 to \$0.08, assuming 144 million common shares outstanding.

Due to better-than-expected first quarter performance and our strong pipeline, we're increasing our full year fiscal 2021 guidance for revenue, billings and profit. For fiscal 2021, we now expect revenue in the range of \$608 million to \$612 million or year-over-year growth of 41% to 42%; calculated billings in the range of \$755 million to \$765 million or year-over-year growth of 37% to 39%; operating profit in the range of \$55 million to \$57 million; other income of \$2.7 million; income taxes of \$4.5 million; and earnings per share in the range of \$0.37 to \$0.38, assuming approximately 145 million common shares outstanding.

We continue to see the market coming to us, and we remain committed to investing aggressively in our company behind the growth in our business. We have a highly efficient business model and are making investments across the organization today in order to capitalize on the large opportunity ahead of us. While we'll balance growth and profitability, growth will continue to take priority considering our significant market momentum.

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

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

Thank you, Remo. Coming off a record Q1, we're seeing the market coming to us and validating our vision for zero trust cloud-native platform. We believe we are in the early innings of a significant market opportunity to enable secure digital transformation.

The value proposition of our zero trust platform is resonating with customers, and we're seeing this reflected in our business momentum over the last 3 quarters. We've scaled our go-to-market engine, and are delivering world-class sales execution, which we believe will drive sustainable long-term growth.

Thank you for your interest in Zscaler. We hope to see you at Zenith Live next week. 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 Sterling Auty from JPMorgan.

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

So Jay, you mentioned financial services a number of times in terms of the traction that you're seeing. Where would you say -- or where would you characterize the penetration in that industry? How big is it as a percentage of revenue? And perhaps, are we seeing some continued momentum as maybe it catches up to other industries?

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

Sterling, thank you. Financial services have been slow in embracing cloud, but now they are all opening up. They are embracing cloud and Office 365 is becoming the catalyst. To make Office 365 work, there had to be some transformation in the network and security. And we have done so much work with Microsoft to make sure Office 365 can be enabled, securely delivering fast user experience.

So that's becoming our #1 application to get into that space, then it's expanding from there. Remo, you want to add anything to it?

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

Yes. So I mean the 3 top verticals that we have are financial, manufacturing and health. But we're broad across all verticals. So there's really no vertical that's dominant. So we haven't given out the percentages of each of those verticals, but we're very broad.

Operator

I show our next question comes from the line of Matt Hedberg from RBC Capital Markets.

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

Congrats on really strong results here. Jay, I'm curious, the conversations with CIOs obviously are showing up in numbers, really the importance of Zscaler.

I'm curious, though, how are those conversations in the tone of a vaccine. I mean, to me, it would feel like a lot of the momentum has sort of cemented the change. But I'm sort of curious on sort of post vaccine, what do you think the tone of buying behavior is in your target customer?

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

Yes. Lots of questions are being asked pre-COVID, post-COVID and whatnot. If you look at our record pre-COVID, we had very good growth. Our business is accelerating. It's driven by acceleration in digital transformation, not COVID. COVID was a catalyst in shaking of inertia. The change in mindset has accelerated demand for zero trust.

When I talk to CIOs they tell me, we did not realize how important it was to do transformation, being able to embrace cloud for collaboration, for security and the like. So they are really moving faster than they did before. And so momentum to our business really has picked up because it has highlighted the limitation of the old legacy and old network, and need to transform. And this transformation works.

So we are pretty bullish. We think even after a vaccine, our business will keep on accelerating.

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

Yes. One follow-on with Jay, is that we take a look at our pipeline, our pipeline is accelerating. So we're seeing an acceleration in our pipeline, and that's across the board, both in ZIA and ZPA.

Operator

I show our next question comes from the line of Saket Kalia from Barclays.

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

Okay. Great. Jay, maybe for you, the question is, do you have any statistics or just general thoughts on how many of your engagements are competitive, meaning a competitive bake-off process, versus perhaps being brought in by a service provider where there really isn't a competitive process? Does that make sense?

