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OKTA.OQ - Q1 2020 Okta Inc Earnings Call

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PRESENTATION

Operator

Good day and welcome to the Okta First Quarter Fiscal Year 2020 Earnings Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Dave Gennarelli, VP, Investor Relations. Please go ahead, sir.

Dave Gennarelli - Okta, Inc. - IR Executive

Good afternoon, and thank you for joining us on today's conference call to discuss the financial results of Okta's first quarter of fiscal '20. 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.

Today's call will 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 and uncertainties that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Forward-looking statements represent our management's beliefs and assumptions only as of the date made. Information on factors that could affect the company's financial results is included in its filing with the SEC from time to time, including the section titled Risk Factors in its previously filed Form 10-K.

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. A reconciliation between GAAP and non-GAAP financial measures and discussions of the limitations of using non-GAAP measures versus their closest GAAP equivalents is available in our earnings release. You can also find more detailed information in our supplemental financial materials, which include trended financial statements and key metrics posted on our Investor Relations website.



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On today's call, we will quote a number of numeric or growth changes as we discuss our financial performance. And unless otherwise noted, each such reference represents a year-on-year comparison.

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

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

Thanks, Dave, and thanks, everyone, for joining us today. We kicked off fiscal year '20 with another strong quarter. Total revenue grew 50%. Subscription revenue grew 52%. Calculated billings grew 53%. And we generated positive free cash flow of \$13 million. We added 450 new customers in the quarter, bringing our total customer account to over 6,550. Once again, we made broad additions across our enterprise customer base with 53% growth in customers with annual contract value greater than \$100,000. The sequential addition of 104 of these customers is even more than our seasonally strong Q4.

What really excites us about these numbers is that well over half of these additions came from new logos, providing a clear indication that we're experiencing increased traction landing customers at scale in the enterprise market. The market tailwinds contributing to our momentum are the rapid growth of cloud and hybrid IT, digital transformation and security. These continue to strengthen, and identity plays a critical role in each of them. Organizations are turning to Okta because we are uniquely able to address the broadest set of use cases across even the most complex technology environments.

I'll share a few customer examples from the quarter that highlight our momentum. First, one of the world's largest banks was a significant new workforce identity deal. The company was looking for a cloud identity solution to enhance their security profile and reduce IT friction of managing over 1,200 third-party SaaS and hosted applications. The company selected Okta because it could easily integrate with its current technology landscape, automate onboarding and off-boarding of employees, and help them transition into a hybrid cloud future.

Another new workforce identity win was Takeda, one of the largest pharmaceutical companies in the world. After Takeda merged with Shire, the combined company needed to streamline access to all applications across their global workforce. Okta will provide Takeda's 37,000 employees with that secure, seamless access that team members can collaborate more effectively.

A new customer identity win was with a Fortune 100 global technology company. The company was looking to modernize its IoT marketplace and improve the experience for its reseller partners. The company will implement Okta's customer identity products to provide secure, flexible access to partners when ordering IoT products and services in their IoT marketplace.

Lastly, eMoney Advisor, a leading provider of financial planning software, serving more than 60,000 financial professionals and 4 million households in the U.S., was a noteworthy customer identity upsell. The company has selected Okta to secure its customers' and partners' sensitive data by providing seamless access to eMoney resources and applications.

What these organizations and many of our other customers have in common is that they are becoming technology companies by necessity. Today, an organization's capacity for technology is what will determine its success. And we've built the Okta Identity Cloud to enable that transition with the speed, scale, security and flexibility that our customers require.

We are on the forefront of capitalizing on 3 broad technology trends. First, we are the platform to enable cloud adoption and hybrid IT. Organizations are rapidly adopting the cloud. These best-of-breed solutions need to coexist with their existing on-premise applications and infrastructure in a frictionless way. One of their biggest challenges is ensuring that the right people are able to access the right technologies at the right time regardless of where they are located. This is why identity has become so important. But unlike traditional identity solutions, Okta is an independent platform that is purpose-built for diverse environments and enables customers to adopt new technologies in a fraction of the time that it would take with legacy solutions. With Okta, companies like Hitachi are able to replace legacy systems, consolidate access and accelerate technology adoption for more than 300,000 employees across hundreds of business units.



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Second, we are the platform to enable digital transformation. Okta is a true platform in the sense that it is extensible, flexible and easy to connect to and build on. Rather than building identity functionality themselves, companies like Allied Financial and Cardinal Health rely on Okta as the identity layer for their customer-facing applications. This enables them to focus their developers on building core functionality so that they can get to market faster while also leveraging the full scale and security of Okta to protect the identities of their millions of customers.

Third, we are the platform to enable Zero Trust security. Mitigating the risk of security breaches is one of the top concerns that CEOs and Boards face, and it has brought a lot of attention to this concept of Zero Trust. Security is now identity-centric and requires organizations to never trust and always verify users who are trying to access resources. For customers like NASDAQ and AECOM, Okta lays the foundation for Zero Trust because of our advanced access management capabilities and real-time threat data that can be used to proactively protect organizations from attacks.

At Oktane last month, I talked about how our strategy is rooted in making our customers successful through our leading products, our growing set of integrations and use cases and the increasingly valuable data that we collect through millions of people using our service every day. As we build more products that leverage these integrations, we unlock more use cases, attract more customers and generate more data that can be used to build better products and make our customers more successful. The result is a powerful network effect that we believe we're uniquely positioned to leverage, and the announcements we made at Oktane are a significant step forward in accelerating every aspect of the strategy.

