NASDAQ:PENG Q2 2025 Earnings Call Transcript

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Operator | Conference Operator:

attending today's Penguin Solutions Q2 Fiscal 2025 Earnings Call. All lines will be muted during the presentation portion of the call with an opportunity for questions and answers at the end. If you'd like to queue for a question on today's call, please dial star 1 on your telephone keypad. I'll now hand the call over to Suzanne Schmidt with Investor Relations to begin. Suzanne, you may proceed.

Suzanne Schmidt | Investor Relations:

Thank you, Operator. Good afternoon, and thank you for joining us on today's earnings conference call and webcast. to discuss Penguin Solutions second quarter fiscal 2025 results. On the call today are Mark Adams, Chief Executive Officer, and Nate Olmstead, Chief Financial Officer. You can find the accompanying slide presentation and press release for this call on the investor relations section of our website. We encourage you to go to the site throughout the quarter for the most current information on the company. I would also like to remind everyone to read the note on the use of forward-looking statements that is included in the press release and the earnings call presentation. Please note that during this conference call, the company will make projections and forward-looking statements, including but not limited to statements about the company's growth trajectory and financial outlook, business plans and strategy, proposed redomiciliation, and existing and potential collaborations. Forward-looking statements are based on current beliefs and assumptions and are not guarantees of future performance and are subject to risks and uncertainties, including, without limitation, the risks and uncertainties reflected in the press release and the earnings call presentation filed today, as well as in the company's most recent annual and quarterly reports. The forward-looking statements are representative only as of the date they are made and accept as required by applicable law we assume no responsibility to publicly update or revise any forward-looking statements. We will also discuss both GAAP and non-GAAP financial measures. Non-GAAP measures should not be considered in isolation from, as a substitute for, or superior to our GAAP results. We encourage you to consider all measures when analyzing our performance. A reconciliation of the GAAP to non-GAAP measures is included in today's press release and accompanying slide presentation. And with that, let me turn the call over to Mark Adams, CEO. Mark? Thank you, Suzanne.

Mark Adams | Chief Executive Officer:

I'd like to welcome all of you to our Q2 fiscal 2025 Penguin Solutions earnings call. We are very pleased with our second quarter financial results. Our revenue was $366 million. an increase of 28% compared to the same period last year. Non-GAAP gross margins came in at 30.8%. Non-GAAP earnings per share was 52 cents, a 97% increase year over year. We achieved non-GAAP operating income of 49 million, up 85% from the prior year, and we improved non-GAAP operating income margin to 13.4%, up 4.1 percentage points year over year. All in all, our Q2 results demonstrate the progress we are making and the transformation of Penguin Solutions into a leader in high performance, high availability enterprise infrastructure solutions. The market for artificial intelligence is growing in the enterprise segment across a number of different industries. market research continues to reinforce the strategic value of AI to enhance corporate productivity, decision-making, and customer satisfaction. As we've mentioned in the past, our belief is that the GPU sales the industry saw in 2023 and 2024 would lead to growth in enterprise deployment in 2025 and 2026. As customers move from proof of concept to full-scale AI implementations, we're seeing signs that we have entered the early stages of growth in corporate build-outs at scale and are excited for what lies ahead.

