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OKTA.OQ - Q1 2018 Okta Inc Earnings Call

EVENT DATE/TIME: JUNE 06, 2018 / 9:00PM GMT

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CORPORATE PARTICIPANTS

Catherine Buan

Jacques Frederic Kerrest *Okta, Inc. - Co-Founder, COO & Director*

Todd McKinnon *Okta, Inc. - Co-Founder, Chairman & CEO*

William E. Losch *Okta, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

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

Gray Wilson Powell *Deutsche Bank AG, Research Division - Research Analyst*

Heather Anne Bellini *Goldman Sachs Group Inc., Research Division - MD & Analyst*

Jonathan Frank Ho *William Blair & Company L.L.C., Research Division - Technology Analyst*

Michael Edward Casado *KeyBanc Capital Markets Inc., Research Division - Associate*

Patrick D. Walravens *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Shaul Eyal *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

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

Terrell Frederick Tillman *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

PRESENTATION

Catherine Buan

Good afternoon, and thank you for joining us on today's conference call to discuss Okta's fiscal first quarter 2019 financial results. My name is Catherine Buan, VP of Investor Relations at Okta. With me on today's call are Todd McKinnon, Okta's Co-Founder and Chief Executive Officer; Bill Losch, the company's Chief Financial Officer; and Frederic Kerrest, the company's Co-Founder and Chief Operating Officer.

Statements made on this call include forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, including, but not limited to, statements regarding our financial outlook and market positioning. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. Forward-looking statements represent our management's beliefs and assumptions only as of the date such statements are made.

In addition, during today's call, we will discuss non-GAAP financial measures. These non-GAAP financial measures are in addition to and not a substitute for or superior to measures of financial performance prepared in accordance with GAAP. There are a number of limitations related to the use of these non-GAAP financial measures versus their closest GAAP equivalents. For example, other companies may calculate non-GAAP financial measures differently or may use other measures to evaluate their performance, all of which could reduce the usefulness of our non-GAAP financial measures as tools for comparison. A reconciliation between GAAP and non-GAAP financial measures is available in our earnings release.

Further information on these and other factors that could affect the company's financial results is included in filings we make with the Securities and Exchange Commission, the SEC, from time to time, including the section titled Risk Factors in the annual report on Form 10-K previously filed with the SEC. You can also find more detailed information in our supplemental financial materials, which includes trended financial statements and key metrics posted on our Investor Relations website.

Now I'd like to turn the call over to Todd McKinnon. Todd?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Thanks, Catherine, and thanks, everyone, for joining us today. Our Q1 financial results marked a great start to the new fiscal year. Revenue and calculated billings growth continued to be strong, both up 60% year-over-year. The economics of our business continued to evolve favorably as we improved our free cash flow margin by 24 percentage points year-over-year, and were operating cash flow-positive in the quarter. We're growing aggressively while prudently managing our cost structure.

Our customer metrics reveal a lot about the drivers behind our growth. While our total customer base grew by a robust 40% in Q1 to over 4,700, the number of customers with over $100,000 of annual recurring revenue grew even faster, at 52% year-over-year to 747. This is a proxy for our increase in enterprise deals and expanding customer relationships. Beyond our strong customer additions, dollar-based net retention rate continued at a healthy 121%, demonstrating our commitment to customer success and our customers' continued investment in Okta.

What's driving this growth is simple, organizations are moving to the cloud, and they want to transform their customer experience. We can help them do both securely. We have 3 major areas of focus that align with the needs of our customers: first, the Okta Integration Network; second, customer identity; and third, security. These areas address significant pain points for CIOs and developers. Here are a few customer examples that are great illustrations of the diversity and scope of our market opportunity.

Mattel, an existing Okta customer, first adopted the Okta Identity Cloud to support its own cloud adoption strategy for its extended enterprise back in 2015. After continued success, Mattel this quarter expanded its investment in Okta to help strengthen its security posture by adding Okta Adaptive Multi-Factor Authentication as an extra layer of security for its 28,000 employees.

Warner Music Group is an exciting new customer for us in the quarter. They selected Okta for an enterprisewide deployment of Single Sign-On, Lifecycle Management and Adaptive Multi-Factor Authentication to modernize their IT infrastructure.

FICO has been using Okta for several years to provide employees with safe and seamless access to its business-critical applications in the cloud. After internal success, they expanded their use of Okta to provide FICO's customers with secure access to their data and advanced analytics solutions. This quarter, to enhance customer security, they've grown their Multi-Factor Authentication rollout and added API Access Management to secure their APIs.

The Centers for Medicaid & Medicare Services (sic) [Centers for Medicare & Medicaid Services], an existing U.S. federal government customer who used Okta for their Quality Payment program, expanded their use of Okta to replace a legacy identity solution used for partner-accessed applications. With Okta, they will connect CMS partners to over 70 applications, all with increased efficiency, a better user experience and improved security. CMS now uses all of the products in the Okta Identity Cloud across both the extended enterprise and customer experience. These customers, along with thousands of others, illustrate the need for an identity platform such as Okta. While they represent a variety of industries and use cases, they all need identity, and Okta can help them.

