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PRESENTATION

Operator

Good day, and welcome to the Zscaler's First Quarter 2020 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Bill Choi. Sir, please begin.

Bill Choi *Zscaler, Inc. - VP of Investor Relation*

Good afternoon, and welcome to the Zscaler First Quarter 2020 Earnings Conference Call. On the call with me today are Jay Chaudhry, Chairman and CEO; and Remo Canessa, CFO. By now, everyone should have access to our earnings announcement, which can be found on our website in the Investor Relations section. In addition, a supplemental financial schedule is available for download at ir.zscaler.com.

Please note, unless otherwise noted, all numbers we talk about today other than revenue 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. For historical periods, the GAAP to the non-GAAP reconciliations can be found in the supplemental financial information referenced a moment ago.

Let me remind you that we'll be making forward-looking statements during today's discussions, 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, 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. Our actual results may differ significantly from those projected or suggested in any forward-looking statements. 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 that could impact our future operating results and financial condition, please see our filings with the Securities and Exchange Commission as well as in today's earnings release.

I would like to inform you that we will be participating in several upcoming investor conferences. Next week, management will be at the UBS Global TMT Conference and Cowen's Networking & Cybersecurity Summit in New York City, and also, the Barclays TMT Conference in San Francisco. On January 14, we will be at Needham's Growth Conference in New York.

Now I'll turn the call over to Jay.

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

Thank you, Bill, and thank you, everyone, for joining us. We reported solid Q1 results, delivering strong revenue and operating profit growth in the first quarter with positive free cash flow while making strategic investments to scale our go-to-market machine to the next level. Our revenue grew 48%, and billings grew 37% year-over-year in Q1. And we are increasing our outlook for revenue and billings for the full fiscal year 2020. Adoption of the ZIA transmission bundle continues to grow, and ZPA remains our fastest-growing product. I'm thrilled that more customers are using ZIA and ZPA together, which provides a single platform for secure cloud transformation that we believe no other vendor can match.

As you know, Dali Rajic joined this September as a President Go-To-Market and Chief Revenue Officer. I'm excited about the key initiatives our sales leadership is putting in place to position us well for the long term. At our recent Zenith Live Cloud Summit, I was pleased to hear CIOs, CTOs and CSOs of Global 2000 enterprises sharing with pride their cloud transformation journeys, enabled by Zscaler, that delivered lower costs, improved security and provided fast and reliable user experience. I'm very proud that Gartner recently recognized Zscaler as a leader in the Secure Web Gateway Magic Quadrant for the ninth year in a row. More importantly, Zscaler is positioned the highest for both execution and vision, significantly separating us from the competition.

We pioneered the cloud-native integrated security platform. And our cloud service is trusted by over 3,900 customers, including over 400 of the Forbes Global 2000 to access applications, no matter where they live. The Zscaler cloud processes over 80 billion transactions per day, which is over 10x the number of Google searches per day. This provides an unprecedented network effect, which allows us to deliver superior security to our customers. We are aggressively investing in our business to pursue a massive opportunity to disrupt traditional network security, which mostly relies on legacy security appliances.

Let me now highlight a few wins in Q1 that showcase what we believe are our sustainable competitive advantages. I will start with an upsell that highlights the scalability and elasticity of our cloud. This Fortune 100 customer purchased our professional bundle for all 40,000 employees 3 years ago. In Q1, they tripled their annual business with us by upgrading to Business Bundle, adding additional users and purchasing protection for server traffic going from the data center to the public cloud. They deployed local Internet breakouts at over 1,000 locations. During their cloud journey, including rolling out Office 365, their Internet traffic increased exponentially, reaching 1.2 petabytes per month, which is equal to 10 billion photos in Facebook. And their IT leaders praised the elasticity of the Zscaler cloud when a company-wide video conference call by the CEO went flawlessly, even though the network traffic doubled during the event. How would a single tenant security cloud possibly handle this?

Now I will share a new logo win of a Fortune 100 customer that needed to up-level their security. Unlike most large enterprises, they had no proxy gateways and instead relied upon next-gen firewalls for the user traffic to the Internet. No wonder they had a high-risk posture. They purchased ZIA Transformation bundle for all 14,000 employees. With Zscaler, they can detect and prevent advanced threats and zero-day attacks, which are increasingly found in encrypted traffic. This results in better security.

Next, I will highlight the win that illustrates benefits of our edge cloud capabilities and enables faster M&A integration. A top global healthcare company that bought our Business Bundle and Cloud Firewall for 30,000 employees, 18 months ago, purchased an additional 30,000 seats to integrate a recent acquisition. The 2 companies have a combined global presence with hundreds of locations across 70 countries. Each company had embarked on a network transformation journey for local Internet breakouts, but with 2 very different approaches to security. The acquired company was a next-gen firewall shop with scores of firewalls deployed in branch offices, giving a false sense of security as 95% of their web traffic is encrypted and was not being inspected. To integrate the 2 companies, they standardized on Zscaler, implemented SSL inspection and are ripping out all the branch firewalls. The result, significant savings and a big improvement in their security posture.

