NASDAQ:ARQQ Q4 2025 Earnings Call Transcript

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Operator | Conference Operator:

Thank you for standing by. On today's call, we will be referring to the press release issued this morning that details the company's first half fiscal year 2025 results, which can be downloaded from the company's website at archit.uk. At the end of the company's prepared remarks, there will be a question and answer period for selected equity research analysts. Please note that those selected equity research analysts that would like to ask a question in the Q&A session will need to dial into the call rather than joining through the webcast link. Finally, a recording of the call will be available on the investor section of the company's website later today. Please note that this webcast includes forward-looking statements, statements about the company's beliefs and expectations containing words such as may, will, could, believe, expect, anticipate, and similar expressions are forward-looking statements and are based on assumptions and beliefs as of today. The company encourages you to review the safe harbor statements, risk factors, and other disclaimers contained in today's press release, as well as in the company's filings with the Securities and Exchange Commission, which identify specific risk factors that may cause actual results or events different materially, from those described in our forward-looking statements. The company does not undertake to publicly update or revise any forward-looking statements after this webcast. And now, I'll turn the call over to Andy Lieber, the company's Chief Executive Officer. Andy?

Andy Lieber | Chief Executive Officer:

Thank you, and thank you for joining our first half of fiscal year 2025 earnings calls. I'm pleased by Arquette's performance for the first half of fiscal year 2025 and by recently announced developments in the business. If one looks at our results solely through the lens of first half revenue, my comment may leave you slightly confused. But please bear with me for a moment. Arquette has developed a transformational technology for addressing significant weaknesses in today's encryption technology. Weaknesses which will be magnified by the arrival of quantum computing. We believe that our symmetric key agreement encryption software is the most secure, standards compliant, and implementation flexible solution to meet the threat to data and communications. We are building a company to deliver our technology to sophisticated large enterprises and government customers. This is an ambitious objective, one with significant obstacles to overcome and timelines which often seem elastic. However, I am pleased that we're making significant progress towards realizing our objective. Circling back to our first half performance of recent announcements, I'm delighted because ARCA has made significant progress in product development, penetration of key identified markets, sales pipeline growth, shifting business model, and cost and business process discipline. Tangible progress along all of these vectors are additional courses of break which build towards long-term success. Before I discuss Archit's performance for the first half, let me briefly outline the market environment for our symmetric key agreement encryption software. The current weaknesses of today's public key cryptography, which safeguards much of the world's data, remain largely unmitigated. The pace of investment in and the development of quantum computers, which pose an existential threat to current encryption, is accelerating. Google, Amazon, and Microsoft all announced quantum computing chips during the last six months. Last week, Continuum, which is majority owned by Honeywell, signed a $1 billion deal with Qatar, which furthers developments of its quantum computing technology. And this week, D-Wave announced its 4,400 qubit sixth generation quantum computer, a major loop forwarding capability which surprised the financial market. There is little doubt that quantum computing at scale, known as Q-Day, is coming. When Q-Day arises, uncertain, but I predict it will be sooner than most expect, given the players developing the technology and the vast sums being invested. And when it does, data that has not been safeguarded with quantum safe encryption is at risk, as quantum computers will render existing public key cryptography obsolete. Awareness of the need