As many of you know, we just completed our sixth annual conference, Oktane18. This year was our largest and most successful event to date as we unveiled a number of exciting new partnerships and products. Thousands of customers, prospects and partners attended the event, and more than 60 of our customers joined Okta on stage to share their experiences.

One theme that has become clear is that more organizations are choosing Okta as the central identity platform standard for every user in their ecosystem. Decision-makers understand the strategic importance of identity in today's complex environment, and they see Okta's essential value as an independent and neutral cloud platform. We believe that this increased awareness will accelerate our ability to truly take identity mainstream.

Our leadership in identity is driven by 2 primary strengths. The first is our platform. Our platform, the Okta Identity Cloud, addresses the challenges and opportunities organizations are facing today. Okta is uniquely positioned to help organizations modernize their IT environments with our IT products and the Okta Integration Network. We enable our customers to build personalized and secure customer-facing applications with our API products while simultaneously helping to secure their businesses with our expanded set of contextual access management capabilities.

The second is our ever-expanding network. The Okta Integration Network amplifies the core value of our platform to customers through network effects that allow them to connect through the Okta Identity Cloud. This brings us to the first growth driver I mentioned earlier, the Okta Integration Network is the foundation of everything we do, and it's why we have invested heavily ensuring that we have what we believe is the broadest and deepest catalog of integrations in the industry. For most of our customers, modernizing IT has been about moving to the cloud and adopting a best-of-breed or hybrid IT environment. In this paradigm shift, a best-of-breed approach is not a choice. It's about necessity. Okta enables this transition by making it as frictionless as possible. We make technologies easy to discover, deploy, manage, administer and above all, more secure.

At Oktane18, we announced 2 new capabilities that will take the Okta Integration Network to a new level. We launched Sign In with Okta, which will enable technology providers to integrate with Okta in a fraction of the time. We also announced the launch of Okta Onramp, which we believe can make it easier for forward-thinking organizations to discover and deploy new technologies. These announcements accelerate our integration network effect. The faster and deeper we enable technology providers to integrate to Okta, the more integrations we'll be able to offer and the more valuable we become to customers. With over 5,500 integrations and over 4,700 customers, this network effect is already powerful and continues to strengthen.

The second growth driver is customer identity. We believe this remains a significant opportunity that Okta is uniquely able to address with our API products. What we're seeing is that customer identity is a build-versus-buy decision for organizations. Either build authentication and user management functionality or buy it from a provider like Okta. We're making it an easy decision by offering multiple ways for organizations to get started with our API products. We offer API products across the spectrum, from developer tools all the way up to enterprise solutions. Many of our largest customers such as JetBlue and MGM Resorts today are using Okta to support more complex scenarios with multiple back-end applications or directories and can support millions of users. At Oktane18, we unveiled an additional path for developers to get started, which addresses the middle ground. We call it API Products for One App, which offers the same functionality as our developer API products only at a much more accessible entry point. And like our enterprise API products, it can scale to millions of users and runs in a managed production environment.

We are also offering Okta-branded components of the One App product, which include the Identity by Okta logo on their sign-in page. By doing this, we feel we've made it easier for organizations to select Okta rather than build this functionality in-house. But with clear upgrade paths, we're also establishing a great way to land and expand our business.

The third growth driver for us is security. We believe the security industry is converging around identity. By understanding the user's context as well as the context of the device they're using, organizations can better secure their business and deliver a better experience to their users at the same time. We enable this with our contextual access management capabilities, our Adaptive Multi-Factor Authentication products and a flexible policy engine that enables our customers to define and enforce rules around who gets access to what, when. We've built on this concept with a new input that will inform these policies called Okta ThreatInsight. Okta ThreatInsight will give our customers the ability to take action on a realtime feed of threatening IP addresses that Okta's security research team has curated based on activity across all of Okta's customer base. We believe this additional insight will be game-changing for a couple of reasons: first, the more organizations that use ThreatInsight, the more valuable it becomes for everyone on the network; second, with the combination of our integrations, user and device context, ThreatInsight and our policy engine, we're enabling our customers to eliminate passwords for their users. So if an employee checks all the boxes from location to IP address to device trust to time of day, they can access their applications by simply clicking Accept on their phones, no password required. We believe we are best positioned to responsibly offer passwordless access because of the power of our network.

At Oktane18, we also announced 2 key partnerships. First, Okta and Workplace by Facebook announced a partnership and product integration to give enterprises a simple, secure way to enable modern collaboration. Workplace by Facebook also joined as an inaugural partner of Okta's Project Onramp.

Second, we are tightly integrating Okta's identity products with the mobility products in VMware's Workspace ONE to enable a secure and seamless experience from the device to every technology in our network. We are proud to be partnering with 2 of the most innovative companies in the world. These partnerships are a result of our presence in the market and the value of our technology.

You'll notice that all these announcements tie back to fuel our 3 areas of focus: the Okta Integration Network, customer identity and security. This is how we'll best serve our customers and maintain durable growth over the long term.

