

Transcript of  
SideChannel, Inc. (formerly CipherLoc Corp)  
First Quarter 2023 Earnings Call  
May 09, 2023

**Participants**

Brian Haugli - Chief Executive Officer, SideChannel, Inc.  
Ryan Polk - Chief Financial Officer, SideChannel, Inc.

**Analysts**

**Presentation**

**Operator**

Thank you, and welcome, everyone to SideChannel's Second Quarter 2023 Financial Results Conference Call. With me this afternoon is SideChannel's Chief Executive Officer, Brian Haugli; and Ryan Polk, the Company's Chief Financial Officer.

Before we begin, I need to read the following statement. Statements or comments made on this conference call may be forward-looking statements. Forward-looking statements may include, but are not necessarily limited to financial projections, or other statements of the company's plans, objectives, expectations or intentions. These matters involve certain risks and uncertainties. The company's actual results may differ significantly from those projected or suggested and any forward-looking statements due to a variety of factors which are discussed in detail in our SEC filings.

At this point, I'll turn the call over to Brian Haugli, who will discuss SideChannel's second quarter financial results.

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Thank you. And good afternoon, everybody. This is Brian Haugli, CEO of SideChannel, want to welcome everyone, thank you for taking the time, out of your afternoon to listen to this call with Ryan Polk, our CFO and myself. I want to just start out with our mission with SideChannel is making cybersecurity simple and accessible. And we feel very confident in our ability to do that with our clients and have been very happy and pleased with the clients we're working with the success we're having and the program and the company that we're building.

So that's just something that's very important to me, in what we've been creating with this firm. And as we've been growing the mission that we're on, and really working with a very underserved market, that is the middle market and emerging technology and emerging companies.

Some Q2 events that I want to highlight that I think are really of note, I always like to listen to my team, our team calls, I started with the top down approach. So you know from an

organizational level and I know she's listening in on this call, she didn't catch it, we announced Debbie McConnell as our Chairwoman, now leading our Board. And I want to thank her publicly for stepping into that role. And we're very excited about the future of this company and the Board that we have and Debbie in the chair seat.

The Board has been set and we're very focused on the best outcomes for shareholders and for the company. And I'm very pleased with working with the Board with Anthony and Hugh, and Kevin and obviously, Debbie. Within the company, you know, our management focus and the team inside of our ELT has been centered on customer success and customer satisfaction.

The middle market is not the enterprise. And we know that the middle market has different needs. But yet some of the very similar needs of enterprises and walking that line is I think, what really makes our channel effective in its mission to make cybersecurity accessible and simple for the types of clients that we are working with.

So a really big heartfelt thank you from myself to David, Joe, Miguel, on our customer success, and the overall management of what we're doing with those accounts and those clients, you would have seen the recent press release that moving David, from sales into the customer account management, the Executive role there, because of our growing client base, and the need and desire to make sure that our customers are happy. And we're addressing the security and privacy and risk management concerns that they have as to why they called on us.

So very excited about how that's how that's working out. And you know, we're just getting ahead of an expanding client base, with David moving into that role.

Also in that same release, we were talking about two weeks ago, moving Trent and promoting him to Senior Vice President role and taking over really all things within sales. We're very fortunate to have Trent Bowling on team and again, it's a testament to the success of what we're doing with our clients and obviously getting people in the door and working with them. That is why we are leaning more now on Trent and obviously have promoted him.

So the team is expanding. It's moving in the right direction. This is the type of team and organization that I want to have in place. And I'm very excited that that we have the folks that we do working in SideChannel and working with our customers.

The sales team has grown as well over the last quarter and six months. That's kind of the timeframe, I'm going to be speaking about within my remarks here. We've welcomed another SDR. I don't I've had questions about you know, well, who's on the sales team and where's the sales team, there's levels of sales. And you know, we're investing in the appropriate levels. So an SDR is a sales development rep, that person's job is to find interested, organizations potential leads, and bring them to our doorstep.