to upgrade to post-quantum cryptography is growing and the call to action increasingly urgent. Last week, Japan's financial services agency instructed Japanese banks to take immediate action to begin shifting to post-quantum cryptography. This is just the latest example of influential government bodies, including the White House and the NSA, sounding the alarm. ARKIT was early in identifying the risk of current cryptography. and early in identifying a market opportunity for a solution. We've developed symmetric key cryptography software, which is quantum safe and easily adopted as it is compliant with many of the most widely used communication standards. Put simply, we as a company have heavily invested in the right products for the current quantum threat at the right time. We feel uniquely positioned to take on the coming threats in the commercial, federal, and defense sectors. The market for our product keeps moving towards us. We're beginning to feel the market bow wave pushing us forwards and is evident in our recent developments and prospective customer interactions. We talked much about our collaboration with a leading tier one telecom network operator during our fiscal year 2024 results. Our partner integrated our ArcIT network secure encryption product into its network as a service and announced in 2024, it will be rolling the product out to market. Importantly, shortly before the close of our first half, to enable commercial rollout, The network operator signed a three-year contract licensing NetworkSecure for resale to its end customers as part of its network as a service offering. ARCHIT NetworkSecure enhances and differentiates its offering. It sees a market need which we can address. The signing was the culmination of a 14-month journey from testing to business care development to go-to-market strategizing. The contract highlights a number of important points. One, Our focused targeting of large-value vertical markets, particularly telecom networks and government defense, was the right decision. Two, our shift to a go-to-market strategy through leading hardware and technology vendors and network operators is the correct approach. Integrating with and enhancing products and services which end users already consume is an easier sell, and our partners are a field Salesforce multiplier. Three, Our shift to a subscription licensing model properly aligns our interests with those of our customers. Our arrangement with a network operator is a B2B2B model. The initial license is for a defined amount of capacity of our products and can grow as end customer demand increases. This style of contract encourages the initial commitment to our product by our customer and a pay-as-you-grow approach as end customers take up the offering. Our customers succeed, we succeed. Our interests are aligned. Four, and most importantly, there is end-user demand. The network operator is already engaged with three significant end-user customers for its network as a service, secure by ARCHIT, network secure. I expect that book of business will continue to grow, and we will be scaling up the contract to meet demand. And a final thought on this contract. It was a 14-month journey from a standing start to a signed contract. It's a blueprint which we are replicating with a significant number of other large brand name network operators with whom we are engaged. We expect cycle times to compress for these opportunities. In addition to the telecom network vertical market, the defense sector is another key market on which we are focused. Cybersecurity is a critical focus for defense and intelligence organizations. The battlefield, from the warfighter to drones and finally command and control, is increasingly being digitalized. The digital battlefield requires the highest levels of data security. We have spent significant time and resources in our effort to penetrate the defense market. Shortly before the close of our first half, we signed a contract which has ARCIT symmetric key agreement software embedded into a solution sold to the U.S. Department of Defense for a funded program of record. This is our first win with the DoD. The solution is in partnership with perhaps the largest IT vendor to the DoD and was sold through one of our established government sales channels. More details will be forthcoming. The importance of this contract win cannot be underestimated. It is a significant break in building the future success of the company. The contract confirms our technology is compliant with the National Security Agency's Commercial Solution for Classified Programme. Compliance with the program is critical to being considered for such contracts. Being able to reference this contract and the DoD program of record makes the pursuit of additional DoD opportunities easier, as well as proves our bona fide to other military organizations around the world. We have our foot now in the door of the large DoD market. It has taken longer than we expected to get to this point. We have arrived and will push to capitalize on this success with additional defense contract wins. An additional area of tangible success has been the continued development of further applications and use cases for our symmetric key agreement and encryption software. Currently, our sales and contract activity is focused largely on our ARCHIT network secure product, which enables quantum secure VPN connectivity, effectively securing data in transit. Ultimately, we want to develop

applications of our core technology for securing data in transit, data in process, and data at rest. Perhaps the most exciting application development has been in securing data in process, otherwise known as confidential computing. Confidential computing protects data by encrypting it while it is being processed by a computer, which is particularly important when processing sensitive data on shared infrastructure like a public cloud. For instance, confidential computing would allow AI to train and run on sensitive data without exposing the data to cloud providers, systems administrators, or data center hosts. We announced in collaboration with Intel the integration of ArcGIS Network Secure running inside a trusted domain enclave created by Intel TDX. What this means is that together with Intel, ArcGIS can protect both data, both on the cloud server and while it's moving between cloud servers in a way that makes it completely hidden from any would-be hackers, as well as the hosting provider themselves. It provides data sovereignty across domains as information is processed, moved through data centers, and sent to or from cloud repositories. Confidential computing is a focus for large enterprises and is a significant addressable market with use cases that include AI training and inference, processing of regulated data, and the enforcement of zero trust. Our collaboration with Intel delivers a highly secure, differentiated solution to the market. The collaboration takes ARCIT a significant step closer to having additional applications for data in transit, process, and at rest. This is our third collaboration with Intel. We now have joint efforts across secure mobile communications, confidential computing, and server technology. ARCIT is working jointly with Intel on further developments of these integrated technologies and go-to-market strategies. We are excited about where our efforts with Intel may lead. We stated on our fiscal year 2024 earnings call that focus was an important watchword for fiscal year 2025. One area of focus has been cost control, be it headcount, infrastructure, real estate, or travel. Nick Point and our CFO will touch on these shortly. We've been disciplined doing more with less and yet making substantial progress. Our performance compared to the budgeted cost has been strong. I'm pleased by the discipline we have exercised and will continue to do so going forward. Despite positive momentum in the market's understanding of our proposition and product adoption, some revenues were slower to be recognized and expected. We previously announced a multi-year contract with seven-figure total contract value for a customer in the Middle East. Revenue under the contract was expected to commence in early 2025. Due to unforeseen delays on part of the end customer, revenue did not commence until very late in March, just before the close of the financial period. As our contract base is still modest, and not able to readily absorb changes in timing, any unforeseen delays in contracts closing or revenue recognition can have an adverse effect on our results. Fortunately, the full terms of our Middle East contract remain in effect, and we expect to be recognizing revenue during second half. I'm pleased with the progress we've made since the beginning of the first half of fiscal year 2025, with contractual wins in our two key vertical markets, telecom networking and defense, with additional visible opportunities to come. We have paying customers in the US, Europe, and the Middle East. We have exciting developments regarding additional applications in mobile communications and confidential computing, plus others that I have not yet discussed. We remain disciplined in our cost control and internal processes. For the balance of this fiscal year, the key focus points for the company will be conversion of concluded test and evaluation engagements into licenses. I see near-term opportunities, particularly in the telecom network space. Also, the commencement and hopefully completion of an end-to-end test and evaluation collaboration, which brings together a leading data center operator, leading telecom network operator, an AI company, and leading network and server technology vendors. Finally, cost control will remain a priority. We have laid many additional courses of brick to support our success going forward. Our progress is being recognized in the marketplace, and brand and product awareness is driving sales inquiries. The level of foot traffic at our stand at the recent RSA cybersecurity conference and the sales leads generated were substantial, higher than we've experienced at prior conferences. The positive inquiry generated from leading IT vendors and network operators resulting from our tech and contract and partnership announcements was exciting. The sales leads generated created grounds for continued and increased optimism for the company's prospects. I believe revenue will ramp. Our encryption software is proven and unique. The market is moving towards us. We are well positioned to meet the rapidly growing quantum threat and address the resulting market opportunity. Thank you. Before I turn over the floor to Nick to discuss the financials, a quick housekeeping note. As of May 20th, Nick has stepped down from the board of directors. I have joined the board in his stead. I and the board want to thank Nick for his service on the board during these formative years of the company. He will continue in his role as our Chief