Next, I would like to share considerable momentum we are building in the U.S. federal market. Last year, ZIA and ZPA received FedRAMP certification at the Moderate level. And last month, ZPA reached FedRAMP readiness at the High Impact level, which puts Zscaler in an elite group of technology companies. ZIA is the only FedRAMP-certified secure cloud Internet gateway today. ZPA is the first and only cloud security service that has received FedRAMP certification for Zero Trust Remote Access. This positions us very well in this large market.

In Q1, we won 2 deals with civilian agencies, each with an annual contract value greater than $0.5 million. The first win is with a large strategic agency with an initial order for ZIA and ZPA for 15,000 mobile users to deliver secure access to applications with Zero Trust Network Access. The second agency purchased the complete ZIA and ZPA platform for all 6,800 employees to enable cloud transformation to secure SD-WAN deployment for local breakouts and to provide direct access to any application from anywhere.

Turning to Japan. We entered this large market only 2 years ago, but have been gaining great traction. In Q1, one of Japan's largest transportation companies purchased our ZIA Business Bundle and Cloud Sandbox for all 30,000 employees to secure local breakouts and increase security for all users. Non-proxy technologies such as next-gen firewalls were not considered since comprehensive security was important.

A common theme of all these wins is that a cloud-first world requires a cloud-native architecture. In a recent groundbreaking research note, Gartner defined a new product category named Secure Access Service Edge or SASE, pronounced SASSY. Gartner predicts that the future of network security is in the cloud and most organizations will move their network security to a SASE model. Importantly, Gartner recommends reducing the complexity of network security by moving to 1 vendor for Secure Web Gateway, CASB, DNS, Zero Trust Network Access and remote browser isolation capabilities. This is Zscaler. We strongly believe this validates our vision when we founded Zscaler over 10 years ago.

Here are the core architectural principles Gartner has outlined for SASE. Number one, SASE demands that the security providers offer security at the cloud edge - close to the user for good user experience. Zscaler provides in-line security at the cloud edge in more than 150 data centers around the world. In contrast, legacy security vendors claiming to offer a SASE service are spinning up virtual machines on public clouds with traffic backhauled to a centralized compute. That is not security at the edge. That is not SASE.

Number two, SASE recommends that a branch office should have a light footprint with simply an SD-WAN router and all security services in the cloud. While the Zscaler cloud is a light branch architecture, the legacy firewall vendors are peddling heavy branch appliances. Again, that is not SASE.

Number three, Gartner specifically says, "Many of the SASE capabilities will use a proxy model", because a proxy is required to inspect encrypted traffic. Zscaler meets this requirement, while next-gen firewalls don't. Hence, next-gen firewalls are not SASE.

Number four, lastly, SASE advocates a cloud-native multi-tenant architecture, which is the foundation of the Zscaler cloud platform. You can't take legacy single tenant security appliances and stick them in the cloud as virtual machines and call it cloud security. That would be like placing thousands of DVD players in a public cloud and calling it a Netflix streaming service.

In summary, Zscaler was designed for the SASE world that Gartner has spelled out.

Some of you have asked questions about competition from next-gen firewall vendors. Over the last 10 years, we have faced various competitors, starting with large legacy Secure Web Gateway vendors who claim to offer a cloud security service. Where are they today? As security must move the cloud, legacy firewall vendors are now making similar noise. Next-gen firewalls are designed to build a moat around the castle - to secure the network and the data center, they are the wrong architecture for securing users.

The next question is, why can't they build a platform like Zscaler? Well, the answer lies in the architecture. Architecture is like the foundation of a building. You can't change the foundation unless you start all over, which is hard and takes a long time. We know that startups like Salesforce and Workday competed and won against much larger on-premise incumbent vendors because of the cloud-native architecture. We believe we are doing the same in the network security space.

Let me talk about our products. I will highlight a few innovations that are expanding our platform. Zscaler B2B and Zscaler Digital Experience or ZDX, the 2 major product lines we announced at Zenith Live, are getting great initial feedback from our customers. The out-of-band CASB that we announced at Zenith Live is receiving very good early reception. Combined with our existing in-line CASB capabilities, we will now offer a complete CASB solution. The integration of browser isolation technology we acquired through Appsulate

is ahead of plan and is already being tested by customers. Building upon the TrustPath acquisition we did last year, we have significantly enhanced our threat detection capabilities with machine learning and AI.

Moving on to tech partnerships. To complement our comprehensive platform, we believe in partnering with tech leaders. This provides an integrated solution for customers and creates go-to-market leverage for Zscaler. For example, we have a deep and wide partnership with Microsoft Office 365 and Azure public cloud. Microsoft named Zscaler the first and only cloud security provider to be a certified partner in the Microsoft Networking Partner Program or NPP for Office 365, which has stringent requirements for user performance. Microsoft only recommends NPP partners for Office 365 connectivity. We are working closely with both VMware and Silver Peak, the only 2 leaders in Gartner's recently published SD-WAN Magic Quadrant.

Let's now turn to our go-to-market. Zscaler is an enabler of cloud transformation. As a result, we have a different top-down sales process and go-to-market strategy than legacy vendors. As I stated during the last earnings call, we are focused on improving our sales execution to take Zscaler beyond $1 billion in revenue. That is why I'm excited to have Dali on board as he's building a highly scalable go-to-market machine. He has already driven rapid and tangible progress, building a multi-dimensional go-to-market model, putting us into a great position to scale.