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I want to thank our customers, partners and everyone at Okta who are the driving force behind our success. Since we founded Okta, the mission has been to enable any organization to use any technology. While we've made significant progress, the market opportunity remains vast, and we are just getting started.

I'd now like to turn the call over to Bill to walk through our financial results. Bill?

William E. Losch - *Okta, Inc. - CFO*

Thanks, Todd, and thanks again to everyone for joining us. Before I go over this quarter's results, I want to remind you that as of this quarter, all of our data will be presented under the new accounting standard, ASC 606. Last quarter, we provided materials that summarize the estimated impact of ASC 606 for fiscal years '17 and '18. The supplemental financial tables posted today on our Investor Relations website include updated and finalized historical data. The updates are immaterial, but please make sure you update your historical models.

I would also highlight that the supplemental financial tables included an updated description of the components that comprise calculated billings consistent with ASC 606, although there is no change to our previously reported calculated billings numbers.

Now moving on to our results for the first quarter of our fiscal year '19. We had a strong first quarter and a great start to the year. Revenue for the first quarter totaled $83.6 million, growing 60% year-over-year. Subscription revenue totaled $76.8 million in the first quarter, an increase of 59% year-over-year and was 92% of our total revenue, consistent with what we saw in Q1 last year. Professional services revenue was $6.8 million, an increase of 68% over the same period last year.

In terms of geographic breakdown, approximately 85% of our first quarter revenue came from the U.S. and 15% came from outside the U.S. compared to 86% and 14%, respectively, in Q1 last year. We continue to see most of our business coming from the U.S. However, the international market for us is emerging and remains an area of opportunity.

Moving on to billings. Calculated billings for the first quarter totaled $95.9 million, an increase of 60% over Q1 last year. Current calculated billings growth was consistent with calculated billings at 60% year-over-year. We are clearly very happy with our billings growth and the underlying demand that is driving our business. Our exceptionally high growth rate was due to better-than-expected linearity in the quarter and the beneficial timing of certain invoices. We saw a similar dynamic last year where Q1 had an especially strong year-over-year growth rate in billings compared to the other quarters in the year.

Our strong billings growth has been driven by momentum both within our customer base and with new customer additions. The total number of customers at the end of the quarter came in at over 4,700. That represents an addition of over 350 net new customers in the quarter, up 40% over the first quarter last year. As Todd mentioned, we saw our customers with ARR greater than $100,000 grow 52% year-over-year to a total of 747 customers.

Our dollar-based retention rate for the trailing 12 months ended April 30 was consistent with the last quarter at 121%. This demonstrates the ongoing success we are having expanding within our existing customer base.

Before turning to expense items and profitability, I would like to point out that I will be discussing non-GAAP results going forward. Our GAAP financial results, along with a reconciliation between GAAP and non-GAAP results, can be found in our earnings release as well as the supplemental materials posted on our Investor Relations website.

Subscription gross margin was 80.7%, up 240 basis points versus the first quarter last year. Our professional services gross margin was negative 1.6% compared to negative 44.3% in the first quarter last year. As you know, Q4 business is often deployed in Q1. The improvement in professional services margin was due to the higher-than-expected utilization from our professional services team in the quarter.

Total gross margin showed continued improvement and was 74.1% in the first quarter, up 520 basis points year-over-year. Gross profit was $61.9 million, up 72% year-over-year. Our gross margin represented a new record high as we continue to scale our platform.

Turning now to operating expenses. We remain focused on responsible growth, and as a result, we've seen continued improvement in our operating margins even as we continued to generate high top line growth. Non-GAAP operating margin in the first quarter improved more than 22 percentage points over the last year to negative 13%. We expect to see continued quarterly fluctuations in operating margin as we grow our business, but expect that operating margins will continue to improve annually as subscription revenue grows at a faster rate than total operating expenses.

Sales and marketing expenses for Q1 was $45.3 million compared to $32.9 million in Q1 last year. This represents 54% of total revenue, a 9-point improvement compared to 63% in the first quarter last year. We continue to invest heavily to capture our large market opportunity but balance that investment with a focus on operating leverage. As a result, you should continue to see us improve the sales and marketing expense margin on a full year basis.

R&D expense in Q1 was $15.7 million compared to $12.1 million in Q1 last year. This represents a growth rate of 30% as we continue to invest heavily in the Okta Identity Cloud platform and our Okta Integration Network. At the same time, R&D as a percentage of revenue came in at 19% of revenue, a reduction from the 23% we saw in Q1 last year.

G&A expense was $11.7 million for the first quarter compared to $9.6 million in the first quarter last year. G&A was 14% of revenue, an improvement from 18% in Q1 last year.

Our operating loss in the quarter was $10.8 million compared to a loss of $18.5 million in Q1 of last year. Our operating margin in Q1 was negative 13% compared to negative 35.4% in the same period last year. Net loss per share in Q1 was $0.09 with 104.2 million basic shares outstanding. This compares to a net loss per share in Q1 last year of $0.47 with 39.8 million basic shares outstanding at the time.

