REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q4 2023 Okta Inc Earnings Call

EVENT DATE/TIME: MARCH 01, 2023 / 10:00PM GMT

CORPORATE PARTICIPANTS

Brett Tighe *Okta, Inc. - CFO*
Dave Gennarelli *Okta, Inc. - VP of IR*
Todd McKinnon *Okta, Inc. - Co-Founder, Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Adam Charles Borg *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*
Adam Tyler Tindle *Raymond James & Associates, Inc., Research Division - Senior Research Associate*
Billy Fitzsimmons
Brian Lee Colley *Stephens Inc., Research Division - Security Software Research Analyst*
Brian Lee Essex *JPMorgan Chase & Co, Research Division - Research Analyst*
Eric Michael Heath *KeyBanc Capital Markets Inc., Research Division - Research Analyst*
Fatima Aslam Boolani *Citigroup Inc., Research Division - Director & Co-Head of Software Research*
Gabriela Borges *Goldman Sachs Group, Inc., Research Division - Analyst*
Gray Wilson Powell *BTIG, LLC, Research Division - MD & Security and Infrastructure Software Analyst*
Hamza Fodderwala *Morgan Stanley, Research Division - Equity Analyst*
Imtiaz Ahmed Koujalgi *Wedbush Securities Inc., Research Division - Analyst*
Ittai Kidron *Oppenheimer & Co. Inc., Research Division - MD*
Jonathan Frank Ho *William Blair & Company L.L.C., Research Division - Technology Analyst & Partner*
Joseph Anthony Gallo *Jefferies LLC, Research Division - Equity Associate*
Keith Frances Bachman *BMO Capital Markets Equity Research - MD & Senior Software & IT Services Analyst*
Madeline Nicole Brooks *BofA Securities, Research Division - Research Analyst*
Matthew George Hedberg *RBC Capital Markets, Research Division - Analyst*
Patrick Edwin Ronald Colville *Scotiabank Global Banking and Markets, Research Division - Analyst*
Patrick O'Neill
Peter Weed *Sanford C. Bernstein & Co., LLC., Research Division - Analyst*
Robbie David Owens *Piper Sandler & Co., Research Division - MD and Senior Research Analyst*
Rudy Grayson Kessinger *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*
Shaul Eyal *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

PRESENTATION

Dave Gennarelli ***Okta, Inc. - VP of IR***

(presentation)

Hi, everybody. Welcome to Okta's Fourth Quarter Fiscal Year 2023 Earnings Webcast. I'm Dave Gennarelli, Senior Vice President of Investor Relations at Okta. With me in today's meeting, we have Todd McKinnon, our Chief Executive Officer and Co-Founder; and Brett Tighe, our Chief Financial Officer.

Today's meeting 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 our filings with the SEC from time to time, including the section titled Risk Factors in our previously filed Form 10-Q.

In addition, during today's meeting, we will discuss non-GAAP financial measures. Though we may not state it explicitly during the meeting, all references to profitability are non-GAAP. 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 a discussion 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.

In today's meeting, we will quote a number of numeric 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 meeting over to Todd McKinnon. Todd?

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

Thanks, Dave. And thank you, everyone, for joining us this afternoon. We're pleased with our Q4 results and the significant improvement in our profitability and record cash flow. It was a strong close to FY '23 with continued improvement in our go-to-market business performance, giving us confidence going into the new fiscal year.

We've positioned Okta for continued success with our customers and improved profitability and increased cash flow as an organization to navigate the evolving macroeconomic environment.

The 3 mega trends that have driven Okta's business over the past several years: the deployment of cloud and hybrid IT, digital transformation projects and the adoption of Zero Trust security, remain top priorities for organizations around the world. These trends are more relevant than ever, and the role of identity has only grown in importance in helping organizations do more with less.

Organizations that can address at least one, if not all 3, of these trends will fare better over the long term. All organizations need to enable a more efficient workforce and invest in security and innovation around revenue-generating initiatives, whether during a recession or emerging from one, and all of these initiatives are powered by identity. Remember that Okta was founded during a downturn.

Over the past several months, how many companies have you heard talk about increasing efficiency? Okta has always enabled organizations to do more with less. And in this new environment, where business leaders are striving for increased efficiency, Okta is well positioned to advance our leadership position in a market that continues to move toward us. I'll dive into a deeper review of the quarter and finish with some comments to wrap up FY '23.

The 2 Cloud, 1 Platform approach that we introduced to the market mid last year, the Workforce Identity Cloud and the Customer Identity Cloud has really hit the mark and continues to be well-received by our customers and partners. Our go-to-market team has enthusiastically embraced the structure, and we continue to see an upward trend line in the number of sales reps that have closed Customer Identity Cloud deals over the past 4 quarters. Just last week, we had our annual sales kickoff summit. The energy at the event was fantastic, and the team is highly motivated to keep the momentum going.

Turning to our Q4 results. We added 550 new customers in the quarter, bringing our total customer base to 17,600, representing growth of 17%. New customer growth is an area where we believe the macroeconomic environment is affecting our business. Conversely, Brett will cover the continued strength we're experiencing with our upsell/cross-sell business with existing customers.

We continue to see growth with large customers for both Workforce and Customer Identity, and we are proud to work with some of the most important brands in the world, such as Sonos, Hewlett Packard Enterprise and MassMutual. In Q4, we added 190 customers with $100,000-plus ACV. Our total base of $100,000-plus ACV customers now stands at 3,930 and grew 27%. Here are just a few notable examples of customer wins and upsells in Q4, which come from a wide range of industries.

OpenAI, the company powering ChatGPT was a great Customer Identity Cloud win this quarter. With the increasing popularity of its cutting-edge AI technology, the company looked to Okta's Customer Identity Cloud to support authentication for the rapid influx of people interested in using the tool. Having utilized Customer Identity Cloud for authentication as a self-service customer, OpenAI's developers were able to bolster its Customer Identity needs, thanks to Okta's ease-of-use, reliability and security.

A Global 2000 agriculture and home improvement supply chain company was a great Workforce Identity Cloud win this quarter. The company selected Okta for its breadth of integrations, partnerships and technology road map alignment. Okta will provide secure access for its 40,000 employees while providing the company with increased automation to reduce administrative overhead.

A Fortune 100 insurance company was an exciting Workforce Identity Cloud upsell this quarter. The company selected Okta's Customer Identity solution last year to reduce complexity associated with its homegrown identity solution and free up developers' time to focus on business-differentiating projects. With this upsell, the company expanded its investment with Okta to replace its incumbent on-prem workforce technology and eliminate the friction in the end-user experience.

We continue to see strong demand for Okta Identity Governance or OIG as our customers are tapping into the power of Okta's unified platform to improve their overall security posture and remove identity silos. This helps our customers gain better visibility across their identity stacks and implement a governance solution with faster time to value and cost reductions. It's still very early days with OIG as it just became globally available in early December.

We are seeing a lot of interest across various business segments and verticals from organizations like Notion, the upstart productivity tool company; to NOV, a Fortune 1000 energy manufacturing company. NOV was a great OIG upsell this quarter. They had been leveraging Okta Workforce Identity Cloud products since 2020 and were looking for a product that would satisfy their regulatory reporting obligations. Since they had already implemented Okta Workflows, OIG was a natural step for them.

Reflecting back on FY '23, we accomplished a tremendous amount. For example, revenue increased by 43%. RPO hit $3 billion. We added 2,600 customers. We added over 800 customers with an ACV of $100,000 or more. We expanded our portfolio of products, including Okta Identity Governance. And we made tremendous progress on the ESG front, including setting validated science-based targets for Scope 1, 2 and 3 emissions reductions.

FY '23 was a year of challenges, learnings, action and change. Our vision, purpose, opportunity and everything we do is grounded in what we make possible for customers. Identity isn't just part of an organization's infrastructure, it's a strategic component. And Okta isn't just a technology vendor, we're a strategic partner. We're a stronger company going into FY '24, with deeper relationships with our customers and an expanding product portfolio.

