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Nutanix, Inc. (NTNX)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for attending today's Nutanix Fourth Quarter for Fiscal Year 2022 Conference Call. My name is Amber, and I will be your moderator for today's call. All lines will be muted during the presentation portion of the call with an opportunity for questions and answers at the end. [Operator Instructions]

I now have the pleasure of handing the conference over to our host, Rich Valera, Vice President of Investor Relations. Rich, please proceed.

Richard Valera

Vice President-Investor Relations, Nutanix, Inc.

Good afternoon and welcome to today's conference call to discuss the results of our fiscal fourth quarter and full-year 2022. Joining me today are Rajiv Ramaswami, Nutanix's President and CEO; and Rukmini Sivaraman, Nutanix's CFO. After the market close today, Nutanix issued a press release announcing financial results for its fiscal fourth quarter and full-year 2022. If you'd like to read the release, please visit the Press Releases section of our IR website.

During today's call, management will make forward-looking statements, including statements regarding our business plans, strategies, initiatives, vision, objectives and outlook, including our financial guidance, as well as our ability to execute thereon successfully and in a timely manner, and the benefits and impact thereof on our business, operations and financial results; our financial performance and targets and use of new or different performance metrics in future periods; expectations regarding profitability, our competitive position and market opportunity; the timing and impact of our current and future business model transitions; the factors driving our growth, macroeconomic, geopolitical and industry trends, including global supply chain challenges; and the current and anticipated impact of the COVID-19 pandemic and its effects.

These forward-looking statements involve risks and uncertainties, some of which are beyond our control, which could cause actual results to differ materially and adversely from those anticipated by these statements. For a more detailed description of these and other risks and uncertainties, please refer to our SEC filings, including our Annual Report on Form 10-K for the fiscal year ended July 31, 2021 and our subsequent Quarterly Reports on Form 10-Q, as well as our earnings press release issued today. These forward-looking statements apply as of today, and we undertake no obligation to revise these statements after this call. As a result, you should not rely on them as representing our views in the future.

Please note, unless otherwise specifically referenced, all financial measures we use on today's call, except for revenue, are expressed on a non-GAAP basis and have been adjusted to exclude certain charges. We have provided, to the extent available, reconciliations of these non-GAAP financial measures to GAAP financial measures on our IR website and in our earnings press release. Lastly, Nutanix management will be participating in the Goldman Sachs Communacopia & Technology Conference on September 12 and the Piper Sandler Growth Frontiers Conference on September 14, and we hope to see many of you at these events.

And with that, I'll turn the call over to Rajiv. Rajiv?

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

Thank you, Rich, and good afternoon, everyone. Against a volatile macro backdrop, we delivered a good fourth quarter relative to the updated outlook we had provided on our third quarter call. We exceeded all our guided metrics and saw continued strong performance in our renewals business. Supply chain constraints with our server partners, while remaining a significant challenge in the quarter, were better than we had expected.

While we're aware that the macro backdrop had grown incrementally more challenging for many businesses, in our fourth quarter, we continued to see solid demand for our Nutanix Cloud Platform with businesses continuing to spend on digital transformation, modernizing their data centers and adopting hybrid multicloud operating models.

During the fourth quarter, I spent a lot of time on the road meeting with customers in-person. I was energized by the face-to-face engagement and struck by their enthusiasm for their overall experience on Nutanix products and the strong customer support they have received. These conversations reinforced my view that our unwavering focus on reducing the complexity and cost of IT environments, as well as our obsession with customer delight is resonating with our customers.

Taking a closer look at the fourth quarter, we delivered bookings well above our expectations, aided by a number of large expansion deals and the continued strong performance of our renewals business. This drove billings and revenue outperformance relative to our guidance. Top line outperformance, diligent expense management and better-than-expected linearity helped us achieve positive free cash flow in the quarter, which was substantially better than our expectations.

Given the largely supply chain-driven headwinds that affected our fourth quarter, I believe looking at FY 2022 in its entirety provides a better picture of the progress we made on our subscription business model transition. Specifically, we saw ACV billings growth accelerate to 27% year-over-year, up from 18% in FY 2021. We also saw non-GAAP operating margin improve by 15 percentage points year-over-year to minus 5%. Finally, for the first time since 2018, we achieved positive free cash flow for the entire fiscal year.

Beyond these financial accomplishments, we had other important achievements, including launching our simplified product portfolio, enhancing our leadership team, making progress with our partners and continuing to delight our customers, as reflected in our high NPS scores and strong renewal performance. Overall, I am pleased with our progress and financial performance in FY 2022. As I noted, our fourth quarter was bolstered by a number of large expansion deals, including customers both increasing their use of Nutanix Cloud Platform and broadening their adoption of adjacent solutions in areas such as storage, Database-as-a-Service and cloud management.

A good example was an expansion deal with an existing customer, who is a global Fortune 100 financial services firm that placed a double-digit-million-dollar order to broaden their usage of our core Nutanix Cloud Platform, while standardizing on Nutanix Database Service for managing and deploying their databases throughout their organization. This customer also plans to utilize NC2 on AWS to enable bursting into the public cloud with their Nutanix-based workloads. We see this customer as a great example of how we're able to land and expand with some of the largest enterprises in the world.

Our largest new customer win in the quarter was with an EMEA-based financial services provider that was looking to modernize their three-tier infrastructure with the aim of improving scalability, performance and management resources required to support future growth objectives, while also providing a path for seamless access to the public cloud. They chose our Nutanix Cloud Platform full-stack offering, as well as Nutanix Cloud Management due to its simplicity and built-in automation for Infrastructure-as-a-Service. They also added Nutanix Unified Storage and Nutanix Database Service for their storage and database automation needs respectively. This win is a great example of customers seeing the benefits of adopting our full stack.

On the product front, we were excited to announce that NC2 on Azure progressed to public preview during the quarter, which would significantly broaden the pool of customers for our cloud offerings. One of our first customers onboarded to NC2 on Azure is a leading global brewer based in EMEA that has standardized on Nutanix Cloud Platform for all of its business-critical applications and SQL Server workloads. This customer chose Nutanix due to its simplicity, performance, ease of management and ability to seamlessly burst into the public cloud of their choice.