The first announcement we made, risk-based authentication, shows how we're using data to make our customers more secure. When someone attempts to sign in, Okta analyzes the user's context, including their device, location and network. Based on this data, they are assigned a high, medium or low risk rating, which automatically determines and enforces an appropriate access decision.

The second Oktane announcement was Okta Hooks, which makes the Okta platform completely extensible. With Hooks, developers and IT teams can customize authentication or user registration flows to include calls to third-party systems. Hooks can be used to enable things like a deeper level of user verification or more streamlined account creation, enabling us to infinitely extend our integration catalog. As our customers build these integrations, they can be published to the Okta Integration Network for our broader community to leverage, further accelerating the network effect I discussed earlier.

We're also making the core functionality of our platform more customizable to enable our customers to address an unlimited number of use cases. The third announcement out of Oktane was Okta Identity Engine, a set of customizable building blocks for every identity experience. We've essentially made the core functionality of our products consumable, such that our customers can customize their identity experiences in the way that best suits their business.

We also announced 2 brand-new products at Oktane. First, Okta Access Gateway enables seamless access to on-premise applications so that our customers, especially large enterprises, can use Okta for secure access from cloud to ground, across their hybrid environments; and lastly, Okta Advanced Server Access, which is generally available today and already being used by dozens of customers. Advanced Server Access uses continuous authentication and centralized access controls for on-premises, hybrid and cloud servers. Secure access to servers is a critical and underserved use case and we're very encouraged by the positive response this new product has already gotten from our customers.

In other news this quarter, we are very excited that Diya Jolly has joined us as our new Chief Product Officer. Diya brings over 15 years of experience leading product development at some of the largest enterprises in the world and most recently was a VP of Product Management at Google, where she drove large-scale adoption of some of their most critical products. We're thrilled to have her on the Okta team and are looking forward to continued innovation.

In summary, I'm very pleased with how we started fiscal year '20. Momentum continues to be on our side both in terms of the market tailwinds that are powering our business as well as the innovation we're driving. We are seeing great traction on all fronts and remain focused on executing against the large market opportunities in front of us.

Thanks again for your time and I'd now like to turn the call over to Bill to walk through our financial results. Bill?



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William E. Losch - Okta, Inc. - CFO

Thanks, Todd, and thanks again to everyone for joining us. I'll go through our results for the first quarter and then discuss our business outlook for Q2 and the full year.

As Todd mentioned, we maintained a strong momentum we had exiting Q4 and experienced better-than-expected growth in many areas, including revenue, calculated billings and cash flow. Subscription revenue totaled \$117 million in the first quarter, an increase of 52%, representing 94% of our total revenue, up from 92% in Q1 last year. Revenue from outside of the U.S. grew 60% and represented approximately 16% of our first quarter revenue compared to 15% in Q1 last year. We continue to view our international business as a long-term growth driver and are investing to expand our international footprint. An example of this is our recent hosted data center expansion in Asia-Pacific and a new office that we opened in Germany, which were both announced this afternoon. Another source of revenue growth is from the momentum of our partner resell channel. While still in its early stages, the partner channel already contributes over 1/4 of our business. These channel partners provide Okta with a global reach and scale that we wouldn't be able to efficiently achieve on our own.

Moving on to billings. Total calculated billings grew 53%, and current calculated billings increased 54% over Q1 last year. The strength in billings continues to be driven by both new and existing customers across enterprise and commercial. Billings also benefited from strong bookings within the quarter and a particularly strong third month. The strong close relates to a combination of factors, including the momentum of our business and some beneficial invoice timing.

That's a good segue for me to provide color on remaining performance obligation, or RPO, for the first time. It's likely that you've heard other software companies reference RPO or backlog, which for us is contracted subscription revenues, both billed and unbilled that have not yet been recognized. We've been reporting RPO in our quarterly SEC filings since Q1 of last year as part of the adoption of ASC 606. We report both current RPO, which will be recognized as subscription revenue over the next 12 months, and total RPO. Total RPO at the end of Q1 was \$792 million and we expect to recognize \$416 million or 53% of that over the next 12 months. Growth in total RPO was 59% and current RPO grew 49%.

We only have 5 quarters of history with this metric and as such, RPO should be viewed as simply an additional metric to gauge our performance in the quarter. Year-over-year growth in current RPO is the more meaningful metric when also viewing subscription revenue or billings growth. Billings can sustain variability caused by changes in invoice duration and invoice timing, while RPO can reduce some of the variability seen in billings because it eliminates variances in these invoice dynamics. However, RPO can be influenced by factors such as contract duration and renewal cycles. There will be some quarters where growth in calculated billings outpaces growth in current RPO, like we just experienced in Q1 and vice versa depending on the influencing factors I noted.

Turning to retention. Our dollar-based net retention rate for the trailing 12-month period remains strong at 119%. This represents a 1 point sequential decrease and is a natural reflection of the larger initial deals we're achieving with enterprise customers, as evidenced by the 53% growth in customers with over \$100,000 in annual contract value that Todd mentioned. So as we increasingly target large enterprise customers and initial deal size continues to grow, we believe our dollar-based net retention rate will remain very healthy and may fluctuate a bit from quarter to quarter.

Turning to gross margin. Subscription gross margin continues to be strong at 81.8%, up 110 basis points versus the first quarter last year. Total gross margin was 75.7% in the first quarter, up 160 basis points. Gross profit grew 53%.