As we go forward into FY '24, organizational leaders around the world are looking for ways to become more efficient in today's environment, and we've never been so confident in our ability to help our customers create more efficiencies for both their Workforce and their Customer Identity Solutions. Okta, too, has taken several actions to create more efficiencies within our own organization as we position the company for our next phase of profitable growth.

I also thought it would be helpful to share a few of Okta's top strategic priorities for FY '24. These are shared across the entire organization to align our execution with our broader company strategy. Keep in mind, these are multiyear horizons.

The first priority is winning the customer identity market. We've made tremendous progress in SIEM, but in many respects, we are still just getting started on what we believe is a $30 billion market opportunity.

Second, take Workforce Identity to the next level. We've done well to establish our clear market leadership over the past 14 years with the broadest independent and neutral identity platform. Consistent with our core value of continuous innovation, we're pushing to advance our leadership position in the $50 billion workforce market.

And third, scale Okta to support durable growth. This includes increasing automation throughout the organization and expanding our international presence in lower-cost geographies, both of which have margin benefits. Scaling for durable growth also includes hardening our own security infrastructure. Of course, underpinning our strategy continues to be our vision to free everyone to safely use a technology.

To wrap things up, we're pleased with our finish to FY '23 and believe we're positioned for profitable growth going into FY '24 and beyond. I want to thank the entire Okta team for their tireless work, and a special thank you to our customers and partners who place their trust in us every day.

Before I turn it over to Brett, I want to give a special thank you to our outgoing General Counsel, Jon Runyan. Jon has been a key adviser since Freddie and I founded the company, an executive team member over the past 8-plus years and will continue to serve as an adviser through mid-September. I'm very excited that Larissa Schwartz, our Deputy General Counsel, who has been a member of the Okta legal team for the past 7-plus years, is being promoted to Chief Legal Officer.

Now here's Brett to walk you through more of the Q4 financial details and our outlook for meaningfully improved profitability this year.

Brett Tighe ***Okta, Inc. - CFO***

Thanks, Todd. And thank you, everyone, for joining us today. We're pleased with the progress we've made over the past 2 quarters. We've taken action to significantly reduce our cost structure while maintaining key investments to fuel our future growth. And we're confident that we have set the path for many years of profitable growth. I'll review our fourth quarter results and our outlook for FY '24.

But first, I'll start with some commentary on the macro environment and the restructuring we announced last month. With regards to the macro environment, similar to last quarter, we have not experienced a meaningful change in sales cycles or close rates. However, customers are requesting shorter-term contract links as they become more conservative with their long-term commitments.

Additionally, our overall business was more weighted towards upsells versus new business across both SMB and enterprise. New pipeline generation was also more weighted towards upsells. And finally, we continue to experience minor FX headwinds on our top line metrics, which are incorporated into our reported numbers and outlook.

With regards to the restructuring that we announced in early February, we've taken a GAAP charge of approximately $15 million in Q4. There were many functions in the organization that were affected, with the biggest reductions within the go-to-market and G&A teams. The vast majority were located in the United States.

Turning to our Q4 results. Total revenue growth for the fourth quarter was 33%, driven by a 34% increase in subscription revenue. Subscription revenue represented 97% of our total revenue. International revenue grew 32% and represented 21% of our total revenue.

Looking at the ACV split between Workforce Identity and Customer Identity. Workforce ACV grew 30% and represented 61% of total ACV. Customer Identity ACV grew 35% and represented 39% of total ACV. Over the long term, we expect the mix to trend towards 50-50, with healthy growth in both businesses.

RPO or backlog grew 12% and hit the $3 billion mark. Impacting total RPO growth is the general shortening of term lengths of recently signed contracts. Our average term length is just over 2.5 years. Current RPO, which represents subscription revenue we expect to recognize over the next 12 months, grew 25% to $1.68 billion.

We view current RPO as the better metric to assess our quarterly performance relative to calculated billings, which, as we've noted, can be noisy due to fluctuations in invoice timing and duration. Calculated billings grew 18% and current calculated billings grew 19%. As we've noted previously, this is the final time we'll be referencing billings performance in our formal commentary.

Turning to retention. Our dollar-based net retention rate for the trailing 12-month period remains strong at 120%. The sequential downtick in the net retention rate was driven primarily by a decrease in the upsell rate with our SMB customers. As always, the net retention rate may fluctuate from quarter-to-quarter as the mix of new business, renewals and upsells fluctuates. Consistent with prior quarters, gross retention rates remain very healthy in the mid-90% range.

Before turning to expense items and profitability, I'll point out that I'll be discussing non-GAAP results going forward. Looking at operating expenses. Total operating expenses for the quarter were lower than expected. The better-than-expected profitability is primarily due to the combination of revenue overperformance and better-than-expected outcomes from spend efficiency measures.

Total headcount at the end of Q4 was just over 6,000, which is flat quarter-over-quarter. That number does not reflect the restructuring action, which will be incorporated in next quarter's headcount total. We will continue to hire in critical areas and backfill open positions.

Moving to cash flow. Q4 free cash flow was seasonally strong, producing a record $72 million. We ended the year with a strong balance sheet anchored by nearly $2.58 billion in cash, cash equivalents and short-term investments. Overall, we're pleased with our Q4 results.

Now let's turn to our business outlook for Q1 and FY '24. While we've been pleased with improved execution over the past 2 quarters, our projections continue to factor in the uncertainties of the macroeconomic environment. We're also factoring in the go-to-market leadership transition and the challenges we faced in the first half of last year.

We're taking several actions to reduce our cost structure and increase our efficiency as an organization, including reducing headcount by 5%, rationalizing our facilities' footprint, narrowing our R&D scope to focus on core product development, eliminating redundant software tools increasing systems and process automation. And we're focusing on building operations in lower-cost regions in Europe and Asia Pacific that have fantastic talent bases.

With that as a backdrop, for the first quarter of FY '24, we expect total revenue of $509 million to $511 million, representing growth of 23%; current RPO of $1.67 billion to $1.685 billion, representing growth of 19%; non-GAAP operating income of $18 million to $20 million and non-GAAP diluted net income per share of $0.11 to $0.12, assuming diluted weighted average shares outstanding of approximately 178 million.

For FY '24, we are raising our revenue outlook by approximately $25 million at the high end. We now expect revenue of $2.155 billion to $2.170 billion, representing growth of 16% to 17%. With our continued expense control we plan to achieve non-GAAP profitability for the full year. We expect non-GAAP operating income of $136 million to $145 million, which yields a non-GAAP operating margin of approximately 6% to 7%; non-GAAP net income per share of $0.74 to $0.79, assuming diluted weighted average shares outstanding of approximately 180 million.

We expect free cash flow margin for FY '24 to improve to approximately 10%. This includes a cash impact of approximately $15 million related to the organizational restructuring, which will be paid out in Q1.

Lastly, I want to provide a few comments to help with modeling Okta. Keep in mind that when viewing our Q1 projections versus our Q4 results, Q1 has 3 fewer days, which impacts revenue and gross margins. We expect non-GAAP operating margin to build as we progress through the fiscal year.

Similar to years past, Q2 is expected to be the seasonal low for cash flow. We are applying a static 26% non-GAAP effective tax rate now that we expect to be non-GAAP profitable for the foreseeable future. Partially offsetting the higher effective tax rate is a significant increase in interest income related to higher interest rates we expect on our cash and investments.

We are also continuing to reduce our stock-based compensation. SBC as a percentage of revenue decreased by 7 percentage points in FY '23, but remains elevated largely due to the Auth0 acquisition. We expect SBC to be in the low 30% range of revenue in FY '24. The improvement is being driven by slower hiring, decreased grant sizes and as the SBC impacts from the Auth0 acquisition begins to roll off. We remain committed to further reducing SBC and dilution over the long term.

To wrap things up, I'll reiterate that we're pleased with the progress we've made over the past 2 quarters. Our business performance has improved, but we recognize there's still more work to do. We've significantly reduced our cost structure while maintaining key investments to fuel our future growth, and we're confident that we've positioned the company for many years of profitable growth.