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

Yes. Saket, thank you. Your question reminds me of my days at air defense at CipherTrust, when I used to sell security appliances, and we used to have lots of bake-offs, which box is faster, with big box is cheaper.

At Zscaler, we're all driven by transformation. Transformation is not a box you sell. It actually starts with the CIO-level discussion to help them enable the applications to network to security all of that. So most of our deals at a higher end, at the large enterprise level, aren't really competitive much at all. When you come to lower end, we do see some of the competition.

But bake-offs are rare. In fact, I highlighted a win in my prepared remarks, where -- even though there was an RFP that we won with managed services partners, all 6 SI and SPs bid Zscaler. Okay. And we're very proud of it. That's because the customers and the SI/SP channel understands that you can't take typical legacy boxes and try to make them do cloud transformation.

So when it comes to competition, I think we got some big, big lead. Unless someone tries really purpose-built something, have a good architecture, we'll maintain this lead.

Operator

I show our next question comes from the line of Alex Henderson from Needham.

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

It's kind of hard to decide what's more to like in your numbers, the margin expansion or the accelerated top line. Good job.

I wanted to look forward a little bit, if I could, with you, talk about machine-to-machine environments, domain to domain, and what you're doing on that front. It seems pretty clear to me that as we see more and more modern applications coming out that it's not just the cloud-direct architecture that's important, but actually the cross domain traffic.

Can you talk a little bit about how you participate in that, and what you're doing to secure it?

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

Yes. The 2 aspects of your question. One is machine-to-machine or app-to-app communication within a public cloud. And the second part is, across clouds, maybe Azure East and Azure West type of stuff.

While companies are trying to do this, doing traditional network security way to doing virtual firewalls and whatnot, we have taken zero trust approach to the public cloud, where we can have app-to-app communication. And where we have the zero trust, a switching technology, we needed identity technology, identity for various apps would be built using the acquisition we did a few months ago for a company called Edgewise Networks.

So with that, we can do, within the data center, machine-to-machine communication without doing network segmentation and achieve app segmentation. And we can also go across clouds.

But having said that, that's a young market, that's a nascent market. It needs some education. So it will take some time for the market to grow. But if we are well positioned to go in early and get positioned there, that's a big area of investment for us.

Operator

Our next question comes from the line of Walter Pritchard from Citi.

Walter Herbert Pritchard - *Citigroup Inc., Research Division - MD & U.S. Software Analyst*

I'm wondering, Jay, on the cloud workload protection market. There's -- you're in that market, clearly new products for you. A number of players are in that market. Could you help us understand what you're seeing in the early deals and sales cycles there? Who's the competition? Is the buyer the same as the buyer that you've generally been selling to? And the differentiation you have there when you're competing in that market kind of as maybe a starting point or when it's a pretty competitive situation?

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

Yes. Thank you. Good question, Walter. Cloud protection is not one piece, but multiple pieces, and they're in different stages of the market. CSPM is one area where we are actually competing well in that. So fairly well understood and fairly simple market.

Your cloud traffic from Azure AWS workload going to Internet, which most of these workloads do. You can try to do some virtual firewalling and whatnot, which doesn't work. Or you can simply send it through Zscaler Internet Access by simply pointing traffic. We're very well positioned in that part of the segment.

Then the third segment is what Alex asked about, machine-to-machine communication and whatnot, app to app. That's a younger area, and that's where we -- we see some young players, some start-ups in the game. But generally, the market being so young, there's not a whole lot of competition in that space, and only selected customers are kind of trying to pursue that.

I see many customer who said, I tried to do network segmentation doing this and this, it hasn't worked. Had tried this. And the buyer is somewhat different, and you said, the 2 types of buyer for cloud protection. One is actually the IT organization that's actually building the application, the dev ops team, because they are actually driven by application, and they often ignore security.