We hit an important milestone this quarter, generating $4 million in positive operating cash flow as we benefited from a seasonally high amount of collections from our strong Q4. This compares to negative $9.7 million in Q1 last year. Free cash flow came in at a negative $1.6 million in the quarter compared to a negative $13.3 million in the first quarter last year. Our free cash flow margin was negative 1.9%, a 24-point improvement compared to a negative 25.5% for Q1 last year.

As we have mentioned before, we expect to see variability in free cash flow margin in the coming quarters due to increased CapEx associated with our headquarter office expansion along with ongoing fluctuations in working capital.

Turning to the balance sheet. We ended the first quarter with $547 million in cash, cash equivalents and short-term investments. This includes net proceeds of approximately $307 million from the convertible senior note offering that we closed this quarter.

Lastly, our total headcount was 1,265 as of April 30, 2018, growing 24% over Q1 of last year. We continue to add headcount across the board as we support the growth of our business.

Moving on to guidance. For the second quarter fiscal 2019, we expect revenue in the range of $84 million to $85 million, representing a growth rate of 39% to 41% year-over-year; non-GAAP operating loss in the range of $23 million to $22 million; non-GAAP net loss per share in the range of $0.21 to $0.20, assuming 106 million weighted shares outstanding.

For the full fiscal year 2019, we now expect revenue in the range of $353 million to $357 million, representing a growth rate of 38% to 39% year-over-year; non-GAAP operating loss in the range of $67 million to $62 million; non-GAAP net loss per share in the range of $0.58 to $0.54, assuming 107 million weighted shares outstanding.

In summary, we had a very strong start to the year, and I'm pleased with the consistent execution we demonstrated in our first year as a public company. We look forward to building our momentum in the quarters ahead, where we see opportunities for growth through continued innovation, additional partnerships and international expansion.

With that, Todd, Frederic and I will take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And at this time, we have several callers in the queue. We'd like to take your first question from Heather Bellini from Goldman Sachs.

Heather Anne Bellini - *Goldman Sachs Group Inc., Research Division - MD & Analyst*

Just -- I had 2 quick ones. One, I guess, for Bill, and then I had another one for Todd or Freddy. Bill, I guess, for you first. If I look at your sequential revenue guidance given how well you guys did in Q1, it looks like you're implying a flat to up 2% kind of sequential guide. I'm just wondering under what circumstances would -- like what would have to happen for you guys to see kind of flat sequential revenue growth? Kind of what things would be factored into that just given all the great momentum in your business? And then, I guess, the second question, for Todd or Freddy, would be just related to how much of your customer conversations right now are being driven by security first? And I guess, if you could just share with us kind of how the momentum might be building there and just, I guess, if you can touch on that as kind of a key driver of the strong results that you're posting, that'd be great.

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

It's really interesting. I'll take the second question first, and then Bill can chime in on the first question. The evolution for us has been when we started, we were really about enabling things. We were enabling platform, right. Like make it really easy for end-users to log in, make it easy to roll out apps and enable technology. And it wasn't until 4, 5 years into building the company that we really started selling to the CISO, the Chief Security Officer. And it became from identity being just an enabling thing to identity being the key to security. And I would say over the last year, and Freddy can chime in on this as well as he talks to a ton of customers, what's happening is the world of identity and security are really merging with concepts like Zero Trust, which is like this post- network perimeter world where you have to really manage the security and identity of every person, every device. That is really becoming one conversation. I think it's a huge driver in our business. Not to mention that as we've all seen just watching the news and so forth and every time you have to -- every time you get a notice that you have to reset your credit card number, we know that breaches and these kind of things are a board-level conversation and a big thing in everyone's mind, and I think that is driving our business as well.

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

Yes. Heather, I would just add that it's in both of those big use cases that we think about we see this trend. First of all, for the extended enterprise, companies just need to do a better job with their employees, their contractors and making sure that they have secure and easy access to all these applications and this infrastructure on any mobile device. But it's also when it comes to customer identity and access management, it's -- the customer websites are no longer just resetting a user name or password. It's about ensuring that you have very easy-to-use 2-factor authentication with SMS to phones. Just making sure that, that experience is simple but secure, I think, is of paramount importance for companies today.

William E. Losch - *Okta, Inc. - CFO*

And Heather, to address the question you had on the outlook we gave for Q2 revenues, I think there were 2 dynamics that happened in Q1 that I think are relevant and informed us as we thought about what our Q2 forecast was. First of all, we beat and exceeded our professional services revenue significantly versus what we had anticipated. Primarily, the reason for that is we had a lot of large enterprise deals closing at the end of Q4, did those deployments in Q1, had much higher utilization from our professional services. So we saw some real uptick in revenues from what we anticipated from that. The second thing is that during the course of the Q1 quarter, we had a lot more linearity in the business than we had anticipated. And both of those things, we took into consideration as we thought about how those dynamics played out in Q1 and factored it into

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what our Q2 forecast is. We certainly are feeling very strong about the business, the underlying market and -- the underlying market landscape and feel like this is a very prudent guidance, but very -- we are still very -- we are very bullish on the business.

