

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2022

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-27687

BSQUARE

BSQUARE CORPORATION
(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

1415 Western Ave, Suite 700,
Seattle, WA
(Address of principal executive offices)

91-1650880
(I.R.S. Employer
Identification No.)

98101
(Zip Code)

(425) 519-5900
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

<u>Title of each class</u>	<u>Trading symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common stock, no par value	BSQR	The NASDAQ Stock Market LLC

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of common stock outstanding as of October 31, 2022: 20,493,827

BSQUARE CORPORATION
FORM 10-Q
For the Quarterly Period Ended September 30, 2022
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BSQUARE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)
(Unaudited)

	September 30, 2022	December 31, 2021
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 26,165	\$ 39,529
Restricted cash	221	557
Short-term investments	10,677	—
Accounts receivable, net of allowance for doubtful accounts of \$50 at September 30, 2022 and December 31, 2021	4,614	4,914
Contract assets	51	46
Prepaid expenses and other current assets	551	364
Total current assets	42,279	45,410
Property and equipment, net of accumulated depreciation	821	726
Right-of-use lease assets, net	1,340	1,598
Other non-current assets	24	24
Total assets	<u>\$ 44,464</u>	<u>\$ 47,758</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Third-party software fees payable	\$ 5,053	\$ 4,628
Accounts payable	329	426
Accrued compensation	379	502
Other accrued expenses	191	219
Deferred revenue	346	944
Operating lease	351	357
Total current liabilities	6,649	7,076
Deferred revenue, long-term	43	194
Operating lease, long-term	1,107	1,363
Shareholders' equity:		
Preferred stock, no par value: 10,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, no par value: 37,500,000 shares authorized: 20,493,827 and 20,374,406 shares issued and outstanding at September 30, 2022 and December 31, 2021, respectively	172,637	172,397
Accumulated other comprehensive loss	(1,086)	(1,024)
Accumulated deficit	(134,886)	(132,248)
Total shareholders' equity	36,665	39,125
Total liabilities and shareholders' equity	<u>\$ 44,464</u>	<u>\$ 47,758</u>

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Revenue:				
Partner Solutions	\$ 7,557	\$ 9,638	\$ 26,042	\$ 28,393
Edge to Cloud	849	1,008	2,490	2,896
Total revenue	<u>8,406</u>	<u>10,646</u>	<u>28,532</u>	<u>31,289</u>
Cost of revenue:				
Partner Solutions	6,574	8,491	22,232	24,528
Edge to Cloud	697	827	2,083	2,648
Total cost of revenue	<u>7,271</u>	<u>9,318</u>	<u>24,315</u>	<u>27,176</u>
Gross profit	<u>1,135</u>	<u>1,328</u>	<u>4,217</u>	<u>4,113</u>
Operating expenses:				
Selling, general and administrative	2,030	1,786	6,195	6,209
Research and development	259	408	776	941
Total operating expenses	<u>2,289</u>	<u>2,194</u>	<u>6,971</u>	<u>7,150</u>
Loss from operations	(1,154)	(866)	(2,754)	(3,037)
Other income (expense), net	29	(29)	116	1,575
Loss before income taxes	(1,125)	(895)	(2,638)	(1,462)
Income taxes	—	—	—	—
Net loss	<u>\$ (1,125)</u>	<u>\$ (895)</u>	<u>\$ (2,638)</u>	<u>\$ (1,462)</u>
Basic and diluted loss per share	<u>\$ (0.05)</u>	<u>\$ (0.05)</u>	<u>\$ (0.13)</u>	<u>\$ (0.09)</u>
Shares used in per share calculations:				
Basic and diluted	20,470	19,603	20,441	15,419
Net loss	\$ (1,125)	\$ (895)	\$ (2,638)	\$ (1,462)
Other comprehensive loss				
Foreign currency translation, net of tax	(14)	37	(62)	(30)
Total other comprehensive (loss) income	<u>(14)</u>	<u>37</u>	<u>(62)</u>	<u>(30)</u>
Comprehensive loss	<u>\$ (1,139)</u>	<u>\$ (858)</u>	<u>\$ (2,700)</u>	<u>\$ (1,492)</u>

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2022	2021
Cash flows from operating activities:		
Net loss	\$ (2,638)	\$ (1,462)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	311	409
Stock-based compensation	298	596
Gain on extinguishment of PPP loan	—	(1,584)
Changes in operating assets and liabilities:		
Accounts receivable	300	185
Contract assets	(5)	(33)
Prepaid expenses and other assets	(191)	(30)
Third-party software fees payable	425	(51)
Accounts payable and accrued expenses	(248)	(451)
Deferred revenue	(749)	(771)
Net cash used in operating activities	<u>(2,497)</u>	<u>(3,192)</u>
Cash flows from investing activities:		
Additions to property and equipment	(406)	(375)
Purchases of short-term investments	(10,677)	—
Net cash from investing activities	<u>(11,083)</u>	<u>(375)</u>
Cash flows from financing activities:		
Proceeds from the sale of common stock, net of issuance fees	—	31,936
Proceeds from exercise of stock options	79	68
Cash settlement of performance stock units	(137)	—
Net cash (used in) provided by financing activities	<u>(58)</u>	<u>32,004</u>
Effect of exchange rate changes on cash and cash equivalents	(62)	(30)
Net decrease in cash and cash equivalents	<u>(13,700)</u>	<u>28,407</u>
Cash, restricted cash, and cash equivalents, beginning of period	40,086	12,960
Cash, restricted cash, and cash equivalents, end of period	<u>\$ 26,386</u>	<u>\$ 41,367</u>

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands, except share amounts)
(Unaudited)

For the Three Months Ended September 30, 2022	Preferred Stock		Common Stock		Accumulated Other Comprehensive	Accumulated	Total Shareholders'
	Shares	Amount	Shares	Amount	Income (Loss)	Deficit	Equity
Balance as of June 30, 2022	—	\$ —	20,468,395	\$172,445	\$ (1,072)	\$ (133,761)	\$ 37,612
Exercise of stock options	—	—	8,125	8	—	—	8
Issuance of common stock upon settlement of restricted stock units (RSUs)	—	—	17,307	—	—	—	—
Stock-based compensation	—	—	—	184	—	—	184
Net loss	—	—	—	—	—	(1,125)	(1,125)
Foreign currency translation adjustment, net of tax	—	—	—	—	(14)	—	(14)
Balance as of September 30, 2022	—	\$ —	20,493,827	\$172,637	\$ (1,086)	\$ (134,886)	\$ 36,665

For the Three Months Ended September 30, 2021	Preferred Stock		Common Stock		Accumulated Other Comprehensive	Accumulated	Total Shareholders'
	Shares	Amount	Shares	Amount	Income (Loss)	Deficit	Equity
Balance as of June 30, 2021	—	\$ —	13,479,220	\$140,494	\$ (1,035)	\$ (130,573)	\$ 8,886
Exercise of stock options	—	—	11,875	14	—	—	14
Issuance of common stock upon settlement of restricted stock units (RSUs)	—	—	72,206	—	—	—	—
Sale of common stock	—	—	6,793,798	31,576	—	—	31,576
Stock-based compensation	—	—	—	218	—	—	218
Net loss	—	—	—	—	—	(895)	(895)
Foreign currency translation adjustment, net of tax	—	—	—	16	21	—	37
Balance as of September 30, 2021	—	\$ —	20,357,099	\$172,318	\$ (1,014)	\$ (131,468)	\$ 39,836

For the Nine Months Ended September 30, 2022	Preferred Stock		Common Stock		Accumulated Other Comprehensive	Accumulated	Total Shareholders'
	Shares	Amount	Shares	Amount	Income (Loss)	Deficit	Equity
Balance as of December 31, 2021	—	\$ —	20,374,406	\$172,397	\$ (1,024)	\$ (132,248)	\$ 39,125
Exercise of stock options	—	—	67,500	79	—	—	79
Issuance of common stock upon settlement of RSUs	—	—	51,921	—	—	—	—
Stock-based compensation	—	—	—	298	—	—	298
Cash settlement of performance stock units	—	—	—	(137)	—	—	(137)
Net loss	—	—	—	—	—	(2,638)	(2,638)
Foreign currency translation adjustment, net of tax	—	—	—	—	(62)	—	(62)
Balance as of September 30, 2022	—	\$ —	20,493,827	\$172,637	\$ (1,086)	\$ (134,886)	\$ 36,665

For the Nine Months Ended September 30, 2021	Preferred Stock		Common Stock		Accumulated Other Comprehensive	Accumulated	Total Shareholders'
	Shares	Amount	Shares	Amount	Income (Loss)	Deficit	Equity
Balance as of December 31, 2020	—	\$ —	13,235,038	\$139,726	\$ (992)	\$ (130,006)	\$ 8,728
Exercise of stock options	—	—	37,380	68	—	—	68
Issuance of common stock upon settlement of RSUs	—	—	182,004	—	—	—	—
Sale of common stock	—	—	6,902,677	31,936	—	—	31,936
Stock-based compensation	—	—	—	596	—	—	596
Net loss	—	—	—	—	—	(1,462)	(1,462)
Foreign currency translation adjustment, net of tax	—	—	—	(8)	(22)	—	(30)
Balance as of September 30, 2021	—	\$ —	20,357,099	\$172,318	\$ (1,014)	\$ (131,468)	\$ 39,836

See notes to condensed consolidated financial statements

BSQUARE CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Bsquare Corporation ("Bsquare," "we," "us" and "our") develops and deploys technologies for the makers and operators of connected devices. These fleets of business-oriented devices, often called the Internet of Things (IoT), offer a powerful means to connect organizations, people, information, and ideas. Hundreds of millions of connected devices have already been deployed and it is estimated that billions more will be. Despite their growing prevalence, these devices and the systems in which they operate remain a significant source of complexity, unplanned and often uncontrolled expense, and operational risk. Our customers are undergoing a massive change in their business practices and Bsquare provides technology that helps them capture the value of connected devices and reduces the cost and risk of doing so.

Since our founding in 1994, Bsquare has helped embedded device manufacturers ("Original Equipment Manufacturers" or "OEMs") design and build cost-effective products. For most of our history, we operated at the intersection of hardware and software, helping our customers select, develop, and configure system software for a variety of purpose-built devices, from mobile computing to point-of-sale systems to healthcare equipment to hospitality, gaming, and more. Our expertise in hardware, device configuration, and operating systems became essential to our customers' design cycles and purchasing decisions. As our customers deployed ever-larger fleets of devices, our understanding of the requirements for large-scale device operations increased.

More recently, our expertise and business prospects have shifted to cloud-connected devices that have been connected to create intelligent systems. This shift coincides with the overall growth of IoT technologies and with our customers' recognition that connected intelligent devices create significant business opportunities. Device makers have increasingly specified their products not only to be connection-ready, but also to be enhanced by the breadth and depth of functionality that connection creates. We have taken to market a valuable and expanding portfolio of products and services that meet the needs of connected device makers. This portfolio captures our experience and our expertise can enable our customers to be more productive, flexible, and financially successful. And, in turn, our customers can then help make people and organizations more productive, improve quality of life, and reduce demands on the limited resources of our planet.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Bsquare have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting and include the accounts of Bsquare and our wholly owned subsidiary. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to such rules and regulations. In management's opinion, the unaudited condensed consolidated financial statements include all material adjustments, all of which are of a normal and recurring nature, necessary to present fairly our financial position as of September 30, 2022 and our operating results and cash flows for the nine months ended September 30, 2022 and 2021. The accompanying financial information as of December 31, 2021 is derived from our audited financial statements as of that date.

These unaudited financial statements and related notes should be read in conjunction with our audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2021, as filed with the SEC on March 10, 2022.

Basis of consolidation

The consolidated financial statements include the accounts of Bsquare and our wholly owned subsidiary. All intercompany balances and transactions have been eliminated.

Use of estimates

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Examples include provisions for bad debts and income taxes, estimates related to contracts with customers, such as determining standalone selling price, useful lives of property and equipment, fair value of stock-based awards, and assumptions used to determine the net present value of operating lease liabilities, among other estimates. Actual results may differ from these estimates.

Income (loss) per share

We compute basic income (loss) per share using the weighted average number of shares of common stock outstanding during the period. We consider restricted stock units as outstanding shares of common stock and include them in the computation of basic loss per share only when vested. We compute diluted loss per share using the weighted average number of shares of common stock outstanding and common stock equivalent shares outstanding during the period using the treasury stock method. We exclude common stock equivalent shares from the computation if their effect is anti-dilutive.

The following potentially dilutive weighted shares were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
Stock options	1,248,513	384,444	1,158,220	317,909
Equity awards	76,036	35,275	36,826	68,341



2. Revenue Recognition

Disaggregation of revenue

The following table provides information about disaggregated revenue by primary geographical area and operating segment (in thousands):

	Three Months Ended September 30, 2022			Three Months Ended September 30, 2021		
	Partner Solutions	Edge to Cloud	Total	Partner Solutions	Edge to Cloud	Total
Primary geographic area:						
North America	\$ 6,877	\$ 821	\$ 7,698	\$ 8,294	\$ 964	\$ 9,258
Europe	100	28	128	68	44	112
Asia	580	—	580	1,276	—	1,276
Total	\$ 7,557	\$ 849	\$ 8,406	\$ 9,638	\$ 1,008	\$ 10,646

	Nine Months Ended September 30, 2022			Nine Months Ended September 30, 2021		
	Partner Solutions	Edge to Cloud	Total	Partner Solutions	Edge to Cloud	Total
Primary geographic area:						
North America	\$ 23,335	\$ 2,407	\$ 25,742	\$ 23,372	\$ 2,695	\$ 26,067
Europe	253	83	336	275	201	476
Asia	2,454	—	2,454	4,746	—	4,746
Total	\$ 26,042	\$ 2,490	\$ 28,532	\$ 28,393	\$ 2,896	\$ 31,289

For the quarter ended September 30, 2022 and 2021, \$7.7 million and \$9.6 million of revenue was recorded at a point-in-time, and \$0.7 million and \$1.0 million of revenue was recorded over-time, respectively. For the nine months ended September 30, 2022 and 2021, \$26.9 million and \$28.4 million of revenue was recorded at a point-in-time, and \$1.7 million and \$2.9 million of revenue was recorded over-time, respectively.

Contract balances

We receive payments from customers based upon contractual billing schedules. Accounts receivable are recorded when the right to consideration becomes unconditional. Contract assets include amounts related to our contractual right to consideration for completed performance obligations not yet invoiced. Contract liabilities, presented as deferred revenue on our condensed consolidated balance sheets, include payments received in advance of performance under the contract and are realized when the associated revenue is recognized. We had no asset impairment charges related to contract assets for each of the three and nine months ended September 30, 2022 and 2021.

Significant changes in the contract assets and the deferred revenue balances during the three and nine months ended September 30, 2022 were as follows (in thousands):

	Three Months Ended September 30, 2022	Nine Months Ended September 30, 2022
	Contract Assets	Contract Assets
Balance at beginning of period	\$ 51	\$ 46
Revenue recognized	—	50
Amounts collected or invoiced	—	(45)
Balance at end of period	\$ 51	\$ 51
	Deferred Revenue	Deferred Revenue
Balance at beginning of period	\$ 577	\$ 1,138
Revenue recognized	(253)	(1,173)
Amounts collected or invoiced	65	424
Balance at end of period	\$ 389	\$ 389

Contract acquisition costs

We capitalize contract acquisition costs for contracts with a life exceeding one year. Amortization of contract acquisition costs was \$3,000 and \$4,000 for the three months ended September 30, 2022 and 2021, respectively, and was \$12,000 and \$57,000 for the nine months ended September 30, 2022 and 2021, respectively. There were no asset impairment charges for contract acquisition costs for any of the periods noted above.

Transaction price allocated to the remaining performance obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The satisfaction of performance obligations varies based on the nature of the underlying promise and the customer. The estimated revenue does not include contracts with original durations of one year or less, amounts of variable consideration attributable to royalties, or contract renewals that were unexercised as of September 30, 2022:

	Remainder of 2022	2023	2024	2025	2026
Edge to Cloud	\$ 326	\$ 1,612	\$ 1,330	\$ —	\$ —

Practical expedients and exemptions

We generally expense sales commissions when incurred because the amortization period would have been less than one year. We record these costs within selling, general and administrative expenses.

When applicable and appropriate, the Company utilizes the 'as-invoiced' practical expedient which permits revenue recognition upon invoicing.

3. Cash and Investments

Cash, cash equivalents, restricted cash and short-term investments consisted of the following (in thousands):

	September 30, 2022	December 31, 2021
Cash	\$ 2,063	\$ 2,506
Cash equivalents (see detail in Note 4)	24,102	37,023
Restricted cash (see detail in Note 4)	221	557
Total cash, cash equivalents and restricted cash	<u>26,386</u>	<u>40,086</u>
Short-term investments	10,677	—
Total cash, cash equivalents, restricted cash and short-term investments	\$ 37,063	\$ 40,086

The following table sets forth information regarding the amortized cost basis and fair value of our short-term investments that are classified as held-to-maturity ("HTM") (in thousands):

	Amortized cost	Allowance for credit losses	Net carrying amount	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. treasury securities	\$ 10,677	\$ —	\$ 10,677	\$ —	\$ 3	\$ 10,674
Total	<u>\$ 10,677</u>	<u>\$ —</u>	<u>\$ 10,677</u>	<u>\$ —</u>	<u>\$ 3</u>	<u>\$ 10,674</u>

The contractual maturity of our HTM investments is within 100 days of September 30, 2022.

4. