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PRESENTATION

Operator

Welcome to the Zscaler Third Quarter Fiscal Year 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question-and-answer session. In the interest of time and fairness, we ask that you please limit yourselves to 1 question. You may get back in the queue as time allows. (Operator Instructions) As a reminder, today's program is being recorded. And now I'd like to introduce your host for today's program, Mr. Bill Choi, Senior Vice President of Investor Relations and Strategic Finance.

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

Good afternoon, everyone, and welcome to the Zscaler Third Quarter Fiscal Year 2023 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 objectives and outlook, our customer response to our products and our market opportunity. These statements and other comments are not guarantees of future performance, but rather are subject to risk 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. I would like to inform you that we'll be attending the following upcoming events in June. Bank of America Global Tech Conference in San Francisco on June 7, Cantor's Security and Infrastructure Conference on June 9. And we will also host an investor briefing focused on our latest innovations at our Zenith Live Conference on June 15.

Now I'll turn the call over to Jay.

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

Thank you, Bill. We delivered strong third quarter results with all financial metrics above the high end of the guidance we provided last quarter. On a year-over-year basis, revenue grew by 46%, billings grew by 40% and current billings grew by 44%. Our new business grew significantly across various industry verticals, and we had approximately half of our revenue come from outside the U.S. We have a strong and loyal base of customers with gross retention rates in the high 90s. We have a disciplined approach to growth.

And once again, our operating income more than doubled on a year-over-year basis. With operating margins now exceeding 15%. While we continue to operate under tighter economic conditions, I believe the comprehensive functionality of our Zero Trust Exchange platform, our strong execution and our customer-first approach will enable us to navigate this macro backdrop and deliver on our guidance. Our consultative sales process enables our account teams to adapt to the changing business environment and stay close to our customers, especially at the C level.

We are partnering earlier with CXOs to jointly create compelling CFO ready business cases that have clear ROI and payback periods. As our Q3 results demonstrate, this high-touch engagement is helping get deals across the finish line. our go-to-market engine enables us to close many large multiyear, multiproduct deals. We are providing increased guidance for the full year, which we believe balances our business optimism and macroeconomic uncertainties.

A few quarters ago, we noted that customers were increasingly scrutinizing their projects and budgets due to macro conditions. We're seeing this elevated level of scrutiny continue in Q3. Nevertheless, we see high priority initiatives still moving forward. In my conversation with hundreds of IT executives, cybersecurity remains their #1 IT priority. Traditional network security based on firewalls and VPNs cannot handle the complexity of safeguarding enterprises in what has become a work from anywhere world given the explosion in ransomware and high-profile data breaches, IT leaders are looking to phase out castle-and-moat security to adopt Zero Trust architecture.

Moreover, C-level leaders from around the globe are telling me that the technical debt of the legacy network and security point products impedes progress and slows down business operations. Our business value message is resonating with customers. Our Zero Trust Exchange offers better security and user experience while substantially reducing cost and IT complexity compared to legacy networking and security. By consolidating point products, and embracing Zero Trust with Zscaler, our customers are modernizing their security and increasing productivity, which gives them the competitive edge they need to succeed in today's rapidly evolving business environment.

We also partner with many tech leaders to deliver easy, jointly integrated solutions for customers, which increases our business value and create go-to-market leverage for us. Our current marketing campaign called Beyond The Perimeter is a great example of the successful field collaboration with our tech partner, CrowdStrike, that is increasing our pipeline. In today's environment, our strategy is to double down on customer success. From presales to deployment and customer success management, we have built our organization to deliver measurable outcomes at the CXO level. We made a number of investments in customer success services, technical account managers, partner services and certification of partners, which together will help our customers move faster towards realizing business value.

We now have 400 customers with greater than $1 million in ARR, including over 35 customers exceeding $5 million in ARR. In Q3, our new logo business grew approximately 20% year-over-year. Our proven experience at scale makes us the partner of choice for customers pursuing the Zero

Trust security journey. We have a blueprint for delivering greater value, which drives strong upsell. Approximately 60% of our new business came from existing customers, and our net retention rate has again exceeded 125%.

Happy customers buy more and our Net Promoter Score of over 70 is a testament to our strong relationship with our customers. As we have indicated before, we have a 6x upsell opportunity with our existing customers for protecting their users. Our engineering team is innovating at a rapid pace and has expanded our comprehensive platform from securing users to securing workloads as well as securing IoT and OT. As I mentioned before, customers are increasingly buying Zscaler for users, which bundles ZIA, ZPA and ZDX, together. Let me highlight one such platform deal in the quarter. In an exciting upsell win, a fast-growing global bank in APJ upgraded to Zscaler for users bundle for 150,000 users after deploying ZIA last year.

With this upgrade, this customer is significantly reducing time to open new branches by 50% and eliminating the need for firewalls and MPLS network services. We are now a strategic partner to them as they continue to expand their footprint and transform into a cloud-centric organization. This customer said, it is the first time they have seen a security vendor that understands the business needs and aligns its solution to address them. With this latest purchase, this customer's ARR surpassed $10 million. This is also an example of the geographic diversity of our business outside the U.S.

Today, we serve 8 out of the 10 largest financial services and diversified insurance companies in the world outside of China. Over the past few quarters, I observed that analysts and investors often equate ZPA with VPN replacement. This is simply not true. ZPA replaces the entire inbound DMC and ZPA is often purchased for all employees. In fact, over half of our ZPA customers have purchased ZPA services for all employees hence, delivering Zero Trust, whether they work in the office or at home. In Q3, ZPA was an area of strong growth, and we saw large new logo deals that landed with ZPA.

Let me highlight 2 such deals. A Fortune 100 logistics company made a 4-year multimillion dollar ACV purchase of ZPA and ZDX, for 100,000 users. ZPA provides Zero Trust application access architecture for their employees, partners and suppliers as it consolidates multiple point products, including multiple VPNs, load balancers, VDIs and dedicated private network services. As a result, ZPA is expected to generate a 300% ROI for this customer. In another ZPA land deal, a global 300 tech manufacturing company made a 3-year 7-figure ACV commitment for ZPA and ZDX, for all 30,000 employees.

Cybersecurity was the top priority as their IP in software development and manufacturing was being actively targeted by nation state actors and hackers. Another aspect of our market, not well understood by investors is that scale and performance are paramount considerations to customers in the real world. When you are providing in-line inspection, you cannot have a trade-off between performance and security. Given our large opportunity and our success in the market, it is not surprising to see a number of vendors claiming that they have the same capabilities as we do. They built their products using something known as service function chaining, in order to reduce their time to market.

The reality is service chaining for in-line traffic inspection using micro services results in poor performance. They are effectively trying to scale lower performance. Our unique architecture with a patented single stand multi-action technology enables us to deliver comprehensive security at high performance and scale. We secured over 40 million users from some of the largest global brands and we surpassed 300 billion transactions daily. We are the largest in-line security cloud, and no one comes close to us. Customers cannot afford to risk the mission-critical operations with immature offerings from unproven vendors.

Let me highlight a deal which showcases the scale of our platform. in a large SSE win, a global 30 health care insurance company purchased ZPA and ZDX for 450,000 users and ZIA for 430,000 users. The incumbent CASB provider could not scale to even 5% of the employees when TLS inspection was turned on. At this customer, we are consolidating dozens of point products from a handful of vendors, including DLP, CASB, web proxies, firewalls and VPNs. Our integration with Microsoft E5 suite across ZIA, ZPA and ZDX, was also an important decision factor for them. In addition, the customer will use Zscaler to rapidly integrate new acquisitions in weeks rather than months that are required by legacy network security architecture.

Next, let me highlight a deal that was led by data protection. In our largest win in the transportation vertical, a Global 50 company purchased the ZIA Transformation Bundle plus ZDX and advanced data protection suite for 165,000 users. Zscaler was chosen over a CASB vendor because of our best-in-class capabilities in DLP, CASB, browser isolation, SSPM and SaaS supply chain security.

And of course, our proven cloud scale and resilience was a big factor. This deal started with data protection and quickly expanded to include web proxy, firewall and sandbox, aim to implement direct-to-cloud architecture across their 6,500 locations. We see more customers buying our data protection along with ZIA and replacing their existing CASB point products. As these deals show, customers are embracing our expanded platform, including our 2 emerging product pillars, ZDX for digital user experience and Zscaler for workloads. These emerging products are on track to meet our full year target of high teens percentage of new business. This quarter, we had an upsell deal with a global 200 bank headquartered in APJ that purchased Zscaler for workloads for 70,000 workloads in a multi-cloud environment.

As an existing ZIA customer, it was easy and seamless for them to roll out workload protection, which increased their annual spend with us by 35%. We are also starting to close larger deals with our federal government customers as the Zero Trust deployments move beyond the initial land deals. A cabinet level agency purchased ZIA and ZPA for 110,000 users to cover all of its sub-agencies. After a thorough evaluation, they are standardizing on Zscaler to consolidate multiple point products across the agency and to comply with the President's executive order, which mandates federal agencies to adopt zero trust principles.

Our highly scalable and reliable platform and our highest FedRAMP authorizations for both ZIA and ZPA have been key differentiators in this win. Having landed 12 of the 15 cabinet-level agencies we have plenty of opportunity to expand further with these very large organizations. To take our customer-centric innovation to the next level, we welcome Syam Nair as our new CTO, who will lead our R&D teams. Syam has extensive experience in leading and scaling engineering and product development teams, the accelerated innovation cycles at Salesforce and Microsoft. He was a driving force in scaling the AI-powered customer engagement platform at Salesforce, which is critical to the next phase of our AI journey.