Operator

We'll hear next from Rob Owens from KeyBanc Capital Markets.

Michael Edward Casado - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Mike Casado on for Rob Owens. In terms of the cross-sell activity in the quarter, how would you rank order the contribution by product? And I guess relatedly, I'm hoping you can speak to the early reception of ThreatInsight and in particular, how the promise of passwordless access might be aiding the pipeline for adaptive SSO and adaptive MFA.

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

The -- so the answer to the ThreatInsight is related to the impact of the -- which products. So the core identity products remain very strong. Adaptive MFA had a strong quarter, and we've also continued -- kind of going down the list, we've also continued to see the Lifecycle Management be a differentiator, especially against some of the more narrow traditional access management players in the market. And then as well as -- the other big driver in our business is customer identity. So every company is figuring how they can become more of a technology company, and identity helps them with that, and that had a strong quarter as well.

Michael Edward Casado - *KeyBanc Capital Markets Inc., Research Division - Associate*

That makes sense, Todd. I also know that Okta had been in the U.K., Australia and Canada. So can you help us understand the considerations that put Paris and Stockholm next on the list and more broadly, how you're thinking about the partnership contribution as you eye that international opportunity?

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

Yes. Hey, Mike, this is Frederic. So happy to do that. I think when you think about the mark -- the expansions that we have across our offices, you've seen us obviously expand throughout the years as we continue to grow. You saw us add San Jose last year and now doubling the footprint there. You see us with the San Francisco headquarters consolidating at 100 First St. later this year, which are great moves. Internationally as well, you continue to see the business expand. When you think about those mark -- those office expansions you mentioned, specifically Paris and Stockholm, I think a couple of things there. First of all, they're markets where we see a quick expansion of cloud adoption and of mobile applications. So when you think about not only Europe, I think France is one of the fastest-growing Software as a Service adoption countries. And then the Nordics have been good adopters of Software as a Service applications for a number of years now. But I would think about those office openings as actually lagging indicators because we've had strong performance in those countries already for a number of years. A good example is our global energy company like ENGIE in France. We've been servicing a lot of those large players throughout Europe from our U.K. headquarters, which continues to grow very fast as well, but we think it's a growing sign of solid play with our customers to have more and more folks in territory with offices and really planting the flag that we're there for the long term.

Operator

Sterling Auty from JPMorgan.

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

I want to start with how, if at all, has the mix of products in both your initial deals and then more of your expansion deals changed in the last couple of quarters? Because it definitely feels like the large deal traction is growing.

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

Yes, thanks for the question. So I think as you've seen, we continue to deepen the breadth of the products that we have. Meaning there's more and more functionality in all of those products. Obviously, with an agile development life cycle, we release software throughout the course of the year and customers benefit from that. I think what that means is that each of those products starts becoming more and more feature complete, so we can really start to land with any of our products in both use cases, both internal and external. And those landing opportunities, first of all, we're doing it inside large organizations, which is why you see the growth in the over $100,000 a year ARR. Over half of the growth of those logos from this past quarter were net new logos. So that's the first thing. You see this increased opportunity for us inside these large enterprises, but also you continue to see more and more use cases. As we deepen the products and each of those products can go into both of the use cases, you've got more and more use cases where we can help larger organizations, something that I'm personally very, very excited about in the times ahead.

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

That makes sense. And then one follow-up. How should we think about how you monetize the new relationship with VMware? And how does that ramp in the coming quarters?

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

Yes. So thanks. For those of you who were not at Oktane, we announced a great partnership with VMware just a couple of weeks ago, which we're very, very excited about. It's something, frankly, that customers are thrilled about. On day 2 of the show, we actually had the Chief Technology and Digital Officer of JetBlue onstage. And he said, hey, I love the announcement from yesterday. It's something I'm already going to put into play, which is great. So we see a great opportunity to work with our friends at VMWare to both improve customer experiences as well as obviously for Okta to broaden the prospective customer base that we can go after. What you should expect in the coming months is we're going to continue to build out not only the product but also the go-to-market partnership on all those sides, and you'll continue to see that. We are not planning on any specific revenue uplift for the next quarter or the next couple of quarters from that partnership. But certainly, I think that over time, it could be a very important partnership, and I think it's also a good indication of larger and larger enterprises and partnerships that we can do to go and address the enterprise market.

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Yes. And I'll just add, Sterling, for me, it's just a kind of a representation of the presence in the market we've built up and the -- how we've become a really compelling partner with some of the largest software companies in the world to work with. It's important for us as we try to integrate broadly and deeply across the entire ecosystem, that leverage in the market that drives to partnerships and collaboration is important for our strategy going forward.

Operator

We'll hear next from Alex Henderson from Needham & Company.