So we've been able to bring on one more SDR to the team, to again, fill that top of funnel, if anybody's familiar with the sales parlance. From there, really, it's up to our sales directors, to bring our prospective clients through the engagement model that we have, and get them to understand the benefits that can have working with SideChannel. And those benefits are -- you're

going to have a cybersecurity program in place, you're going to have a micro-segmentation product, addressing risks within your organization, you're going to have better encryption, better insight, better capabilities, that you can stand up and say, I have a cyber-program, I can tell those that are asking about it.

And the catalysts, are many, and it's actually a big reaction to what we're seeing inside of the market, which is people build cyber programs for a variety of reasons, but the core ones in the middle market are the board leadership, our investors are asking about the current posture, regulations are seeking a level of compliance to be met, or customers are actually expecting you to have a program in place in order to do further business.

This is why you build a program. And those organizations are realizing this. And they're coming to SideChannel because of the experience that we can deliver the type of program we can deliver turnkey, to meet one of these three catalysts.

And that's a very important thing to understand, why are those -- why does this problem exist within the middle market and startups, it's because those companies can't afford the right type of security or leadership and the trust that they deserve, like traditional delivery models or hiring full time employees. So they come to us because we have the leadership, we have the experience, we can deliver a robust cybersecurity strategic plan, an operational program with an experienced team of chief information security officers, engineers, project management, to build, execute and govern any type of cyber program policy solutions or even work with third-party providers.

On top of that, we're able to deliver our own Enclave product and position that for sale within our client base. So we're constantly looking at the problem. And we're confident in the solutions that we're able to provide, because of the nature of how cybersecurity is effective. It's effective, because good programs that stand up to those catalysts that I talked about, are ones that are continuously managed and led by experienced professionals.

And our engagement model is very straightforward. And it produces the results, we're able to assess and identify assets within an organization, build sets of recommendations, drive agendas for our clients, set the initial deliverables, and then execute and establish governance for those clients so they can see the outcomes.

That delivery is exactly what the market is looking for. And if you're watching the news, you're seeing that cybersecurity as a risk, a business risk, as an enterprise risk, is not going away is not getting smaller. And the middle market clients that we have, and the small enterprise as we scale up stream, they recognize this, that they do not have the financial wherewithal to be able to afford the alternative, which is full time employees, enterprise class products or solutions working with VARs or traditional resellers. They genuinely need a different approach. And that's where SideChannel has been incredibly effective.

And so I really want to just kind of like highlight really, where the market is and why we're capitalizing on the market's current posture and how that -- the trends really are not getting better as far as cybersecurity risk goes as far as meeting or addressing risk. It's actually getting worse unfortunately.

I see quite a bit in the news, I see quite a bit amongst my peers, just even talking to folks within my own community about how you know, these risks have crept up and hit them in some way. And I know that when we work with clients, and when we are executing, and I think what we've shown over this quarter and the last few quarters, people see our differentiator, and they recognize that we are bringing the A team, we are bringing the capabilities that they badly need, and we're bringing it at a cost point that they can afford long term.

And that's why we have clients that are reoccurring and long term partnerships and relationships. And that's, again, the direction that we're going to continue going with our products and our services will continue to listen to our customers and continue to listen to our clients and keep watching industry trends, and making sure that we are bringing everything that we need to those to that industry and to that market to solve for an area that I still consider very underserved.

So with that, I will turn it over to our CFO Ryan Polk for remarks on our current Q2 financials. Ryan?

**Ryan Polk - Chief Financial Officer, SideChannel, Inc.**

Thank you, Brian. My name is Ryan Polk, Chief Financial Officer for SideChannel. Revenue for the quarter that ended on March 31 2023 was \$1.6 million. That is up by \$382,000 compared to the prior year, which is 30.9%. We track revenue in two categories. The first is a vCISO services. The second is a cybersecurity software and services.