Let me give you a few examples. We implemented a more refined metrics-based model of accountability and transparency, giving us better visibility into how our business is run. We are ahead of our plan to build a new sales process and enablement program that will deliver consistent and high-level execution in the field. It is already having a meaningful impact in our day-to-day execution, and we continue to mature our sales leadership structure.

With all that we have implemented in a very short time, I'm very pleased with our progress and confident that we are building a solid foundation for a highly scalable sales machine for our long-term growth.

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

Remo Canessa *Zscaler, Inc. - CFO*

Thank you, Jay. Revenue for the quarter was $93.6 million, up 9% sequentially and 48% year-over-year. From a geographic perspective for the quarter, Americas represented 51% of revenue, EMEA was 41%, and APJ was 8%.

Turning to calculated billings, which we define as the change in deferred revenue for the quarter plus total revenue recognized in that quarter. Billings grew 37% year-over-year to $88.3 million. As a reminder, our contract terms are typically 1 to 3 years, and we primarily invoice our customers 1 year in advance. Remaining performance obligations or RPO, which represents our total committed noncancelable future revenue, was $555 million on October 31, up 35% from $411 million 1 year ago.

Our strong customer retention and ability to upsell have resulted in a consistently high dollar-based net retention rate, which is 120% for the quarter ended October 31. This compares to 118% a year ago and last quarter. Our increased success selling bigger deals starting immediately with our Transformation Bundle and faster upsells within a year, while good for business, can reduce our dollar-based net retention rate, which is calculated on a year-over-year ARR basis. Considering these factors, we feel 120% is outstanding, and it will vary quarter-to-quarter.

We are pleased with the continued adoption of our comprehensive cloud platform by our customers as they increasingly rely on us for their transformation journey. In fact, 2/3 of our top 25 customers were also customers 2 years ago, and their cumulative ARR has more than doubled over this period.

Total gross margin was 81%, flat sequentially and down 1% year-over-year. We feel that 80% continues to be a good target range in the near term as it is important to continue to invest in our platform to drive top line revenue growth.

Turning to operating expenses. Our total operating expenses increased 17% sequentially and increased 44% year-over-year to $72.7 million, but decreased as a percentage of revenue to 78% compared to 80% last year.

Sales and marketing increased 20% sequentially and 46% year-over-year to $49.4 million. The year-over-year increase is due to higher compensation expenses and the cost of 3 major marketing events, Zenith Live Americas, Zenith Live Europe and our sales kickoff.

R&D was up 12% sequentially and 44% year-over-year to $14.8 million as we continue to invest to enhance our product functionality and innovate new products.

G&A increased 6% sequentially and increased 32% year-over-year to $8.5 million. The year-over-year growth in G&A includes investments in building our teams. These expenses exclude $2 million in litigation-related expenses.

Our first quarter operating margin was 3%, which compares to 2% in the same quarter last year. Net income in the quarter was $4.1 million or non-GAAP earnings per share of $0.03.

We ended the quarter with $378 million in cash, cash equivalents and short-term investments. Free cash flow was positive $9.4 million in the quarter compared to positive $5.2 million for the same quarter a year ago. Our ESPP program increased our free cash flow by approximately $3 million in the quarter, same as a year ago. The ESPP program does not impact overall cash balance.

Now moving on to guidance. As a reminder, these numbers are all non-GAAP, which excludes stock-based compensation expenses, amortization of intangible assets, certain litigation-related expenses and any associated tax effects. For the second quarter, we expect revenue in the range of $97 million to $100 million, reflecting the year-over-year growth of 31% to 35%. For the year-ago comparison, recall the Q2 2019, revenue was aided by $2.3 million in nonrecurring revenue from a large public sector customer deploying our platform as a private cloud. Excluding this revenue from last year, guidance reflects 35% to 39% growth. Operating profit in the range of $3 million to $4 million; income taxes of $900,000; and earnings per share of approximately $0.03, assuming 138 million common shares outstanding.

For the full year fiscal 2020, we expect revenue in the range of $405 million to $413 million or year-over-year growth of 34% to 36%. Calculated billings in the range of $500 million to $510 million or year-over-year growth of 28% to 31%. Operating profit in the range of $15 million to $18 million. In Q4, we expect to host our annual Zenith Live events in both EMEA and Americas. We expect the cost of these 2 events to be in the range of $5 million to $6 million; income taxes of $3.6 million; and earnings per share in the range of $0.13 to $0.15, assuming approximately 139 million common shares outstanding.

Our guidance reflects our plans to invest aggressively in our business to pursue our significant market opportunity. We are pleased with the progress our CRO is making, and we are confident he is the right person to drive our sales and go-to-market execution. We are stepping up sales and marketing investments in order to build the foundation for long-term growth. In addition, we will increase investments in our technology platform and cloud infrastructure.

As you model billings, I want to remind you that historically, Q2 and Q4 have been our strongest billings quarters with sequential declines in Q1 and Q3 quarters, respectively. With our outperformance in Q1 billings, we now expect first half billings to be approximately 43% of full year billings compared to our prior expectations of 42% to 43%. Also, please keep in mind that we have a large upfront billing of $11 million in Q2 of 2019 from a large public sector customer deploying our platform as a private cloud, which will pose a tough year-over-year comparison in Q2. Excluding this deal, our billings guidance for the full year implies 32% to 35% growth.