Penguin Solutions helps customers manage the complexity of AI adoption by leveraging our proven know-how and advanced cluster implementations in the data center coupled with our differentiated portfolio of hardware, software, and managed services. We work with our customers to design, build, deploy, and manage these environments with a focus on time to revenue and reliability while targeting the highest level of performance and availability. Our products and services are primarily sold to hyperscalers, cloud service providers, and Fortune 500 companies in the financial, energy, education, federal, consumer, and manufacturing sectors. Historically, we have sold directly to our end customers. However, we are also expanding our go-to-market breadth by focusing on developing channel partnerships, which we believe will provide new opportunities for growth longer term. The foundation of Penguin Solutions' success is our 25-plus year history of deploying large-scale complex data center clusters originating from our early days in high performance computing, or HPC. This expertise is integral to our AI infrastructure offering. Our experience understanding the complexity of how best to integrate advanced technologies such as power, cooling, AI compute, memory, storage, and networking enables us to deliver high performance high reliability enterprise infrastructure solutions. As we mentioned at the beginning of our fiscal year 2025, we have transitioned from providing a quarterly financial outlook to providing a full year financial outlook. We believe that a full year outlook affords a broader perspective of our business, especially in relation to AI infrastructure, where the timing of actual deployments and associated revenue recognition can be unpredictable. And that aligns well with our emphasis on achieving long-term strategic objectives. We also understand that our investors, customers, and partners appreciate commentary on our progress each quarter, and we intend to offer that as well today. On our Q4 fiscal 2024 call, we forecasted fiscal year 25 revenue to grow 15% at the midpoint. When discussing our full year outlook last quarter, we highlighted that a large advanced computing order would finish shipping in Q2. Due in large part to that shipment, we expect revenue and profits to be more first half weighted when compared to our second half. In light of our strong first half performance, we are raising the midpoint of our revenue outlook for full year fiscal 25 from 15% year over year growth to 17% year-over-year growth, which Nate will discuss in more detail later. Let me now provide more detail on our business segments. Our advanced computing revenue the second quarter of fiscal 2025 was $200 million, up 42% year-over-year when compared to Q2 fiscal 24, representing 55% of Penguin Solutions revenue. We had some exciting wins at our existing customers and added three new logos in the technology, telecom and media, and federal spaces. Our core competency in successfully managing large-scale infrastructure deployments helps customers accelerate their time to successful implementation. We believe our customers value our technology-agnostic approach to creating a unique, overall solution to meet their AI infrastructure needs. As a trusted advisor, we evaluate which technologies would best fit an individual customer requirement. Beyond the technology building blocks, we leverage Penguin's ICE clusterware in working with our clients to design the optimal software stack to enable a robust platform to manage their infrastructure. For many of our key customers, Our Penguin Services organization will help manage post-deployment operations to support continued high performance and availability. We have seen growth in our pipeline during the first half of fiscal year 2025 and remain focused on working to convert these opportunities into bookings over the remainder of the fiscal year and into fiscal year 2026. Integrated memory is represented by our smart modular brand. In our second quarter of fiscal 2025, integrated memory was $105 million, up 26% compared to the same period last year, representing 29% of total Penguin Solutions revenue. Memory is a critical component of our computing, networking, and telecommunications customers platform. Large enterprise require higher performance and higher reliability memory to support complex workloads. In line with this increasing demand for improved memory bandwidth and availability, we are executing on new product development plans for our Compute Express Link or CXL family of products. We are seeing positive momentum in our customer qualification efforts, resulting in sample orders of CXL from OEMs and AI computing companies, which reinforce our optimism about its appeal to a new type of customer. In addition, in March, Dell added Smart's CXL add-in card as part of their server configuration options program. We enter Q3 with a strong backlog buoyed by AI-related demand, improving market conditions and enterprise memory, and more stable inventory levels that keep customers in data center, networking, and telecommunications. Optimized LED operates under the Cree LED brand. In the second quarter of fiscal 2025, optimized LED revenue was flat as compared with the year-ago quarter, while non-GAAP operating margins were up nearly five points comparatively. Q2 has traditionally been a seasonally lower quarter due to the U.S. holidays coupled with the

Chinese New Year holiday, and this year was no exception. We believe Cree LED's capital light outsource model was a contributing factor to our improved profitability in the first half of fiscal 2025 and will continue to be a competitive advantage longer term. In early Q2, we announced that we entered into a patent license agreement with Daktronics, a US-based leader in large-scale LED displays. Our strong intellectual property coupled with a cost-effective operating model has led to some exciting new customer design win activity. with larger LED lighting customers in the US and Western Europe. As we continue the transformation of Penguin Solutions, our strategic focus on research and development and partnerships will remain critical to our future success. Let me highlight three of our key initiatives and the progress we are making on each of them. First, in early March, Penguin Solutions announced that it has expanded its ICE Clusterware software platform with multi-tenancy support, streamlined workflows, and enhanced controls. We also announced the launch of ICE Clusterware AIM Service, an advanced optimization service that leverages prediction automation to enhance performance, availability, operational efficiency of our customers' AI infrastructure. These new software capabilities are compatible with multiple chip vendors such as NVIDIA, AMD, and Intel, enhancing our ability to successfully support customers' AI deployments across a broad set of technologies and use cases. Second, in memory, which continues to play an increasingly vital role in AI systems performance, the Smart Modular R&D team is focused on the development of a Smart Modular Optical Memory Appliance, or OMA, addressing the need for greater bandwidth performance and availability to support future AI compute requirements. While in our early stage of development, we believe this to be an exciting new market opportunity with first revenues anticipated to be late calendar 2026 to early calendar 2027. Finally, In the area of strategic partnerships, our relationships with SK and Dell are also expected to provide new opportunities for longer-term growth. We are in discussions with SK Telecom regarding potential collaborations related to their AI strategy, including AI data center infrastructure initiatives. In addition, an already strong relationship between SK Hynix and Smart Modular is evolving as we look at ways to address markets not historically served by SK Hynix in custom low-volume Hynix segments. Regarding the Dell partnership, Penguin's AI software and managed services are now being able to be sold by Dell's worldwide sales force, expanding our market reach. We are in the process of training Dell sales teams and are seeing favorable early response to co-marketing opportunities with large enterprise customers. As part of this relationship, we have also expanded our origin AI offerings to include Dell servers, along with Penguin software and services, which can help expand our customer TAM for future engagements. Combining our unique value proposition with larger go-to-market companies will remain a priority for us. We are evaluating both domestic and international partners who could benefit from working with Penguin Solutions to deliver world-class AI infrastructure solutions. More to come on future calls. We've also recently announced that we intend, subject to court and shareholder approval, to re-domicile our parent company from the Cayman Islands to the United States. We believe this aligns with our strategic objectives and reflect our increased business and operational focus in the United States. Additionally, before we conclude today's call, I'd like to share some important organization news. After close to 25 years with us, Jack Pacheco, our Executive Vice President, Chief Operating Officer, and President of Integrated Memory, has decided to retire at the end of our calendar year. Jack has been instrumental in our company's growth and success, particularly in strengthening our memory solutions business and building an outstanding operations team. We are grateful for Jack's contributions and appreciate his willingness to help with the transition. In closing, I want to thank our global team for the strong results in Q2. We are laser focused on short-term execution in Q3, while also expanding our pipeline for longer-term growth. Our first half results give us the confidence to raise the midpoint of our revenue outlook for the full year, fiscal year 2025. Edwin's value proposition of solving the complexity of AI infrastructure for our customers positions as well to address the increasing market opportunity of enterprise AI adoption at scale. Let me stop here and hand the call over to Nate to provide more color on our performance and outlook for the remainder of fiscal 2025. Nate?

Nate Olmstead | Chief Financial Officer:

Thanks, Mark. I will focus my remarks on our non-GAAP results, which are reconciled to GAAP in our earnings release tables and in the investor materials on our website. Now let me turn to our second quarter results. Total Penguin Solutions revenues were $366 million, up 28% year-over-year and up sequentially for the fifth consecutive quarter. Non-GAAP gross margin came in at 30.8%, which was down year-over-year and flat sequentially. Non-GAAP operating margin was 13.4%, up 4.1 percentage points versus last year, and non-GAAP diluted earnings per share were 52 cents for the second quarter, nearly double from Q2 last year. In the second quarter of fiscal 2025, our overall services revenue totaled $64 million, up 30% versus Q2 last year. Product revenues were $302 million in the second quarter, up 28% versus the prior year. Second quarter revenue by business segment was as follows. Advanced computing, $200 million, or 55% of our total revenue, and up 42% year over year. Integrated memory, $105 million, which was 29% of our total revenue, and up 26% year over year. And optimized LED, $60 million, or 16% of our total revenue, and flat year over year. Tom Connelly- Non gap gross margin for penguin solutions in the second quarter was 30.8% down 0.7 percentage points, year over year, driven primarily by a higher mix of advanced computing hardware revenue compared to last year partially offset by improved margins in memory and led. Tom Connelly- gross margin was flat sequentially with a higher mix of advanced computing hardware sales offset by higher margin rate in both memory and led. Non-GAAP operating expenses for the second quarter were $63 million, down 0.2% year-over-year and down 1.4% sequentially. Operating expenses as a percentage of sales were down both year-over-year and sequentially, driven by higher revenue volumes and disciplined expense management. Non-GAAP operating income was $49 million, up 85% year-over-year and up 20% versus last quarter. The combination of top line growth and operating expense efficiency is translated into a 4.1 percentage point increase in operating margin versus Q2 last year. Non-GAAP diluted earnings per share for the second quarter of fiscal year 2025 were 52 cents, up 97% versus the prior year and up 7% versus the prior quarter. Adjusted EBITDA for the second quarter was $54 million, up 61% year-over-year. Turning to balance sheet highlights, for working capital, our net accounts receivable totaled $330 million, compared to $170 million a year ago, with the increase driven by higher sales volumes. Base sales outstanding came in at 50 days, up from 42 days in the prior year quarter due to variations in sales linearity across the quarters. Inventory total $200 million at the end of the second quarter, up from 173 million at the end of Q2 a year ago due to higher sales volumes. Days of inventory was 37 days, down from 54 days a year ago, primarily due to the timing of receipts and shipments. Accounts payable were $238 million at the end of the quarter, up from 148 million a year ago to primarily to higher sales volumes. Days payable outstanding was 44 days compared to 46 days last year due to the timing of purchases and payments. Our cash conversion cycle was 43 days, an improvement of six days compared to last year due to faster inventory turns. Consistent with past practice, days sales outstanding, days payables outstanding, and inventory days are calculated on a gross sales and gross cost of goods sold basis. which were $596 million and $492 million, respectively, in the second quarter. As a reminder, the difference between gross and net revenue is related to our memory business's logistics services, which are accounted for on an agent basis, meaning that we only recognize the net profit on logistics services as revenue. Cash and cash equivalents and short-term investments totaled $647 million at the end of the second quarter. up 181 million from Q2 last year, and up 253 million sequentially. The year-over-year fluctuation was due primarily to proceeds from the issuance of preferred shares offset by debt repayments for our term loan in fiscal year 2024. Second quarter, cash flows generated from operating activities totaled $73 million, compared to 22 million used by operating activities in the prior year quarter. The increase year over year was due primarily to higher net income, faster inventory turns, and increased deferred revenues from our services business. Additionally, the prior year included a $29 million payment of contingent consideration as part of the Stratus acquisition earn out. We spent approximately $3 million to repurchase 167,000 shares in the second quarter under our share buyback program. Since our initial share repurchase authorization in April 2022, we have used a total of $83 million to repurchase 4.7 million shares through Q2 of fiscal year 2025, and we have $67 million remaining in our authorization. We did not make any debt prepayments in this past quarter, and the principal on our term loan remains at $300 million as of the end of the quarter. Our net debt at the end of Q2 was $23 million. For those of you tracking capital expenditures and depreciation, capital expenditures were $2 million in the second quarter, and depreciation was $5 million. And now turning to our outlook. Given our strong first half performance, we are pleased to raise the midpoint of our revenue outlook for the year, which now calls for growth of 17% year over year, plus or minus three percentage points. Based on a previously mentioned large advanced computing order that shipped in the first half of fiscal year 2025, we expect that second half revenues and profits will be lower than the first half. And this expectation is included in our higher overall outlook for the year. By segment, our full year revenue outlook reflects the following. For advanced computing, we expect full year revenue to grow between 15 and 25% year over year. For memory, we expect revenue to grow between 20 and 30% year over year. And for LED, we expect revenue to be approximately flat year over year. Based on strong hardware sales and faster growth in our lower margin memory business, our non-gap gross margin for the full year is now expected to be 31% plus or minus one percentage point. We expect our non-GAAP operating expenses for the full year will be $265 million, plus or minus $5 million. We are also raising our outlook for non-GAAP full year diluted earnings per share, which is now expected to be approximately $1.60, plus or minus 10 cents. This is up from our prior outlook of $1.50, plus or minus 20 cents. And finally, our non-GAAP diluted share count is now expected to be approximately 55 million shares for the year. As a reminder, we are utilizing a long-term projected non-GAAP tax rate of 28%, which reflects currently available information. While we expect to use this normalized non-GAAP tax rate through 2025, the long-term non-GAAP tax rate may be subject to changes for a variety of reasons, including the rapidly evolving global tax environment, significant changes in our geographic earnings mix, or changes to our strategy or business operations. Our outlook for fiscal year 2025 is based on the current environment, which contemplates, among other things, the global macroeconomic environment and ongoing supply chain constraints, especially as they relate to our advanced computing and optimized LED business. This includes extended lead times for certain components that are incorporated into our overall solutions, impacting how quickly we can ramp existing and new customer projects and higher tariffs in our LED business. We believe we are continuing to manage our operations in a prudent manner as we navigate a challenging environment while also investing in our long-term growth. Please refer to the non-GAAP financial information section and the reconciliation of GAAP to non-GAAP measures tables in our earnings release and the investor materials on our website for further details. With that, operator, we are ready for Q&A.