Let me highlight a few examples of how we are leveraging AI/ML to deliver better cyber protection today. Our first acquisition in 2018 was an AI/ML company. we leverage the technology together with Zscaler data to deliver far better detection for zero-day attacks. This resulted in reducing the number of files being sent to our sandboxing engine by 80%, reducing time to detection and improving user experience.

ZDX, our digital experience service was launched 3 years ago. It was built from the ground up to leverage AI/ML do not just show where performance is degraded, but what caused the issue. The data protection advancements we launched in October 2022, leveraged AI/ML to classify unstructured documents for policy enforcement. And after the launch of ChatGPT, Zscaler delivered policy-based access controls to ensure that customers can use AI applications safely. If the employees submit sensitive data to ChatGPT like applications, our DLP technology detects it and blocks it. While plenty of AI apps like ChatGPT, GPT-4, Bard and Bedrock used public data, AI-powered cyber security for enterprises requires their own private data.

Based on a proxy architecture, Zscaler Zero Trust Exchange is like a private switchboard for all communication for users, workloads and devices that captures all communication logs of whopping 300 billion logs per day. These are not DNS logs that have little information beyond the domain. These are not firewall logs that cannot often see SSL traffic. These are complete logs that have structured and unstructured data, including the full URL providing trillions of signals per day. Zscaler has AI experts and data scientists and the most valuable anonymized private data to customize and effectively trained LLM models for the security domain.

Imagine a world where our customers will know that they're about to be breached before they are breached so they can proactively prevent the attack. Using AI, I believe Zscaler has the opportunity to predict most of today's ransomware and other sophisticated attacks on our customers. We plan to launch a number of innovations, including many for AI/ML at Zenith Live, our Annual Cloud Summit in mid-June in Las Vegas. I invite you to join us.

In closing, we believe that we are still in the early stages of a significant market opportunity to disrupt 30 years of traditional network security and capture a large share of our $72 billion addressable market. Our Zero Trust Exchange is built on a unique architecture that securely connect users, devices and applications using business policies regardless of their location. We believe our 10-plus-year track record of running a massive in-line cloud that has to be highly reliable and available, makes Zscaler the go-to platform for vendor consolidation, cost savings, increased user productivity and better cyber protection. We remain focused on creating shareholder value by driving customer-centric innovation, new business growth and increased profitability.

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

Remo Canessa - *Zscaler, Inc. - CFO*

Thank you, Jay. Revenue in Q3 was $419 million, up 46% year-over-year and up 8% sequentially. ZPA product revenue was approximately 20% of total revenue, growing 66% year-over-year.

From a geographic perspective, Americas represented 54% of revenue, EMEA was 31% and APJ was 15%. Our total calculated billings in Q3 grew 40% year-over-year to $482 million until we get more certainty around the macro environment, we believe looking at total billings on a sequential basis can be a relevant measure of our billings performance in the near term.

On a sequential basis, billings declined 2% quarter-over-quarter which is better than our normal seasonality. Our calculated current billings grew 44% year-over-year. Our remaining performance obligations, or RPO, grew 36% from a year ago to $3.023 billion. The current RPO is approximately 50% of the total RPO.

Our dollar-based net retention rate was once again above 125%. While good for our business, our increased success selling bigger bundles, selling multiple pillars from the start and faster upsells within a year, can reduce our dollar-based net retention rate in the future. This is not a metric we try to optimize quarter-to-quarter, which could lead to variability on a quarterly basis.

At the end of Q3, we had 400 customers with greater than $1 million in ARR, up 39% from a year ago. The continued strength of this metric speaks to the strategic role we play in our customers' digital transformation initiatives. We also entered the quarter with 2,432 customers with greater than $100,000 in ARR. Turning to the rest of our Q3 financial performance. Total gross margin of 80.2% compares to 80.4% in the prior quarter and 80.6% in the year ago quarter. Higher public cloud usage for emerging products drove the year-over-year change in gross margins.

Our total operating expenses increased 3% sequentially and 33% year-over-year to $272 million, primarily due to higher compensation expenses. Operating margin of 15.3% increased approximately 600 basis points year-over-year. Following our optimization efforts in Q2, we're seeing higher efficiency and supporting roles across the departments. Our free cash flow margin was 18%.

We continue to expect our data center CapEx to be around the high single-digit percentage of revenue for the full year. We ended the quarter with over $1.97 billion in cash, cash equivalents and short-term investments. Next, let me share some observations about the macro environment and our framework for guidance.

From our perspective, the global macro environment remains uncertain and customers continue to scrutinize large deals. We're seeing deals getting larger as customers are trying to consolidate more and accelerate their security transformation around our Zero Trust Exchange. Customers are expanding their commitments with us, from a targeted use case to a much broader platform centric approach. While good for our business, larger deals take longer to close as customers introduce more checks and reviews. In addition, in select instances, we enabled new strategic customers to ramp into larger subscription commitments.