Another exciting product development was the recent release of AOS 6.5, a comprehensive and feature-packed release, which reflects our continued investment and innovation in our platform. Release 6.5 has features focused on improving performance, security and integrated data services required for demanding database workloads and business-critical applications. Go-to-market leverage with partners is one of my top priorities, and we continued to see progress on this front during the fourth quarter. Our partnership with Red Hat, with whom we have a growing number of joint wins for both OpenShift and Red Hat Enterprise Linux workloads running on Nutanix Cloud Platform, continues to show good momentum.

One example of a joint win in Q4 is a central bank of a country in the EMEA region that shifted their business-critical applications running on Red Hat OpenShift from a competing three-tier solution to Nutanix Cloud Platform, including our AHV hypervisor, due to the resiliency, scalability and reduced total cost of ownership offered by our solution. We're excited about the growing opportunity pipeline we see with Red Hat. Also on the partner front, we were pleased to be named 2022 HPE GreenLake Ecosystem Partner of the Year. We view this award as a testament to our growing partnership with HPE.

Now, I'd like to comment on our recent sales leadership transition. Following Dom Delfino's decision to pursue an opportunity with another technology company, on August 1, we appointed Andrew Brinded as our new Chief Revenue Officer. Andrew has been with us as a sales leader for over five years, most recently as our Senior Vice President and Worldwide Sales Chief Operating Officer, and has developed a deep understanding of our business model, go-to-market strategies and sales operations. Our sales organization is in excellent hands under Andrew's leadership, and I look forward to working closely with him in his new role. More broadly, I feel confident that we've got the team in place to take Nutanix to its next stage of profitable growth.

In closing, I'd like to provide some thoughts on our priorities and outlook. First, our overarching priority remains driving towards sustainable, profitable growth. To enable this, we will continue to judiciously invest in the growth of the business, execute on our growing base of renewals, and diligently manage expense levels. Towards this end, as part of our comprehensive review of our business and operating model, and along with a number of other expense reduction actions, we made the difficult decision to reduce our head count by approximately 4%. This was not a decision we made lightly, but it was important to ensuring that we could continue to drive towards profitable growth in a variety of macroeconomic scenarios.

However, we are also seeing businesses continuing to prioritize digital transformation and believe the challenging macro backdrop is providing further incentive for them to optimize their IT and cloud spend. We see these dynamics as playing to the strength of our hybrid multicloud platform, which enables companies to reduce the complexity and cost of their IT environments.

Finally, we see the business achieving positive non-GAAP operating income and continuing to be free cash flow positive in FY 2023. We plan to do this through a combination of strong continued top-line growth and diligent expense management. We remain confident about the opportunity ahead of us and enter FY 2023 with a sense of excitement and cautious optimism.

And with that, I'll hand it over to Rukmini Sivaraman. Rukmini?

Rukmini Sivaraman

Chief Financial Officer, Nutanix, Inc.

Thank you, Rajiv. The fourth quarter of fiscal 2022 came in better than the expectations that we had set forth in our last earnings call, as indicated earlier this month. ACV billings for Q4 were $193 million, above our guidance range of $175 million to $185 million. The outperformance was due to both renewals and new ACV bookings coming in better than expected. Q4 also benefited from a few large deals, which are harder to forecast. New logo additions in Q4 were around 620.

ARR at the end of Q4 was $1.202 billion and grew 37% year-over-year. Average contract duration was 3.2 years in Q4, flat from 3.2 years in Q3. Revenue for Q4 was $386 million, above our guidance range of $340 million to $360 million. As described during our last earnings call, the percentage of orders with future start dates was a key assumption in our Q4 guidance. This percentage came in higher than it was in Q3 2022, as expected, but not as high as our forecast. This also positively impacted ACV billings and revenue performance relative to guidance with a larger impact on revenue.

While our largest server partner had almost no impact from supply chain challenges during our Q4, we did see a significant percentage of orders with future start dates from other server partners. Sales rep productivity increased year-over-year in Q4. Non-GAAP gross margin in Q4 was 82.6%, higher than our guidance range of 79% to 80% because of higher-than-expected revenue. Non-GAAP operating expenses for Q4 came in at $356 million, better than our guidance range of $360 million to $365 million. Non-GAAP net loss for Q4 was $38 million or $0.17 per share.

Billings linearity was good in Q4 and better than our forecast. DSOs were 30 days in Q4, down from 40 days in Q3. Free cash flow in Q4 was significantly better than expected at positive $23 million, while we had previously expected a significant use of cash. This was driven by three factors. One, our bookings and billings coming in higher than expected; two, linearity of billings was better than expected and in line with historical linearity; and three, diligent expense management. We closed the quarter with cash and cash equivalents of $1.324 billion, up slightly from $1.3 billion in Q3 2022.

Moving to full-year fiscal year 2022 results, ACV billings in fiscal year 2022 was $756 million, representing strong growth of 27% year-over-year compared to year-over-year growth of 18% in fiscal year 2021. New ACV billings grew year-over-year, but came in below our expectations, largely due to the challenges identified in Q4, while renewals ACV billings outperformed our expectations. As we transition more fully to a subscription model with total ACV billings and revenue guidance, along with disclosure around metrics such as ARR, we no longer plan to share the breakdown between new ACV billings and renewals ACV billings.

Our gross retention rate or GRR for fiscal year 2022 continued to be within our 90% or greater target range. Net retention rate for fiscal year 2022 was around 125%. Revenue for fiscal year 2022 was $1.581 billion and grew at 13% year-over-year, returning to double-digit growth for the first time since the start of our subscription journey, despite the impact of increased future start dates in Q4 2022. Non-GAAP gross margin for fiscal year 1022 was 83%, greater than our guidance of approximately 82%, largely due to revenue coming in higher than expected.

We delivered meaningful operating leverage as non-GAAP operating margin went from negative 20% in fiscal year 2021 to negative 5% in fiscal year 2022.