Financial Officer. With that, now over to you, Nick. Thank you, Andy.

Nick Poynton | Chief Financial Officer:

For the first half of fiscal year 2025, ARCIT generated $67,000 in revenue as compared to $119,000 in revenue for the comparable period in 2024. As discussed earlier, Revenue for the first half of the fiscal period was adversely affected due to end customer delays in commencing activity under a previously announced multi-year contract in the EMEA region. The variance between periods was also due to less revenue being recognized under customer contracts as Arquette continues to transition from primarily enterprise sales, for which revenue is recognized up front, to sales through channel partners, for which revenue is recognized over time as services are provided under the contract. Going forward, we expect less further impact from the transition from enterprise sales to SaaS sales as the shift is now largely complete. Revenue from the ArcIT SKA platform as a service and ArcIT network secure products totaled $52,400. Professional services and maintenance revenue in support of contract activity was $14,500 for the period. For the comparable period in fiscal year 2024, ARCHIT SKA Platform as a Service and ARCHIT Network Secure Contract revenue totalled $65,000, and Professional Services and Maintenance in support of contracts activity was $54,000. ARCHIT SKA Platform revenue for the period was generated from contracts with six customers. For the six months ended 31 March 2024, The revenue was generated for contracts with nine customers. Four contracts represent a license for SKA Platform as a Service. Two such contracts represent multi-year recurring revenue contracts, specifically our contract in EMEA and our contract with a Tier 1 telecom network operator. We began recognizing revenue under both contracts immediately before the close of the first half period. Two of our six revenue generating contracts were for R-Kit network secure licenses. Two contracts for R-Kit SKA platform as a service are professional services and maintenance contracts attached to them. It is our expectation that future SKA platform as a service contracts will similarly have professional services and maintenance contracts attached. Our administrative expenses equate to operating costs for those more familiar with US GAAP. Administrative expenses for the first half of fiscal year 2025 were $18 million versus $16.8 million for the comparable period in fiscal year 2024. The variance between periods was due to a lower headcount resulting in lower staff expenses and share-based compensation. and a reduction in property costs as a result of the termination of Arquette's previous office lease arrangement, being more than offset by unfavorable changes in foreign exchange. Arquette's headcount as of 31 March 2025 was 72 employees, as compared to 125 as of 31 March 2024. Administrative expenses for the period include a $1.3 million credit for a non-executive cash charge associated with share-based compensation versus the $293,000 credit for the comparable period in 2024. Operating loss for the period was $17.8 million versus a loss of $16.6 million for the first half of fiscal year 2024. The variance in operating loss between the periods primarily reflects lower revenue and an increase in administrative expenses for the period. For the period, loss before tax from continuing operations was $17.2 million. For the first half of fiscal year 2024, loss before tax from continuing operations was $16.1 million. The variance between periods is primarily due to lower revenue, increased administrative expenses, lower finance income offset by lower finance costs. As of 31 March 2025, the company had cash and cash equivalents to hand, of $24.8 million. And with that, I turn the call back to Andy.