Typically, these ramp deals reduced our first year billings but will grow into a higher annual run rate level in the second year. We are entering Q4 with a record pipeline and our customer engagement remains strong. However, predicting close rates in any 90-day period has become more challenging in this environment. Our guidance assumes that new business will take longer to close over the remainder of the fiscal year in view of the macro. As a result, we're assuming a slightly lower close rate in Q4 compared to Q3. We will continue to balance growth and profitability. In our outlook for Q4, we intend to deliver operating margin expansion of more than 400 basis points year-over-year.

With that in mind, let me provide our guidance for Q4 and fiscal '23. As a reminder, these numbers are all non-GAAP. For the fourth quarter of fiscal 2023, we expect revenue in the range of $429 million to $431 million, reflecting a year-over-year growth of 35% to 36%. Gross margins of approximately

80%. I would like to remind investors that a number of our emerging products, including ZDX and Zscaler for workloads will initially have lower gross margins than our core products.

We are currently managing the emerging products for time to market and growth, not optimizing them for gross margins. In addition, we will continue to invest in our cloud infrastructure as we scale with the growing demand. Operating profit in the range of $69 million to $70 million, net other income of $13 million, income taxes of $6 million; earnings per share of approximately $0.49, assuming 157 million fully diluted shares. Please note that starting the fiscal 2023, we adopted the new accounting standard, which requires the use of the if-converted method for calculating EPS. To account for our convertible notes, you will need to add back $360,000 in quarterly interest expense.

For the full year fiscal 2023, we expect revenue in the range of $1.591 billion to $1.593 billion or year-over-year growth of approximately 46%, calculated billings in the range of $1.974 billion to $1.978 billion or year-over-year growth of 33% to 34%. Operating profit in the range of $224 million to $225 million. Our guidance reflects approximately 400 basis points of operating margin improvement compared to last year. Income taxes of $21 million. Earnings per share in the range of $1.63 to $1.64, assuming approximately 156 million fully diluted shares.

As noted earlier, to account for our convertible notes in EPS, you will need to add back $1.4 million in annual interest expense. We remain confident in our ability to capture our large market opportunity while increasing profitability. We will balance growth and profitability based on how our business is growing. The recurring nature of our business model gives us good visibility on top line revenue and allows us to adapt quickly to changes in market conditions to deliver on our operating profit and margin goals with a large market opportunity and customers increasingly adopting the broader platform, we'll continue to make disciplined investments to position us for long-term growth. Operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Brad Zelnick from Deutsche Bank.

Brad Zelnick - *Deutsche Bank AG, Research Division - Head of Software Equity Research and Senior US Software Research Analyst*

Congrats on a strong Q3, especially in light of all the craziness going on in this world. Jay, I wanted to ask you about the U.S. federal opportunity really seems like you've got a number of good things happening there. You're now in 12 of 15 cabinet-level agencies. Can you double-click on the opportunity and pipeline ahead? And maybe talk just more about your strategy in public sector more generally, not just Fed but SLED and maybe international government as well.

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

Thank you, Brad. As we have been saying for the last several years, we made early investments in federal certification. In fact, ramp got some of the highest level of certifications. In fact, we use the same certification to get what's known as StateRAMP certification that states require. So we have very strong presence in a number of States had stayed wide level. We've done well there. On the federal front, as we said, we got early lands and got 12 of 15 agencies, but now they beginning to do full rollout, and that's what we are beginning to see. And it's being also helped by White House guidelines, zero trust implementation. And of course, certifications are helping. We created a public sector vertical some time ago that covers U.S. federal as well as set part of it. So very happy to see the performance of both. We have a strong pipeline for federal sector -- sorry, for public sector for Q4.

And we feel good about it. It was natural for us to expand the own U.S. And what we've done is looked at the West friendly nations or NATO-friendly nations, who depend upon FedRAMP certifications for protecting their federal governments. And we have a pretty good degree of engagement with those countries, and we expect to share more success with you in next year and beyond.

Operator

And our next question comes from the line of Matt Hedberg from RBC.

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

Congrats on the strong results. Jay, for you, you spent some time talking about generative AI and the ability to monetize it with large data sets. I'm just curious, how do you think about a couple of years from now? Are we going to be able to see that generative AI was actually a tailwind to growth? And perhaps could there be additional pricing, perhaps consumption element that could support LLM expanded usage in the future?

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

Yes, Matt, all of the above. First of all, AI as being kind of used in some of the current products to do better threat detection, better data protection and the like. That's number one. Number two, as AI/ML gets backed up. There will be bigger cyber risks.

It's a race with bad guy. They'll be able to do some of the more sophisticated attacks along more easily than they can do today. That means companies like Zscaler will need to step up to provide protection against such trends. And these are protection requires to do good stuff with AI/ML, you need 3 things. Good data scientists, you need large language models and you need high-quality large volumes of data. While many companies can hire data scientists and large language models are becoming open source and will probably be available more easily.