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

Just a housekeeping item. Can you tell us what the ending share count was if you had been profitable for valuation calculations? And while you're looking that up, let me ask the broader question. So very impressive conference Oktane19 (sic) [Oktane18], up 50%. A huge turnout there. It seems pretty clear that you guys are really outrunning any competitor that might want to get into this space with the scale of your integration network and the attention you're getting. Have you seen any change in the competitive dynamics as your integration network gets larger and larger? Are there any reactions from these competitors? Are they falling out of -- showing up at fewer deals? Can you give us any metrics around how you see the competitive landscape as a result of your obvious huge success?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

So it's a really -- it's a key question, and while we look at -- we definitely track competitive win rates and think about competitive landscape. The primary focus is on addressing more use cases and broadening the platform and the capabilities. And I think a lot of the -- as you mentioned, a lot of the things that Oktane or a lot of the announcements are around that, more use cases, more applicability, more value to our customers. And I think in turn -- like specifically on competition, the other thing I'll add is that employee identity has a different set of competitors than customer identity. Customer identity is build versus buy. So the strategy there is make sure we communicate to the world that there is a better alternative than building this themselves. That you can use Okta as a component and solve these identity and security challenges and make your customer experience better and make your product or website or mobile app better. So that's on the customer identity side. On the internal identity -- on the employee identity side, I would say kind of the numbers and the growth there tell the story of the competitive environment, namely the competitive positioning we're seeing is strong and consistent with what we've seen over the last several years, so we're very happy about that. And I think it's -- you mentioned it in one of your questions, kind of like we see the big platform players, but folks like Microsoft, they have a different worldview than us, or even Salesforce or Microsoft. They think about their platform, Azure or the Salesforce platform. They don't think about a broad ecosystem of technology. All of that can be used by our customers to be successful regardless of whose platform it might run on. So that's just a different worldview, and I think that's why you see strength in competitive win rates against those kind of folks. And then the other thing you talked -- you said was just scale. And I think a bunch of other competitors that are more point providers or identity-type providers, we're just kind of out-executing them on a scale and a product perspective, and that's adding up to the success we're seeing.

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

So no change in pricing in reaction to your success?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

No, we're not seeing that.

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

And that share count?

William E. Losch - *Okta, Inc. - CFO*

Alex, I don't have that at my fingertips since you were asking it based on if we were fully profitable, but we'll get back to you on that after the call.

Operator

(Operator Instructions) We'll hear next from Terry Tillman from SunTrust Robinson Humphrey.

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Terrell Frederick Tillman - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Can you hear me okay?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Yes. We're hearing a little static on the line. Hopefully everyone can hear us as well.

Terrell Frederick Tillman - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Yes. Sorry about that. I'm going to blame it on my phone. This kind of quarter, when it's strong like this, we end up getting relegated to asking like a CapEx question, but I actually still have a couple of questions -- I have a couple of questions that hopefully are worthwhile. First, I guess, Todd, in terms of Okta API for One App, is this just kind of a test-and-learn type dynamic? Or do you actually see enough already that this could actually accelerate customer identity business or at least the landings, if you will?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

It's definitely the second thing you said. It's a result of learning that isn't a test-and-learn. So we've learned being in this business now for a few years that traditionally, we've entered the customer identity business from the enterprise side. Meaning that it was complex, multi-directory, multi-application, high scale, high user load. And then last year at Oktane, we -- the year before this Oktane, we introduced the developer -- API products for developers. And that was more of the -- for a developer to do a quick proof-of-concept or POC. And the learning there was that they needed something in the middle. They needed something that was beyond the developer API products but not all the way up at the enterprise level. And that's -- API products for One App is a result of that. So we're really excited about this, and we think that it's going to give us another landing point for this important part of our business.

Terrell Frederick Tillman - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Great. And as a follow-up on the customer identity side. This is maybe just selfishly an education question for me in terms of are there any notable demand differences or trends as it relates to you guys getting customer identity wins where it's a custom-develop type situation as opposed to like an ISV or a packaged app like Adobe?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Yes, no problem. Happy to answer the questions. The customer identity business is -- the majority of it is they're building a website or a mobile app versus them being a software vendor themselves. We have many of those, but the majority is that it's a company transforming their customer experience by building a website or a mobile app. The example we gave earlier on the call of FICO, right, that's FICO modernizing their customer experience using Okta as a component inside something they're building.

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

And I will just add that I do think you touched on the Adobe piece. That is -- I wouldn't say it's a trend, but we're seeing more and more of that. For example, we have customers like Splunk or Palo Alto Networks or ServiceNow, where they start using us for the extended enterprise, then they start using us for customer identity and access management, and then they just see the value of actually putting us right inside their products. So that is something where we're very excited about the opportunity to work with some of the leading technology providers out there. But yes, customer identity and access management more broadly is every company has to become a technology company and provide better interfaces and experiences for their customers and their partners and their vendors, and that's something we're very excited to help them with.

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Operator

We'll move next to Jonathan Ho from William Blair.

Jonathan Frank Ho - *William Blair & Company L.L.C., Research Division - Technology Analyst*

I just wanted to, I guess, go back to one of your comments around more evidence that the company is now becoming the central identity platform. I guess, I wanted to kind of delve a little bit further and understand maybe what supports that claim and maybe what the implications are in terms of how your customers will then deal with their other partners and suppliers.