Operator | Conference Operator:

Thank you. We'll now begin the Q&A session. If you'd like to ask a question, please dial star 1 on your telephone keypad. If for any reason you would like to remove that question, please dial star 2. Again, to ask a question, it is star 1. As a reminder, if you're using a speakerphone on today's call, please remember to pick up your handset before asking your question. We'll pause here briefly to allow questions to generate in the queue. The first question is from the line of Dennis Piechanin with Stiefel. Your line is now open.

Dennis Piechanin | Analyst, Stiefel:

Hi, good afternoon. Thanks for letting me ask a few questions. This is Dennis on for Brian Chin. Maybe we can start with advanced computing. You know, given the hyperscale of strength in the fiscal first half, maybe you can talk about, you know, which customers or verticals you see driving revenue in the fiscal second half for this segment?

Mark Adams | Chief Executive Officer:

We typically don't forecast that way, but we would just kind of suggest that The second half is going to be, you know, not driven primarily by that vertical and look to verticals like federal, like financial, energy and the likes. So, but we don't really forecast, you know, obviously inter quarter or that way, especially at the vertical market level. But you can assume embedded in, you know, our commentary um, that, uh, there'll be other places where we, uh, where we're deploying, uh, AI solutions that are, uh, complimentary to, uh, the markets that drove our first half success.

Dennis Piechanin | Analyst, Stiefel:

Yeah. Great. And then for my follow-up, so it sounds like, you know, federal budget uncertainty isn't impacting the government related projects, but, uh, maybe on the topic of economic uncertainty, um, have you seen any impacts in your engagements with enterprise and cloud customers or, uh, maybe around this like deep seek news and AI capital efficiency, uh, has that been a topic of discussion for you and customers? Have there been any impact on like infrastructure build out plans related to all of that?

Mark Adams | Chief Executive Officer:

It's pretty dynamic to be honest with you. So, um, we're doing our best to reflect what we see in our business today as best we can. But you know, these are a little bit unprecedented times and, um, You know, we can't sit here and say there will be no future impact. Having said that, you know, current to date, we have not had a lot of those conversations.

Dennis Piechanin | Analyst, Stiefel:

Great. It's all for me. Thank you.

Mark Adams | Chief Executive Officer:

Thank you.

Operator | Conference Operator:

Thank you. The next question is from Semek Chatterjee with JPMorgan. Your line is now open.

Semek Chatterjee | Analyst, JPMorgan:

Thank you for taking my questions. Maybe if I can start on the topic of tariffs, and I think in your prepared remarks you mentioned you're including the higher tariffs on the LED segment, but if you can just remind us in terms of the manufacturing footprint. for LED related to advanced computing, and how should we think about, given some of the news on the tape right now related to tariffs on more wider breadth of geographies, how should we think about the manufacturing footprint and where your sensitivity to the tariffs would be?

Mark Adams | Chief Executive Officer:

Thank you, and have a follow-up. The LED supply chain and manufacturing, the design of which happens primarily in North Carolina, our manufacturing is through partners in Taiwan. And then we have, of course, our test assembly and phosphor application facility in Huizhou. By the way, we've been in this environment with this business for some time, so the question around tariffs is something that we've been dealing with for the past couple quarters, so to speak. And I think that the footprint we're looking at to continue to evaluate longer-term solutions, but it's embedded in our number. Ironically, the gross margin in LED was fantastic for the quarter. So, you know, it's something we'll continue to deal with and we'll monitor relative to any changes. But again, it's like my earlier comment, you know, at this point we're digesting news like everybody else and, you know, we'll adjust accordingly as we need to. And for advanced computing? Sorry. Of course, some of the components that we source may or may not be from other regions, but from an integration where we manufacture and build, most of our products are built in the U.S. at our Fremont operations facility. And similarly, with Smart Modular, A lot of our design and manufacturing is in our Newark operation site. We do have a Malaysia operations that complements the smart modular business and some segment of our compute, advanced computing business, which is, you know, more of the embedded edge products. But it's primarily that, that's kind of the footprint we have for advanced computing. and memory.

Semek Chatterjee | Analyst, JPMorgan:

And for my follow-up, I know you've mentioned that you're trying to sort of look at the, we're in a dynamic environment and you're trying to take the best sort of estimate at this point for the remainder of the year. And you mentioned elevated backlogs as well. But when I think about the revenue forecast for the remainder of the year, particularly when it comes to advanced computing? Can you give us a sense of how much of that revenue is already part of booked backlog or booked orders relative to what is the incremental portion you would have to rely on new orders coming in for the remainder of the year? Just asking from the perspective that given all the changes in the macro, if customers do end up being more cautious about new orders going forward. Thank you.

Mark Adams | Chief Executive Officer:

Yeah, again, we typically don't break up our forward-looking forecast into that type of segmentation, so to speak, bookings versus required to get. But I would also say we've always taken a very conservative approach relative to that, because you have to remember, in order for us to ship products in a given quarter, given the supply chain limitations, around specifically AI and broader compute, we have to be pretty close to knowing early in the quarter. So I think that we do our best and we plan for what we kind of know to be true without a lot of risk because we sense and we have risk in the actual lumpiness of the orders and the revenue recognition post-deployment with customers, it doesn't always happen perfectly, which we've talked about on a number of our past calls. So I would think that the question around bookings as a percentage of what we think the number to be, I would just go back on our past performances. We're very mindful of that and are pretty conservative in nature.

Semek Chatterjee | Analyst, JPMorgan:

Thank you. Thanks for taking the question.

Operator | Conference Operator:

Thank you. The next question is from Alex Valero with Loop Capital. Your line is now open.

Alex Valero | Analyst, Loop Capital:

Hey, guys. Thank you for taking my question. This is Alex. I actually have a question on SK Telecom. I just wanted to ask about any progress. How's the sentiment? Are you guys more enthusiastic about the partnership now? And also, if you could possibly provide some insights on SK Telecom's goals and any customers they aim to attract.

Mark Adams | Chief Executive Officer:

What was the last piece? I'm sorry, Alex.

Alex Valero | Analyst, Loop Capital:

Yeah, the last piece was on if you could provide any insight on SK Telecom's goals with the partnership and any customers they aim to attract.