The data will become the new IP, the new barrier to entry. Zscaler with 300 billion logs per day and trillions of signals, we have probably the most precious private data and then we anonymize and feed it to our large language model to give us an advantage that I believe other competitors would not have. These things while they enhance the functionality but expect us to have new SKUs, new products that give us plenty of upsell opportunity. So I expect AI/ML to expand our TAM.

Operator

And our next question comes from the line of Andrew Nowinski from Wells Fargo.

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

Congrats on another amazing quarter. I wanted to ask about, I guess, I mean, a number of questions here, but I guess I'll go with the 1 question on the RAMP deals. It's something you started talking about at the start of the year. And it seems, if I'm understanding this correctly that right now, what we're seeing is the headwind piece of those RAMP deals. And so you're not getting any benefit really from those.

And in the, I guess, when they'll start to anniversary after year 1, that's when you start to see a tailwind from the RAMP deals when those customers move to more of a full price for their subscription. If you could just walk us through sort of the timing of when you're seeing that shift from headwind to tailwind from these RAMP deals.

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. I mean it's a great question, Andy. I'll take it. You may take a look at ramp deals in Q3 of last year and Q3 of this year, percentage amounts are the same. So there's really no headwind or tailwind related to the ramp deals. Ramp deal started coming in a few years ago and now that's basically pretty much the same on a year-over-year basis. I do expect ramp deals to go forward as we go forward. If you take a look at basically duration, the billings duration, our growth rate was 44% short term, that basically was related to duration.

The duration that we had in Q3 of last year was at the high end of our 10 to 14-month range. And this year, the duration basically was slightly above the midpoint. So ramps did not create basically the positive impact to our billing short-term billings, it was really duration.

Operator

And our next question comes from the line of Joel Fishbein from Truist Securities.

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

And again, congrats on the margin outperformance here and expense discipline. So I guess a question for Remo. And I know you addressed it a little bit on the call, but I'd love to take a little bit step further about the methodology you consider and making sure that you're not sacrificing growth as you continue to expand margins at this pretty impressive level. It's going to be a balancing act. And I know you have some levers there that you're pulling.

But it looks like it's got to be very difficult. So I'd love to just understand that or peel the onion back on that. So.

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. From our perspective, when you take a look at the market size that we talked about at our Analyst Day a few years ago, it's a $72 billion market for our addressable market. It's much bigger than that. You take a look at (inaudible) we're in the $1.5 billion or so basically revenue. So the penetration into this market, our ability to upsell also 6x that still remains. We will balance profitability and top line growth.

Our focus is still top line growth. But if you take a look at -- as you called out, the margin expansion, 600 basis points margin expansion in Q3, 400 basis points margin expansion for the full year that's outstanding, but that's the model that we talked about. When your top line slows down, you're going to get that natural leverage. I want to make sure that our investors recognize, we feel that we are in a great position to move forward. We're going to continue to invest, and we're going to balance basically top line growth and operating profitability.

Having said that, to give you more clarity related to fiscal '24, current Street consensus is about 15.5% operating profitability. I think a good place for the Street to be fiscal '24, just to give you kind of a framework, is that 15.5% to 16% range. I do believe that gives us plenty of room to invest and really to continue to capture this market.

Operator

And our next question comes from Saket Kalia from Barclays.

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

Jay, maybe this question is for you. First of all, the numbers speak for themselves. I wondered if you could just address the competitive backdrop a little bit. Certainly, it doesn't appear in the numbers again, but I know that there was some noise out there with competitive quadrant stuff.

Wanted to see if you just had any views on that. And more importantly, whether you've seen that maybe make its way into customer conversations at all?

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

Thank you, Saket. So regarding the Magic Quadrant, I believe that customers are the real judge and I'll give you 3 points why I believe they view Zscaler as a real leader. Number one, as you said, they're voting us by spending on the Zscaler. In fact, in Gartner's Pure Insight ratings, which is a customer survey done by Gartner. Zscaler is the only MQ leader who is in #1 in 8 Gartner's categories. So they have 8 categories. We are #1 in 8 of them. That's wonderful. And also, we have expanded our vision on beyond just SSC or users.

We do SSC for workloads, IoT, OT, B2B and all the like. There have been a number of conversations that I had with customers. As you know, I talk to hundreds and hundreds of customers. I can tell you more than a dozen at least have asked me, hey, what is this MQ, how could this show up? I said, "I don't know. You are the judge. So is it impacting our performance? No. Is it impacting our engagement? No. I think we're focused on building, delivering, keeping our customers happy, our NPS code sits north of 80. So very happy with what you're doing and we'll keep on executing.

Operator

And our next question comes from the line of Sterling Auty from MoffetNathanson.