In terms of free cash flow, please note that we will have additional spend for tenant improvements related to our headquarters move in January as well as ongoing cash outlays for lease payments on our existing San Jose buildings and litigation expenses related to our ongoing Symantec lawsuit. These extraordinary items are expected to be approximately $15 million to $20 million in cash payments for the full year. As a result of these payments, we expect our free cash flow margins in fiscal 2020 to be 0 to 2 percentage points lower compared to our operating profit margins. Longer term, we expect our free cash flow margins to be higher than our non-GAAP operating margins.

Now I'd like to turn it back over to Jay.

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

Thank you, Remo. In closing, let me state 4 key points that make me excited. Number one, architecture matters, especially for a cloud security platform that must sit in line to inspect all traffic for policy enforcement. We believe we have the best architecture with 10 years of operational experience to run a massive cloud and enormous barrier to entry. Number two, with multiple tailwinds such as Office 365, SaaS adoption, SD-WAN and app migration to public clouds, we believe the market is coming to us. Number three, we are in early innings of the cloud journey. We are disrupting a $20 billion TAM with ZIA and ZPA. In addition, we recently announced Zscaler B2B and ZDX, which we believe will expand our TAM significantly. Number four, with new go-to-market leadership on board, we're building a sales machine that can deliver world-class execution and sustainable long-term growth.

We thank you for your interest in Zscaler and look forward to reporting on our progress in the future. Operator, you may now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first will come from Alex Henderson with Needham.

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

I was hoping to ask a question around the new sales head, the Chief Revenue Officer. To what extent he's come in and been effective? How long do you think it takes for his programs to be fully ramped and to get to the maximum benefit? Is that a 3- to 4-quarter process of reacceleration?

And then the second piece of it, if I could. A lot of questions coming at me from clients about the competition from the next-gen firewall players. It seems to me that, that has not been a factor, but can you talk about whether that's shown up in terms of pricing pressure or any other notable metric other than lost deals, but maybe some other elements to the mix that may have pressured things?

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

Yes. Alex, thank you. This is Jay. Regarding your question about our go-to-market, our CRO, as you know, we have done very well so far, built a business to hundreds of millions of dollars. Now our goal is to take it to $1 billion and plus, which means scaling our sales execution. Dali actually is the right guy who is driving a number of these things. Let me give you a perspective of what all he's driving.

So, for execution at scale, I'll give you 3 examples. One, when you have scores of salespeople, it's one thing. When you have hundreds of salespeople, you need far better sales enablement, far better training. For us, we used to have a small sales enablement team. Dali has come in and built a very sizable team, and the team is already rolling out some of the training programs. Number two, to really scale your business, you need a very consistent and repeatable sales process that may be more refined. And Dali has come in and taken our process and further refined it, and it's being rolled out to the whole field. Number three, while we had tools and systems in place to scale to the next level and to have better accountability, better visibility to give us better leading indicator and sales activities, he and the leadership team has started work in many areas. So a lot of these things are already making a difference, and we are seeing it. And I think as each quarter goes by, we will see more and more impact of the work being done by Dali and his team. Remo, do you want to add anything?

Remo Canessa *Zscaler, Inc. - CFO*

Yes. A couple of add-ons to that also. I mean, our plan is still to be about a 20%-plus operating margin once we hit $800 million to $1 billion of revenue. Related to pricing pressure, our discounts are lower this quarter. Our average prices per user are higher. When I take a look at our ARR where customers are greater than 3,000 users, it's higher this quarter. It's in the high 300,000 range. And our churn is down.

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

Alex, regarding your second question about competition from firewall vendors, somehow this question keeps on coming. I tried to address it during my statements. But fundamentally, if you look at the large enterprises, to protect users, they almost always look for a proxy architecture. You guys deal with large banks. If you talk to top 20 banks and ask anyone, would you just depend upon on next-gen

firewalls for user protection? I haven't found a yes answer from a single bank so far. Now it's probably true. Some of that is happening on the lower end, where the customer is less security savvy and they're able to go with some of that switching happening. So probably on the SD-WAN side, some of that is happening on the lower end, but where are our primary focuses? We don't really think any of the impact from the firewall vendors making noise has happened and impacted us. So far, I think it's the architecture, that we got much better that's giving us an edge, and I think it's a long-term edge.

Operator

Our next question comes from Daniel Bartus with Bank of America.

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

Great. First for Jay, maybe. No mention of the longer sales cycle order. So can you just walk us through the changes you're seeing versus last quarter when you called that out? And then I got a quick follow-up.

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

Yes. The changes in terms of the sales cycle and all... haven't really changed a whole lot for us. I think what we are doing is tightening our sales process and tightening our execution. We aren't really seeing much market impact in terms of a slowdown or any of the stuff. With better leadership and some of the things I outlined, I think focused execution is what we are doing, and we are beginning to see it make a difference for us. And I think it will help us in the long run because we are building a stronger infrastructure to scale our sales.

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

Great. Makes sense. And then, Remo, quick question. Good to hear the new products are getting good reception. I'm curious if you have any ZDX or ZB2B in your fiscal '20 expectations. And what's the potential for these new products to ramp and maybe drive some upside this year?