Now looking at operating expenses. Total operating expenses for Q1 grew 68%. The increase is primarily driven by sales and marketing investments as we look to capture more of our large addressable market, win more of the world's largest organizations and expand geographically. Importantly, we also moved the timing of Oktane from Q2 last year to Q1 this year. The overall expense growth reflects what we talked to you about last quarter and the commitment we've made to investing in our strategic priorities, which include driving business with the world's largest organization, strengthening the network effects of our platform, the Okta Integration Network, expanding our presence with customer identity, and investments in security with the Okta Identity Cloud. As usual, the biggest component to the spend increase is related to scaling headcount to support the strategic initiatives. We've been successful in attracting and retaining great talent, and total head count grew 40% to 1,770.

We continue to invest in our business as we scale for durable growth. Operating loss in the first quarter was \$25 million, a margin of negative 20% compared to negative 13% in the same period last year and reflects the increased investments I just noted. Keep in mind that Q1 each year



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experiences operating margin seasonality due to the reset of payroll taxes, expenses related to our annual worldwide sales kickoff event and, as I said, the shift in Oktane timing to Q1 this year.

Net loss per share in Q1 was \$0.19 with 113 million basic shares outstanding. This compares to a net loss per share in Q1 last year of \$0.09 with 104 million basic shares outstanding at the time.

Our top line performance and seasonally strong cash collections drove our solid cash flow performance. Operating cash flow was \$21 million in Q1. Operating cash flow margin was 17% compared to 5% in Q1 last year. Free cash flow was \$13 million, positive for the third quarter in a row. Free cash flow margin was positive 11% compared to negative 2% for Q1 last year. We remain encouraged by these results and expect to see continued variability in cash flow margins due to ongoing fluctuations in working capital, the growth in enterprise business and seasonal factors.

We ended the first quarter with \$547 million in cash, cash equivalents and short-term investments.

During the quarter, we adopted the new lease accounting standard, ASC 842, to reflect our operating leases on the balance sheet, resulting in a new operating right-of-use assets and liabilities line items. We have recast our prior year balance sheets to reflect the adoption. This has no impact on our current and prior period income statements or cash flows.

Moving on to our business outlook. We remain optimistic about the current demand environment. And based on our strong first quarter results, we are raising our full year outlook. For the second quarter, we expect total revenue of \$130 million to \$131 million, representing a growth rate of 37% to 38%; non-GAAP operating loss of \$14.9 million to \$13.9 million; non-GAAP net loss per share of \$0.11 to \$0.10, assuming shares outstanding of approximately 115 million. For the full fiscal '20, we are raising our guidance and now expect total revenue of \$543 million to \$548 million, representing a growth rate of 36% to 37%; non-GAAP operating loss of \$67 million to \$62 million; non-GAAP net loss per share of \$0.49 to \$0.45, assuming shares outstanding of approximately 116 million.

In summary, we had a strong quarter and a great start to the new fiscal year. The overarching trends that are propelling our business remain in place and we believe we are still in the early stages of this tremendous market opportunity. As such, we are making the appropriate investments to innovate our platform, fuel growth, further enhance our competitive positioning and capitalize on the tremendous market opportunity.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Rob Owens with KeyBanc Capital Markets.

Robbie David Owens - KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst

As you're seeing this increased traction with enterprise accounts and the move upmarket, I guess, with customer acquisition, is that coming vis-à-vis the channel? Or is that coming more so direct at this point? And as channel contribution ramps, do you think that will be across market, mid-market? Maybe just give us some flavor there?

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

Yes, it's a good question. I would say that the things you mentioned are all factors but I would back up a second. I would say what's really going on across the business is everyone's companies, large and small, every industry is figuring out how they can do more with the cloud, how they can



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transform digitally and then how they can do that all securely. So these are secular -- big secular trends we've talked a lot about before but you're seeing it, particularly with larger enterprises, really contribute to our momentum there.

So when you talk about a large enterprise, the channel is a factor. From the systems integrators that are helping those companies figure out how to do those things, adopt the cloud, transform digitally and do it securely, whether it's in certain parts of the markets they want to buy through a reseller channel, especially internationally, it's like a reseller channel contribution. And not only are enterprises in every company wanting to capitalize on these macro trends but the channel partners themselves are. They see big opportunities helping companies adopt the cloud and so forth. And so it's a pretty positive combination across the board for us.

Robbie David Owens - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

Great. And as a housekeeping follow-up, Bill, do you have a fully diluted share count for us?

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

Yes, Rob. The fully diluted share count that I would use is 136 million.

Operator

And we'll take our next question from Heather Bellini with Goldman Sachs.

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

Two questions. The first is maybe if you could talk to us a little bit about how the message of Identity Cloud is resonating and how this might be impacting the size of initial lands. And the second question is just if you look at the increase in customers greater than \$100,000, you actually added more in Q1 than you added in Q4 and it was almost double the amount from a year ago. Can you share with us kind of what's driving that incredible momentum?

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

The -- so the Identity Cloud -- the question first about the Identity Cloud and how it's resonating. It's pretty interesting, Heather. When we started selling the Identity Cloud 7 years ago, 8 years ago, it was a pretty new idea, right? This concept that there was going to be enough of your infrastructure, enough of your application stack that was going to be delivered from the cloud, that it would make sense to have your security and your identity and your access control and your access management also delivered from the cloud. And over the past 8 years, 7 years, that has dramatically shifted to where now it's -- in many cases, especially in the larger enterprises, they understand that and they are coming to us looking for that versus us trying to position that as the way forward, which is very powerful.