Then CSO comes and says, wait a second. You can do things fast, but you must put security in place. So we end up dealing with 2 parties: CSOs, we already deal with; and dev ops party that's a little bit new for us to get to know and learn.

Operator

I show our next question comes from the line of Tal Liani from Bank of America.

Tal Liani - *BofA Merrill Lynch, Research Division - MD and Head of Technology Supersector*

Great quarter. I want to -- my question is more higher level. I'm trying to understand the expectations for next year.

So if I look at your guidance and I add a little bit more for beat and raise, which you've done in the last few years, you're going to be staying in the same growth rate we have seen this year. And I'm trying to get the qualitative part of -- you have older solutions and you have newer markets.

How do you view the growth rate in older solutions like ZPA? How do you view your level of competition there, new customer -- ability to gain new customers versus grow with existing customers?

And then same question about your newer areas. What are the driving factors? I'm trying to understand how to build the spreadsheet for next year when it comes to the various solutions that you're offering.

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

I mean it's a very good question, Tal. Think about the 4 key solutions that I talked about. ZIA has been a workhorse, has been growing rapidly. But in spite of that, if you look at our penetration in Global 2000, we are just under 25%. And there's a big market. Majority of the market's sitting open out there. In fact, there's still a sizable market of legacy web proxies like Blue Coat that's to be removed. And we are taking more and more part of that.

So that's kind of one piece. And ZIA is not one product. As you know, ZIA is a portfolio of several offerings. And more and more customers are buying either bigger bundles like Transformation to start with or they're moving up from business bundles or professional bundles. So that's a pretty sizable thing on ZIA. We are nowhere close to leveling off at all.

ZPA, relatively younger, only about 4 years old, has gone from 0 to about 30% of the new business in that range. And if you look at our customer base, just about in the mid-30 somewhere, 30% or so of the Global 2000 ZIA customers have ZPA. So even in our installed base of ZIA there's a big market out there. So we think these 2 big proven product portfolios, or call them 2 big pillars, there are plenty of room for opportunity.

And in ZDX, Digital Experience, is becoming an interesting product. It's a new product in a new area because as you go on the Internet, no one has any meaningful offering to let someone know end-to-end response time. We expect pretty good growth from it. One day, we expect almost every user will have ZIA, ZPA and ZDX. That's the way we are driving towards.

The fourth area is new area, the cloud workload, the data center. I think that market will take some time to mature. As Remo has said, we are not really putting tons of revenue in some of the new areas. But you shouldn't think about CASB-type of things as new products. I mean they're part of -- they're new, but they're part of ZIA portfolio. They automatically attach to our ZIA bundle.

In the same way, we are seeing browser isolation picking up, which either goes with ZIA or goes with ZPA. But plenty of room in all areas. And I always said to my sales leaders, we have lots of product to sell. Let's scale our sales organization.

And that's what we are focused on. We are focused on growing go-to-market, which is doing very well. So excited for next year. Remo, did I cover everything?

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

Yes. I mean, it's a great question. I mean you take a look at the percentage of customers that have transformation, we've indicated was 49% in our last call in July. And it's gone up this quarter, has continually gone up.

ZPA, 13% of revenues. So big opportunity with their installed base for that and our emerging products. We had an acceleration in growth of new customers in Q1 versus the growth in Q4. So we're seeing momentum. We're seeing deal sizes getting bigger. We're seeing the need for transformation on a broader scale that as Jay mentioned, driven by COVID.

But COVID started the visibility. What we're seeing right now is the realization on the part of CIOs and others and companies at high levels, who understand that the legacy architectures they have got are really not the right architectures. That's what's driving the business for us. It is that.

In addition to that, proof points that we have, pipeline, interest, productivity. Just -- there's -- you feel the momentum. We feel momentum that's coming our way. The -- what it comes down to at the end, it comes down to the people. It comes down to the execution. The market is there. The product is there. The vision is there. And I believe the people are there also.

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

And I think in the past 3 quarters, we had done an amazing job in scaling our go-to-market, which was the last piece we needed to scale. And we're very -- feeling very good about it.