With that, I'll turn it back to Dave for Q&A. Dave?

QUESTIONS AND ANSWERS

Dave Gennarelli ***Okta, Inc. - VP of IR***

Great. Thanks, Brett. I see that there's quite a few hands raised already, so I'll take them in order. (Operator Instructions) So with that, let's take the first question from Rob Owens at Piper. Rob?

Robbie David Owens ***Piper Sandler & Co., Research Division - MD and Senior Research Analyst***

Curious how you're thinking about DBNRR as we move throughout the year. You've seen some pressure there, obviously, and I think you addressed it in the script. But especially as we contemplate OIG ramping some of the cross-sell activity that you're seeing on the SIEM front, can you put some guardrails around where this could be as we move throughout the year?

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

Rob, thanks for the question. It's nice to see everyone. We're pleased with the results, and I think one of the themes to the results are the foundation of the business are very solid. And the core of that solidity is the customer success. And in that net retention rate, the foundation is the gross retention rate, which remains healthy and consistent in the mid-90% range.

I think the change you've seen in the rate sequentially and projecting forward the change will largely be because of just the amount of upsells. And as there are headwinds on the business and the amount of upsells change, that's going to be the changing factor.

We have the macroeconomic impact in the business overall that we're trying to account for going forward. But we also have a lot of positives, like you mentioned. We have really record performance in terms of cross-sells in the quarter we just finished. And we expect, with our improved execution on the Customer Identity side, that will continue.

And then we have this product, OIG, which is early, and it's only been generally available since December, but it's got all the markings of a hit. It's exceeded our expectations, and we're going to get 1 full year in market with that in FY '24. So we're super excited about that.

Brett Tighe ***Okta, Inc. - CFO***

Yes, I would just add to that. Rob, thanks for that question. I think to put a finer point on what Todd was saying, I totally agree with everything he's saying around gross retentions. We think it's going to travel in that 90% -- mid-90% range that we've seen be very stable for a while now. I think we are going to see a little bit of net upsell rate he was describing.

I think we will see a little bit of headwind for the reasons he was saying around macro. And then I think the other one is around -- we didn't close as many new customers in FY '23 as we would have liked, which means there's less customers to upsell into in FY '24. So I do think we see a little bit of a headwind on that net retention rate as we travel through FY '24.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Let's go to Gray Powell at BTIG.

Gray Wilson Powell ***BTIG, LLC, Research Division - MD & Security and Infrastructure Software Analyst***

Okay. Great. And really good results here. I was happy to see the guidance. One thing I want to make sure that I understood correctly, just looking at the Q1 revenue guidance, it implies that revenue is flat from Q4.

I understand the commentary around 3 less selling days or just 3 less calendar days, services around the macro, but it just seems really conservative. Anything else that we should be thinking of that's going on in Q1? And then just your confidence level in the ramp needed to hit the full year guide in terms of sequential growth.

Brett Tighe ***Okta, Inc. - CFO***

Yes, Gray, it's a good question. Yes, it really has more to do with that 89 days versus 92 days. Just as a reminder for everybody, we recognize revenue on a daily basis. So at these dollar levels and these growth rates does become very material for us.

In terms of the top line guide for the full fiscal year, yes, we're confident. Obviously, we're taking a prudent approach given we're still very early in the year. We've talked about the macro headwinds. And we've talked about, obviously, go-to-market leadership transition and then also some of the challenges we had last year.

We're not saying job done. Despite the fact that we've had good -- 2 good quarters in a row for both attrition in the field and also participation of the field in Customer Identity deals, we're excited about the momentum, but I also want to be thoughtful given how early we are in the fiscal year.

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

Yes. And I think that if you -- when we first gave that top line guide 3 months ago, from that point until now, our confidence in the ability to execute this year has, I would say, increased. So I think we're turning in the right direction along with some of the positives in the business we've talked about.

Gray Wilson Powell ***BTIG, LLC, Research Division - MD & Security and Infrastructure Software Analyst***

That's perfect. Nice work.

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

Thanks. Nice to speak with you.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Thanks, Gray. Next, we'll go to Hamza Fodderwala at Morgan Stanley.

Hamza Fodderwala ***Morgan Stanley, Research Division - Equity Analyst***

And Todd, congrats on the Open AI win.

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

Thanks, Hamza.

Hamza Fodderwala ***Morgan Stanley, Research Division - Equity Analyst***

So I wanted to ask, I mean, you've been running effectively the sales force now for about a quarter. I was wondering if you could give us any finer points around what the sales execution is looking like from an attrition standpoint, in particular, I looked at the Customer Identity growth at 35%, it's slowed down a bit, obviously, given the execution. So I imagine you can't be satisfied with that just given the opportunity ahead of you in Customer Identity. So I'm curious when that sort of starts to stabilize?

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

In general, I'm the type of person that's not satisfied with a lot of things. So yes, I think we can -- across the business, I think we can always improve. In terms of the go-to-market organization, it's obviously very important part of Okta. There have been a bunch of changes there. So let me just level set the group.

So first of all, Susan, our outgoing President of go-to-market, was here through the end of February. So her and Steve Rowland, who's also leaving, cranked it out, and obviously, you can see the numbers. They did a good job, and their teams did a good job delivering in Q4. Now with them leaving, we have interim leaders on the Chief Revenue Officer side stepping up.

Jon Addison was -- has been in Okta a couple of years now, has been running Europe, and he is in the interim CRO role. Now we were looking -- and I'm spending a ton of time looking for the next great go-to-market President over all of it. So until we find that person, I'll obviously be more involved working with Jon. But we've also collapsed and focused the organization so that marketing, customer success, services and everything is under one leader, Okta veteran, Eric Kelleher.

So we have 2 go-to-market leaders running go-to-market with me, the leader over them. And then as part of that change, we're also moving marketing under Eric. That's led to another change, which is our Chief Marketing Officer is going to be leaving Okta. So that's a change as well.

But we have this consolidated team under Jon, under Eric, that's really -- it has a deep bench. There's a lot of people that are psyched up. They've delivered Q4, Q3. The trends are getting better in terms of number of reps doing CIC deals, which is very positive. The attrition, which is a key metric we've talked about for the last couple of quarters is -- we've had really 2 positive quarters in terms of low rep attrition, which is great.

We just got back from Las Vegas, where we had an amazing sales kickoff and got the reiterated the product positioning and the messaging and got everyone psyched up and trained for the year. So there's a lot of very positive things happening there, and I'm very confident in this team to go out and have a great FY '24.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Next up, we have Jonathan Ho at William Blair.

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

Congratulations on the strong quarter and the operating margin guide. I just want to drive a little bit deeper into the operating margin and guidance and sort of take a look at the $15 million cost restructuring actions. How is that going to translate into cost savings for 2024? And how do we think about sort of that balance going forward between showing reacceleration in growth as well as the operating leverage?

Brett Tighe ***Okta, Inc. - CFO***

Yes. I would say, if you look at the non-GAAP operating margin for FY '24 or the free cash flow margin for FY '24, you look at both, there are about a 7-point increase relative to what we just produced in FY '23. And it's not really just a single action that's producing that. You brought up the restructuring action, right? It's really a tale of multiple actions that we've been taking over the last few quarters.

If you remember, the last couple of quarters, I've talked about slowing down hiring. I've talked about real estate rationalization, cost efficiency measures like software rationalization. And you see the results Q3 and Q4, you see pretty large beats on our expectations for both non-GAAP operating margin in both of those quarters, right?

And so it really was -- it's been a plan that we've been working for a while now to set ourselves up to have that cost envelope as we enter into FY '24. But we don't think we're going to be done in FY '24. We're not going to be okay, 6% to 7%, we're all set and done and we're going to go on our merry way.

It's all about continuing to scale this business to be able to profitably grow this business, and that's why you heard about 1 of our 3 strategic initiatives that Todd talked about a few minutes ago was around scaling and automating the business. So we want to be able to profitably grow this business, not just in '24, but also '25 and beyond. So that's one thing to keep in mind, Jonathan.