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

It's a good question. We think about that a lot. And I think as we were preparing the comments and the materials for the release and the call, it really comes down to the different types of identities in their ecosystem that they're managing through Okta and then the use cases that they're using Okta to solve. And the more types of identities, be it customers, partners, employees, in managing through Okta and the more use cases, whether it's customers logging in to a website or employees or partners logging in to collaborate, that -- when enough of that happens, that's when we say we're the standard in that organization versus -- a lot of times, the journey with Okta begins very, very flexibly in solving an immediate problem a customer has, right? Maybe it's one application they're trying to get rolled out or a new project they're trying to build. And then over time, we become the standard as we take on more and more identities and use cases. I think that -- we talked a lot about reducing friction and complexity and allowing our customers to focus on the benefits of technology versus like the plumbing. And the challenge to that is complexity and different ways things are done and different protocols and different standards and different design patterns. And I think to your question about what our growing presence in this market, in this ecosystem allows us to do is it allows us to help standardize some of that stuff. So it standardizes the approaches of identity and how you get to this world of Zero Trust perimeterless security, how you really create a customer experience without having to reinvent the wheel from identity. And the more prevalence we get, the more partners we can work with, and the more things we can connect to, the more we standardize how things are done and the more effective we can be removing that complexity from customers' environments and helping them achieve their business goals faster, and that's kind of the core of what we're trying to do.

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

And Jonathan, I would just add, since you were at Oktane, you heard folks like the CIO of Cardinal Health or the CISO of Allergan, Fortune 15, Fortune 500 companies talking about how they are seeing Okta. After solving specific problems, they really start thinking about Okta as a foundational platform throughout their organization as they're modernizing IT both for the extended enterprise and for customer identity management, which is very exciting. But I think what's more exciting even is that it's very early innings. Our penetration in the enterprise is just starting, and the opportunity in the years ahead is very exciting.

Jonathan Frank Ho - *William Blair & Company L.L.C., Research Division - Technology Analyst*

Great. And then just as a follow-up. Just given the strength in the gross margins this quarter, how should we be thinking about that as we think about the margins over the course of the year just given the overperformance on professional services?

William E. Losch - *Okta, Inc. - CFO*

Yes, Jonathan. This is Bill. Like I said, we thought Q1 was an exceptional quarter because of the fact that it's a seasonally strong quarter when you have a lot of business coming in at the end of Q4 and you've done those -- you do those deployments in Q1. So we had very, very strong utilization in that quarter. I think that going forward, we're not changing, making any fundamental changes in our gross margin assumptions. I think to the

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extent we do continue to overperform on professional services margin, there will be some upside. But I think overall, we're keeping the same assumptions going [progress through] the year.

Operator

Shaul Eyal from Oppenheimer.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Todd, can you share with us how GDPR playing into the equation? Are you seeing accelerated conversion from just interest over the course of the past few quarters into actual revenues?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

It's definitely on everyone's mind and the conversations are very prevalent. And it's kind of happening at the same time as all these other trends we're talking about. Companies trying to modernize their technology environments. Companies trying to transform their customer experience. So sometimes, it's hard to tease apart about what is driving what, but I will tell you this, that every company is trying to figure out this inevitable -- the inevitable regulatory impact on everything they're trying to do. And they're looking for partners that can help them do that. They're looking for people that know how to be GDPR-complaint and other regulations, by the way, compliant themselves, or looking for people that have expertise in like how that maps to what the customer is trying to do, both from an internal perspective and from a customer -- their customer's perspective. So we've become very conversant in that both in our own compliance and in the industry we're in. And it's -- we're having productive conversations that are resonating helping customers. So I think -- overall, I think it's a very positive thing for us and for the industry. But I do -- I also think there's a lot of work to do as an industry to regulate and to effectively balance all of these competing priorities, personal data, security, privacy, compliance. And I think we're happy to work with our customers and with the regulators to push that all forward.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Understood. And my follow-up question could be a little tricky here. Looking at your new net 350 customers that you booked this quarter, even just from a qualitative perspective, how many of them are -- would you define as displacements? How many do you think are pure greenfields?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Yes. I don't know. I don't know the number. Yes. It's essentially like why I don't know the number is because I think it's very -- it happens gradually, right? Our motion is we start solving problems and deliver value very quickly. And over time, it might end up into a sizable account even before we've displaced anything, let alone a global multimillion dollar installation of a legacy identity suite. So I'd say the default motion for us is coexistence and over time add more and more value with more use cases and more capabilities and becoming the standard and then over a number of years, it's a displacement. So yes, I think that's been our motion, and that's kind of the trend we've continued to see. With the -- obviously, we see more and more displacements because the product has gotten a lot better than it -- over the last few years, it's continuously improved. And customers' move to the cloud and modern technology has put their architectures in a place where what we do in the Identity Cloud makes incredible amount of sense, and the pattern of using it to displace legacy technologies is more obvious than ever. So those are more prevalent than they have been, and we've continued -- we expect that to continue going forward.