And as you talked about the impressive results, it's as much about these macro trends and how that positions the Identity Cloud in the context of these trends than it is about anything. There's of course a lot of just bigger companies are having success with Okta. So they -- companies see that success and realize they can have this success, too. So there are some people wanting to imitate or emulate their peers and so forth. That's driving success there.

But I'd say more than anything, it's the fact that these enterprises have enough cloud, they want to do more with the cloud, they want to do it in a way that drives not only their cost and their internal efficiency but moves their business forward as a digital technology company themselves. And then finally, they do it securely and they're seeing -- and the message of Identity Cloud is the key to do that is resonating. So it's a powerful combination and it's driving our results.



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Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

And Heather, I would just add -- this is Frederic. I would just add to that, that you have to keep in mind, it's still very, very early in the business. I mean the opportunities ahead of us in these markets are large. And I think when you start to see things, like last quarter, we talked about some large federal opportunities where they're starting to come to us with the State Department. This quarter, we have one of the world's largest banks that is now adopting the Okta Identity Cloud for workforce because they're moving to hybrid. When you start to see these large markets that are typically not the first early adopters to modern technology, that's where it starts to get exciting, and I think that times ahead are going to be very interesting as more and more of these large organizations realize the opportunities and the power of the cloud.

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

Great. And any comment just on the fact that you were able to increase your net adds above. You usually don't see Q1 better than Q4. I mean is there -- like is there anything that you think just (inaudible)

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

We were -- we've been -- yes, it's a good question. By the way, we're very happy with it. But if you look at the root causes, I would say we've been working on it for -- it's not a new thing for us, focusing on larger enterprises. And it's the customer success. It's the market trends fueling the growth. I wouldn't say it's any particular tactic or a specific thing we did. It's just kind of a lot of good execution coming together.

Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

And I would just add that keep in mind, we're an organic software development company. So we're going to keep building products. We rev the product and come out with new releases all the time. That's more and more use cases that we can solve. That's more and more opportunities for people to take different components of the platform and address them. So you just start to see more and more organizations who can find different ways of leveraging the Okta Identity Cloud to move their businesses forward.

Operator

And we'll take our next question from Jonathan Ho with William Blair.

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

Congratulations on the strong results. I just wanted to start out with one of the large announcements you made around Major League Baseball. Could you maybe give us a sense of how that additional revenue uplift -- what it sort of looks like and how these external use case opportunities can maybe add up over time?

Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

Yes. So we're happy to talk about that. So as you mentioned, Major League Baseball has actually been a customer of ours for some time. They used it first internally at headquarters. And then more and more of the teams, the Major League teams started adopting the Okta Identity Cloud for their employees and their teams, so pretty small deployments. What they then realized was that as they were trying to modernize MLB and MLB.com, what you see is more and more digital access and the importance of bringing in younger customers and folks who are really digitally native. They realized they had to upgrade the entire infrastructure, and that was the opportunity there. So now -- and we managed to do it very quickly for them. We got it up and running for opening day, which they were thrilled about. And so MLB.com, whether you were streaming any of the games or getting any of the updates live for the millions and millions of customers for MLB.com, they were all running on Okta.



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Now you asked about -- we're very, very happy with that deployment. It worked out very well. So we're very thrilled of that. You asked also about the uplift and kind of the economics behind that. Obviously, there's 2 main components to the business: Workforce identity management, which is priced per user; and then customer identity and access management, which is priced per authentication. So they obviously consume a certain number of authentications for all that access. And so it's really right in line with the way as customers become more successful with customer identity and access management, we kind of share in that as they go up on a market and these products become more and more successful.

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

Yes. I was just listening to Freddy explain that. One thing that popped into my mind is that as the product and platform have gotten more powerful both on the workforce side and on the customer identity side, we're seeing that it's a benefit of they're interested in us -- companies are interested in us because we can do more use cases for them. But also, the initial deals get bigger because they start looking at us for one part of the platform and end up buying initially even many parts of the platform. A good example of this is we've had a stand-alone multi-factor authentication product for a number of years, and what we've seen increasingly happen is people evaluate us just for multi-factor authentication and they see the benefits of having that tightly integrated to the whole identity platform and they end up buying more than multi-factor authentication upfront. So it makes that initial deal bigger, which I think is very positive for the business.

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

Got it. Got it. And then can you maybe give us a sense as well when you talk about Zero Trust, how are customers sort of looking at this as an opportunity to increase their security? How does ScaleFT fit in with this? And again, what does this look like from an economic perspective in terms of the Zero Trust side?

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

Zero Trust is a big trend and it's pretty broadly defined. Basically, it means a world where you don't have a separate network inside your firewall that is secure and trusted and it's separate outside that's not trusted. You just kind of flatten the whole thing and you treat everything as untrusted. And the advantage of that is it allows you to give your users much more free access, so much more flexibility. They can -- whether they're in the office or outside the office or in the data center, outside the data center, they can access in the same way. And the powerful thing for Okta is to do that, you can't rely on a network perimeter. You have to rely on identity. And you have to have an identity system that knows who should access the resource, what time, from what device. You have to have an identity system to get that right and it's what's -- as companies try to be more secure, try to have this more flexible Zero Trust environment, they need identity, and it's really a fortuitous position for us to be in.