But also just that balancing of growth and profitability. One of the things that we did in this year's budget is really focus our investments for those 3 strategic initiatives that we talked about around solidifying our leadership in Workforce Identity, capturing more of the market in Customer Identity, and then obviously, the scale and automation I just talked about.

Those are about how can we focus our investments, make us grow as fast as possible, but doing it in a responsible way from a profitability perspective. And so we're going to continue to balance growth and margin just like we've done for years now, and we're going to continue to do it as we move forward.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Next up, we have Ittai Kidron from Oppenheimer.

Ittai Kidron ***Oppenheimer & Co. Inc., Research Division - MD***

Congrats, guys. Great quarter. I guess a couple of small ones for me. One on comp, starting with you here. Are there any changes to the comp plan, if you can go into that? And then, Todd, a little bit more to you. I want to dig into OIG, maybe you could give us a little bit more color on that.

Clearly, you're off to a solid start there. But maybe you can give us a little bit of a flavor? If I'm a $100,000 customer, what is the percent uptake in deal sizes that could come if I adopt OIG on a broad basis? Number one.

Number two, are deployments mostly greenfield? Do you find that you're just entering into open-wide space or they're displacement-driven? Any color you can give on the traction there would be great.

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

The -- on the comp, the comp plans and the comp changes, the one thing that is very positive for the go-to-market team and for Okta's plan for this year going into FY '24 is that relative to last year, there are far, far fewer changes in terms of product mix that the sales rep [pass] to be able to sell, territory changes, org structures. It's nothing like last year.

Last year, there was a lot of change, which I think was, in retrospect, pretty hard to navigate through. We've kept things much more consistent this year, whether it's structure of the comp plans, whether it's territory changes, whether it's organizational changes. There obviously are some, but we've cut things largely the same and focused, and so that's really good for continuity there.

We've also tried to keep it simple. I think a lot of companies try to overly make comp plans complex, and sometimes it's better to keep it simple. Customer Identity, Workforce Identity make customers successful and so forth. So I think that's part of the -- when I talk about being confident in the year, that's a big contributor in terms of change there. So hopefully, that gives you some color there.

On the -- on OIG, specifically, the -- I think that the way to think about it is it's a natural adjacency for us. If you think about access management and what it does is it gives you -- it creates profiles and roles and gives you access to resources, and it does that in real time and checks it as you log in and gives you single sign-on, et cetera.

So it's a natural extension to have the system that reports on who can go where, and it does exception reporting and compliance reporting on who can go where and make sure the right people are going to the right place. It's tightly coupled to that system. So it's a natural adjacency. It's a natural upsell.

I think in the history of identity, the reason that governance grew up independently than access management is basically because there was no Okta. There was no independent and neutral leader of access management, so companies had to create these governance solutions in an unnatural way, which is off to the side. I think it's a natural thing to bring them together.

The success of the product has actually been pretty interesting. We -- the IGA solutions out there tend to be sold to larger enterprises and be more complex implementations. And so we thought that our product would start more at the smaller companies and be bottoms up, and we've seen a much more balanced enterprise success and mid-market success than we expected.

And to your question about $100,000, the simple way to think about it is, if it's a $100,000 customer, it might be a $30,000 to $50,000 upsell for the governance solution. And that -- I think that will increase as the product gets more mature, and our selling motion gets more mature.

And just in the examples I gave on the call, the Notion is a relatively small company, a great innovative company, relatively small. You think of them as cloud-first. But NOV is actually a Fortune -- it's a large Fortune 1000 energy company. And it's this combination of Okta Access Management, Okta Identity Governance is magical for them. It's very impactful.

And the last thing about is it greenfield versus net new, it's -- the majority of it is greenfield. But again, I think the replacements have exceeded our expectations. And what also has exceeded our expectations is our ability to win in RFPs. We thought greenfield would be good. I think replacements, we thought, would be pretty infrequent. We've seen some of those, not many, but some. And then the RFP wins have exceeded our expectations. We have a lot of work to do, but it's off to a really good start.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Next, let's go to Adam Tindle at Raymond James.

Adam Tyler Tindle ***Raymond James & Associates, Inc., Research Division - Senior Research Associate***

Okay. Todd, I wanted to acknowledge you've seen obviously significant improvement in profitability of the business, proving a lot of what the business can do. At the same time, in the slides, you talked about how you're so early in this opportunity based on this $80 billion market.

So I guess, more of a philosophical question at the end of the fiscal year to ask, why is focusing on profit right now the right strategy? Given we are seeing moderation or deceleration in the growth metrics concurrent with this. And if you're trading off a little bit of growth for profit, what do you do with the $2.5 billion of cash on the balance sheet and more coming in?

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

I think about it broadly in 2 buckets. One is the growth rate and the spend in sales and marketing, those things are very related. The more we spend in sales and marketing, the more we grow. That's one bucket. And so when you think about how we're balancing growth rate with sales and marketing expense, there's the 2 factors.

There's the macroeconomic expense. We don't -- there's a limit in terms of the growth rate with the macroeconomy. At least, go forward, we're being prudent about that limit. So that gates our investment in sales and marketing, and thus, our growth rate.

The second factor is just some of the execution challenges we had last year. We had a bunch of attrition, which brings down the cost, brings down the growth, and it takes time to ramp that back up again, whether it's hiring people and now having them ramp, which translates into the growth.

So there are some factors there that are -- we're not being limited by the market opportunity. It's execution, macro and which is leading to some of this profitability improvement. Although you could argue that we -- maybe we don't want that profitability improvement because we could be growing faster without the macro issue or without some of our execution challenges.

Now the second bucket is just call it efficiency and better discipline and running the business more rigorously. And I think like a lot of companies, we were -- we lived through many, many years of 0 interest rates and growth, growth, growth. And we need -- and it's healthy. We need a dose of being more efficient and making sure we're investing in the highest ROI things. And we're not spreading ourselves too thinly, both from the go-to-market side, but also the R&D side, and other areas of G&A, we're being efficient.

So that's why that drove the workforce reduction we did about a month ago. But it also is this third pillar of our company strategy, which is scale Okta for durable growth and make sure we have that as a core value. Because when we're -- right now, we're -- our run rate is around $2 billion. And as it goes to $4 and $8 billion and $10 billion over the next several years, the investments and the efficiency we're building now can be hugely impactful down the road, and we're very cognizant of that.

And the final point about the cash on the balance sheet. We're -- we think about that as a little bit of it was when we raised that money and as we build that cash on the balance sheet, a little bit of it is margin of safety to run the business. And now that we're really turning toward profitability and generating cash, and you've seen our outlook on that.

The second use of those funds is for M&A at the right point. How can we expand the portfolio in a way that makes sense and is strategic for our customers and will be synergistic to what we're doing from a go-to-market perspective? And we're still open to that. The things we're looking at tend to be smaller, so it's a good option to have. And we're always looking at managing the balance sheet overall, but those are some ways we think about that balance.

Brett Tighe ***Okta, Inc. - CFO***

Yes. I would just add to, yes, obviously, what Todd was just saying. We're obviously looking at options. But to your point, Adam, the additional cash flow that we're going to generate this year does give us even more optionality as we think about those 25 and 26 converts, about what to do with them. So it's -- I think it's a win-win for us to, obviously, as Todd was saying, become a more efficient company. That's something we want to become.

We've already made a lot of progress, but we need to continue to make more progress while also balancing that growth aspect that you were just talking about. But it just helps us in a variety of ways that, like you just are saying around capital allocation, let's give ourselves a little more optionality.

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

A lot of this I go back to over and over. As we execute and we have our challenges and we improve our challenges and we work to fulfill our vision, it's all built on this foundation of this really strategic thing we're providing. I was having a meeting with a CIO of a global -- one of our large customers, a global media company, that's been through a lot of change themselves. And they were telling me that identity is that 1 of our top 3 priorities at our whole company this year.

