
These prepared remarks contain “forward-looking statements” under applicable securities laws. Such statements can be identified by words such as: “expect,” “believe,” “plan,” “future,” “may,” “will,” and similar references to future periods. Forward-looking statements include statements regarding our future leadership, expected financial and operating results, and other statements regarding strategies, growth, or other future events or conditions. Such statements are based on our current beliefs, expectations and assumptions about future events or conditions, which are subject to inherent risks and uncertainties, including our ability to realize the cost savings and other benefits of our planned restructuring initiatives, to execute our business development initiatives and sales and marketing strategies, to gain new long-term customers and retain existing ones, and to leverage strategic partnering initiatives with companies such as Microsoft, AWS and Intel, along with the other risks and uncertainties discussed in our most recent Annual Report on Form 10-K and other filings with the Securities and Exchange Commission. Actual results may differ materially from those indicated in forward-looking statements, and you should not place undue reliance on them. All statements herein are based only on information currently available to us and speak only as of the date hereof. Except as may be required by law, we undertake no obligation to update any such statement.

BSQUARE Corporation

Second Quarter 2019 Conference Call

August 12, 2019

Leslie Phillips, Investor Relations

Thank you and good afternoon everyone. Before we begin, we'd like to remind you that this call is being webcast and that a recording of the call, and the text of our prepared remarks, will be available on Bsquare's website. During this call, we will be making forward-looking statements. These statements are based on current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially. Please refer to the cautionary text regarding forward-looking statements contained in Bsquare's earnings release issued today and in the posted version of these prepared remarks on our website at www.bsquare.com under "Investors", both of which apply to the content of this call. All per share amounts discussed today are fully diluted numbers where applicable.

Now, I'd like to turn the call over to Ralph Derrickson, Bsquare President & CEO.

Ralph C. Derrickson, Bsquare President & CEO

Thank you, Leslie. It is a pleasure to speak with you today and participate in this, my second earnings call since joining Bsquare.

When I joined the company in March of 2019, we initiated an assessment of our product and service offering, the market landscape, and our experience with Industrial Internet of Things (or “IIoT”) customers, and legacy smart device customers.

Since our founding in 1994, our business has largely focused on providing software solutions and services to businesses that develop, market and sell dedicated-purpose standalone smart devices. Our solutions included reselling software from Microsoft. Examples of these smart devices include connected computing devices such as smart phones, set-top boxes, point-of-sale terminals, kiosks, tablets and handheld data collection devices, as well as smart vending machines, ATM machines, digital signs and in-vehicle telematics and entertainment devices. These smart devices utilize various versions of Microsoft Windows Embedded, Android, Linux, or QNX operating systems, and are typically connected to a network via a wired or wireless connection. Our customers for these smart devices include world-class original equipment manufacturers, original design manufacturers, corporate enterprises, silicon vendors and

peripheral vendors. The majority of our revenue continues to derive from the reselling of Microsoft Windows Operating System Software to these customers.

In early 2014, the company initiated development of a proprietary software platform to address the then emerging IIoT market. This business initiative, referred to as DataV™, included software products, applications, and services designed to allow IIoT devices to generate meaningful and actionable data for our customers. The intention of the DataV initiative was to enter a new market with a Software-as-a-Service business model with higher margins and recurring revenue. At the time, the Internet of Things and IIoT markets were identified as high-growth opportunities by industry analysts and venture investors poured millions of dollars into IoT and IIoT start-up companies. Bsquare initiated sales and marketing of DataV late in the first quarter of 2016 becoming an early player in the IIoT market. The company believed the revenue from re-selling Microsoft Windows Operating System Software would decline quickly and the DataV program became the primary focus of our sales and marketing efforts. We continued to market DataV in 2017 and 2018. Most of the DataV sales were for “proof of concept prototypes” or “pilot projects” that did not proceed to operational deployment. However, four large industrial customers did proceed beyond pilot projects into deployment and we continue to serve those customers today.

The IoT and IIoT markets, which I will refer to collectively as IoT, continue to represent a significant growth opportunity for Bsquare and are the focus of leading technology companies including Microsoft, Amazon Web Services, Google, and Intel. We believe the promise of IoT will be realized through the development of intelligent devices and intelligent systems that are cloud-enabled, contribute data, facilitate distributed control & decision making, and operate securely at scale.