We generated free cash flow of approximately $18 million in fiscal year 2022, the first year of positive free cash flow since fiscal year 2018 and since the beginning of our subscription journey. Fiscal year 2022 was a significant year as we saw the thesis around our subscription business model and diligent expense management start to bear fruit with renewals performing better than expected and positive free cash flow for the year. As we have demonstrated over the last couple of years, we expect to continue to make steady progress each year towards continued top line growth and profitability.

Now, turning to Q1 guidance, the guidance for Q1 2023 is as follows: ACV billings of $210 million to $215 million, a year-over-year growth of 16% at the midpoint; revenue of $410 million to $415 million, year-over-year growth of 9% at the midpoint; non-GAAP gross margin of approximately 82%; non-GAAP operating margin of approximately negative 6%, with non-GAAP operating expenses of $360 million to $365 million; weighted average shares outstanding of approximately 229 million.

I'll now provide some context around our Q1 guidance. First, the top line guidance for Q1 assumes that supply chain dynamics would remain more or less the same compared to Q4 of 2022. It also assumes that contract durations stay approximately flat to slightly down in Q1 2023 compared to Q4 2022, given that Q1 is a seasonally strong US Federal quarter, which typically has lower contract duration. Second, in line with our stated priority of driving towards sustainable profitable growth, we conducted detailed expense reviews as part of our annual planning process.

Earlier this month, we made the difficult decision to reduce our head count by letting go of approximately 270 employees, about 4% of our total head count, which we expect to result in estimated annualized expense reduction of approximately $55 million to $60 million. Finally, we expect free cash flow to be around breakeven for Q1 2023 after factoring in approximately $20 million of one-time severance payments related to the head count reductions in Q1. Excluding those one-time payments, free cash flow expectations for Q1 2023 would have been around $20 million.

Moving to full-year expectations, the guidance for fiscal year 2023 is as follows: ACV billings of $895 million to $900 million, year-over-year growth of 19% at the midpoint; revenue of $1.77 billion to $1.78 billion, year-over-year growth of 12% at the midpoint; non-GAAP gross margin of approximately 82%; non-GAAP operating margin of approximately 2%, with non-GAAP operating expenses of $1.41 billion to $1.42 billion.

I'll now provide some color on our full-year guidance. First, the guidance assumes that contract durations would decrease slightly compared to fiscal year 2022. The fiscal year 2023 revenue guidance also assumes that supply chain dynamics would remain more or less the same through the first half of fiscal year 2023 and would start to ease modestly in the second half of the fiscal year. Growth in ACV billings is expected to be greater than growth in revenue because orders with future start dates that are billed are reflected in ACV billings, but revenue can only begin to be recognized in the quarter of the actual license start date.

Second, while the demand for our solutions has remained solid, we have considered the uncertain macroeconomic environment in our guidance. Finally, we expect to deliver about $75 million to $100 million of free cash flow for fiscal year 2023. We are also happy to reiterate the previously stated target of being sustainably free cash flow positive as of the first half of fiscal year 2023, excluding the one-time severance payments.

Moving on to add some color to fiscal year 2025 expectations, we expect free cash flow margins in fiscal year 2025 to be around 10% to 15% of revenue, representing at least $300 million in free cash flow. We also expect to continue to make steady progress each year towards becoming a Rule of 40 company by driving growth and margins.

With that, operator, please open up the line for questions.

QUESTION AND ANSWER SECTION

Operator: Yes, of course. Thank you. We will now begin the Q&A session. [Operator Instructions] Our first question comes from James Fish with Piper Sandler. James, your line is now open.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Hey, guys. Thanks for the questions and congrats on a really good quarter and bounce back here as well. That reiteration of that $300 million of cash flow in the out-year, really good to hear that. Rukmini, on the upside in the quarter and on the guide for fiscal 2023 though, how much of that prior $90 million reduction for fiscal Q4 that you had to lower by came back into fiscal Q4 versus how much of that really flows into that fiscal 2023 number? And what's really driving your confidence around guiding that fiscal 2023 revenue to that level, especially in the macro, the change in kind of leadership at the sales level and the head count reduction that would, in theory, lower your capacity a little bit? And I know you're talking about easing supply chain dynamics in the second half of the fiscal year.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you. Thank you, Jim, for the question. So, let me just share a little more context around how we thought about fiscal year 2023. So, there are a few drivers here that we considered. First, there's – when we think about our billings and revenue, we talk about both renewals and our new and expansion business. So, first, talking about renewals, as we've talked about before, the renewals business continues to perform really well, and given the growing base of renewals, we expect renewals to grow strongly in fiscal year 2023 as well. And renewals contribute a significant majority of the growth expected from 2022 to 2023.

We're also expecting growth in new and expansion business. But when I alluded to the comments around the macroeconomic environment, that's where – it's in the new and expansion business that we have factored in some conservatism as it relates to the macro environment. And then, we did exit Q4 and fiscal year 2022 with record levels of backlog. And so, we're factoring that in as well into the fiscal year 2023 guide. And all of that combined, especially the renewals and the strong and healthy backlog position, helps us to reduce the risk around the forecast. And I think supply chain, as we talked about, Jim, where we expect will stay more or less the same for first half and then maybe start to ease modestly in the second half. But that again could evolve and we'll keep everybody sort of updated of what we see as it relates to supply chain as we go here from quarter to quarter.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Makes sense, and appreciate the color. And then, Rajiv, obviously, your major competitor is having their user conference this week and released an updated version, and I know it's only been 24 hours in terms of the announcement. But from that new functionality that was announced, how does Nutanix actually stack up and what continues to differentiate Nutanix versus your primary competitor? Are you seeing a change in that competitive landscape already given concerns around VMware?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc. A

Yes. I'll give you a couple of points there first. Yes, there is definitely a higher level of engagement from VMware customers as a result of what's going on out there, and they're more open to discussions with us. They're also seeing more talent out there looking – from VMware looking for new career opportunities. Now, with respect to the portfolio itself, we feel very good about where our portfolio is at this point. We have a complete cloud platform that – and if you look at our fundamental differentiation, the platform provides a lot of simplicity. We make these problems really, really simple, right, and it's – from the beginning, we haven't put together two or three different products to build a solution actually. We've engineered it as such from the very beginning. That's number one, simplicity.