And there's macroeconomic stuff, there's structural stuff in their industry, but they're still prioritizing identity. And that's gold when you're trying to build a company. If you're building a company, you have that customer success and that kind of focus and that kind of mind share, it can really give you a foundation to work through a lot of what may be short-term issues for a long-term success.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. Let's go to Gabriela Borges at Goldman.

Gabriela Borges ***Goldman Sachs Group, Inc., Research Division - Analyst***

I want to follow up on the comments on growth and profitability, and I can appreciate it's a little bit too early for normalized long-term targets. I'd love to get a little bit of a preliminary -- your preliminary books on how are you thinking about what does the normalized growth profile of this business look like minus the macro of what's happening right now?

Brett Tighe ***Okta, Inc. - CFO***

I mean, obviously, we're going to balance growth and profitability as we go forward, I mean, it's something we've been doing for years. But what I will say is we want to -- our goal is to profitably grow the business, right? And so if there's areas that we can invest in that can stoke growth, we're going to do it as long as it's efficient, just like Todd was talking about. We want to make sure that we have investments that are high probability of payoff and high ROI, right?

And so trying to be a little bit more thoughtful around those acceptance of investments. And so we're -- I can't give you an exact number, Gabriela. But I mean, obviously, we're going to try to balance both the growth and the profitability over time. We want to continue to expand margins. I can't tell you that beyond '24, but we're going to try to grow as fast as we can, but do it in a responsible way.

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

Gabriela, thanks for the question. It's nice to see you. One thing I think about a lot is the strategy is we want to -- basically, we want to be the one-stop shop for identity. We think identity is so strategic and so impactful, and there's such a value to having an independent -- for customers to having an independent neutral partner there that will give them a choice of technology and not lock them in.

So to do that, we have to have really a lot of balance in terms of the use cases, which are Customer Identity and Workforce Identity. So the business has to get to more of a 50-50 mix, both growing very -- at a healthy pace. So if you look at the numbers now, they're about 60-40. We think there's a big TAM over there. So when you add that all up, it's -- if we do this right, it's a healthy grower and profitably for a long time.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Next up is Rudy Kessinger at D.A. Davidson.

Rudy Grayson Kessinger ***D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst***

Great. I guess, I'm curious, maybe kind of related to Gabriela's question. The restructuring, the cuts you made last time, I'm curious how that impacts your capacity to grow? And I guess, maybe the question is, if your execution improves, maybe the macro impacts on is severe and maybe you get better traction with SG&A, what kind of growth do you have the capacity to deliver if things go right? Is 20% to 25% completely out of the question? Or is something like that doable?

Brett Tighe ***Okta, Inc. - CFO***

Look, I can't give you the exact number, Rudy. But what I will say is when we thought about the plan, we were going to sacrifice capacity build for FY '25, right? Because really, when you think about it, right, the capacity we have for '24 is the capacity we're going to have. I mean, you could -- we could hire some folks in the first half and have a small amount of capacity built for the second half.

But in reality, when we think about this year's plan, it's about making sure we have the capacity for '24, but also having it for '25. So we're not getting over our skis in one period to the other and not sacrificing growth in one period or the other. So we've been very thoughtful about that in terms of how we're thinking about the capacity build for both the fiscal years.

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

Yes. And more specifically on that, the way we run the business is the headcount growth in the second half of the year really is, as kind of restating what Brett just said, it's really like that tells you the bullishness and the capacity build going into next year. Because like he said, by the end of Q4 this year, the people that are on the capacity onboard is going to drive the growth number for next year.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. Let's go to Matt Hedberg at RBC.

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

I'll offer my congrats as well. Todd, maybe a higher-level question. During COVID, we heard a lot of customers that wanted to just stay put on a legacy identity provider. Now there were few years removed, a lot of the partners we talked to think there could be a more material replacement opportunity from the legacy side. Can you talk about that as like a long-term catalyst within maybe identity and access management, IGA and PAM, less so SIEM, obviously, more greenfield opportunity?

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

I think the -- it's a great question. It's super insightful. I think the biggest opportunity we have is actually what you're saying, which is the mainstream -- or sorry, the mainstream, more traditional organization deciding to do security and identity from the cloud. That's still not mainstream. That's more of a progressive thing. It's getting more mainstream, but it's still relatively progressive.

And the companies that choose not to do that are maybe building their own Workforce Identity or maybe customizing a legacy Oracle or IBM or computer associates or they're just going with one of those solutions. So this is a big opportunity. And so how do we -- part of it is natural. The cloud is the future. The benefits of being more integrated and more flexibility that an Okta provides is going to help us. But another thing, which is just these are smart, economical buyers. And if they can get more functionality from one vendor, whether it's not just access, but it's a governance and it's privilege, that's going to help.

And another big thing, which might sound maybe counterintuitive coming from me. But what is Microsoft, they're significant -- in terms of competitors, they're a competitor of ours. But what are they telling the whole world? They're telling the whole world is that use the cloud for identity and security. And this is a huge boon for us because I do think the biggest opportunity we have is the mainstream company wanting to go to this model for Workforce Identity. And it's -- we're both -- we're all making it mainstream.

And I'm very confident that the value we provide, which is more integration, more security, best-of-breed choice on security tools, on the technology you want to do to make your business successful, our differentiation there against any platform provider, whether it's Microsoft today or another major platform tomorrow that wants to be broader in identity, our independent neutral choice is going to win out.

So you can see this in the IDC numbers, where it's still a pretty fragmented market. You see Microsoft. You see Okta. You see a bunch of other little slices in that graph that are eventually going to go to the cloud, and we're set up to continue to be the leader to benefit from it.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. Next up is Brian Colley at Stephens.

Brian Lee Colley ***Stephens Inc., Research Division - Security Software Research Analyst***

So last quarter, you talked about the macro impacting the SMB market in the U.S. most acutely. I mean have you seen any of that macro impact start to bleed in, impact larger companies or customers in other geographies as well? Or is it still mostly limited to U.S. SMB?

Brett Tighe ***Okta, Inc. - CFO***

Yes, Brian. It's mainly U.S. at this point from our perspective, at least what we can see in the quant. In terms of it leaking into enterprise, we have seen that new business versus upsell mix in both SMB and enterprise now, more so in SMB. But it's -- so it is, to your point, Brian, it's starting to leak a little bit into the enterprise from that perspective.

In terms of international, we haven't seen it quite as much there, but I will -- from a quantitative perspective. But from a qualitative perspective, if we just talk to sales leadership in most of the regions, they have heard the, hey, budgets are tighter or budgets are being delayed or projects are being delayed. So we've got the quant side of it, and then we've got that qualitative side of it as well to kind of prove out that it does feel like the macro has started to hit us in the last couple of quarters.

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

One thing that's interesting from my perspective there is that in the enterprise, big deals are doing well. So I have this theory that if there is some macro headwinds in the enterprise, there's a dynamic there that's it's being counterbalanced by big deals going through.

I mentioned on the prepared remarks, one of our biggest wins was a big deal and a well-known insurance company, that was an upsell. So some of these things are even though the economy is -- there's some questions about the economy, these big deals are going through, which, I think, when we look at in the aggregate at our enterprise business, it might be balancing out any headwinds from a quantitative perspective.

Dave Gennarelli ***Okta, Inc. - VP of IR***

All right. Next up, Shaul Eyal from TD Cowen.

Shaul Eyal ***Cowen and Company, LLC, Research Division - MD & Senior Analyst***

Congrats on the ongoing notable improvement. Todd or Brett, so the business remains on solid fundamentals, as Todd indicated. We're seeing the macro impacting new logos predominantly. As you think about the fiscal '24 guidance, how should we be thinking about the new logos in that context?

Brett Tighe ***Okta, Inc. - CFO***

Yes. I would say it's really -- that's probably where the headwind will exist. I mean, we'd want to grow -- frankly, we want to grow both as fast as we possibly can, both new business and upsells. But we do believe that if we do see a headwind, it is probably more likely to happen there in FY '24. We'd love to have that not happen and not be the macro situation.