Sterling Auty

Jay, you talked about the success in kind of the go-to-market function and customer success teams. I wonder if you could just highlight for us or remind us the timing of when you did your big hires where you are in the capacity of your sales force and what the hiring might look like going forward to extend the durability of the growth that you're seeing currently?

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

Yes. Hit a broad go-to-market level. Our goal is to make sure we keep on hiring at the right pace in broad go-to-market team as well as some of the take-off teams that help us push forward some of the new products. We did moderate some of the hiring as we saw the market come down quite in the past couple of quarters. Remo, do you want to give some more color to it?

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. From a capacity perspective, we're in good shape. When we reduced our workforce at the end of Q2, 1 of the things we talked about is we're still going to prioritize basically quota-carrying heads and R&D. That's still the case. We are in a hiring moat, and we'll continue to hire.

One of the things I've mentioned, Sterling, is that not lost on us is that this is a huge market opportunity. We're going to invest to continue investment in hiring and R&D and throughout the company for that matter. But really, what we did in Q2 was to better position ourselves to make the proper hires going forward, and that's what we're doing.

Operator

And our next question comes from the line of John DiFucci from Guggenheim Securities.

John DiFucci - *Guggenheim Securities, LLC, Research Division - Research Analyst*

So this quarter was -- as people have said and you said, you preannounced it, it was really a strong quarter. And looking at the numbers, it looks like real clean results. It's nice to see that. But it's also odd to see that in this environment. And you guys have talked about things are -- the difficult environment has continued. So I'm just trying to figure out like what changed for you guys this quarter relative to the past 2 quarters.

Not that they were -- they were -- you struggled more in the last 2 quarters, at least from our measures of new ACV signings and this quarter was really strong. I mean was it -- I mean, you did talk about larger deals. Were there any like sort of anomalous large deals out there? Or is it just really just you guys now buckled up and are executing better. What happened? What changed?

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

So this quarter was strong across all areas. Our Americas and APJ were particularly strong on a year-over-year basis. And last quarter, we set some of the large new logos in Americas were taking longer to close. We also said those deals were not lost but just delayed, and we did close a good number of those deals. From a vertical perspective, it was very well diversified, strong verticals for federal, financial services, health care and transportation.

Our large and major segment did well. We highlighted a number of 100,000-plus user deals. So the fundamentals of business are very strong. Customers are not going to delay cyber as a priority. It is a priority. Cost saving is a big priority as well, and we do well in both areas, cyber as well as cost saving.

And tell you when it comes to cyber companies, we're probably the only company that delivers significant ROI because we are actually eliminating a bunch of point products. So it is fitting well. It's a tougher market. There's more scrutiny, but our foundation is strong and our pipeline is strong.Remo?

Remo Canessa - *Zscaler, Inc. - CFO*

Yes, I'll go with Jay mentioned pipeline, maturity pipeline, execution, strong across the board. Americas was strong, APJ was strong, federal was strong. Again, I think the key thing was really good execution in our sales organization on a worldwide basis. Related to large deals, mega deals. We talked about mega deals when we first went public at the deals of greater than $10 million. We bought that now megadeals deals of greater than $20 million. There were no deals of greater than -- no deals greater than $20 million. We did have 1 deal of $10 million in the quarter.

Operator

And our next question comes from the line of Roger Boyd from UBS.

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

Great. Again, congrats on the very strong results. As we think about fiscal 4Q and fiscal '24, it sounds like you're broadly being pretty conservative around close rates. But Jay, you talked a little bit about some of the efforts you've made internally to get in front of budget scrutiny with some of these CFO ready business cases. I guess I'm wondering, relative to a few quarters ago, are you feeling incrementally better about controlling your own destiny, your ability to influence sales cycles? And just curious how material these internal efforts have been in practice.

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

Yes. So this tougher market has made us a lot more sophisticated than we were before. For example, for new logos, what have we done.

We are now doing early engagement. Our sales team is getting good and engaging at C level early on in the cycle. And number two, we had to refine our business value case, CFO-ready case studies a lot more. No longer annual numbers are good enough. Now they want to go in the quarterly level to see when the ROI can be done. Our engagement cloud marketplaces have gotten much better because we are leveraging annual commit that's already -- annual spend that's already committed to the hyperscalers. Now we had to do ramp deals more frequently, which is kind of to meet their timing of the budgets and the like.

For upsell, we had done a number of things in the past few quarters, we are ensuring that customers are realizing the value more and more, our customer success team, our TAMs are doing a great job. And then the product specialty team we put in place for emerging products that's working well. It's working very closely with our field sales team. So having a great, highly differentiated platform, which we've built on Zero Trust as a key platform. We are not a firewall company that's trying to pivot to Zero Trust. They're not a CASB company that's pivoted. This is our core business, our North Star from day 1 and our sales execution is good, and we'll keep on improving it.

Operator

And our next question comes from the line of Mike Walkley from Canaccord Genuity.