ScaleFT, as you mentioned, is pretty interesting. So when we bought the technology, the company ScaleFT, originally, we bought it because they had some key technology that would help us do continuous authentication in the Zero Trust world. So we know a lot about the device and we could do really strong authentication no matter where you were, where we just look at the device and be able to identify it uniquely. And then as we got into it, what we found is that the product they had, which was Advanced Server -- or eventually became Advanced Server Access, was a hit product just on its own. So forget about just the base-enabling technology. Advanced Server Access had the makings of a hit product and that's what we've seen. We announced general availability of the fully integrated Okta product, Advanced Server Access, at Oktane and that product continues to exceed our expectations and we've had to up the forecast of that product since we started initially selling it near the end of last year.

So it's been very helpful both ways. And I think also, that story kind of informs our overall approach to M&A. Largely, we think about organic. We're an organic product company. We build our own technology, but where there's customer demand or where we see the ability to add technology in key markets or kind of take advantage of key trends, we're open and looking and flexible for that and we see, like an example, ScaleFT, it's worked out very well.



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Operator

And we'll take our next question from Gray Powell with Deutsche Bank.

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

Congratulations on the strong results. So maybe can you help us think about the launch of your -- or the upcoming launch of your Access Gateway product and the potential to support more on-premise applications? Is that something that should move the needle with larger enterprise accounts? And then just how are you thinking of that product impacting deal sizes?

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

Yes, absolutely. Happy to talk about that. So Okta Access Gateway, as you mentioned, is another one of the exciting announcements that we made at Oktane. We are -- it is live in the wild with a first set of customers right now and we're very excited about this product because as we had a question earlier about the growth in larger organizations adopting the Okta Identity Cloud, those large organizations, it is very early innings for them in terms of thinking about how they're going to deploy more and more cloud technology. And the reality of it is, enterprise IT, they don't throw anything away. They kind of glue new things on the front.

And so these large organizations are thinking about how they can take advantage of the investments they've made today but still take advantage of all the modern aspects of the cloud. And a key factor for that is why they think about hybrid cloud, which is how they can leverage the new cloud technology but also leverage their on-premise infrastructure. The Okta Access Gateway gives a lot of these large organizations a very simple, easy, powerful way to connect their on-premise applications that do things called header-based authentication and integrate them with the Okta Identity Cloud. So they'll still have all the capabilities and capacities of the Okta Identity Cloud for their deployments but they can now very powerfully plug in their on-premise infrastructure. Traditionally, they've used products from companies like CA and others to do this kind of technology, but they want a modern way of moving forward and that's what Okta Access Gateway allows them to do.

In terms of the second part of your question, Gray, around the revenue from it, there will be revenue from it. But that's not really the main driver here. The main driver is helping these large organizations find more and easier ways to get going with the cloud and to adopt the Okta Identity Cloud. We're really looking to make sure that this first set of enterprise customers over the next quarter or 2 is happily deployed, very successful, understands how it all works. And we think that that's a trend that's going to be very powerful in the times ahead.

Operator

We will take our next question from Sterling Auty with JPMorgan.

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

I wanted to circle back to the line of question that Rob Owens started. We are getting a growing number of questions from investors just understanding the source of the growth, talked a lot about the large enterprise. So maybe I'll ask the question this way. How would you stratify your revenue in terms of what percentage of the revenue is now coming from large enterprise versus midsized enterprise versus even SMB?

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

We don't break it out like that. But I would say that we have -- if you look at our internal plans and our internal strategies, we've made success with the large enterprise but we still -- it's a big market and we're still -- we still have a lot of potential there. And if you look at how we're investing and how we're focusing, it's commensurate with that. So I would give that color or clarification. A lot of our -- we're still we doing very well in the mid-market or even the commercial market. So I would say it's balanced and large enterprise is successful, but we've kind of talked about it in a



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few different ways on the call. The potential is massive, especially in large enterprise, and we're kind of focusing over the long term to really capitalize on that.

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

All right. Sounds good. And then Bill, maybe one for you. You talked about the hiring. How should we think about the pace of hiring through the year? Are you front-loading more of the hiring? Or should we expect the onboarding of new headcount to be equal through the year?

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

Yes. Thanks. As we talked about, this year, we are focused on investing in the strategic areas that we talked about last quarter and that we talked about at Oktane. And we're going to continue to focus on investing, both in customer-facing headcount and R&D because we think there's just tremendous opportunities for us. And we're going to continue to hire aggressively. The headcount growth that we had in the first quarter was 40%. I think you should expect that as we get into the second half of the year, that growth is actually going to accelerate because we feel -- like I said, there are very strong strategic opportunities we want to capitalize on and we are having strong success attracting and retaining talent and we want to continue that. And we're going to continue to make those kind of prudent investments as we try to capitalize on what we think is this huge market opportunity and maximize growth.

Operator

And moving on, we'll take our next question from Melissa Franchi with Morgan Stanley.

Hamza Fodderwala - *Morgan Stanley, Research Division - Research Associate*

This is Hamza Fodderwala on for Melissa. Just a couple of quick ones from me. I just wanted to see if you could share any color on your traction outside of MFA and SSO particularly with lifecycle management? And then as a follow-up for Bill, you mentioned the net -- dollar net retention being down about 1 point sequentially given the larger initial lands. Should we expect that going forward as you increase your enterprise adoption that should remain in that 115% to 120% range? Or could it move lower? And that's it for me.