But I mean just think about it, if you're a customer today or a company today, you're likely going to go to the vendors you trust and love, right? And you can see it in some of the numbers that we've produced. Our customers love us. Look at that solid or strong gross retention rate, that's been in the mid-90s for a very long time now. You can see it in the net retention rate. You can see the growth in the customer count and the greater than $100,000 growth, which comes from a lot of our current customers, it's upselling into those cohorts.

So I can see how customers will be a little bit more hesitant to engage in new partnerships at this time just because there is an unknown macro situation out there or the fear of the unknown, if you will. So we do believe it will hit us a little bit more on the new business side, but we're obviously actively working to try to sell both new business and upsells. We're just being prudent with our expectations at this point.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Great. Next up is Joe Gallo at Jefferies.

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

I really appreciate the question. And I love that you laid out your top priorities for fiscal '24. Todd, can you just double click on what's needed to win in the SIEM market? Is there a technical moat you need to widen? Or is it more go-to-market focused?

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

I'd say the primary is go-to-market focus, not that it's -- I guess I should be more precise. It's -- the whole company and the engineering product, product marketing, demand generation, it's the whole end-to-end at Okta maturing in that motion. Because as we talked about, it's a big opportunity, it's related, but it's distinct in a lot of ways that require the company to work hard to get that second act going.

So that's the -- that's things like clarity of the product portfolio. That's things like enablement. That's things like clarifying the messaging. We talked last year about the systems, all that stuff coming together to execute there. There are -- it's an interesting market because, in a lot of ways, just the size is interesting, but also the boundaries of it and what it means to be a Customer Identity provider and how that overlaps with general customer data functionality or the more of the marketing use case of finding new users.

There's a lot of gray areas in how the market, I think, eventually will crystallize to be a mature category in what will be included and what won't be included. The strategy in that business now is we have a marketplace of partner solutions around there, and you can get like fraud detection, identity verification, more kind of market integration functionality. So it's almost like a platform in itself.

And the advantage is it gives customers -- as the category is being created in many ways, it gives customers a ton of value with these integrations, but also, it puts us in a position to help define what the final market in terms of the boundaries around the market, how it will play out. And it's important that we not only execute on that, but keep innovating and define that market as it eventually comes into a mature status in several years from now. We're the leader, by far. It's not even close. And so it's an exciting place to be in.

Dave Gennarelli ***Okta, Inc. - VP of IR***

We'll go to Adam Borg at Stifel.

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

Awesome. Maybe just for Todd on the macro. Obviously, we talked a little bit about some of the headcount reduction that you guys made, and we'll be hearing more broadly about headcount reductions across the industries. Maybe just remind us how correlated of this top line growth is to headcount changes in your installed base overall.

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

The first thing to understand is that the -- our products, whether it's Customer Identity or Workforce Identity, are licensed on their recurring subscription. So the -- there's -- on the Customer Identity self-service business, the credit card business, this is accepting that. But everything else, it's 1-year subscriptions minimum. The average is over 2.5 years.

So these aren't month-to-month subscriptions or pure usage-based subscriptions that can get downsized if there's less usage or less employees. So that's one level of -- that's just a level set about the business. They're licensed on a number of users in the employee case or a number of monthly active users in the Customer Identity case.

So all things being equal, when the contracts come up for renewal, more employees or more users is going to be more money, and less is going to be less. So there is some correlation. What we've seen in the business is that there is some insulation just because of the contract duration. And then when companies do come up for renewal and they have much more employees or users are much less, a lot of times, the difference can be made up with the other dimension, which is just selling them more products.

So let's say, you go into a renewal on the workforce side and there's fewer employees because of the reduction, well, you can maybe keep the contract flat or even increase it by upselling workflows or life cycle management or advanced multifactor authentication. So I think those 2 dimensions, usage, contracts and the product portfolio insulate what we've seen. It insulates our foundations of our gross retention and our NRR, to some degree. Of course, we talked about it earlier about how that could -- how that will trend over time, but those are some important dynamics there.

Brett Tighe ***Okta, Inc. - CFO***

One other thing to factor in there, Adam, is the diversity of our customer base. I think sometimes everyone thinks we just sell to tech companies, but we don't. If you look at the slide at Investor Day, the diversity of industry that we have is quite good. In fact, there's no industry on that slide, if you go back and look at it, that is greater than 10% of our total portfolio of annualized contract value.

So yes, there's been a lot of -- a fair amount of layoffs in tech. But if you look at the rest of the economy, it hasn't quite hit it as much. And so I think that's one of the benefits of our product. That's why identity is this universal problem that everybody has. It's not a tech problem. It's not a financials problem. It's not a U.S. versus international problem. It's not a small company or a big company. It's a universal problem that we're solving here.

Dave Gennarelli ***Okta, Inc. - VP of IR***

All right. Let's go to Sterling Auty at MoffettNathanson.

Billy Fitzsimmons

This is Billy Fitzsimmons on for Sterling Auty. I'll keep it quick for you. You guys talked about how macro compared for -- from Q4 to Q3. But I'm curious, how did Q4 2023 end-of-quarter close rates compared to Q4 a year ago, so back in 2022?

Brett Tighe ***Okta, Inc. - CFO***

Close rates have been fairly similar across that time frame. Also, sales cycles, sales duration. We haven't seen a change there either. So when we're talking about the macro, we were talking about those major factors of new business versus upsell mix, contract duration and then the qualitative talking with our sales leadership. Those other 2 factors that you just -- I just mentioned around sales cycles and -- and the other one is it just -- it hasn't changed. Close rates haven't changed. It's been more of the same.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. Next up is Wolfe Research.

Patrick O'Neill

This is Patrick on for Josh. A similar vein to the last question. Just kind of now that you're 2 months into the year and selling into 2023 budgets, what changes have you noticed, if any, in customer budget dynamics, both kind of in general and then also specifically with regard to like the priority of identity security within the budgets?

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

We're only a month into our fiscal, so it's pretty early. Our fiscal starts Feb 1. I think that I haven't -- we haven't noticed a change, but the honest answer is it's pretty early to get a really good read for that. We are confident in the ability to execute our plan for the year. And talking to sales reps at our sales kickoff last year, they're confident about their plans and the ability to be successful in their plan.

So when I look at the -- what makes me comfortable or confident, that's a big factor. So I think we've got to maybe get a few more months before we get a real good look on customer buying behavior. Because I think a lot of times, the customers are figuring out things in the macroeconomic situation like we are.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Great. Let's go to Eric Heath at KeyBanc.

Eric Michael Heath ***KeyBanc Capital Markets Inc., Research Division - Research Analyst***

Great. Good to see the strong results here, Brett and Todd. So Brett, I guess 2 questions for you, just on the margins. If you look at subscription gross margins, it's kind of been improving quarter-over-quarter for a handful of quarters now. Just curious, what's driving that improvement? And how to think about that going forward? That's one.

And then two, if I look back to Okta and the kind of pre-COVID, pre-Auth0, I saw that your free cash flow margins were typically about 10 points higher than your EBIT margins were. I think your guidance for this year calls for about 6 points of delta there. So just talk about maybe any dynamics that might be happening on that front as well, too.

Brett Tighe ***Okta, Inc. - CFO***

Yes, sure. In terms of the gross margin, the reason why you're seeing the improvement is kind of what I've been talking about in terms of just becoming more efficient across the board, slowing down hiring, cost efficiency measures. Those are the 2 things that we're really kind of focused on. As you could see, through the second half of the year in terms of just margins in general, we do expect subs gross margins to probably roughly travel about the same percentage in FY '24 as we do in FY '23.

And then on the question around Auth0 and the delta between Okta or the delta between cash flow and op margins, that's just a function of the business slowing down a little bit, right? You build a little bit less. And you have -- obviously, if you're growing a little bit faster, the billings are growing a little bit faster, you're going to collect cash a little bit faster and so, thus, you're going to get that little bit of compression between the 2 numbers of free cash flow and non-GAAP operating margin.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. We're running up on the hour, but I think we can go a little bit over time here and try to get as many as we can. We'll go to Peter Weed at Bernstein.

Peter Weed ***Sanford C. Bernstein & Co., LLC., Research Division - Analyst***

Congratulations on the continued momentum in the business.