The second is the freedom of choice that we provide to our customers, no lock-ins. The third is our focus on customer delight, which is becoming even more critical now these days in terms of how we support our customers for the long-term. And the last bit is about our architecture and how we manage all forms of data. So, from a portfolio perspective, we have a very competitive portfolio. Our win rates continue to increase related to our competition against both our large competitor as well as our legacy three-tier competition. So, we feel pretty good about the product side of this.

James E. Fish
Analyst, Piper Sandler & Co. Q

Helpful. Thanks, guys.

Operator: Thank you. Our next question comes from Rod Hall with Goldman Sachs. Rod, your line is now open.

Rod Hall
Analyst, Goldman Sachs & Co. LLC Q

Yeah. Hi. Thank you for taking the question. I guess, Rukmini, I wanted to come back to the impact of the cost reductions and just kind of make sure I understand what the timing on that impact is, how full an impact we have in the guided quarter. Is it some proportion of the total savings that you talked about of $55 million to $60 million a year or is it the total amount for the whole quarter? So, that's my first question, and then I have a follow-up to that. Thank you.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc. A

Hi, Rod. Thanks for the question. So, on the $55 million to $60 $million is the expected annualized savings coming from those reductions, and we are – we're through most of the notifications. Several of the head count reductions are complete. However, we – as we all know, we're a global company. And so, there are some notifications and exits that are still due to happen. We expect them to be largely complete by the end of Q1, and then we have a few that are outstanding for Q2. But that $55 million to $60 million is sort of an annualized number, Rod, with, like I said, most of them expected to be complete in Q1.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Most complete in Q1. Okay. Thanks, Rukmini. So then...

[indiscernible] (00:32:54)

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. Sorry. Go ahead. Finish your question.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Oh, no, please.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

I was just going to add, Rod, that the annualized operating expense and operating margin guide factors in that $55 million to $60 million of course, as you can imagine. So, that factors in the actual impact and $55 million to $60 million is the annualized number.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. The other thing that I was going to ask about this, Rukmini, is if I take the annualized number and divide by four, even at the high-end of the savings, it's $15 million a quarter, but your severance number is $20 million, which suggests you're doing more of this maybe overseas, not as much in the US. So, I was just kind of curious what the balance of that is and why that severance number is so high in the one quarter, given the quarterly savings you're kind of indicating here.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. So, the approximately $20 million that I mentioned is a fully loaded number, right. So, it includes on-time earnings, the salaries, any kind of bonuses. It includes sort of – the $55 million to $60 million includes the benefits. It includes all of that, Rod, right? So, the $55 million to $60 million is a fully loaded number for the year, payroll taxes. It's a full number. And like I alluded to, it is a global action that we've taken, depending on what we've seen as our priorities and where we want to invest versus we don't want to or we've sort of decided to optimize in certain areas. So, I'm not providing sort of a breakdown by geography, Rod, but I think it is fair to assume that it was a global action.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Great. Okay. That's very helpful. It's really good to see the cost reduction and the cash flow here. Much better than what we expected as well. Thank you.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you.

Operator: Thank you. Our next question comes from Pinjalim Bora with JPMorgan. Pinjalim, your line is now open.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Awesome. Hey, everyone. Thanks for taking the question and congrats on a great quarter, much better than I expected here. I wanted to ask you about, again, the ACV billings guidance. It seems like you took some conservatism into that for the new business. But it seems like you might not have factored much into the renewals business. So, I'm just trying to understand what exactly are you assuming. Are you assuming close rates to deteriorate? Are you assuming elongation of sales cycles? Maybe any context there would be helpful.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yes. Hi, Pinjalim. Thank you for the question. Yeah. So, on renewals, like I said, we're not assuming anything sort of beyond what we've actually delivered. So, I want to be clear on the renewals space, right? We're continuing – we're assuming continued performance in the renewals business. And to your question on the new and expansion business, what we're assuming is that this business will be impacted in some way by supply chain. Again, we're seeing solid demand so far, Pinjalim.

So, it's not so much elongation. We haven't seen that many elongation in deal cycles or anything like that so far. So, we're assuming that effectively, the growth in new and expansion business will be – may be impacted, right, by macro conditions should they happen. So, that's sort of what we've factored in at this point. And the last piece that I talked about when – in thinking about the ACV billings guidance for the full year is the backlog piece, right, which – it's a healthy backlog number. So, it gives us an additional sort of benefit of reduced stress thinking about fiscal 2023.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Understood. One question for Rajiv. You introduced the pricing and packaging earlier in the year. You have noted some kind of full end-to-end customers adopting Nutanix. Are you starting – especially with the acquisition of one of your largest customers as a backdrop, I guess. Are you seeing any meaningful change in customer conversations turning more strategic to adopting Nutanix in a broader sense?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yes. I think this is a – it's a good question, Pinjalim. What I'll say is we're definitely seeing a much higher level of engagement with customers being much more open, and of course, they're concerned in terms of what might potentially happen. And so, the level of engagement has definitely gone up for us. Now, in terms of what we've assumed on how quickly this translates – and by the way, we're not assuming any meaningful benefit from this in our fiscal 2023 outlook. We do expect to see some long-term benefits from this transaction as the customers will look for alternative. So, that's what I would say for the VMware-Broadcom situation.

Now, in terms of the portfolio itself, to your question on the portfolio, we're certainly seeing good traction with our new portfolio. It's helping definitely upsize deals in the sense that you're seeing more of the portfolio being consumed. For example, especially Nutanix Cloud Management, we're seeing a much higher level of attach from

Nutanix Cloud Management to Nutanix Cloud Infrastructure. And so, some of the larger deals with customers are actually being transacted using the new portfolio now, and we're seeing more of the portfolio which has upsized our deals and potentially also makes these deals go faster.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you and congrats again.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Thank you, Pinjalim.

Operator: Thank you. Our next question comes from Meta Marshall with Morgan Stanley. Meta, your line is now open.