In May of 2019 we announced a series of initiatives we call “One Bsquare” that recognize and build on the connection between the emerging IoT opportunity and our historic smart device business that includes the re-sale of third-party software including Microsoft’s embedded OS. Our expertise in embedded operating systems, smart devices and our early experience with IIoT from our DataV efforts uniquely position Bsquare to help companies transform their businesses and operations.

As part of our One Bsquare initiatives, we are going to market with an edge-to-cloud software and service suite that connects our customers devices, “edge” to the “cloud”, creating an intelligent system that allows the devices and systems to operate securely at scale sharing critical operating and performance data, empowering AI and machine-learning, that lowers operating costs and create the potential for new business models.

Bsquare's software and services will allow customers to upgrade and enhance existing devices and systems or to build the capability into new devices and systems. Our solution will include embedded OS software and services as well as IoT software components and services that we harvested from our DataV platform. These data and services enhance the capabilities of cloud platforms offered by Microsoft Azure and Amazon Web Services. Our solution takes our customers from the hardware and operating system on the edge to the cloud, at scale, with service and support to help them manage their business in the cloud. And very importantly, our software and service offerings allow us to partner naturally with cloud offerings from Microsoft and AWS and their technology partners. Technology partnerships, dating back to Microsoft Windows CE in the early nineties are a hallmark of Bsquare's history and reputation.

Moving forward our revenue is expected to be a mix of revenue from the re-sale of third- party software, including Microsoft Embedded OS, revenue from the licensing of Bsquare software, and professional services including software development, Dev/Ops services, and cloud management.

Let's talk about the One Bsquare implementation

In May we began implementation of the One Bsquare initiatives as we announced on our last earnings call. Recall we announced the following 5

initiatives: 1) revising our go-to-market strategy, 2) strengthening our strategic partnerships, 3) offering customers an edge-to-cloud software and services offering, 4) re-tooling sales & marketing, and 5) focusing on operating excellence.

Starting with operating excellence, we began the process of restructuring our executive leadership team, adding entrepreneurial leaders and flattening the organization. I would like to highlight the addition of Mary Haggard, VP of Strategic Partnerships, to build on our existing relationships with Microsoft and Amazon and develop new ones. More on partnerships in a moment. We also downsized our software development organization to better align capacity and utilization. We are implementing a common approach for managing projects through-out all regions building on best practices and the processes developed in our UK operation.

We have revised our corporate messaging and will be rolling out changes to our marketing materials and website in Q3 that reflect our edge-to-cloud focus. We have consolidated our sales efforts creating one sales team selling all products and services. And in June we announced a new customer in the facilities management space, Arcus FM, that we believe is representative of the type of business and customers we will be selling to moving forward.

We are also investing heavily in partnerships with the formation of a team dedicated to building and maintaining strategic relationships with hardware, software, and cloud partners. We have a long history of partnership with Microsoft in the embedded OS space that we intend to build on. We have new relationships such as Amazon Web Services that will evolve and mature, and we are forging new relationships that we will be announcing in the second half of the year.

Looking at our operations progress

Our revenue was near the high end of our guidance and our One Bsquare efforts to manage expense are starting to impact our financials. Excluding restructuring costs, our expenses were at the lowest level since Q4 2016 when started ramping expense to invest in DataV. While I am pleased with these results, it will likely take another two or three quarters before the full impact of our rebuilding efforts is consistently evident in our operating results. As I mentioned on our last call, until we have improved visibility, we will not provide guidance as to timing of profitability. I would expect by year-end we will have a much better sense of our progress.

Now let me turn it over to Peter Biere, our Chief Financial Officer, to discuss the second quarter of 2019 financial results.

Peter Biere, Bsquare Chief Financial Officer

Thank you, Ralph.

First, let's look at our revenue for the second quarter.

Total revenue was 14.2 million dollars, near the high end of the 12.5 million to 14.5 million-dollar guidance range announced in our Q1 2019 earnings call. Compared to the prior year quarter, total revenue was down 26% and down 6% sequentially.