We lead with -- we start with leadership. That's our primary way of engaging clients and then we surround that client with the cybersecurity software and services that they need to be successful, as Brian's described. Our category of vCISO Services for the quarter grew by \$98,000, which is just a little under 12%. And our second category, cybersecurity software and services grew by \$284,000, which was a year-over-year increase of 73%. That's indicative of our growth in that area. And I'm sorry -- the growth of our offering in that area manifesting itself into client engagements.

One of the things that we've observed as SideChannel has continued to grow is that we are attracting the interest of companies that have tools that solve cybersecurity risks, and they're asking SideChannel to represent those tools at our clients. We are selective in how we engage those folks. But as we continue to engage more of them and add more tools, the benefit of those relationships will show up by continued growth in cybersecurity software and services. We expect that category to have growth rates that exceed vCISO.

We do expect vCISO to continue growing. But we will not be surprised if we see growth in our second category that exceeds the growth in our vCISO services category.

We pointed out that during the quarter, we had licensing revenue from software resellers of 12.7% of our total revenue. That's up significantly compared to the prior year and again evidence of our ability to attract good relationships good partners. That solves cybersecurity risks that we can bring in alongside of our vCISO.

For the year-to-date, we are up \$880,000 in revenue, which is just a little over 39%. The certainly vCISO services has grown by 516,000, which is a 36% year over year increase cybersecurity software and services is up 364,000 which is 40 -- let's we'll call it 43%. And we just mentioned for the first time in this particular financial results released that we expect full year revenue to range from \$6.3 million to \$6.5 million, which is a minimum of 31% up to a high end of our range 35% increase on a year-over-year basis. We do intend to update you on that figure when we announced our results for the third quarter.

On a trailing 12month basis we reached revenue exceeding \$5.7 million for the 12 months ended March 31 2023. That did trigger the issuance of a second tranche of shares that were adjusted for a final working capital balance related to the business combination that we closed on July 1. Those shares were the revenue was revenue you'd buy our accountants would who submitted a report to our board of directors who then authorize the issuance of those shares on May 4. So those shares are now in our new outstanding shares total of just over 211 million shares.

We want to point out that we are a relationship company, not a project company. We believe that through a key measure that we use to track our performance, which we call revenue retention. Revenue retention is a measure of how successful is SideChannel at repeating revenue customers in the current year than it generated at those same customers last year.

Our revenue retention for the 12-month period ending March 31, was 83%, meaning 83% of the revenue that we generated at customers last year, we were able to repeat and roll forward into the current year, which we believe is quantitative evidence for our role as a relationship partner with our clients. Brian highlighted that we added annual contract value or potential annual contract value of \$2 million in the last six months of the year, that growth, those new contracts are going to fuel our growth during the second half of this year. We expect to continue repeating new client acquisition to fuel growth in future quarters and future fiscal years.

Moving to gross margin, we were 45.6% for the quarter, which was down quite a bit from the prior quarter of just over 55%. On a year-to-date basis margins are at 50.6%. We believe that we'll trend somewhere between 50% and 52% for the full year, that would be a 1.5% to 3.5% increase in gross margins compared to the prior year. So we do expect gross margins to continue being above 50% for the remaining two quarters in our fiscal year.

We reported a net loss of just under a \$1 million, which was a little over -- which was right about a \$0.01 a share. We ended the quarter with \$1.9 million of cash, we used \$0.7 million or \$700,000 of cash during the quarter for operations. And we want to highlight to everyone to point out to everyone that we are obviously focused on growth as it is evidenced from our revenue numbers. We have also increased the emphasis on becoming profitable. And to that point we initiated during March we begin initiating or implementing operating expense reductions that will have an annualized value of \$900,000.

So 30 plus percent revenue growth, with growing margins gross margins of 1.5% to 3.5% higher, and operating expense reductions we believe will combine to decrease our losses and push us into cash flow positive territory.