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

I just want to make sure everyone knows that we would go over even if the results weren't strong.

Peter Weed ***Sanford C. Bernstein & Co., LLC., Research Division - Analyst***

It's even more fun than...

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

We're not cherry picking. We're not cherry picking, right?

Peter Weed ***Sanford C. Bernstein & Co., LLC., Research Division - Analyst***

We can always celebrate something right now. And maybe we carry on that theme. I think you answered a couple of questions here recently that clarified saying, hey, at the beginning of this year, whether or not it's January or February, you're not seeing any new deterioration relative to what was seen kind of in the second half of last year. And we kind of know how that played out.

And in those quarters, we ended up seeing kind of on a quarter-over-quarter basis, like 6% growth rates, right? So things we're continuing to hum forward. Yet if I look at the guidance for this upcoming year, if I take the quarter 4 results and annualize that, you're talking about for an entire year having a 6% growth rate relative to just annualizing the fourth quarter.

Like when you set that type of guide, what are you seeing out there that you think could be this credible reason why what has been seen at the second half of last year and what you continue to see in January and February this year might fall apart and result in such a huge deceleration relative to kind of the quarter-over-quarter path that's been going on without accelerated problems?

Brett Tighe ***Okta, Inc. - CFO***

Well, keep in mind, the second half of the year, revenue growth rates are a reflection of the prior periods, right, and so because of the obvious -- the way the revenue model works, the revenue accounting works.

In terms of going forward, we're just being thoughtful with the guidance at this point, right? I mean we've talked about the macro. We've talked about go-to-market leadership changes. We've talked about not getting too aggressive in our expectations around attrition in the field and Customer Identity Cloud. But we're very early in the year, right? We still got 11 months left in the year, and we want to make sure that we're just being thoughtful about all those factors, given that...

Peter Weed ***Sanford C. Bernstein & Co., LLC., Research Division - Analyst***

Are you seeing any specific things that worry you? Like, hey, there's reasons to believe that new customers are going to further deteriorate relative to what we're seeing, which, I think, I heard sales pipelines look okay. You said, hey, SMBs are a little bit weaker. But I think we've started to see some indications that maybe SMBs may be bottoming. So like maybe not a lake down there. So it's enterprise is the worrier. Are you seeing reasons to be worried on the enterprise?

I think you had a great point around NRR saying, hey, from an NRR standpoint, when you have fewer new customers, over time, you're going to just see a headwind because you've got fewer people to upgrade. But like that's a relatively small number because you didn't fall off the cliff that big with new customers. I'm just trying to figure out like what keeps you up at night the most when you look forward. What should we watch for that, that would like tell us, hey, something might be going on?

Brett Tighe ***Okta, Inc. - CFO***

What keeps me up at night, that's a dangerous question. Yes, I'm sure Todd's got some answers on that one as well. But no, I think it's just some of the items I've already talked about around just being thoughtful about the productivity in the field, making sure we're doing the right actions, right, doing the right things.

And like I said earlier in the year, we just want to be thoughtful about things. We do think the macro is going to get worse, right? So we're not expecting things to get better from here on a variety of fronts, and so that's really what our expectations are at this point.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Let's go to Keith Bachman at BMO.

Keith Frances Bachman ***BMO Capital Markets Equity Research - MD & Senior Software & IT Services Analyst***

I'm going to ask question. I think, Todd, this is for you. A, could you talk about your win rates over the last kind of 90 -- 1 to 2 quarters and how those might have changed, in particular with regard to any of the categories that you may want to find, whether it's SMB or large enterprise or SIEM versus employee?

And then, B, I just wanted to make sure I understand on the go to market. I know there's a lot of transition at the top. Comp plan sounds like they're not changing much. But in terms of -- I just wanted to broaden that out about territories or strategies or anything along those lines.

I think the go-to-market is relatively stable, but you had previously highlighted a different question, just comp plans. But I wanted to broaden that out to just talk about go-to-market more broadly than comp plans, including geo. Any geo redistributions or any other or kind of changes that might be involved in go-to-market changes?

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

Yes. I think it's a really insightful question because it is more than just comp plans. It's the sum of all changes that our go-to-market team has to adjust to and pivot around. And there just aren't many of them, whether it's countries entering or not entering or territories or organizational shifts or down at the -- we talked about leadership changes at the top, but the go-to-market strategy is not changed.

And so when you talk about SCO last week, and Jon Addison gets up there as the interim Chief Revenue Officer and kicks off the year;

and Eric Kelleher gets up there about professional services and customer success, what they're saying is -- sounds very consistent to the teams, such as we have to win SIEM, we have to keep executing on workforce.

The -- you asked a question about win rates. Our win rates remain very healthy, and it's a very good situation to be in. I think whether it's on the Customer Identity side, where it's really is are you going to build it or are you going to buy it from Okta?

And we have things like ChatGPT is a super in the news right now, and everyone is talking about it. So we had some success there. So we use that to illustrate that market, which is developers found the product, put it in that product when it was as the login and the identity when the product was very nascent. And all of a sudden, it takes off, and it's a huge deal for us.

But that's happening in a lot of places in customer nowadays. There's engineering teams that are thinking about what to use and thinking about should they use open source, should they build it themselves? And we have the best product there for developers, which is a huge advantage.

On the workforce side, it's -- like I mentioned, it's -- are we going to use the cloud for identity and security? And there's lots of forces, whether it's great solutions like Okta, whether it's just legacy maintenance contracts expiring. There's reasons to use something, and we continue to execute well with our message of independence and neutrality. And yes, it's a solid foundation to work off of.

Keith Frances Bachman ***BMO Capital Markets Equity Research - MD & Senior Software & IT Services Analyst***

Okay. When you say -- just to push on that, when you say healthy, I was just asking, have they changed much in the last 1 to 2 months?

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

No. There's been -- they've been healthy for a long time.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Let's go to Madeline Brooks at BofA.

Madeline Nicole Brooks ***BofA Securities, Research Division - Research Analyst***

Just a really quick one here. I wanted to just get a sense of what an ideal split is for Okta between upsell and cross-sell and new business. And then additionally, on the new business side, would you just be able to give us some color if, over the last quarter, you needed to implement any discounting or further bundling?

Brett Tighe ***Okta, Inc. - CFO***

In terms of the discounting, the discounting has actually been very consistent as well. It's one of those things that we just -- it hasn't changed very much. In terms of the mix between new business and upsell, right now, we want it to higher new business than it is. We're too weighted towards upsells, and that's something we're focused on, but it's -- and it could be -- it's definitely like a factor of the macro, but we got to get better at doing new business in the future.

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

Yes. We were -- right now, we were talking about this earlier this week. I think another factor on new business versus upsell is ramping reps. Brett talked about a customer that wants to double down on their vendor relationships that's in place. If you're a new sales rep that's ramping, what's the easiest thing to sell to? A customer that the company already has a relationship. So I think so you'll see us make progress there just as reps ramp.

Brett Tighe ***Okta, Inc. - CFO***

Yes. That's a good point.

Madeline Nicole Brooks ***BofA Securities, Research Division - Research Analyst***

Sorry. Can you just remind us of the percentage breakout between them as it stands for the fourth quarter?

Brett Tighe ***Okta, Inc. - CFO***

We don't usually talk about that. We just talked about net retention, which was 120%.

Dave Gennarelli ***Okta, Inc. - VP of IR***

We'll go to Brian Essex at JPMorgan.

Brian Lee Essex ***JPMorgan Chase & Co, Research Division - Research Analyst***

All right. Congratulations from me as well.

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

Thanks, Brian.

Brian Lee Essex ***JPMorgan Chase & Co, Research Division - Research Analyst***

Maybe if I could, I guess, take one layer deeper on Keith's question with regard to sales force organization, how that's structured, so I better understand it. It sounds like maybe it's still relatively siloed between workforce and SIEM. But are you -- do you envision shifting towards more of a platform approach? And are you seeing a lot of multiproduct workforce plus SIEM deals? Or are you going to stick with maybe a more what seems to be a land anywhere approach or keep those kind of sales forces relatively siloed?