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

So Hamza, I'll take the first question around kind of how the products are doing. They're all doing very, very well. Certainly, single sign-on on Universal Directory continue to do very, very well across all the segments. Same is true for multi-factor authentication, lifecycle management. We do see a lot of opportunities in all of these areas. Obviously, we added an adaptive version of single sign-on and an adaptive version of multi-factor authentication last year because there are more and more signals in the system, so a lot of data that we can help our customers with.

But as you think about lifecycle management, there's a lot of different ways that we can enhance that product. And in fact, that was one of the drivers in our purchase of Azuqua last quarter, which I think is important to highlight. First of all, there's a lot of things that happened with our existing LTM product and it's pretty deep. So for a lot of preconfigured workflows, it addresses a lot of opportunities there. But Azuqua is going to allow us, which is now Okta workflows, to do more and more there. And workflows is going to not only strengthen that offering but also allow us and our customers to centrally manage more and more workflows. And you're going to start to see more and more of that as we continue to deepen and broaden the Okta identity network and as we continue to think about how we can enhance capabilities in the system.

You have to realize more products obviously mean bigger upfront deals. And so what you're going to see is with introductions like Hooks, which we talked about at Oktane as well, you can now really configure the system with the base functionality that you have, whether that's UD or SSO, but also with these advanced functionalities to have different workflows to drive different triggers and events out of the system. And there's a lot of capability and flexibility there for customers to leverage the Okta Identity Cloud.

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

And as it relates to the net retention rate, you're right. As we target larger enterprise customers, as we build our customer base, which are all very healthy indicators for the business and as those initial deal sizes continue to grow, we do expect to see some fluctuation in the net retention rate. I think it will be at the very healthy level we are right now at 119% and in a range that might go down -- up or down a few points. So the range that you talked about of 115% to 120%, I would say, would be a comfortable range for you as far as your modeling.

Operator

We will take our next question from Gregg Moskowitz with Mizuho Securities.

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

Congratulations on a strong quarter. You mentioned the high level of demand -- so you mentioned a high level of demand around multi-factor authentication a few moments ago, but I'm just wondering what sort of uptake you've been seeing around adaptive MFA in particular over the past few months or so.

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

Yes. It's very strong. And whether it's -- like I mentioned, it's a deal that is just for adaptive MFA and then it later sells broader parts of the platform or its interest that's just from the multi-factor product and upsell as adaptive MFA or the broader suite. It's doing very strong. It's -- the whole Okta as a whole is -- helps with security and visibility and technology enablement, but the multi-factor and the adaptive multi-factor authentication products specifically are the most directly security-related products we have. And as every company is figuring out how to be more secure, it's really driving the demand there. So it's an important part of our suite both from a -- just a dollar perspective and also as a powerful entry on-ramp into the whole platform.

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

And just to give you a couple of quick examples there, you can think of a situation with a financial services company. We have some customers who have private wealth management businesses where they want that adaptive technology to make sure the right consumers are accessing, obviously, the right financial records. You see the same thing in the government. I don't know if all of you are aware but the Office of The President released a memo last week specifically around basically Zero Trust and making recommendations around shifting from simple managed access to making it more complicated. There's a lot of opportunity to do that with multi-factor and adaptive multi-factor authentication in the government as well.

And then finally, we have a number of large manufacturing customers who use the Okta Identity Cloud to solve some supply chain opportunities. And in that case, you want to make sure that you're allowing the right person to access the right supply chain, whether that's a customer or a supplier, and you might want to do that with real-time signaling and that's what makes it adaptive. So there's a lot of flexibility there and different ways in which the customers are adopting that product and baking it into their workflows.

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

Okay. That's very helpful. And then Freddy, just a quick follow-up on Azuqua or Okta workflows. Is it still your expectation that, that will be more or less fully integrated with lifecycle management in under a year or so?



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Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

Yes. Absolutely. So we are already doing very well with that. It's just been a couple of months and we've already seen some very good integration work to kick it off. I think that within the next quarter or 2, customers are going to be able to take advantage of some of the advanced functionality using Okta workflows. And certainly, it will be fully integrated within the year, absolutely.

Operator

And moving on, we'll take our next question from Shaul Eyal with Oppenheimer.

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

Welcome on board, Dave Gennarelli. Congrats on continued outperformance and improved outlook. I wanted to ask about the ongoing traction you're seeing with your channel partners. As you've indicated, I believe it represents 25% already of the business. What should we be expecting down the road as we think about your 5-year plan with respect to channel contribution?

Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

Yes, absolutely. Thank you, Shaul, for the kind words. Happy to talk about that. So for those of you who might not be as familiar with the story, partners and channel partners to us, there's a couple of different buckets of it. The first one obviously is independent software vendors, so organizations like Microsoft Office 365, Workday, ServiceNow, Salesforce, where they're very good partners of ours because obviously, integration to the Okta Identity Cloud means faster deployments and better results with those products.

Secondly, the global system integrators. In particular, there have been a number of comments on today's call about how we're doing with large enterprise. Whether it's Accenture, Deloitte, PwC, they're all building very strong practices around Okta, which is great. We saw them as very strong sponsors of sales kickoff, which happened in February as well and they're all getting more and more trained and certified, whether it's for their security practices, so implementing for workforce, or helping large organizations with digital transformation in a managed service environment.