Remo Canessa *Zscaler, Inc. - CFO*

Yes. So no, there's nothing we're planning for, and you shouldn't plan for anything either. We're planning to get these products out in the second calendar quarter of '20. The potential for the products, as Jay mentioned, with the CASB out-of-band, browser isolation, user experience and the B2B, we feel that there's a pretty significant upside for us with these types of products, but nothing for this fiscal '20 should be accounted for.

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

Yes. If I may add, we are engaged with customers, as you would expect, in beta stages during evaluation and testing. The interest is real. I mean, just to clarify, what we announced was 2 big product lines, Zscaler B2B and Zscaler Digital Experience. And then we also announced 2, what I would call, features. Out-of-band CASB, CASB is a feature. Browser isolation is another feature. That's relevant for both ZIA and ZPA. Early indication is very positive. These products become generally available in calendar Q2.

Operator

Our next question will come from Patrick Colville with Arete Research.

Patrick Edwin Ronald Colville *Arete Research Services LLP - Analyst*

Can we just talk about the CASB product because, I mean that's something that from speaking to your customers, there's been a lot of interest in CASB right now and some have said that the scale will be a natural insertion point into that CASB debate above and beyond your current partnerships right now with Microsoft and McAfee. So just it's good to better understand that product, if possible, please?

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

Yes. So, for a long time, we have had what we call inline CASB. If all traffic goes through us, we have to do CASB, which includes threat detection and protection, DLP and the like. And for out-of-band, it will be dependent upon 2 partnerships, you mentioned McAfee and Microsoft. Our customers kept on telling us that it's a small add-on, we should be doing it. So, we took them seriously, we built it. So, we become a single provider. So, it's a natural feature for us to add on, and we're seeing lots of traction. We will continue our partnership with Microsoft and Skyhigh, McAfee in this area. If customers want something like that, they have it. But we believe a large number of customers will take Zscaler. And if there's another CASB solution, I think, we'll end up displacing it.

Patrick Edwin Ronald Colville *Arete Research Services LLP - Analyst*

Great. And can I just ask a quick follow-up on the dollar-based net retention rate. So, the 120% is extremely impressive, no doubt, and especially given it's a sequential and annual increase, but it does imply that revenue from new customers would have tailed off, both sequentially and annually. So, do you mind just helping me understand if that's correct. The revenue contribution became increasingly skewed to existing customers? Or if there are any metrics you can share to help me better understand new customer revenue and customer count?

Remo Canessa *Zscaler, Inc. - CFO*

Yes, that's a good question. So typically, we range with new versus upsell, 60% or 40% new versus upsell and also 50% to 50%. In Q1, the mix was closer to 50% to 50%. What's important to recognize, we don't really distinguish internally the difference between new and upsell. We track it, but we incentivize our sales organization, both for new and upsell. When you take a look at the installed base that we have and the penetration that we have with our installed base, there's a significant opportunity for us to upsell into that installed base. We don't want to disincentivize our sales organization selling into that installed base. With Dali on board, I'm sure he'll be driving all aspects of the business, including new customer acquisition.

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

Yes. Remo, if I may add, if a company is a single-product company with a narrow offering, they have to keep on worrying about new customers in order to drive their growth. We have such a wide platform and more products being added to it. So, we are less worried about making sure we just do new customers. So, our #1 goal is to maximize new ACV. Hence, we don't have a difference between new versus upsell. And Remo said the range of new has varied from 50% to 60%. And I think that's a good range. But as you see more new products coming, some of them can be sold on its own without the installed base, we expect over time to go up. But we don't look at NRR, net retention revenue, as the most reliable indicator. It varies quite a bit. Remo, you have commented on in the past why it varies...

Remo Canessa *Zscaler, Inc. - CFO*

Yes. So I mean 120%, that's clearly outstanding. We've ranged from the 118% for several quarters. We called out several quarters ago that there could be pressure on that NRR, net retention rate, as more companies are buying transformation upfront, which is what we're seeing. In addition, if customers are buying things quicker within the year because our net retention rate is based on ARR at the beginning of the year versus what it is currently. If customers buy product within that period, that's going to put pressure also on the net retention rate. Now those are the negative effects to it. The positive effects to it are that is 43% of our ARR in ZIA was transformation, 14% of our new and upsell business last year was the ZPA. So, there's upsell capabilities with those products. In addition, as Jay mentioned, with our new products, there's a potential for it also going up. The point to make is it's going to fluctuate. It's a hard, hard metric to really put your finger on. 120% is outstanding, but it could fluctuate.

Operator

Our next question will come from Andrew Nowinski with D.A. Davidson.

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

Thank you and congrats on the nice quarter. I want to start with a question on the Fed side. So I think you mentioned a few modest-sized deals with civilian agencies, but I'm wondering if you can give us your thoughts on how Microsoft being awarded the JEDI contract might impact Zscaler, given your strong partnership with Microsoft and now having both ZIA and ZPA FedRAMP certified.