Dave Nwokonko
Analyst, Morgan Stanley & Co. LLC

Q

Hi, team. This is Dave Nwokonko on for Meta. Congrats on the quarter. Just with the CRO transition, I was wondering if you're seeing any major changes to the sales organization as a part of that transition. And then, I have a follow-up question.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. No, I think – look, Andrew – so, as Dom moved on, we made Andrew Brinded our new CRO. And Andrew has been with us for four, five years. He's had a variety of sales roles. He used to run the EMEA region for some period of time. And also, most importantly, he's actually been in the throes of our subscription journey. For the last year or so, he's been our Chief Operating Officer inside of sales. And so, he's been driving the entire transformation of the sales organization. So, he's very well-set. We've got a very good positive continuity here, and he understands the business. He understands the product portfolio. He understands our customer base. So, it's been a very smooth transition.

The other thing we'll say is we just had our first annual Sales Kickoff in three years since 2019 in-person last week. And the team left super energized and excited about the vision. We also invested a lot in training and enabling them to go sell. And we're also reinstating our annual, what we call, circular excellence for our highest performing salespeople. So, all in all, I think we are in a good place from a sales perspective going into FY 2023.

Dave Nwokonko
Analyst, Morgan Stanley & Co. LLC

Q

Okay. So, it sounds like other than Andrew, not really any changes below that.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

No, I wouldn't say there's no – there are changes below that. We've got some changes below that. We've brought on a new person to run Americas for us. He came over from VMware as it turns out. He was running their enterprise business, and he now leads our Americas team. So, there has been changes underneath, for sure. But there is a lot of continuity and knowledge of the base as well. So, we feel very good about the sales leadership team that's in place right now, not just at Andrew's level, but also the level below and a couple of levels deeper inside the organization.

Dave Nwokonko
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. And then, just the new reps that you're bringing on, has that been able to stem some of the turnover that you mentioned seeing last quarter? And do you happen to have, I guess, an estimate of their productivity timeline?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yes. I think in the fourth quarter, we did see our rep retention improve. Our rep head count was roughly flat quarter-over-quarter. In FY 2023, we do expect to grow our head count modestly from current levels on the sales side, while also continuing to drive rep productivity. So, there is a significant focus on rep productivity. We talked about our new portfolio. We talked about solution selling. We've refined our segmentation going in. We're investing in training and enabling our sellers, and we're getting more leverage through the partners. So, that combination, all of which continues to improve our productivity and it's been going up consistently.

Dave Nwokonko
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you and congrats on the quarter again.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Thank you.

Operator: Thank you. Our next question comes from Mike Cikos with Needham. Mike, your line is now open.

Mike Cikos
Analyst, Needham & Co. LLC

Q

Hi, team. Thanks for getting me on here. I guess for my first question, I know in your prepared remarks, you guys talked about the strong performance here and attributed that top line growth partially to the large – I guess a greater number of large expansion deals in the quarter, as well as strength in that renewal space. And I just wanted to see, can you help us parse through those different components as far as what they did contribute to the growth this quarter? How much was the large expansion deals versus the renewals? And the reason for the question is, first, just want to see this – the development of that renewals initiative that you guys keep pressing on, and then secondly, I think it would just help us think through our forecast when we think about potential upside that might have come in this quarter from a greater-than-expected number of those expansion deals. Does that make sense?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Let me try and take a shot at that, Mike. Thank you for the question. So, in Q4, as you alluded to and that we talked about in the scripted remarks, there were a few factors that led to the outperformance. And renewals for us is a business model, right. So, it's much more than an initiative. It's something that we've sort of undertaken in the last few years to fundamentally change how we operate, and that's – we're starting to see all of that bear fruit, right, over the last several quarters including in Q4. So, renewals did come in better than we expected, and we expect that performance to continue.

The large deals you were referring to are really on the expansion side. They were not so much on the renewals side, but really on the new and expansion side. And those contributed to the outperformance on the new ACV – on the new ACV side. And so, when I think about Q4, all of that kind of factored into Q4 outperformance. And as I alluded to, we're also entering fiscal year 2023 with a healthy level of backlog. The only thing I'll add is then more generally for 2023, our renewals business continues to perform. Renewals, I will remind you, is sort of – the forecast for our renewals business is really built on what we've already sold, right.

So, we looked at – we look back at what we've already sold to our customers. We know when those contracts are up for renewal, and that's what the renewals forecast is based on. And as we've talked about, our GRR is in the 90% or greater target range. And so, that renewals forecast is very predictable as we look out to 2023. And we have continued to invest in new ACV growth. Rajiv just talked about sales rep productivity and so on. And so, we do expect new ACV to grow in fiscal 2023 as well. But that's where we moderated our assumptions somewhat in light of the uncertain macro environment. So, I realize we're not quantifying it for you here, Mike, but hopefully that color helps.

Mike Cikos
Analyst, Needham & Co. LLC
Q

It definitely does. Thank you for providing some more detail there, especially with the predictability of that renewals business. It's very important when we're going through our thesis on our side. If I could just ask another question, and I guess it's maybe more philosophical in perspective. But if I just think about this past year, there has been some turnover, obviously, when I think about the management team. We now have the new CFO with you sitting in the seat. We also have the announcements around the new Chief Marketing Officer, the new Head of Engineering, the new Chief Revenue Officer most recently, which we were talking about on this call. Can you just help us think through the leadership team at Nutanix? Do we have the pieces in place at this point when we're looking at the guidance parameters set for this year? Is this the team that's going to get us to those free cash flow targets that you guys have been articulating now as we think about that fiscal 2025 target? Thank you.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Yes. Yeah. Let me take that question here. So, companies transition through different phases in their lifecycle as a public company. And as we do that, we think it's natural for there to be some transitions in management, and we've looked to capitalize on these. And the talent market is also quite strong in terms of bringing in execs. And so, we've been quite excited about the caliber of exec talent that – some that we have hired from the outside and others that we have promoted from within. We believe we have an exec team at this point that brings significant experience and domain knowledge that will serve us well, right, for our next stage where we're focused on profitable growth. And so, that's I think – some of this, like I said, is a very natural transition as the company evolves.