Remo E. Canessa - Zscaler, Inc. - CFO

Agreed.

Operator

Our next question comes from the line of Hamza Fodderwala from Morgan Stanley.

Hamza Fodderwala - Morgan Stanley, Research Division - Equity Analyst

Jay, a question for you. You mentioned earlier that COVID has been a catalyst for Zscaler more longer term in terms of the market coming to you in terms of customers coming to you for cloud transformation deals as well as talent coming to you as well. And you mentioned a really strong hiring environment for you guys.

I'm wondering where are these newer hires coming from. Are they coming from some of your competitors within the security space? Or is it coming from outside the security space? Can you give us any sort of color on that.

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

Yes. So first of all, I think our hiring is happening at a faster pace than we had even expected. So very good actually. Remember about a year or 2 years ago, we used to say we are behind in hiring sales reps. Remo, you recall that? All that has passed. I think probably our brand is helping, well-known out there. Also, sales leadership has put a deep and wide leadership in place.

And then, getting more specific to answer your question, if you look at 2 broad areas of sales hiring even though there are multiple areas beyond that are RSMs. Typically, sales reps are not coming from box selling background. Majority of our sales reps come from solutions selling SaaS-type of background because our sales is very different from than a typical box security selling. So they come from generally software and SaaS-type of companies by and large, that's number one.

On the technical side, the SE side, we generally hire from someone that comes with a little bit networking and security background because they need domain expertise, which takes a little longer. But we are getting tons and tons of interest. And we are trying to stay selective when we hire, but we are pretty much tracking our progress on hiring very well.

Remo E. Canessa - Zscaler, Inc. - CFO

Yes. On a net hiring basis, one of the things I'd like to call out, we had a record quarter for net hires in the quarter. We hired over 260 people. The quarter before it was 200. The quarter before that, it was 150. And the quarter before that, it was 100.

Of that 260, about 60% were in the sales and marketing area. We had a record quarter for quota-carrying sales rep hires in Q4. We had a comparable number in Q1. We are accelerating the hiring even more than what we had anticipated on our last call given what we're seeing.

Operator

Our next question comes from the line of Patrick Colville from Deutsche Bank.

Unidentified Analyst

This is [Dan Kyle along] for Patrick. Congratulations on a great quarter. I just wanted to ask on the pricing environment. Obviously, it seems really strong, but I'm just curious if you guys could comment on how prices have trended.

And then, obviously, really impressive retention rate. So I'm curious how much of that is adding new products on versus expanding more into the organization, if that makes sense.

Remo E. Canessa - Zscaler, Inc. - CFO

Yes. So it's a comparable pricing environment. Our price per user did go up quarter-over-quarter. Related to what drove the net retention rate, as Jay mentioned, the emerging products are not significant impact. So it's more of the existing products, the movement to transformation as well as ZPA, which is what drove the increase in net retention rate.

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

Yes.

Operator

Our next question comes from the line of Brian Essex from Goldman Sachs.

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

Congrats from me as well on a great result in the quarter. Jay, I was just wondering if you could maybe give a little bit of color on the sales force and the maturity of deals that you're seeing. I think in your 10-K, it looked like you -- customer growth was just over 15%. But it sounds like deals are getting larger, as you noted, record number of 7-figure ACV deals.

Can you maybe help me understand what is the -- what factor is the maturity of the sales force playing into the type of deals that you're seeing. How much is new customer versus expansion of the -- expansion into your installed base or better penetration into your installed base. And how do you see that maturing throughout the rest of the year?

I know that you've noted previously that the elevated hiring of last year should drive better growth in the back half of this year. Is that accelerating? Just to maybe get a little bit of color in terms of the level of confidence we have for growth through the back end of the year based on the deal activity and sales force maturity.