And then finally, there's a lot of regional identity experts and consulting firms who are partnering with us to bring Okta Identity Cloud out there to the channel. In particular, what you're talking about, Shaul, there, it's also international. It's a huge opportunity for us. We're very happy with the overall growth of the business. International obviously grew 60% year-over-year, which is phenomenal. But there's a lot of opportunity out there. We're excited to open offices where it makes sense, like we just did in Germany. But in a lot of the other territories where every organization is looking to adopt public cloud services and think more about this hybrid environment, we are going to partner more and more with organizations to do that in the channel. So you're going to continue to see that.

What does the model look like over the next 3 and 5 years? We don't have specific numbers that we're sharing at this time, but I think that having 1/4 of the business impacted by the channel today is very, very good and I expect that strong growth to continue in the times ahead.

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

Let me just add to that -- I was just going to say it's a super important part of our strategy because it really is a differentiator because if you look at the competition broadly, we're the only scaled player that doesn't have infrastructure platform we're trying to sell or an apps platform. We're very neutral. And that resonates with all of the partners in the channel because they see us as this neutral party they can bring to their customers that will then give them choice. And so that channel, the channel network and their relationship bolster our competitive position, our competitive mode. So while we aren't giving specific numbers over time, it is an area we're very interested in investing and making productive because it is that competitive differentiator.



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

Thank you for that. And if I may, my follow-up. So the Access Gateway, the Advanced Server Access product recently introduced during Oktane, given its on-premise focus, do you see a new list of competitors when you've recently started going out with both these products?

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

Maybe -- I would say maybe on the edges. But what we find is that, first of all, these products, like a lot of our products, are pulled from customers, meaning customers request these things. Customers want to connect Okta to more on-premise resources. Customers want to use Okta to secure more things. So we build products in response to that. So what that means is that if there was a great solution in the market, if there was some competitor that just excelled at these use cases, the customer probably wouldn't be asking us for it. So we find ourselves kind of putting these products in greenfield places where there's a lot of room to run before there's any competition.

So even though some of these areas might seem adjacent to other vendors you follow or may have heard of, the reality is what we find is when really talk to these other vendors, there's way more partnering we do than competing and that kind of governs our behavior. If you look at our relationship with SailPoint or a company like CyberArk, it's very positive, synergistic relationship. Although on the surface, it might seem like we're bumping up against each other, what we find with customers is that we can do far more together than we can do by fighting each other.

Operator

And we'll take our next question from Alex Henderson with Needham.

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

Great. That actually feeds very nicely into the question I wanted to ask. There was a...

Operator

I'm so sorry, Alex. You are very quiet. If you could please just get closer to the mic or the phone.

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

Can you hear me?

Operator

Yes.

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

That's better.

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

That's perfect. Thank you.

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

Great. So the last question actually feeds very nicely into the question I wanted to ask. There was a SailPoint patent that was filed recently addressing identity risk technologies and granted to them. And I know at the Oktane19 event, you had launched a product that actually overlapped pretty heavily with what they offer in that space. And I was wondering if there's any implications for that patent relative to you guys.

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

I'm not familiar with it. We have a bunch of patents. Every -- most vendors have a bunch of patents. I think that -- so I'm not familiar with the specifics of that one, but our relationship with SailPoint is great. We do overlap in some areas of lifecycle management. But as I -- as we found is that we go to customers. We're having a very productive relationship working together because they excel particularly on the governance side of functionality. They do very well with on-premise software deployments and doing governance for that and we're more on the cloud side. So the partnership is strong, and I'm very confident it's going to continue to be long in the future.

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

The second question I'd love to ask is you've had an unbelievable attendance at Oktane in each of the last 2 years. Can you translate that attendance into an uptake post the event that has an implication for the timing of those events for new customer adds? I mean by my calculation, you had somewhere in the order of 8,800 type of attendees at that massive show, which -- that's almost the size of Cisco Live. For a company your size, it's pretty amazing. But does that translate to specific deals that happen within reasonable time frame post those events?

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

Yes. Thanks for that question. Certainly, Oktane has grown significantly over the last few years since we started. And I think it's a testament to these tailwinds that we're focused on, around more cloud, more digital transformation, prioritizing security. Originally, we started just because there's so much innovation coming out of the platform, we just wanted to keep customers up-to-date on what was happening. They get so many releases of the software. This is a way for us to tell them, "Here are the big things that you received and here are the big things that are coming." That was the original idea behind it. It started to grow pretty fast and now there's obviously more and more customers that are attending not only to see exactly where we're going but also to make sure they're leveraging all the products and all the different use cases they can address.

So there's a lot of customers who attend and then realize they can purchase new products or find new ways to address use cases, which is great. But there's also more and more prospective customers who are hearing about Okta and who are working with either our account teams or channel partners and say, "I should go find out more about that." Certainly, I think that it does drive not only retention but net new business both in existing customers and in new, prospective customers. The main driver there in terms of the timing of it and moving it up from Q2 to Q1 really had more to do with the way -- the cadence of running the business on an annual basis. It doesn't have anything to do with the timing. Obviously, the subscription business, we -- the business is going to come when it's going to come and we recognize it ratably.

So there's no upside to it there, but we are excited about the growth of the event. I think this year, we had obviously a record attendance but also record number of partner attendance both on the software side as well as the channel partner side. And I think that really speaks to the opportunity for people to take advantage of the products in the Okta Identity Cloud platform, and that's really what they're getting out of it.