We conclude our remarks and Tom will pass it back to you to open up the floor for Q&A.

**Operator**

[Operator Instructions] And the first question today is coming from Rodney Bauer. Rodney, your line is live. You may begin. Rodney, your line is live. You may ask your question.

**Unidentified Analyst**

Sorry, I must have muted. I apologize. Guys, thank you for the update. I may want to come into the queue later. But I want to ask a question because I'd like to know the answer this. Your opening up new accounts, you got the current account base that you have. Tell us about the accounts you're opening up a little bit. Are you going out and calling on a \$10 million company that doesn't have cybersecurity properly lined up is all there. Are you talking about \$50 million companies? I know you got larger ones, you got smaller ones.

But tell us a little bit about who you're going out to hell, because everything I read about the market for cybersecurity, the numbers are just incredible. I read an article today talking about \$5 trillion of cybersecurity issues that are going on out there that are impacting our economy every day. It's just such an enormous problem. The segment that you're going after, I'd like to understand that better tell us -- Brian tell us a little bit about who are these new people for you going after? What kinds of accounts are they trying to penetrate?

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Yes, Rodney, thank you. Great question. So, we currently have clients that are, \$20 million Series A, VC backed startups. They're pre revenue, they're creating company, they're creating a platform, we've got clients that are upwards in the \$4 billion or \$5 billion of revenue range, some are publicly traded, some are privately held. So we are a great fit for this entire space. And it's because, unfortunately, there is no good definition for what is quote, unquote, middle market. It's a broad, broad definition.

But what I tend to tell you is, we are the solution for companies that do not have a Chief Information Security officer. For companies that are looking for the right program to be built and led and governed. Because this entire industry is based around trust, whether you're hiring a full time chief information security officer, or you are picking the right product like Enclave, you make these decisions based on trust, and we are selling trust. That is very essential to what we are doing.

We're going after really everybody inside of that, that mid-market space, and I think the areas that we get the best penetration are those that are tied to some level regulation, or some type of oversight or insight that's needed. And those three catalysts that I hit on, in my opening remarks. Boards, or leadership or investors, whether it's private equity, or venture capitalists are asking about the current posture and plan, so just cybersecurity risk at a company that is putting pressure on the C suite and management, the CTO, CFO, CEO, to go build that program, those folks are not, are not in the know of how to do that's not there, that's not their specialty.

You can't ask your CTO necessarily to build and run a cyber-program, they have a day job. So we're going after those types of clients like we are targeting CTO, CFO CEOs, at this mid-sized company, size, really, revenue generating or Series A Series B Series C backed where they've got, you know, dollars to be able to spend and put towards doing this because there's an initiative that's pressuring the company to do the right thing and build a program.

Regulators are probably the other one. So looking at highly regulated areas, highly regulated spaces. Those are key areas for us to go after. And we are and I'll just give you an example. The SEC is about to put out new regulations for publicly traded companies to talk about and present disclosures on cybersecurity in their filings. There are currently 9000 companies in the United States underneath SEC rules, if we can figure out that the addressable market for this 9000, just as a single addressable market, is probably going to spend between \$450 million to \$900 million in cyber spend, based on most cyber spend is about 10% -- 10.5% of an IT spend. IT spend at companies usually about 10% of revenue.

So you're looking at about a 1% to 2.5% being spent on cybersecurity. So when you look at those 9000 companies, you can figure out that an average spends of \$0.5 million to a \$1 million for only 10% of that addressable market is somewhere between \$0.5 billion to a \$1 billion of potential revenue. That is one TAM that is one regulation that is created in the addressable market.

You've got the FTC that's got their safeguard rules, you got the DOD and its new ruling that's coming out for the entire manufacturing space. There's, quite a few addressable markets for us to be able to go after, and because they are well defined, right, I can look up who is a publicly traded company, I can then go look up and understand who is their CTO, CEO, CFO, and then I can have a conversation with them and find out do you have a cybersecurity program in place. It should be SideChannel. So I think we've got a good sales motion and a good area to go target. And we have a very underserved addressable market inside of these inside of that I'm talking about.