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

Actually, very excited with the opportunity. We started investing in FedRAMP certifications over 2 years ago. It's a very hard certification, but we made the investment. And as you've seen in recent press releases and the like, we got certification for both ZPA and ZIA. And as I said, we are the only vendor that's FedRAMP certified with cloud security gateway. And on the ZPA side, only vendor certified for Zero Trust Remote Access. That puts us in a very, very good position. Now the way Zscaler works is it's independent of cloud, we can access Microsoft, AWS, Azure, all these clouds work with us, but having a good partnership already in place with Microsoft will help us work closely with them in the field from a go-to-market point of view. So, while we have begun to get some early deals, we are pretty optimistic about the opportunity, though we do realize that federal deals can take a little bit longer time. But very pleased with the team we have put in place. The team has grown quite a bit and it's delivering.

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

Okay. And then the telcos have also been a fairly large driver of demand over the course of the last few years. Can you just give us any color on what, if anything, has changed with regard to the revenue contributed by the telco providers?

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

Yes. Telco, they have been an important partner for us. I won't say any partner has been driving a lot of demand for us. As you know, as we drove transformation, we have done a lot of evangelism. So, we have been driving a lot of demand. It is in high-touch sales. But as customers are asking for more and more transformations, now we do see now more leads coming from telco partners to say, "My customer is asking for it." We're beginning to see RFPs coming out and say, "I need to do transformation." The deal I referred to in my earnings call from Japan actually was an RFP that was issued to 3 telcos, and all 3 telcos with Zscaler because we met the requirement. It's a good business happening. We are trying to go further down market with telcos. That's a new project, actually, Dali, is trying to drive. So far, a lot of business we've done with telcos on the very high end with the large enterprises. So excited about the opportunity. They're natural partners for us, even though there is, yes, some contention about network costs and whatnot. But they really don't impact us. It's the market that's looking for it, and we are taking advantage of the market.

Remo Canessa *Zscaler, Inc. - CFO*

Yes, telcos typically represent around 50% of our revenue, and that's about where it was in Q1.

Operator

Our next question will come from Saket Kalia with Barclays.

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

Jay, maybe to start with you, a lot of talk on competition, particularly from the firewall side. I'd actually love to shift a little bit, maybe talk about competition from the traditional Secure Web Gateway players here that are transitioning, most notably with Blue Coat. I guess the question is, what are you seeing in terms of sales engagement with those types of opportunities since the deal is closed? And really, their willingness to explore a solution like Zscaler?

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

When it comes to competition, our real competition from incumbency point of view is Secure Web Gateway, because they have the right architecture as a proxy architecture. Where we have been winning against them is because they have a good on-premise single tenant proxy architecture, but they couldn't pivot to the cloud, they couldn't build a viable, multi-tenant architecture, right? Remember my DVD versus Netflix example. Now among these traditional vendors for Secure Web Gateway, Blue Coat had big presence at large enterprises as an appliance. And with the sale to a new owner, there's some uncertainty out there. So, we are seeing a lot of additional interest from large enterprises who are looking for alternatives. Some of these customers are moving to the cloud. So, it is actually helping us. So, we're getting inbound inquiries that we were not getting before. So, we think it's a big opportunity for us. We are focused to take advantage of this.

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

Makes sense. Remo, maybe my follow-up for you, somewhat related, but now that Symantec is part of a larger entity, you talked about $15 million to $20 million in one-time cash cost, including litigation. Can you talk about the litigation portion of it? And how does that sort of progress now that ownership on Symantec has sort of changed hands?

Remo Canessa *Zscaler, Inc. - CFO*

Yes. The litigation portion is $8 billion to $10 billion. The transaction with Broadcom and Symantec just was completed. So there's not much update. I mean the only thing I can say is that we do not feel we infringed, we're going to defend ourselves vigorously and the lawsuit that is currently out there is not having any impact on our business at all.

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

Yes. We're carrying on. But as you pointed out, change of hands can present an opportunity. And if it did, we will be open to it.

Operator

Our next question will come from Brian Essex with Goldman Sachs.

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

Jay, maybe I could point to a couple of the sustainable competitive advantage examples that you gave. One, the first one pointed to scalability and elasticity of your platform? And the third one, pointed to your edge cloud capabilities, but both were really interesting instances of pursuing Internet breakouts. Maybe if you could help us understand a little bit how these deals transpired and who the partners on the SD-WAN side were? And was this driven by maybe an SI that was putting the deal together and working with the company on a consultative basis? Or was this something that you led and held their hands through this process and pulled maybe the SD-WAN vendors in and put the deal together on your side?

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

Yes. The way these things are happening, it's still not a process where market is mature, and RFPs get sent out all the time. As we have mentioned, we are still in a high-touch sales model. There is a good amount of evangelism needed though it's getting easier and easier, what used to be a typical process. Our sales team goes and engages with the customer, shows them the value of transformation that can deliver user experience and lower cost, and that basically leads to a natural discussion and say, let's get an SP or SI together because it generally involved transformation, SP vendor awareness is out there. We start collaborating with SP vendors out there. As I mentioned to you, VMware and Silver Peak, are good partners for us, they're the leaders out there, and we come together and offer a proposal and solution. So, I would say, a majority of the large deals that are driven and closed they're still led by us, then we bring the partners along. But in a good number of them, they do come from partners. And many times, our SD-WAN vendors introduce us to a deal. And sometimes we introduce them to deals. So that's why we like these technology partnerships. Microsoft, VMware are 2 big technology partners that are helping us. On the SP front, the large SPs, the top 4 or 5 SPs globally are very good partners.