Thomas Walkley - *Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst*

Great. Thanks. Remo, you talked a little bit about future lumpiness in dollar-based net retention, I guess, given some large deals that you'll grandfather in. But could you just share with us kind of that mix you expect to maybe fiscal '24 of new logo sales versus upsell that's still around a 60-40 ratio given that 6x upsell opportunity?

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. I mean net retention rate is something we don't guide to or look at. Our mix this year, we're expecting 40, 60 new versus upsell. We look at really -- as we look at new and upsell, that's the driver in total. And what we've talked about before is we believe the best measure for Zscaler is really billings at 125% is outstanding.

Operator

And our next question comes from the line of Joshua Tilton from Wolfe Research.

Joshua Tilton - *Wolfe Research*

This is Patrick on for Josh. First off, just wanted to congratulate you all on the great results in what's been a tough environment. Clearly, the mix checks in the quarter were not exactly correct. So I was wondering what do you think is sort of driving that disconnect between the strong numbers put up in the quarter and then the general feedback from the channel we've heard recently.

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

So, I think this is not new. We have said many, many times that we are not the typical security company selling boxes through people VARs. We are a transformation play. It's a high-touch sale. And working closely with customers and sometimes large SIs, that's how we do business. These channel checks will always be misguided, okay? I mean that's how I personally look at it.

When you are driving transformational C-level and whatnot, it is different. So I would say, yes, let's be more defined in channel checks. Look, our business is strong. Our customer engagements are very strong. Our differentiation is very strong. Yes, our competitors are trying to create fun.

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They are trying to mislead the market. It's our job to make sure we educate them, we communicate them. But the best results we do is when customers deploy our technology then they say, Jay, we're able to turn on 20,000 users in 7 days and results are amazing.

And then they say, if you really contrast, I've only seen a couple of cases to say, yes, we've got a competitive solution. This thing is still struggling out there. We are trying to extend our network from our office to the cloud, it's old-school architecture. So I do believe that in spite of all the noise and fun that comes from out there our engagement, our differentiation, the way we are executing in the market, the way we are innovating and now the new area of AI/ML where we have a unique advantage of better data, better private logs with structured and unstructured data.

We will do better than any of the vendors out there, maybe a comment on unstructured data. Every vendor has log. Logs are simply structured data, where are you coming from? Where are you going? The most intelligent information that generative AI can use comes from a URL, which could be hundreds of bytes long. And that's where you figure out what all is going on. Most of the firewalls don't have any URL, they generally sit at the domain level stuff. As we do some of the stuff, I believe, will further increase our lead and really that will give us actual TAM and further growth that we are striving for.

Operator

And our next question comes from the line of Adam Borg from Stifel.

Adam Borg - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Awesome. Maybe for Jay, you talked in the script about increasing traction with Zscaler for users. And I'd love to get a sense when a new customer comes in, any way to think about the mix of new customers that are taking Zscaler for users from the start? And how should I think about the overall mix of Zscaler users within the installed base?

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

Yes. So thank you. Zscaler for users, this bundle was created about a little over a year ago, and we have seen very, very good growth of this combined bundle. And we have some customers who will go with just the ZIA, ZPA. We actually have some customers interesting, a large customer who actually started with ZPA and ZDX at the same plan. But overall bigger bundle to eliminate a bunch of point products is the trend we are seeing. And as I had said even 2 or 3 years ago, it's a matter of time -- when every customer buys ZIA, ZPA, ZDX for every employee and that trend is happening more and more. And as we said before, if we do so, our current customers, our spend -- their spend with us could go through 5 or 6x kind of stuff. And I think we are tracking well.

And we're tracking well for 2 reasons. One, customers are seeing value they are realizing value from it; number two, we're actually able to remove a bunch of point products and show ROI, and that actually gives them more incentive to buy more from us.

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. And customers that have bought ZIA, ZPA and ZDX, it's more than 25% of our total customers. So it's definitely getting traction.

Operator

And our next question comes from the line of Shrenik Kothari from Baird.

Shrenik Kothari - *Robert W. Baird & Co. Incorporated, Research Division - Senior Associate*

And congrats on the strong execution despite the macro. So for Jay and Reno, feel free to chime in. You mentioned on a sequential basis, you saw better-than-normal seasonality. And then, of course, you guys touched upon your factors, you're starting to close larger deals with federal. You, of course, are seeing benefit from kind of strategic customers ramping into larger commitments. And then, of course, the execution, high-touch engagement is helping to get to finish line international. Can you help us unpack all these drivers in terms of kind of maybe relative impacts on this better than normal seasonality? And then I have a quick follow-up.

Remo Canessa - *Zscaler, Inc. - CFO*

I think everything you mentioned is a 100% correct. I'm a traditionalist, I'll go back to what I feel. I think it's better execution on our sales organization.