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

Yes, the sales -- there's one sales team. So every customer has one rep from Okta. And the rep from Okta sells them all our products, OIG, workforce, customers. So it's -- there's no -- there's some technical specialists, but it's -- I think people call it the IBM model. There's one -- I think that's the first time I've ever compared myself to IBM. It's a great company. It's a great company.

Anyways, there's one sales rep. And the idea is that we want to be the strategic partner for identity. So that's incumbent on the sales reps to use their capability to appeal to different buying centers in their company. The disadvantage of that is it's sometimes it's harder to train and enable. The advantage of that is you can get higher if you do it right, and that's in line with our strategy of being the strategic platform. So it's one sales team. They're selling all the products with specialist's help and presales' help when they need it when it's fair to.

Brian Lee Essex ***JPMorgan Chase & Co, Research Division - Research Analyst***

Are they incentivized to sell the platform? Or do they go into like a customer has a specific use case and they go in to solve that problem?

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

Well, they're incented to. There's -- the compliance, we kept them simple, but they're incentivized to sell more, and they're incentivized to sell multiyear. And they are -- there's a little bit of a kicker for our priority, which is customer a day. Yes.

And I think the other really important thing is we had a really, really good quarter for cross-sells. And I think you're starting to see this work, whether it's our company starting with Customer Identity Cloud and selling workforce or the vice versa or even OIG, which is modules inside of workforce. So it's a positive energy.

Brian Lee Essex ***JPMorgan Chase & Co, Research Division - Research Analyst***

And then those responsible for developers, is that completely separate? Or is that under that same team umbrella as well?

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

There's one sales team. Yes, one sales team. Yes, there's a lot of -- so for the developer motion, so there's a team that's dedicated to getting -- making that developer experience. That developer team at open AI that found online and learned about Customer Identity Cloud and put in their APIs and read the documentation, that's all a different team. But once it gets to a rep, once the lead from a self-service credit card customer goes up to a rep, we're going to do a bigger deal, that's the one sales team.

So the sales team loves this because, in addition to their leads, they get from normal demand gen, they get a bunch of leads off to

Customer Identity self-service. So they have to -- like we've talked about, they have to be -- we have to ramp them and make sure they're ready to sell it. But once that starts to happen, it's a good time to be a salesperson at Okta.

Brian Lee Essex ***JPMorgan Chase & Co, Research Division - Research Analyst***

Very helpful.

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

Sure. Happy to lay it out there for you.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. I'm going to call a 5-minute warning here if we can get as many as we can here. Let's go to Taz Koujalgi, Wedbush.

Imtiaz Ahmed Koujalgi ***Wedbush Securities Inc., Research Division - Analyst***

Question for Brett. Brett, your guide implies 5% growth in OpEx for the quarter and for the year. Is that also reflective of the sales capacity increase? Would your sales capacity increase at that same 5% rate?

Brett Tighe ***Okta, Inc. - CFO***

Our sales capacity is designed to be able to hit -- like I said earlier, designed to hit the FY '24 bookings number and also set us up for success in FY '25. So we're not saying, one way or the other, exactly what the quota increase or the quota capacity out there on the street is. But ultimately, we're making sure that we're -- we've got the right people in the right places, right segments, right geos to be able to go after this opportunity, both this year and in fiscal year '25.

Imtiaz Ahmed Koujalgi ***Wedbush Securities Inc., Research Division - Analyst***

One quick follow-up, please. Your CRP guide implies CRP is stepping down from Q4 to Q1. That's never happened before. Or are you just being very conservative? Or is there something happening with seasonality, backlog getting built into the...

Brett Tighe ***Okta, Inc. - CFO***

Yes. I mean, at the top end, it would imply about flat. But I mean, keep in mind, remember, Q4 is our seasonally biggest quarter of bookings. Q1 is our seasonally lowest quarter of bookings. And so we're just being thoughtful about that and making sure we're incorporating in the guidance for you guys today.

Imtiaz Ahmed Koujalgi ***Wedbush Securities Inc., Research Division - Analyst***

But nothing changing in terms of the booking mix by quarter? Like are you shaping a smaller mix in Q1 versus the usual mix in Q1? Because you've always said that Q1 being smaller than Q4, but your CRP system is going up.

Brett Tighe ***Okta, Inc. - CFO***

Yes. Keep in mind, though, if you look at the quarters before from Q4 to Q1, the growth rates were higher, and so you'll see a slightly different result when you have that. So a slightly lower growth rate, you're going to have a seasonality that looks a little bit more like what we're talking about this time around. So nothing really different from an overall seasonality of bookings, it's just the results of having slower growth than we have in the years past.

Dave Gennarelli ***Okta, Inc. - VP of IR***

We'll go to Patrick Colville at Scotiabank.

Patrick Edwin Ronald Colville ***Scotiabank Global Banking and Markets, Research Division - Analyst***

And congrats on a very solid set of results. I guess my question is around the ACV disclosure you guys gave, which is extremely helpful. When I look at the numbers, my take is that workforce has held up very like robustly in 4Q and over the trailing kind of 24 months, whereas the, I guess, the deltas have been really in the customer segment.

So I guess, can I sneak in a 2-parter? One is the Street thinks that workforce is in the maturing segment at Okta. What is the Street missing? And what would it take you in that customer bit customer segment for that growth to start plateauing or maybe in increasing?

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

We're very excited about both. I think the Street is underestimating workforce. I think that they -- there's been this narrative that Okta is so much focused on Customer Identity because workforce is -- there's a problem with it. I couldn't disagree more. I think it's a great opportunity long term. We want these businesses to be -- we want to build this partner and independent neutral one-stop shop for identity, and you got to have both. So I think that workforce can grow. Customer Identity can grow.

If you look at those numbers, besides just thinking that the depth of workforce is greatly overrated, I think you see some of our -- in the Customer Identity number, you see there's an opportunity for better execution. I think that even with all the things we talked about, whether it's macro, whatever, we can execute better in Customer Identity. And we're set up to do that.

We're the leader, by far, and we got a bunch of stuff we've done to improve that. And I'm confident about that one getting -- that growing faster as well because it's still smaller. You saw the growth rates are 30% and 35%. -- that customer growth rate should be higher, given it's coming off a lower base.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. We're going to take the last question from Fatima Bolani at Citi. Apologies to Carson, Fred and Brad. We'll get to you next time.

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

You're first next time, Carson. You're first.

Fatima Aslam Boolani ***Citigroup Inc., Research Division - Director & Co-Head of Software Research***

Ladies last in 2023 -- '22. Brett, I'll make it quick for you. So between you and Todd, you quantified for us the contract duration and some of the dynamics there. But I'm wondering what you're assuming in your guidance as it relates to some of the contractual duration with -- especially with your renewals business. And as a related matter, if there's any particularly large cohorts of renewals that are coming up that you're being maybe more cautious about by way of shortening contract duration?

Brett Tighe ***Okta, Inc. - CFO***

Yes, that's a good question. There's no real cohort that's wildly different than the other. I mean that's one of the benefits of having these longer duration contracts, just spreads everything out. So there's nothing really to speak of in terms of like major assumptions in terms of what we're thinking about from a renewals perspective.

We talked about the gross retention earlier as being a subset of the net retention. We do expect that to remain stable because, from our forecasts, from what the teams are telling us and what we can see in the business, we do believe that to continue going to be stable, and really, one of the strengths of our business, right? We've talked about this for a long time that gross retention really reflects the value that we deliver on a day-to-day basis. And so yes, it's probably how it kind of put it to.

Dave Gennarelli ***Okta, Inc. - VP of IR***

Okay. That's the time we have today. Before we go, I want to let you know that we'll be attending a couple of investor conferences this quarter. We'll be at the Morgan Stanley conference in San Francisco next week on the 6th and the KeyBanc conference in San Francisco on the 7th, and we hope to see you at one of those events. And if you have any other follow-up questions, you can reach us at ir@okta.com. Thanks.