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

Got it. Maybe just a follow up to, that's very helpful. Remo, when we spoke with Dali in September, he had a goal of maybe taking 30 to 60 days to evaluate data on the platform, build models, evaluate talent and hire and so forth. Is he through with that? And do you know, like definitively kind of the framework of what the incremental spend on the sales and marketing side will be for this year? Or might that kind of bleed into next year? I'm just trying to get a sense of when we might anticipate some meaningful leverage on the sales and marketing side of the model?

Remo Canessa *Zscaler, Inc. - CFO*

Yes, good question. I would start seeing basically improvement to next year related to, and again, the guidance that we gave contemplates the investment we're making in sales and marketing. Dali's 30- to 60-day plan, I mean, I've worked with a few CROs. And watching what Dali is doing here in the first couple of months is he's moving very quickly and doing outstanding. I mean he's building the sales leadership in the organization. And he's building, as Jay mentioned, our sales enablement and training, he's better defining sales responsibility and putting in place the framework for us to be a much bigger company and putting in place that accountability. In summary, what I see what Dali is doing, he's putting structured, disciplined leadership and it is a passion that he has. Quite frankly, I don't know when he sleeps. It's going very quickly, but it is going to take time. So that was the reason for our guidance initially at 42%, 43% billings in the first half, and we increased that to 43%, and increased our billings guidance to $500 million to $510 million. I'm excited working with Dali and what he's doing and look forward to it.

Operator

Our next question comes from Matthew Wells with Citi.

Matthew Ryan Wells *Citigroup Inc, Research Division - Associate*

Can you provide an update on customer feedback and learnings around ZB2B and ZDX? I understand both are still in beta and plan to go live, I believe, next quarter, actually?

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

Yes, I think we'll be able to give you more tangible and meaningful customer feedback probably next quarter. Right now, I would say, the degree of interest and opportunity I had anticipated 3 or 6 months ago, it seems bigger than that. So high customer interest. But again, it's a limited engagement so far. So, the limited engagement we have had, a very high degree of interest, but we'll give you more as we have more tangible feedback.

Matthew Ryan Wells *Citigroup Inc, Research Division - Associate*

Got it. And just a follow-up on that. Is the sales force incentivized around products while they're still at beta? Or it's just when they go live next quarter?

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

We have no incentive. In fact, product management is actually working closely with a selective number of customers. But we are not really pushing, we would rather not push until the products are properly cooked and all the kinks are out of it. Once they become GA, only then sales force start selling it.

Remo Canessa *Zscaler, Inc. - CFO*

Just wanted to clarify that these new products are going to be generally available in calendar Q2. So, it is not next quarter.

Operator

Next, we have Melissa Franchi with Morgan Stanley.

Melissa Louise Dunn *Morgan Stanley, Research Division - Research Associate*

This is Melissa Dunn on for Melissa Franchi. I was hoping you could provide some color around activity in EMEA. Revenue growth in that area was slightly slower than the rest of the region. So, wondering if there were any macro softness in your view or maybe execution considerations?

Remo Canessa *Zscaler, Inc. - CFO*

No, from a macro perspective, we really don't see it. EMEA grew 40%, which is slower than the Americas and APJ. We did have a leadership change in EMEA, which we're very excited about. But at 41% of total revenue in EMEA, APJ at 8%, Americas at 51%, it's pretty consistent with what it's been in the past. But from a macro perspective, not really seen any changes.

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

Yes, we are bullish on EMEA. I think we've got a good incumbent installed base. We'll keep on growing it. We are making the right amount of investments for EMEA.

Melissa Louise Dunn *Morgan Stanley, Research Division - Research Associate*

And just a quick follow-up. To what extent is ZPA driving initial conversations with new customers versus ZIA? And there's been a lot of other vendors that are seemingly trying to address this opportunity. So has there been any change in what you've seen in competitive deals?

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

So in the past few quarters, we have been seeing about half the new customers coming from ZPA, sorry, half the ZPA deals coming from new customers and half coming from upsell. So that's kind of number of customers. But having said that, the ZPA deals are smaller than ZIA deals. As we've said before, when ZIA is bought, it's bought for everyone in the company, for all employees as ZPA are based on number of applications. So that's one. ZPA is opening more doors for new logos than we had initially thought of. So, pleased with that.

Your second question is competition for ZPA. ZPA market in what Gartner called Zero Trust Network Access or others call SDP, it is still a young market. We kind of rarely run into each other because it's relatively small. So, not a very competitive space. It's more of a matter of evangelizing and showing people that doing traditional network security with things like VPN is a dangerous thing. They don't need to do it. Once they get it, you win the deal.

Operator

Our next question will come from Fatima Boolani with UBS.

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

Jay, I have a question for you and a follow-up for Remo. Jay, you talked a lot about the internal improvements and pipeline rigor and sales enablement initiatives that Dali had sort of put in place and put into motion. So internally, you're really elevating the rigor in the sales organization and go to market. I'm wondering if you can speak to the external and external distribution avenues and sort of what you're doing there from maybe a channel perspective or a service provider or SI distribution perspective. Because as we understand, your model doesn't traditionally lend itself well to the box pushers, so I wanted to get your sense of what sort of investments are in play from an external distribution perspective?