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

Yes, Brian, well, that's quite a few questions. So let me give a piece at a time. Sales force maturity, right? Since Dali joined us, we spent about 3.5, 4 quarters to make sure we bring in a systematic and disciplined sales process, sales enablement and sales metrics to understand the business leading indicators and all that stuff, plus putting a number of leaders in place.

So you ask me, what do I think about the maturity of the sales organization? I say, extremely happy, very good about it. Because having that in place drives the rest of the stuff. So very comfortable. And it's because of that comfort, we are accelerating, hiring more and more salespeople in the field.

Next question's related to deals, customers, new customers, customer growth. I think if you look at one number holistically that out of whatever, 4,500 or 4,800, whatever those customers are, those percentages will be misleading because there's some small customers, some large customers, we need to get to a level where we start kind of looking at proper segmentation and growth within segmentations.

We -- our big focus traditionally has been large enterprises. And we have done extremely well that among the penetration we are doing in those customers in terms of percentage. And in terms of the deal, the ARR we're having, those customers is actually going up very well. We're very pleased with that. And as I finish, I'll let Remo talk about some of those numbers.

And then we also expanding more into the lower enterprises, so to speak. I think over time, we'll give you more color, so you can start computing the growth pattern. But if you look at the segment, we are now getting more focused on 2,000-user to 10,000-user segments because we already got the largest segment, over 10,000, and it's pretty well covered, and we are getting great wins out there.

So there's a big market for us to come downstream and expand as well. Remo, you want to add more?

Remo E. Canessa - Zscaler, Inc. - CFO

Yes. I mean the -- Jay is absolutely correct. The ARR per customer is definitely increasing. One of the ways we break it out is customers with greater than 3,000 users, we're over \$450,000 ARR per customer, which is up year-over-year, it just keeps on going up.

New customer growth, we've stated, it's within the range or historical range of 50%, 60%. As I've mentioned before, we had an acceleration of new customer growth in Q1.

Also, the comment about sales productivity, the thing to keep in mind, which is really encouraging, is that significant majority of the RSM headcount increase occurred in the second half of fiscal '20. Also, the comment that I made about Q1, that the hiring that we had for RSMs in Q1 was comparable to our record quarter in Q4. And our sales productivity on a year-over-year basis in Q1 was up.

Those are all good indicators from my perspective and give me confidence that things are looking strong for the company as well as what we've put in place, the structure, the organization. I can -- I've been around for a long time. And I've seen a lot. I have never seen anything like we've got here at Zscaler with our go-to-market, quite frankly.

Operator

I show our next question comes from the line of Andrew Nowinski from D.A. Davidson.

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

Congrats on a great quarter. I just wanted to ask about the partnerships. So you announced a new partnership with VMware, and you've always had a very strong partnership with Microsoft. So I'm just wondering if Microsoft contributed to the record number of 7-figure deals you had in the quarter. And how you're thinking about the new partnership with VMware.

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

So let me start with VMware. VMware has been a good partner for us. The portfolio of SD-WANs, if you look at SD-WANs, we have always said that SD-WAN is a good complementary area for us. And we have been actually securing some very, very large SD-WAN deployments out there. And it was natural for us to team up with VMware.

So what did we do? We had done integration so those SD-WANs can be deployed a lot more easily with a single click. And -- but more exciting than that, we are actually working them on -- with them on a number of joint go-to-market initiatives. Our salespeople are kind of doing joint account planning, and we were a number of market initiatives. So we think that will be a good partnership for incremental revenue for both our companies. That's on the VMware side of it.

Microsoft, you know that partner goes for several years, it started with helping Office 365 deployments with great user experience, single-configuration type of deployments. And then expand it beyond to Azure AD, to Azure Access, to Azure Sentinel and even to end point areas.

Microsoft is pushing now Office 365 in financial services because they have been the late adopter of Office 365, and that's particularly helping us because those large companies want to make sure this deployment goes well, and Zscaler is the go-to partner in those deployments. So Microsoft is helping -- or we are helping Microsoft and they are helping us in these financial services customers.