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

Yes. I mean, all the factors aligned, but we are still in the tougher environment, which is not more scrutiny. And it's doing better execution. But if you've got good product offerings that are highly differentiated, and there's a need for it because customers do want to save money and better cybersecurity. That's really what's positioned us well.

Remo Canessa - *Zscaler, Inc. - CFO*

Yes. I mean just to follow on. Customers recognize the ROI. It is significant. The ability to simplify your network is significant also. Architecture related to in-line cloud multi-tenant architecture, not only for users, but workloads and IoT, OT and B2B, that's a vision basically Zscaler. The pioneer with all this is Zscaler. The leader, if you take a look at our penetration into the Fortune 500, which is 40% in Global 2000, 30%.

I mean, CIOs, CISOs, they talk to each other. We do -- I mean, customer advisory board meetings, Jay, we would do 1 like an average like 1 a week, I believe. I mean companies typically do this once a year. We do it once a week. And so what is the strength -- it's all the things I mentioned. And your comments, it's pretty much across the board, all those things.

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

One point I'll make, which hasn't come at us so far in this discussion. What we do being the switchboard is probably the most critical mission-critical business service, and it must work. And so customers basically want to go with a proven vendor who knows how to operate and run and manage such a massive cloud. It is becoming a differentiator. When a new vendor comes and say, "Oh, I got the cloud, too."

And then the customer say, what's your track record, what's your experience? That's helping us. One of the area that's helping us with some of the new private companies and all customers are kind of very of trying to go with someone who may be losing a lot of cash and who may not be around tomorrow. And that's helping us as well because customers are looking at vendors who will be around and who will be the leaders in safety.

Operator

And our next question comes from the line of Peter Levine from Evercore.

Peter Levine - *Evercore ISI Institutional Equities, Research Division - Analyst*

We've seen one of your competitors come out this quarter with a very specific campaign kind of targeting you guys or somewhat kind of reverse engineering your tech. So Jay, is there any validity behind kind of what they're building to explain to us the complexity, the lift and shift customers overnight -- and if you're even seeing any attrition on that front?

And then just one quick one for Remo. Thanks for the color on the fiscal '24 margins. But to the extent you can, any color or high-level discussions you can share with us now on how you're thinking about the growth outlook, and to what extent is macro playing into that thought process.

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

So every vendor has a core competence and they do very well in that competency. A firewall company will be a great firewall company a CASB company will be a great CASB company, and someone who does CDN and DNS should be a good CDN/DNS company. You can try to pivot, but that competency you build and create over years and years is very hard. if I came and told you in 1 year, I'm going to build the best firewall. Well, it will be hard, for me to say that because I can't make statements like that.

But when companies try to pivot, it takes a while, and especially if pivoting do something that's in line, multi-tenancy, figuring out all the fiber threats without slowing things down, is hard. It's an architectural change. We believe that the intellectual property, the IP needed to do so is very hard. That's number one. Number two, the amount of traffic one has to handle to really deliver the service. Your gross margins are likely to be sitting some of the 50s and 60s and not like 80% where we sit at. It's because we purpose-built the stuff.

So it is not unnatural for us to see the competition trying to come and say, maybe I can get into this space. I have many times described Zscaler being the in-line business, almost like an ERP application. They can there are thousands of SaaS applications out there, their point product. They can be built. How many ERP vendors do you see out there doing SaaS, very few. It's hard. Sitting in line is heart, we think that gives us a big, big barrier to entry for others to compete, and we are not sitting. We are expanding our platform at a larger pace. So do I kind of try to focus too much on some of the competitive campaigns that are kind of trying to spread my zone? I don't. We focus on innovation, we focus on our customers, and we're doing well.

Remo Canessa - *Zscaler, Inc. - CFO*

And top line growth. We'll talk about that on the next call. You know, for year-end.

Operator

And our next question -- our final question for today comes from the line of Joseph Gallo from Jefferies.

Joseph Gallo - *Jefferies LLC, Research Division - Equity Associate*

Really appreciate the question and great job on the billings performance in a tough environment. I appreciate the commentary regarding the year-over-year mix of ramp deals in F3Q. Is F4Q the same expected year-over-year mix based on the pipe you guys are seeing today? And then just any other color or commentary on how to think about F4Q billings, which appears seasonally conservative. I know you mentioned lower close rates is there anything else timing renewals or anything else we should think about?

Remo Canessa - *Zscaler, Inc. - CFO*

Yes, ramps, I would consider the same quarter-over-quarter. But just remember, it is a tough compare. Last year, our billings growth was approximately basically, I think it was close to 60% billings growth in Q4. Also, we had a strong Q3. So basically, it's a tough compare.

Operator

This does conclude the question-and-answer session. I'd now like to hand the program back to CEO, Jay Chaudhry, for any further remarks.

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

Thank you for your interest in Zscaler. I hope to see you at Zenith Live in Vegas in a couple of weeks. I would also like to thank our shareholders, our customers and our partners. Talk to you next quarter. Great. Thank you.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.