Andy Lieber | Chief Executive Officer:

Thank you, Nick. I want to thank you for joining us today. My final comment is that we believe momentum is building for ArcIT. Market awareness of the need for quantum-safe encryption is growing. Awareness of our products is growing as well. Partners are selling ArcIT-enabled solutions to their customers Leading technology players are actively integrating our encryption software into applications to address market needs. The breadth and depth of discussions with additional potential partners is significant. All indicators are pointing in a positive direction for the company. Thank you again. And with that, I hand the call back over to the operator for Q&A. Thank you.

Operator | Conference Operator:

We will now begin the question and answer session. If you have a question, please press star 1. 11 on your touchtone phone. If you wish to be removed from the queue, please press star 11 again. If you are using a speakerphone, you may need to pick up the handset first before pressing the numbers. Once again, if you have a question, please press star 11 on your touchtone phone. One moment for our first question. Our first question comes from Scott Buck with HC Wainwright. Your line is open.

Scott Buck | Analyst, HC Wainwright & Co.:

Hi, good morning, guys. Thanks for taking my questions. Andy, there's a lot to digest there. The deals that closed at or near the end of the fiscal period, are they currently generating revenue today? And are these under multi-year contracts for the most part or shorter periods? Hey, Scott.

Andy Lieber | Chief Executive Officer:

Appreciate the question. Thank you. Let me tackle that. So as we mentioned in the earnings release, the contract with the Tier 1 network operates for three years. The initial size of the contract minimizes its risk. We expect the contract will grow materially as it signs up end users. We noted it's already engaged with three significant end users, as I mentioned, and we expect to revisit the contract relatively soon. As for the DOD contract, it's a one-year contract. A successful completion of the contract could lead to a reunion. Great.

Scott Buck | Analyst, HC Wainwright & Co.:

And then I'm curious on the sales team, it sounds like you guys have been doing some hiring there. What type of folks are you hiring? What industries are they coming from? And generally, how long does it take to get a new sales hire up to speed? Hello?

Nick Poynton | Chief Financial Officer:

This is Nick Poynton. I feared Andy may have lost reception. Just bear with us, please, Scott. Of course, Nick. Thank you. I see he's trying to get back in. He's back on, I think. Andy, are you there now? I am. I'm not even sure where I cut off. Apologies. My line dropped. It dropped at the end of Scott's first question, your answer to your first question. So, Scott, will you please repeat the second question regarding the sales people?

Scott Buck | Analyst, HC Wainwright & Co.:

Yeah, of course. Andy, it sounds like you guys have been active in hiring on the sales side. I'm curious, you know, what types of people have you been hiring? What industries are they coming from? And generally, how long does it take to get a new hire up to speed?

Andy Lieber | Chief Executive Officer:

Yeah. Hey, great question, Scott. So if you think to what I just talked to in the release there is the early salespeople are the people that have really proved out a lot of these use cases. So I said that For instance, the telco operator was a 14-month cycle from start to end. So these people have really had to roll their sleeves up and get to work in figuring a lot of things out. Now that the majority of that is done, we can hire more commercially available salespeople because we have a blueprint and a sales book for that. The first of

type operators for each space in each region and each vertical, of course, they need to figure out the use cases and everything around compliance, how it fits in the infrastructure, et cetera, et cetera. Behind that then, we're starting to hire people that know that vertical very well so they can talk the language of the customer. So for instance, in the US now, we're looking at filling roles around telco. and we'll be looking to fill roles more around defense. So these are people that are well-versed and deep operators in those sectors. But we have a number of open roles which we're actively recruiting for within our operating plan to start capitalizing all that inbound that we saw at the RSA show recently in San Francisco. Hopefully that helps.

Scott Buck | Analyst, HC Wainwright & Co.:

Yeah, absolutely. So as you guys start stacking these contract wins, It sounds like the sales cycle is starting to compress a little bit. How much of that do you attribute to your ability to sell versus kind of broader market interest and maybe even a little bit of fear of missing out by some of the folks that are not as quick to move?