Operator

Moving on, we'll take our next question from Andrew Nowinski with Piper Jaffray.



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Andrew James Nowinski - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

So you've launched a number of new products targeting new markets, including the on-premise hybrid environment. I'm wondering, do these new products change the average contract duration relative to your historical duration?

Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

I don't think there's any specific change yet because of these new products. I would say overall, what you're starting to see is the same we've always seen in terms of multiyear contracts. As you get into larger and larger organizations, they want longer and longer duration contracts and you're starting to see whether that's 3 or even 5 years sometimes because when a large organization decides to change an identity platform, either for workforce or customer identity, that is a major undertaking. And so they really want to make sure that they are partnering with us for the long term and that we can really build into that relationship.

Certainly, in products like Okta Access Gateway that lend themselves more to the enterprise business, that's really focused on enterprise companies, that are really focused on taking advantage of the hybrid model, that will certainly drive -- fall into that category of longer-term length for the agreement. But there's no specific driver to that today.

William E. Losch - Okta, Inc. - CFO

Yes. One thing that I would refer to is -- to Freddy's point that the larger enterprise deals and some of the ones that we specifically landed have had longer contract lengths. I mean we're just starting along with you guys to really understand RPO and backlog, but if you see the year-over-year growth and our total backlog of 59%, the biggest driver, as we know, of that number is contract duration. So that's what you're seeing there with that growth.

Andrew James Nowinski - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

Okay. And then along those lines, given all the new products you're offering, I'm wondering, is there any metrics that you could share with us in order to sort of track your progress on how these are being adopted, whether it's the average number of products per customer or perhaps a percentage of customers that have deployed, call it, 3 or more solutions?

William E. Losch - Okta, Inc. - CFO

Yes. I mean we have had continued success with all our customers -- or our customers on average deploying a number of the products. As we've talked about before, we still have all of those products at scale. We continue to see a little bit more increased traction on lifecycle management and multi-factor authentication, but they're all going strong from that perspective.

Operator

And we'll take our last question from Joshua Tilton with Berenberg Capital Markets.

Unidentified Analyst

It's actually [Ganwun Zahir] for Josh. Thanks for taking my question. The first one I have is just around the enterprise market. Again, if you guys are moving more into enterprise and talking to CSOs, how is perception changing from access management to becoming a security partner? And whether the implications, the -- in terms of expecting the larger deals adding more and more products?



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Jacques Frederic Kerrest - Okta, Inc. - Co-Founder, Executive Vice Chairperson, COO & Director

Yes. Happy to talk about that. What we are seeing, as you mentioned, as we discussed on the call, is the world's largest organizations are seeing more and more opportunity to leverage the various parts of the Okta Identity Cloud, again, for very straightforward reasons. First of all, they want to adopt more cloud for their workforces and they want to do that in a hybrid capacity. Second of all, they need to focus on these digital transformation initiatives because every company is basically under attack by a new software, modern technology company. You look across industries, whether it's financial services or health care or retail, they have to do this and they need to do it quickly because it hits the top line of their businesses. And that's why we're seeing a lot of opportunity with customer identity and access management.

And finally, security is a priority, right, at the C level and the Board level in all of these large organizations. You mentioned CSOs, Chief Security Officers, they have become a much more important part of the buying process over the last 2 or 3 years. They've become an important number of executive buyers and decision-makers for us in large organizations. And they have a lot of challenges on their plate. They're looking for partners who can help them address some of these major concerns quickly, efficiently, effectively, and identity is at the core of that. So typically, we engage with these Chief Security Officers. We help them understand what we do. We show them quickly how we can help them solve specific problems and then we get rolling. And they become not only strong advocates of ours but also great partners in terms of helping us. As Todd mentioned earlier, think about what we want to build next. When we think about products like Advanced Server Access, we're getting pulled by these customers into these new opportunities and these new markets and they're saying, "We're looking for a modern way to solve these modern problems and we're hoping that Okta can help us do that," and we're -- that's why we're very bullish about the opportunities ahead.

Unidentified Analyst

And just a follow-up on that one. You mentioned the pull, which is an interesting concept prize when you kind of prove your concept and then the product becomes more of a pull. In enterprise market itself, you have the partnerships in place with the system integrators. You have technology partners, even the security guys. And then Access Gateway kind of links you to on-premise. So all the pieces seem to be, in theory, in place for the enterprise market to become more pull. Are you seeing that? Or is it still more of a push market? And I'm kind of obviously implying of what the relationship for that could be an implication on OpEx in the future as well as it becomes more of a pull market.

William E. Losch - Okta, Inc. - CFO

Yes. I don't think it's binary. I think it's -- we're making progress but it's still early. So that's why it's so exciting. The progress is solid and substantial and the opportunity is still big and we're going to keep working hard to capitalize on it.

Operator

And that was all the time we had for today's question-and-answer session. I would now like to turn the call back over to Mr. Gennarelli for any additional or closing remarks.

Dave Gennarelli - Okta, Inc. - IR Executive

Well, thanks for joining us, everybody, this afternoon. Coming up just next week, we'll be attending the Baird conference in New York on the 4th and the William Blair conference in Chicago on the 5th. So we hope to see you at one of those events. And if you have any additional questions, you can reach me at dave.gennarelli@okta.com. Thanks.

Operator

Once again, that does conclude today's conference. Thank you for your participation. You may now disconnect your phone lines.



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