Mark Adams | Chief Executive Officer:

I'm not sure I can answer that last piece. I can't speak for them. But relative to the relationship, we continue to have very good dialogue And we're evaluating ways that we can help in really two parts of their business. One is their AI strategy deployment of infrastructure, of which they have a number of good assets to complement our capabilities, both for their internal needs as well as potential joint customer collaboration. And we're optimistic in our ability to work together and to drive future results. Nothing to announce today. But, yeah, good conversations, and I actually had that in my prepared remarks that, you know, that continues to move favorably. And on the memory side, we're working closer with SK Hynix. Now, that has not been a relationship that just started. That relationship's been going on for years, and it's getting stronger, and we're helping SK think about reaching Robert Marlayson, markets that historically they have not had on their radar screen cooperatively working with smart modular on so we're very pleased with the relationship to date, and I think we'll be able to keep updating people. Robert Marlayson, Investors on a quarterly basis, but the directionally seem to be very pleased.

Alex Valero | Analyst, Loop Capital:

Thank you for that. And I just have a quick follow-up. So my quick follow-up is on your thoughts around the growing Neocloud opportunity and just Penguin's ability to participate there.

Mark Adams | Chief Executive Officer:

Yeah, I think it's really an interesting segment. You're calling it Neocloud. We've called it, and by the way, it's probably better said Neocloud. We used to call it on our calls Tier 2 Cloud Service Providers. it's a really interesting market because there's a shortage in overall ai ready data center locations and it's primarily driven around a shortage around the power getting to data centers and so with this shortage a number of companies and i mean a large number of these these smaller cloud service providers uh who have uh access to megawatts and up through gigawatt type uh, power into data centers, they're kind of repurposing themselves away from legacy businesses, for example, crypto, and they're driving themselves to offer or partner with people to deliver AI, uh, in some type of rental GPU market or private cloud public cloud type business model. And, um, these businesses have been able to get financing to build this out. What they don't have is they don't have the ability to really develop a plan for managing the complexity part of the deployment, which is the design, build, deploy, and manage framework that we deploy. And so it's really proven to be a very interesting market for us because these older models that they had didn't require sophisticated IT teams. And so we've found it to be a very good market for opportunities for us. and continue to invest in growing our business there in what you're calling NeoCloud.

Alex Valero | Analyst, Loop Capital:

That's super helpful. I really appreciate the answer. Thank you, guys. Thanks so much.

Operator | Conference Operator:

Thank you. As a reminder, if you'd like to ask a question, please dial star 1. The next question is from Kevin Gerrigan with Rosenblatt Securities. Your line is now open.

Kevin Gargana | Analyst, Rosenblatt Securities:

Kevin Gargana, yeah hey good afternoon all this Kevin Gary on for Kevin Cassidy thanks for taking my questions for the first one. Kevin Gargana, We were wondering how moving your your domicile from the Cayman Islands to Delaware changes your federal and state contract opportunities and where some other other benefits from this move.

Nate Olmstead | Chief Financial Officer:

Kevin Gargana, yeah hey thanks for the question Kevin you know, I think the important thing here to consider is really just our goal is to align our current operations with our future plans. You know, if you look at the structure of the company today versus in 2011 when the Cayman entity was set up, things are really much different for us. Our headquarters, substantial number of our employees, the executive team, and really the majority of our operational assets are in the U.S. So this move simplifies things for us operationally and gets things aligned. In terms of impact for us with federal customers, I don't think that that's really something that we considered. This was really about aligning our operations with the entity structure.

Kevin Gargana | Analyst, Rosenblatt Securities:

OK, great. And then as a follow up, just kind of looking at some of the trends in the market, co-packaged optics is a big buzzword, if you will. So how do you see this trend kind of changing the need for your memory solutions?

Mark Adams | Chief Executive Officer:

Well, we've said all along that we were on a path for developing these type of products. First of all, the requirements for AI and memory only keep getting more demanding if you will and the the co-packaged optics as you refer to it is definitely on our roadmap we've made an investment in a partner who we're collaborating collaborating on and designing this optical memory appliance that we've referenced and while it's early and it is we are super excited about this opportunity and and our conversations with customers on design and eventually out in the next 12 months of getting some type of prototypes. And in my commentary, I said earlier, revenue probably earliest at the end of calendar 26, and then maybe that leaks into 27, just depending on, you know, availability of key parts and products and testing and what have you. So, but nonetheless, we think it's a brand new category. We're in great shape with it. We're able to leverage a lot of our capabilities, both on the design side and the customer collaboration for testing and evaluation. So super exciting, and we think it is revolutionary in terms of enhancing the bandwidth and performance that future compute requirements are going to drive on memory for AI in the future.