Reviewing results by revenue grouping:

Third-party software revenue was 11.7 million dollars, lower year-over-year and sequentially. The year-over-year decline resulted from softer buying across the portfolio, with the biggest impact coming from the loss of Honeywell's EMEA business, which we previously announced in our Q1 2018 earnings call. Both the year over year and sequential declines are attributable to the quarterly variability we've experienced over the past two years.

Proprietary software revenue was 300 thousand dollars, down 8% year-over-year but up 3% sequentially.

Professional engineering services revenue, which totaled 2.2 million dollars, was up 16% year-over-year and 28% sequentially. The year-over-year and

sequential increases were primarily the result of completion of an existing DataV project in North America during the current quarter.

Next, I will discuss gross profit and margins in the second quarter:

Gross profit totaled 2.4 million dollars during the quarter, or 17% of revenue. Second quarter gross profit was down year-over-year and flat sequentially, with gross margin at the upper end of our guidance of 15% - 17% announced in our Q1 2019 earnings call. Third-party software gross margin was 15%, flat when compared to the prior year quarter and last quarter. Professional engineering services gross margin was 22%, compared to 29% in the prior year quarter and 23% last quarter, driven primarily by a lower margin on the DataV project completed in the current quarter.

Turning to operating expenses and our bottom-line results in the second quarter:

Total operating expenses for the second quarter were 6.4 million dollars, including a 1.4 million dollar charge for restructuring costs. The restructuring charge reflects approximately 1 million dollars of severance costs associated with previously announced headcount reductions and just under four hundred thousand dollars associated with the non-cash write-down of previously

capitalized software development costs. Excluding the charge for restructuring costs, operating expenses were 5 million dollars, an improvement of 2 million dollars from the prior year quarter, reflecting the cost reductions we've made over the past several quarters. Sequentially, operating costs, excluding the charge for restructuring costs, improved by three hundred thousand dollars.

We recorded a net loss of approximately 3.8 million dollars, or negative 30 cents per share for the second quarter of 2019. Excluding the 1.4 million dollar charge for restructuring costs, net loss for the second quarter of 2019 was 2.5 million dollars, or negative 19 cents per share, compared to a net loss of 3.7 million dollars, or negative 29 cents per share per share, in the year-ago quarter, and a net loss of 2.8 million dollars, or negative 22 cents per share for the first quarter of 2019.

Adjusted EBITDAS is a non-GAAP financial measure defined as operating income before depreciation, amortization, stock-based compensation, restructuring costs and goodwill impairment. Our Adjusted EBITDAS was negative 2.2 million dollars in the second quarter of 2019, compared to negative 3.6 million dollars in the year-ago quarter, primarily due to lower revenue year over year, and partially offset by lower operating expenses from the cost reductions we took in 2018 and 2019.

Please refer to the reconciliation to the comparable GAAP financial measures in our earnings release issued today and posted on our website at bsquare.com under “Investors.”

Moving to the balance sheet

Cash, restricted cash and investments totaled 12.6 million dollars as of June 30, 2019, down 2.7 million dollars from March 31, 2019. In spite of lower expense levels, cash usage for the period was higher as a result of the timing of receivables collections and lower revenue. We continue to expect an easing in cash utilization in the second half of 2019.

Our accounts receivable balance totaled approximately 9.0 million dollars at June 30, 2019, about 2.0 million dollars of which is due from Honeywell. We extend 270-day terms to Honeywell and pay Microsoft for these products in 45 days, so approximately 1.7 million dollars of this receivable will convert to cash.

Moving to guidance for the third quarter of 2019

As noted in today’s press release, we currently have the following expectations for the third quarter of 2019:

- We expect revenue in the range of 12.5 million to 14.5 million dollars; and
- We anticipate blended gross margin to be in the 15% to 17% range.

I will now turn the call back to Ralph for closing remarks.

Ralph C. Derrickson, Bsquare President & CEO

Thank you, Peter. While I am pleased with the progress of our One Bsquare initiatives to date, there is much work to do. I look forward to sharing our progress as we continue building a future based on integrity, innovation, collaboration with our customers and partners, and fiscal responsibility that builds value for you, our shareholders.

Moderator, please open the call for questions.

Ralph C. Derrickson, Bsquare President & CEO

Before concluding the call, on behalf of the entire Bsquare team I would like to thank our investors, customers, and business partners for your interest and for your business. We look forward to reporting back to you next quarter.

Thank you for joining us.