Operator

We'll hear next from Gray Powell from Deutsche Bank.

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Gray Wilson Powell - *Deutsche Bank AG, Research Division - Research Analyst*

So at the conference a couple of weeks ago, you talked about how customers are purchasing more modules on day 1. So I'd be curious like what's the typical increase in a contract if a customer buys MFA in addition to SSO and Universal Directory. And then would it be common for that customer to expand MFA to all users at the company? Or is it just -- is it really just like a certain subset of high-priority users?

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

Yes. Gray, thanks for the question. So I think there's a couple of things there that you talked about. The first one was as customers purchase more, as you know, for the different products, they're priced on a per product basis. So as you would go up and add more modules, as you call them, from Single Sign-On, Universal Directory, adding in something like Multi-Factor Authentication, obviously, you would pay in addition for that specific product. I think what's more exciting when we take a step back is that each of these different products are now so feature-rich that you can land with any of the products. So it might be the case, for example, that you have Single Sign-On, Universal Directory and layer on Multi-Factor Authentication. We certainly see that in examples like Mattel, where they've been a customer for a while using those Single Sign-On, Universal Directory products and then added Multi-Factor Authentication this quarter, which we talked about. But you also start to see a situation where each of the specific products can be purchased as a point solution. For example, we talked on this call a couple of quarters ago about a large financial institution. They were looking to enhance their customer-facing web properties, and for high net worth individuals, they wanted to provide Multi-Factor Authentication for that specific piece. So that would be a good opportunity where we'd start externally with customer identity management and then be able to go back internally for extended enterprise later on. So I think what you start to see is you can really land with any of these products in either of the use cases.

Operator

Your final question today will come from Pat Walravens from JMP Securities.

Patrick D. Walravens - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Todd or Frederic, I'm not sure who, but can one of you guys comment on what the pipeline and opportunity look like in federal government? So -- and maybe does that -- that Centers for Medicare & Medicaid deal, does that help you position -- help position you for future things?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Yes, it's strong. I mean, the government's a big part of the world and a big part of the economy. And like everyone else, they are figuring out how to leverage technology and balance the demands of citizens with also the realities of security. And I think the deal you spoke of, the Center for Medicaid & Medicare Services (sic) [Centers for Medicare & Medicaid Services] is a good example of that. We've done a lot of work in terms of -- we mentioned GDPR earlier, but we've done a ton of work on compliance for federal government regulations. And the more agencies we bring on board, the more evidence for other agencies that we can help them solve their problem. It's definitely an important area for us.

Patrick D. Walravens - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

So like if I have a log-in as a citizen for whatever you do for Medicaid, is there a path to that later when I need to get my passport renewed, being able to use the same one?

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

It's a potential. It's a potential. I mean, there's a lot of different websites and different properties involved there, but we'd like to have Okta be behind all of them. And with the success we've had in some parts of the government, we can think it's decently possible that we could leverage and eventually having that be a reality.

Jacques Frederic Kerrest - *Okta, Inc. - Co-Founder, COO & Director*

I think what you're seeing -- Todd, I would just add, is what you're seeing in the federal government, also in state and local but particularly in the federal government, I think it's very similar dynamics to the enterprise, where we've been working with them for some time. For example, we're FedRAMP Moderate-certified, which we were sponsored by the CIO over at the Department of Justice, to give you an idea, a couple of years ago. We're continuing to build on that. CMS, which you mentioned, is actually an upsell. They've been a customer for a year now, and this is actually an upsell to the extended enterprise to integrate more services for their partners. But we're -- it's early. Giant market, as you mentioned, it's early. And there's a lot of opportunity, and we're going to continue to make very good progress as we go.

Operator

And at this time, I would like to turn the conference back over to Mr. Todd McKinnon for any additional or closing comments.

Todd McKinnon - *Okta, Inc. - Co-Founder, Chairman & CEO*

Thanks, everyone. We appreciate the time, and I love this quote, and it's from one of our customers who -- he's the Chief Digital and -- I want to leave you with this quote as a final thought. So he's the Chief Digital and Technology Officer of JetBlue. And the quote is, "Everything in aviation starts with who you are and what you do. Identity is the key to the success of this airline to keep us safe and secure." So it's really a manifestation of how identity is becoming so important to JetBlue and to that industry, but it's not just aviation. It's every industry that is -- every industry in the world as they all strive to connect their people with the important technologies that -- and make it easy and make it secure. And so the Identity Cloud is truly a foundational platform, and we're investing in all these strategic areas we've talked about. And we believe that, that's going to be the key to our sustained, long-term and durable growth. So the market opportunity is immense, and we're still in the early days. So I look forward to bringing some of this excitement and energy that we've talked about today and we're seeing in the marketplace out into when we go on the road and meet with a bunch of you one-on-one in the coming months. So until then, thanks for your attention, and I look forward to speaking with you soon.

Operator

That does conclude this evening's teleconference. We thank you all for your participation.