Mike Cikos
Analyst, Needham & Co. LLC
Q

Very helpful. Thank you again, guys. I'll turn it over to my other colleagues. Appreciate it.

Operator: Thank you. Our next question comes from Jeff Koche with Raymond James. Jeff, your line is now open.

Jeffrey Koche
Analyst, Raymond James & Associates, Inc.

Q

Yes. Thanks. This is Jeff Koche in for Simon Leopold. So, specifically on the cost cuts, where are you guys targeting those cuts? Is it all coming out of G&A? Sorry if I missed that. And how do you – is there some reinvestment that you think you can – an opportunity there specifically with some of your competitors on the sales side? And then, I have a follow-up.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. I'll just give you a high-level view. We, of course, look at every function and then we look at benchmarks of our every function. But the majority of the impact was in sales and marketing. And within sales, it was mostly non-quota carrying salespeople. And so – and then, of course, the rest was across all the other functional areas.

Jeffrey Koche
Analyst, Raymond James & Associates, Inc.

Q

Okay. And then, secondly, like where are you seeing the strength? Just given the macro weakness, is there specific verticals that you can point to that are holding up better?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Our products are fairly broad-based. So, [indiscernible] (00:48:57) over here. But keep in mind we have a very strong base of renewals, and the renewals business, of course, provides a good strong foundation. And renewals is already a business that we've already sold and needs to be renewed, and we renew that with higher renewal rates, given the customer satisfaction and the NPS scores that we have. So, that provides a very good foundation. We have closed – this particular last quarter, we saw good strength in financials as a vertical to your question on verticals. We saw great strength in some regions, of course. I think our Middle East has been a high-performing region consistently for a while, so – but nothing that stands out.

Jeffrey Koche
Analyst, Raymond James & Associates, Inc.

Q

And then, I guess maybe I'll fit one more in here. So, with this higher engagement that you're seeing, maybe you can talk about specifically where you think the biggest opportunity is for you guys, given VMware is getting acquired. Like what are you most optimistic about? That's it. Thanks.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

No, again, I think if – look, we are already in a market that – where we are doing relatively well in terms of gaining share even before this news came on with the portfolio, and we're executing and we're very focused on this. Now, with this news coming onboard, there's just more customers who are concerned about what could potentially happen. It's a very broad base of customers across the world, right, and they've all seen what's happening. They've all heard the public – what's been said in public. And they're just – there's just more uncertainty, which means – uncertainty equates to risk and risk means that our customers have to consider more alternatives. And so, that's what we see. And like I said earlier, it's a little too premature for us to comment on this in the sense that we're not factoring in any major upside from this in FY 2023 in what we guided and what we're planning. But in the long-term, I think this should result in some tailwind for us.

Jeffrey Koche
Analyst, Raymond James & Associates, Inc.

Q

Great. Thanks.

Operator: Thank you. Our next question comes from Matt Hedberg with RBC Capital Markets. Matt, your line is now open.

Daniel Bergstrom
Analyst, RBC Capital Markets LLC

Q

Hey. It's Dan Bergstrom for Matt Hedberg. Thanks for taking our question. On the supply chain challenges, it sounded like it tracked better than expected. That's great to hear that. Last quarter, you noted they started very late in the quarter. Just wondering about the timing of improvement this quarter. Was it – was supply chain consistently better than you thought or was there more of a gradual improvement through the quarter?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you. Thank you for the question.

[indiscernible] (00:51:46)

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Oh, go ahead, Rukmini. Go ahead. Go ahead.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. I'll start, Rajiv, and you can add in. I was going to say that I want to be clear that it did not improve in Q4 relative to Q3. It actually did get worse in Q4, as we expected. It just didn't get to be quite as bad as we thought, right. I think it's an important point that supply chain challenges that we saw, the percentage of orders that came in with future start dates did increase in Q4 relative to Q3.

To your question, I think your question was on linearity and how do we sort of see that play out throughout the quarter. I would say we do have, just as a general practice, more of our bookings coming in in the last month and in the last couple of weeks of the quarter. So, that's a natural linearity. So, it does tend to – all of the trends tend to reflect that as well. So, I wouldn't say it was as backend sort of loaded as we saw in Q3. So, it was more gradual than that. But it is – I do want to point out that Q4, we did see a higher percentage of future start dates come in in Q4 than we did in Q3, but it wasn't quite as drastic in terms of the last couple of weeks like we saw in Q3.

Daniel Bergstrom
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for the clarification.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah. And one more point maybe I'll add to that is that the linearity overall was better as well for Q4, as I alluded to in my remarks, which helps with things like free cash flow, which linearity impacts.

Operator: Thank you. Our next question comes from George Wang with Barclays. George, your line is now open.

George Wang
Analyst, Barclays Investment Bank
Q

Hey, guys. Congrats on the quarter. I have two questions. The first question is any thoughts on the consumption-based model versus subscription? If you look at other software companies, more and more companies are adopting consumption base, which is based on usage versus sort of more [ph] feed-based (00:53:50). So, just curious if you guys have existing contracts just based on consumption.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Yeah. We don't have much by way of consumption at all here yet. I would say that we do a subscription model. Some of our partners, of course, take that and deliver that as a consumption-based service. For example, we have a very small, but hopefully growing managed service provider business. It's still really, I would call, incubation small, but that business – the MSPs could be selling that as a consumption business. Some of the business with partners effectively might go that way. But our business is all just subscription at this point.

George Wang
Analyst, Barclays Investment Bank
Q

Okay, great. So, the follow-up is kind of curious about the cadence of the contract term compression. You guys talked about kind of for FY 2023, it's going to be flat to down. Just curious how that's tracking versus your target of 2.8 to 3.2 years.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah. George, I can take that.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Rukmini?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you for the – yeah. Thank you for the question. So, I would say I think if I go back to what Duston had outlined at our Investor Day in fiscal year 2021 – in last year, actually in June of 2021, he had said that we expect to settle at about 2.8 to 3 years. 2022 – for fiscal year 2022, we came in slightly higher than our internal expectations. We had some large deals that were of longer duration, so came in slightly higher than we expected in fiscal year 2022. And so, 2023, we do expect term lengths to go down slightly, not by much, but slightly, and we'll watch this closely, right.