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

Absolutely. There are several points I could make there. In fact, I heard from someone the other day, they said, "Hmm, it seemed like you're defocusing on channel." I said, "Not sure where that's coming from because actually, we are putting more focus on channel." But the point is, it's not the same traditional channels. So, what are we doing about channel? We know SPs have worked for us. We will keep on making more investments, rather looking at going downstream with some of the SPs and not just do the very large enterprise deals.

On the channel or maybe called the VAR channel traditionally, right? The people who largely are in the box selling business, that has limited synergy with us. But Dali is focused on 2 types of channel partners. One, we have done cloud-native boutique VARs well, but only limited. We are expanding the reach. Dali has successfully done those cloud-native type of vendors in his previous life, so we are focused on getting those things done. Two, finding more vendors who are ready to pivot. Every channel person doesn't want to pivot, or they wish they don't have to pivot because boxes will keep on selling forever. So those are the 2 things we're doing. I talked about sales enablement and training. That's really not just needed for channel, sorry, for internal teams, that's needed for channel as well. So, we are putting a lot of focus in that area as well because that's needed for them to become more effective.

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

I appreciate that. That makes a ton of sense. Remo, a question for you. You've been very explicit on the level of investments, especially on the sales and marketing front, as reflected in your guide. But as I think about Analyst Day, you're a little bit more explicit on your sales capacity investments, so maybe accelerating that sales capacity footprint to 60% this year. I just wanted to get a sense of an update of how the sales hiring has been tracking as you started the new year? And that's it for me.

Remo Canessa *Zscaler, Inc. - CFO*

Yes. Our sales tracking for Q1 is a little bit behind, but our expectation is still to get to that 60%. We're looking for Q2 to be a good quarter for us, but that's all taken into account in our guidance.

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

Yes, I would add that in the past quarter, we raised the bar in hiring better quality people and also acceleration of hiring. In fact, under Dali, we have put together a new recruiting playbook where we are educating, we are training all of our front-line sales leaders to make sure we hire the right kind of people. Again, product scaling. When you only have 10 leaders who are hiring, it's a small problem. When you've got 50 sales leader who are hiring, it needs better scaling and better methodology and process, and that's what we are really scaling out.

Operator

Our next question will come from Dan Ives with Wedbush Securities.

Daniel Harlan Ives *Wedbush Securities Inc., Research Division - MD of Equity Research*

So maybe can you talk about the government market? Obviously, a lot of deals moving to cloud. JEDI is just, I think, one of them. And just given where you are in terms of Azure, in terms of that channel, maybe just talk about that as an opportunity over the next 6, 12 months in terms of how you're viewing that going in 2020?

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

Yes. I think I'll add upon what I said earlier. Getting FedRAMP certifications is the first thing. Unless you have them, not much matters. So, we have done that. And also, in FedRAMP, there's a moderate level certification and there's a high impact. Having done both of them for ZIA, sorry, ZPA is both done; ZIA, we are at moderate, will get to high-impact shortly. The door is wide open for us leverage. And Azure with Microsoft partnership is a good opportunity, but we also work with, there's a fair amount of AWS out there. Very bullish on it. Remo, can I say that? A good team. I would say, if you asked me a year ago versus today, I feel we are significantly ahead of where I thought it would be.

Operator

Our last question will come from Yun Kim with Rosenblatt Securities.

Yun Suk Kim *Rosenblatt Securities Inc., Research Division - Senior Software Research Analyst*

Congrats on the solid quarter. On the ZPA front, just wanted to ask about the competitive nature of that market. Are you seeing some of the same competitors of ZIA, for your ZPA product? And also, are you selling to the same department? Or are there typically 2 different buyers for ZPA and ZIA?

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

It's a good question. ZIA is generally driven by transformation. In our ideal world, we start from the CIO, go down to head of infrastructure who wants to transfer the network and security gets brought along, and it's a full-blown play. ZPA actually has a few different paths. I'll talk about 3 of them because it's very different opportunities. One case, that we go to the customer and say, "If your applications are going to the cloud, public cloud, like Azure and AWS, you don't need to go back through your data center, go direct through Zscaler." It's a good opportunity in that case. So, who is the buyer? It's actually generally head of infrastructure because he was providing that connectivity before. Number two, many customers say, "Yes, I'll look at cloud, but I have one problem to solve today. My remote access is VPN. I hate it. It's slow and it's not secure." So, replacing that, the VPN, the buyer could be security, the buyer could be networking. Third area, a very different buyer, M&A. When companies are bought, generally, they want to bring the networks together in the old world of network security. In the Zscaler world, you don't bring the networks together. You simply with ZPA brought access to each other's applications transparently. In that case, traditional IT is less of a buyer, you basically deal with the CIO level, but it's also sometimes the M&A team that's put in place to bring the 2 companies together. Some common buyers, some different buyers.

Operator

Thank you, gentlemen. That concludes our question-and-answer session, and I would like to turn the call back over to Mr. Jay Chaudhry for any closing remarks.

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

Well, thank you all for your time, and we look forward to seeing you at our upcoming conferences this quarter. Thank you, again.

Remo Canessa *Zscaler, Inc. - CFO*

Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's teleconference, and you may now disconnect. Please enjoy the rest of your day.