### **Operator**

Thank you. [Operator Instructions] And there are no further questions in queue at this time. I would now like to turn the floor back to Brian Haugli for closing remarks. I do apologize. Actually, Brian, Rodney Baber has reentered the queue with a follow up question.

### **Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

I see that. Yes, go ahead.

### **Unidentified Analyst**

Brian, thank you. Can you hear me? Can you hear me? Okay.

### **Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Yes, we can.

### **Unidentified Analyst**

Okay, good. The next thing I want to talk about if I was going jump back in the queue, if there were other questions, but if you look at this company now and you look at it in a year or so you're going to get growth from the vCISO market, and then you're going to get growth from the Enclave software product, and the you're going to get growth from acquisitions.

And so I'd love to understand better about how you guys are viewing that opportunity, because there would seem to be huge opportunities in all three sectors. If we fast forward a year, what do you think the growth will be coming from what would be like vCISO market. I've seem to remember you had like 25 people that you have that are vCISO.

And then you've got the Enclave product that apparently is doing well, and coming on, that software product can grow rapidly? And then you can make acquisitions put those into perspective? For us, how you think the company might grow there?

**Ryan Polk - Chief Financial Officer, SideChannel, Inc.**

Brian, do you want to answer.

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Oh, yes, sorry. I was trying to come up. Yes, Ryan, go ahead. Take the first.

**Ryan Polk - Chief Financial Officer, SideChannel, Inc.**

Mr. Rodney, I think you understand the growth drivers well. I mentioned earlier, that as we've grown, we've attracted the attention of people who want us to sell their tools and their services, we're also attracting the attention of companies that want to join with us. I think Brian's reputation is really strong inside of cybersecurity, the background, this experiences, he's had the roles he's played at a national level when he was with the Pentagon. And some of the work that he's done as an advocate for vCISO role, I think, have connected him with people that admire what he's built, like the culture that he's established.

And so we do have companies that maybe aspire to be like SideChannel but lack the resources or just lack something to replicate exactly what we've done that that are asking us to consider bringing them in. We have some criteria for acquisitions, we want our acquisitions to be generating revenue, they need to be cash flow positive, and we're very conscious of two things, one, conserving cash, two, continue funding the growth that we have. But also how using stock for acquisitions might be dilutive. And so we're only going to be interested in companies that are generating revenue, they're cash flow positive, and we can buy at a lower multiple than we're currently trading at.

And so there's some other things as well, obviously, we want there to be some adjacencies. Hopefully, they're bringing a service or a market segment that we don't have a strength in. And so that's how we -- that's what we think. That's how we're approaching acquisitions, acquisitions for us, because of our size are probably going to be a large percentage of our revenue, it's very easily we could trip over the 20% threshold that is required for us to do extensive due diligence. So the timing of acquisitions could be longer than we would all like just because of the



requirements that are going to be expected of us by the SEC for any acquisition, that's over 20% of our current revenue value.

So, we don't want to create the expectation that we're going to see acquisition benefits in the current fiscal year, but we certainly have a pipeline that we're working that we hope to have some meaningful benefits in upcoming fiscal years. The second area you talked about just picking this just the organic growth. Brian went through our sales team.

We've got a second sales Director that's relatively new to us. And we expect that position to begin generating new deals during the rest of this fiscal year. So there's growth coming on the BC, so aside from the work that that sales team is doing, and then I think the other thing that we want to keep mentioning, is that we're adding partners, we mentioned Darkbeam.

Recently, I think on March 28, we announced our partnership with a UK company that offers a threat intelligence platform. That's one of the key technologies that we would expect our CISO to have access to, as they're protecting our clients. And so getting that getting a good strategic partnership with a leader in that space, like Darkbeam, helps us bring a tool that we know will work at a margin structure that's good for us.