Kevin Gargana | Analyst, Rosenblatt Securities:

Okay, perfect. I appreciate that color. Thanks, guys.

Operator | Conference Operator:

Thank you. The next question is from Nick Doyle with Needham & Company. Your line is now open.

Nick Doyle | Analyst, Needham & Company:

Hey, guys. Thanks for taking my questions, and best wishes to Jack on his next steps. You talked about the software platform expansion, the new ICE clusterware, and one of the new features discussed was multi-tenancy support. My understanding was that your core business is really focused on single tenants, you know, where their cluster needs to be optimized for their own workloads. So my question is, does this new multi-tenant support signal an openness to support a CSP type customer more than the enterprise customer that you talk about? Thanks.

Mark Adams | Chief Executive Officer:

Hey, Nick, thanks for the question. That's a good question. I would think it's more additive, and one of the earlier questions, I think it was from Alex from Loop, talked about NeoCloud and what we referred to as Tier 2 cloud service providers. We keep running into companies who are deploying different models to help build out and have these revenue models that in some cases, multi-tenancy is a given, and you have to have it. It skins in the game. It's not an either-or proposition. It's just that with the evolution of some of our key customers, new additions to the portfolio of customers we have, multi-tenancy is a key feature. And even in the enterprise, you know, you can make an argument for how that's segmented, that there's some applicability. But more than not, it's in the cloud service providers. And when I say the enterprise, it could be a private cloud where they're using it internally for some reason. a segmented way. But more often than not, it's back to this hyperscale or Neo cloud capability requirement from the customer. And it's something we really have heard and taken to heart and developed.

Nick Doyle | Analyst, Needham & Company:

That makes sense. It sounds like you're just kind of listening to your customers and building what they need. So the deferred income had a really big jump. Can you talk more about that line item? You know, it's not typically a focus on these calls, I think. But how should we think about these getting recognized? I know you talk about services contracts are typically a year or so. Yeah, so how should we think about that?

Nate Olmstead | Chief Financial Officer:

TAB, Mark McIntyre, yeah well you got it right, so the deferred revenue line really relates to our services business, and so what you see there are some customer renewals which often happen early in the calendar year or at the end of the prior calendar year and that's what you see driving the increase this quarter.

Nick Doyle | Analyst, Needham & Company:

TAB, Mark McIntyre, And it would make sense that it's more it's a it's around a year, I mean can these extend to 235 years.

Nate Olmstead | Chief Financial Officer:

It does vary. I think one year is typical, but we do see some that extend further than that, more probably to the three-year time period.

Nick Doyle | Analyst, Needham & Company:

Okay. Thank you.

Nate Olmstead | Chief Financial Officer:

Yep. Thanks, Nick.

Operator | Conference Operator:

Thank you. There are no further questions in queue. I'd like to turn the call back over to Mark Adams, CEO, for closing remarks.

Mark Adams | Chief Executive Officer:

Thank you. And thank you all for joining today's call. As we close, I want to reflect on the progress we have made in the fiscal year to date. The first half has demonstrated our ability to execute our strategic priorities while delivering strong financial results. Our investments in hardware, software, and services have positioned us to address the rapidly growing demand for AI infrastructure on premise, in the cloud, and at the edge. With a growing portfolio of innovative products, a focus on leveraging strategic partnerships and expanding go-to-market strategy, we remain optimistic about our ability to lead in this evolving market and meet our revised growth plan for fiscal 2025. Thank you and have a great day.

Operator | Conference Operator:

That concludes today's conference call. Thank you for your participation. You may now disconnect your lines.