I don't think there's any – we'll be around that three-year mark is our expectation at this point, and we'll see how it plays out. Because what we largely do is we let customers kind of choose what ultimately they would like to do, whether it's sort of a one-year or a three-year or a five-year term, obviously, making sure that the economics work for us from our standpoint. But we want to make sure that that is being met while managing for making sure the economics are good, right. So, about 3 years, I think, is what we'd expect, so not too different from what we said last year, and we'll keep everybody updated as that progresses.

George Wang
Analyst, Barclays Investment Bank
Q

Okay. That's helpful. Thank you.

Operator: Thank you. Our next question comes from Aaron Rakers with Wells Fargo. Aaron, your line is now open.

Jake Wilhelm
Analyst, Wells Fargo Securities LLC
Q

Hi. This is Jake on for Aaron. Congrats on the great quarter. Just starting out, I was wondering if you could maybe give a little bit more color on the degree of macro slowdown you have embedded in the 2023 guide.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yes. I can take that. So, we are – we're not assuming sort of a full-blown recession or a deep recession or anything like that, Jake. But we are – I think we believe it's prudent to consider the macroeconomic environment as we think about just how uncertain things are right now as we all read in the newspaper. And so, I would say I think that's why we've thought about our new ACV – new and expansion ACV and tempered that growth somewhat, tried to make sure that we are factoring that in. So, that's how I'd characterize kind of what we assumed in terms of macro.

Jake Wilhelm
Analyst, Wells Fargo Securities LLC
Q

Okay. Great. And then, just as a follow-up, maybe could you give a little additional color around the backlog and do you see that drawing down?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Can you repeat that question, Jake? I heard backlog. But can you say that again, please?

Jake Wilhelm
Analyst, Wells Fargo Securities LLC
Q

Sorry. I was just...

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah.

Jake Wilhelm
Analyst, Wells Fargo Securities LLC

Q

Yeah. I was just asking if you could give us some additional color around the backlog and how you see that going into 2023.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Sure, sure. Yes, I can. And I think just to maybe finish out actually the answer to your previous question, I do want to reiterate this point about the significant growth in 2023, say the majority of that growth is coming from actually our growing base of renewals, which we generally expect to be relatively resilient in a challenging macro environment, right? So, that's part of the thought process here as well. And then, like I said, we've taken into account some uncertainty in the macro as it relates to IT spending into our new ACV billings growth. And then, on the backlog point, we are – we did exit Q4 with record backlog, as I said. And we typically use backlog in Q1. And so, we'd expect that to be the case this quarter as well. But overall, between the growing base of renewals and the backlog, it just provides a good foundation for our growth in 2023 and helps reduce the risk of our forecast.

Jake Wilhelm
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you so much.

Operator: Thank you. Our next question comes from Erik Suppiger with JMP. Erik, your line is now open.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Yeah. Thanks for taking the question and congrats on a good quarter. Most of my questions have been asked, but I'm curious – I assume you're still targeting kind of mid-40s-percent of revenue for sales and marketing as you get into fiscal 2025. What growth assumptions are you making for head count as you start looking out?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. Maybe I will answer that, Erik, without giving our specific head count growth assumptions, right, because there's obviously a lot of variables go into that as we think about a global company and so on. But I will say that, look, we are committed to really improving our overall Rule of 40 score each year, right, by both focusing on growth and on free cash flow and operating margins, right? So, that's how we thought about investments. Clearly, we have already taken some actions here as it relates to our overall expense profile. As Rajiv said, the majority of the reductions that we did earlier this quarter were in sales and marketing. And so, we're going to invest prudently where we need to going forward, keeping in mind that overall sort of pieces of sustainable profitable growth.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

What I would say just to add to that, Erik...

Erik Suppiger
Analyst, JMP Securities LLC

Q

Thank you.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

...we will continue to invest in innovation and R&D for innovation. We'll continue to focus on continuing improvements in productivity on sales and marketing. With the renewals cost base coming – renewals growing up at a lower cost base, we do expect that sales and marketing as a function of revenue will continue to drop, as we've indicated in our last Investor Day. But we will continue to invest prudently for the future, right? We will manage our cost carefully. We will continue to innovate – invest in innovation, and we will make sure that we are investing the appropriate amount in sales and marketing, but combine that with productivity and make sure that our percentage spend there is going down as a function of revenue.

Erik Suppiger
Analyst, JMP Securities LLC
Q

Very good. Thank you.

Operator: Thank you. Our next question comes from Ben Bollin with Cleveland Research. Ben, your line is now open.

Ben Bollin
Analyst, Cleveland Research Co. LLC
Q

Good afternoon. Thanks for taking the question. Rajiv, I was hoping we could focus a little bit about – into the share gain opportunity within hypervisor and hyperconverged infrastructure. How do you think about the longer-term potential from a net new customer perspective as well as wallet share expansion? And any thoughts on how this could influence future bundled sales opportunities? And then, I had a follow-up.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Yeah. I think, first of all, there's many levers here. It's not one instant lever, right? I think – so, first, if you look at the core HCI itself, the core stack, the really software-defined storage, regardless of whether it's running on any hypervisor, right, whether it's a VMware hypervisor or our own hypervisor AHV, we see a market opportunity for that continuing to grow as we continue to displace largely three-tier and continue to improve our win rates versus, say, VMware or other players. So, that market opportunity – I mean, there's still a lot of three-tier out there that can be converted to HCI and run more efficiently with better TCO. So, that's one piece of it.

The second, of course, is we do see more – I mean, at this point, for the folks that use our HCI stack, more than half of them have converted over to AHV. And we will see that, I think, especially with the impetus now in terms of what's happening potentially, that will probably continue to go up. And once we get to that path in terms of customers coming to our own hypervisor – and by the way, our hypervisor is included in our offering in our cloud platform. We're not selling it separately. And when we do that, then we also get to attach the rest of the portfolio, take them to the public cloud, [ph] and so we view it as an (01:03:14) expansion opportunity.

We get to attach on the Nutanix Cloud Management. We'll attach Nutanix Unified Storage, our Database Service, and then extend all of this into the public cloud. So, when you look at that sum total of the opportunity here, I think it's just quite significant. And today, we have a well-established position in HCI. But this is beyond HCI. This is for a full cloud platform, including all the other pieces there. We don't have as much share, and I see a lot more opportunity for share gains in those areas as well, right, as we see this conversion happening. And again, I think now there's more – given the – whenever there's a disruption in the industry – and in this case, it happens to, I think, be somewhat favorable to us at least long-term, it's only going to help us accelerate this piece of it.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Okay. And that takes to the second part. When you have a customer that makes the decision to transition from another party to yourselves, could you share any commonalities you've seen from those experiences? Any thoughts on average duration, how long they think about that, how long that engineering effort – how big that lift might be, just so we have an idea of how long that tail could last? Thanks.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. We have been doing a lot of migrations over time from, say, ESX to AHV, to be very specific there. And we've gotten very good at the migration. We've gotten a lot of tools to automate that. We have a tool called Move, which actually handles that piece of it. And so, that piece of it, customers, once they do the initial planning, they qualify the workloads that they want to run on this platform and they make sure that we have the appropriate ecosystem support needed. Once that initial bit of qualification work is done, the actual move itself is quite smooth. We can get that done within a couple of months usually and that part of it is not difficult.

Now, the other part that comes into play here is the automation and the scripts that they have potentially invested on top of their existing environment to integrate with the rest of that environment. So, some customers don't do much of that. Other customers do a fair amount of custom work. And if they've done a lot of customizations, then we will have to invest in some services to help migrate all of that automations that they've done over to our platform. But that's also doable and we have done that as well.

So, there's no laws of physics here that prevent this migration from happening. The degree of complexity can vary depending on it's just a simple hypervisor to hypervisor migration that's actually quite straightforward. If it's a lot of automation that they've invested in, it takes a little bit more time and some services effort to make that migration happen.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Great. Thanks, Rajiv.

Operator: Thank you. Our next question comes from Wamsi Mohan with Bank of America. Wamsi, your line is now open.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Hi. Thanks for taking the questions. It's actually Ruplu filling in for Wamsi today. I have a couple of questions. First, Rukmini, you talked about how the percent of orders with future start dates positively impacted the ACV billings and had a larger impact on revenues. Is there a way to quantify what the benefit was versus the guidance ranges that you had given for ACV billings and revenue?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. Hi. Thank you for the question. So, I will say that, as we talked about last quarter, right, in general, revenue can only be recognized in the quarter in which the license start date happens, right, whereas ACV billings, if we – we do invoice it and collect soon after the bookings is received, right. That was my comment on sort of revenue being impacted more than ACV billings even looking forward, right, when you think about what we've assumed for Q1 and fiscal 2023. For Q4 specifically, we're not breaking that out, Ruplu. But I will say that what we assumed as a percentage of future start dates for Q4, the actual percentage was lower, right, but it was sort of between what we saw in Q3 and what we'd assumed for Q4, right. So, it came in somewhere in between those two, and that's what you see reflected in kind of the revenue numbers and in the ACV billings number but to a lesser degree.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay. Okay, thanks for that. And then, can I ask you – looking at the fiscal 2023 full-year guidance, you're guiding gross margin to 82%, but you did 83% in fiscal 2022. So, on higher revenues year-on-year, you're guiding 100 basis points lower on the gross margins. So, any – how should we think about that? What are some of the drivers for gross margins this year?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. So, I'd say on gross margins, our product gross margins have remained fairly steady and we don't expect any changes to that. One of the things we are focused on – and it's interesting, because Rajiv just mentioned services, right. One of the things that we are looking at is making sure that we are attaching services where it makes sense to do so in situations like the one Rajiv just described or for example where there's a significant portfolio solutions that are deployed and we want to make sure that our customers are adopting them and using them as they intend to. So, we might see a slight uptick in services as we go through fiscal 2023 here. So, that's factored into that 82% guidance that we provided.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay, got it. And if I can just sneak one more in for Rajiv. Rajiv, this quarter, you added 620 new customers. I think last year in the fourth quarter, you added 700. And I think 700 was the average that you've done traditionally. But then you've also talked about focusing on quality of customers versus quantity. How should we think about new customer adds and is this even a metric to focus on going forward? Thank you.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. It's a good question there. So, Q4 for us is seasonally stronger with respect to new customer adds or new logs than Q3, and we saw an increase roughly in line with that historical seasonality this last quarter as well. Now, to your point, we have been focused on higher quality, higher ASP new logos, more so than just raw new logo count. And that continued. So, this quarter, again, we continued to see year-over-year new logo ASP growth in Q4 as well. So, now as we go forward in terms of these new logos, we do want to drive more of this by enabling more partner-based selling. We have this program internally that we call Autonomy, which is really enabling partners to go drive business by themselves, and also continuing to get some leverage through our strategic partners and making sure that we have the appropriate sales incentives in place.

So, we are focused on, yes, continuing to add new logos for sure, but also making sure those are the right new logos coming in with higher ASPs and also ones that we can continue to build on. So, that's probably the way to think about it. And so, our business always is going to have some portion with new logo. If you look at our entire slate, so it's the new business – new and expansion and then the renewals. The renewals business continues to grow. When you look at new and expansion, expansion is a big chunk, right, of what we do, because in many cases our land – first deal with customers is small and then it continues to grow a lot with many of these customers, and then the land provides the new fuel to the fire over the long-term, right. We continue to provide that. So, all are important, all these three legs of the stool, new logos, expansion at existing customers and renewals are all equally important to the business model.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Got it. Thanks for all the details and congrats on the quarter.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you.

Operator: Thank you. That ends today's question-and-answer session and that concludes today's conference call. Thank you for your participation. You may now disconnect your line.