So in a price point that fits in with our target clients. So yes, the acquisitions are certainly part of that. I think the organic growth that we've talked about, we don't see that slowing down 30 plus percent is what we would say is a good expectation. The cybersecurity software and services outpacing vCISO growth, I think we should all expect to continue seeing that. And let's hope we can get some meaningful acquisitions layered it on top of what we're doing with our own efforts.

**Operator**

Thank you. And the next question is coming from Jacqueline de Pepe [ph]. Jacqueline is a private investor.

**Unidentified Analyst**

Yes, hi. I was just -- it's kind of a nuts and bolts question. You commented earlier on the SDRs and the sales directors, and the vCISO. So, I was just kind of curious, so are the SDRs, like at a call center? Are they independent? And how many of each does the company have? Do we have like one guy calling or? Because I remember, there were like, 23 employees when the company started, or when the takeover happened in July, I was just wondering how the increase?

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

I can take this.

**Ryan Polk - Chief Financial Officer, SideChannel, Inc.**

Yes, go ahead.

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Yes, thank you, Jacqueline. So we have two SDRs right now. And we have two sales, what we call Sales Directors. So people who are really working, leads to close. So the two SDRs are the

ones who are calling cold calling and doing outreach. They're predominantly focused on the Enclave product actually positioning Enclave, they're the ones who are filling the pipeline. So those two, and then the two, says Branden, and John, remember their names correctly, I should get that wrong, hopefully. And then Julie, and Lee are our two Sales Directors, and what their jobs are also to outreach, and as well as to close deals and bring clients into and through the pipeline.

So Julie and Lee are the ones who are closing, and then they're overseen by Trent, who is our SVP of Sales. And Trent is very much a player coach on the team, he's actively engaged with the SDRs on making sure that they are the most effective that they can I know, he's doing call reviews with them, we record calls for training purposes, and then we're able to follow up and see what works and what does not.

The question you had around where they are? They're working out wherever want, SideChannel, since its inception in 2018 2019, has been a remote native company, even before pandemic. So we're able to use that to our advantage because we can acquire and attract the really any talent that we want, because we don't need people to move. And a lot of that job can be done from wherever it doesn't need to be done out of a call center. But these folks are all employees of SideChannel. They're not independent, they're not there in any fashion. So they're working with us in full time capacity and very much part of the team.

Ryan, do you want anything? I miss any part of Jacqueline's question? Want to make sure, I given everything.

**Ryan Polk - Chief Financial Officer, SideChannel, Inc.**

No.

**Operator**

Thank you. There were no other questions in queue at this time. I would now like to hand the call back to Brian Haugli.

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

Oh, he disconnected that's why. Nigel, I saw him there. Okay. All good.

**Operator**

I like to have the call back to Brian Haugli, for any closing remarks, Brian?

**Brian Haugli - Chief Executive Officer, SideChannel, Inc.**

So, just make it short and sweet. Thank you so much, again, for everybody on the call, we are looking forward to the future of this company and the continued growth. I am very excited about the possibilities, and what we're building out with Enclave, the roadmap that we have with the product and the capabilities that we are bringing to market.

So, I just invite all of you to continue to follow us, follow us on our investors page on the SideChannel.com Please follow me and SideChannel on LinkedIn, we put out quite a bit of information about just what's going on in the market, and what we're doing just in the sector in

the cybersecurity space in general. And feel free to feel free to reach out to us at [IR@sidechannel.com](mailto:IR@sidechannel.com) That is our Investor Relations email if you have any questions, but again, we invite you to learn more about us ask questions, talk to talk to us about the direction of the company and on behalf of Ryan Polk, the Executive Leadership team, the entire company and the Board from SideChannel, I want to thank you again for taking the time today. And we look forward to speaking with you again. Thank you.

**Operator**

Thank you. This does conclude today's conference. You may disconnect your lines at this time and have a wonderful day. Thank you for your participation.