Andy Lieber | Chief Executive Officer:

Yeah, so I think for us... We talked about earlier a kind of pay-as-you-grow model, and I think it really aligns the two of us, us and the customer, but then it also allows them in this B2B2B model to align with their end customer, particularly in telco. So we spent a lot of time trying to remove the friction in the sales model such that incremental contracts particularly around consumption of our services. So you think about things such as endpoints of the number of keys generated, make it as easy as possible for them to incrementally sign up and absorb incremental capacity under the existing contracts. And again, for renewal, upsizing, we make it as easy as possible. So once we're in the estate of an existing customer, broaden our footprint, we think we're making it as easy as possible. And we have technical familiarity with the customer's architecture, so implementation becomes more of a blueprint. And again, I want to stress we're a software company, not a professional services company, so we want to make that implementation as smooth and as simple as possible. And we really believe we are probably one of the best in the market at that in terms of just embedding our tech into more complex customer environments. As for new customers, being able to point to existing customers and having precedent implementation blueprints makes the initial sale easier than in the past. As I just talked about for the new salespeople, that should compress sales cycles substantially from the first to type 14-month in telco, for instance. That being said, any new customer will still want to feel comfortable that when they're adopting new technology, particularly into their critical infrastructure, that the new technology is properly tested before it's adopted. All that said, we do believe the bigger picture is we're going to see shorter sales cycles as we move forward, which means it speeds up that adoption and redirect cycle. I called it a course of breaks, and I kind of think of subscription revenue recognition that way, as you layer it on a course of breaks, especially if they're multi-year agreements, because then you've got the out years. and that deferred revenue to take as well. So it just builds and builds and builds rather than the older world, which we've moved away from, which is these very big one-off perpetual licenses, which had a lot of friction commercially and had a lot of friction to adopt, and were just causing us slowdown in the market. So we believe this new model is really to the benefit of us and the customers. Now, that makes a lot of sense.

Scott Buck | Analyst, HC Wainwright & Co.:

And your Intel partnership on confidential computing, How should investors think about how that can be monetized?

Andy Lieber | Chief Executive Officer:

So we're working on a number of different use cases, and I mentioned some of them in the earlier part of the call, which is really, for us, if you think about any large enterprise, and even in federal defense as well, they have substantial investments in cloud infrastructure And now they have substantial investments in AI as well. And we feel with a common thread and common wrapper that enables them to take advantage of those existing investments, but basically protect themselves from the emerging quantum threat. Intel is a fabulous partner for us, and I cannot speak more highly of the work we're doing with them. We feel like we've really clicked into a great rhythm with them. And we have a very common view of kind of this emerging confidential compute space. They believe it's going to be a big additive for their business, and we believe that as well. But now being able to adopt the new public cloud infrastructures, multi-cloud infrastructures, AI, LLMs, et cetera, and not have to worry about that threat of quantum is a big weight off their shoulders. And again, we make this as easy to consume as possible. And running on chip in the TDX enclave, which Intel provided in the new generation of devices, means that we're exactly where it's needed as well. And you can see the footprint of our technology is small enough to fit in there, but powerful enough to protect against all of those different variables I talked about. So we're thrilled with the work we're doing with Intel.

Scott Buck | Analyst, HC Wainwright & Co.:

That's perfect. And then last one, if I can squeeze in. Nick, given the momentum in the business on the sales side, do you expect any increase in OPEX to support some of these new contracts you signed towards the end of the period? I just want to understand what the operating leverage could look like here as the business scales.

Nick Poynton | Chief Financial Officer:

Okay. So I think the main thing is to mention is that our headcount is down materially from a year ago. And we kind of repositioned our employee base to increase the focus on customer fulfillment as we have been winning customer contracts and expect more to come. We are currently sufficiently staffed for the near term. We do have a handful of budgeted open positions, as Andy mentioned earlier, that we are looking to fill. But we have no plans for meaningful growth in headcount at this time. In terms of other operating costs, we do not see significant growth over the near term. Our trailing monthly cash burn has been around $2.2 or $2.4 million-ish, and we expect that to stay around that level for a meaningful amount of time. Does that give you what you need?

Scott Buck | Analyst, HC Wainwright & Co.:

Yeah, very helpful.

Nick Poynton | Chief Financial Officer:

Okay.

Scott Buck | Analyst, HC Wainwright & Co.:

Well, I appreciate the added color, guys. Thank you very much, and congrats on all the momentum in the business. Thank you, Scott.

Andy Lieber | Chief Executive Officer:

Appreciate the questions.

Operator | Conference Operator:

Thank you. We have no further questions at this time. Now I'll turn the call back over to Andy Lever for closing remarks. Andy?

Andy Lieber | Chief Executive Officer:

Thank you. Again, thank you for joining us today. We look forward to speaking with you again following the close of our first half fiscal 2025 results. That said, we will find additional forums in which to engage with you in the coming year in an effort to be more timely in providing updates to investors. We appreciate your interest in the company. Thank you again.

Operator | Conference Operator:

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect. Speakers, please stand by for your debrief.