I'm not sure if any of the specific deals this quarter were impacted by Microsoft. But in large companies, there will be large deals where we'll be working together with Microsoft to close those deals.

Remo, did I miss something?

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

No. I think you got it.

Operator

I show 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*

Jay or Remo, I wanted to hit back on some of the commentary in the prepared remarks around ZPA, ZPA deployment. I mean, we've gone from 0 to mid-teens percentage of your revenue now derived from ZPA. So I'm wondering, and appreciating some of the bigger picture factors that are driving the demand for ZPA, I'm wondering if you can be more specific about where some of the budget dollars are coming from that are getting reallocated in your favor for ZPA adoption?

And to what extent is there more expansion runway here that hasn't necessarily been pulled forward because we've all started working from home overnight over the course of this year? So just getting some more specificity around where sort of the ZPA budgetary dollars are being earmarked away from in your favor.

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

So if you think about it, while a lot of stuff we do are transformation, generally, there's an entry point for each area. That's the easiest one from a budget point of view. So VPN ends up being the entry point, that's the first point. But as we have said many times, ZPA is being bought for zero trust implementation.

In the past 1 year, I have seen interest in zero trust gone big, big time. And it's a specific architecture where you don't connect users to the network. So any product, that's VPN related, whether it is an on-prem product or it's a cloud-based VPN, it's still VPN and doesn't really get counted as a zero trust offering.

So it starts with taking out the VPN budget. But more importantly, all the wins we are having are being done to make sure they can also do zero trust access, to not only your data center, but also do cloud applications sitting in Azure or AWS. And more and more customers want to implement zero trust even when you are in the office.

So we don't think the ZPA wins are coming because some of the deals are being pulled forward. We think COVID is actually accelerating and showing the need for zero trust, being able to access anything from anywhere. And we see this acceleration continuing. So very confident about that, the ZPA projection, and that's reflected in the pipeline we're seeing for ZPA. Remo?

Remo E. Canessa - Zscaler, Inc. - CFO

Yes. With -- for new customer business, you take a look at what percentage of our new customers are buying both ZIA and ZPA? It's in the high 30% range. That's up from Q4. It was low 30% range. That's what's resonating. That is the digital transformation occurring that we see.

So it's -- again, the things that we're seeing internally related to what's occurring in the market indicates that digital transformation is top of mind for many IT professionals, and Zscaler's got a great solution -- or the best solution for them. And so that's giving us confidence.

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

Yes. If I may say, the combination of ZIA and ZPA ensure that any user can work anywhere, office, home, wherever, and that's where the zero trust comes in. It's the same user experience, same level of security, same level of policy. That's what CIOs are buying.

Operator

I show our last question comes from the line of Catharine Trebnick from Colliers.

Catharine Anne Trebnick - Colliers Securities LLC, Research Division - VP & Senior Research Analyst

Congratulations on a phenomenal quarter. You had said in your prepared remarks that you had done well in the 3 verticals, finance, health care and manufacturing. But it seems like the federal government is a pretty big greenfield for you in 2021. And can you describe or give us some background on what you're doing to prepare to do well in that because they're also moving to Office 365, similar to the financial folks -- space.

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

Yes. Catharine, thank you. Federal is a big opportunity for us. And our business is making good progress there. Our market -- we have a sizable team in place now. We have some very good FedRAMP certifications. And we've got a growing pipeline. In '21 and beyond, we expect federal to be a bigger part of our business.

Remo, do you want to give color of where it is now?

Remo E. Canessa - Zscaler, Inc. - CFO

Yes. Yes. Federal in Q1 was mid-single-digit of our new and upsell business. And as Jay mentioned, we're very pleased with the progress of our federal and see that as a substantial opportunity going forward.

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

All right. So I think we're done with the questions. And I would like to say thank you for your interest in Zscaler. We hope to see you at Zenith Live and upcoming several investor conferences that we are participating in. Goodbye.

Remo E. Canessa - Zscaler, Inc. - CFO

Great. Thank you.

Operator

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

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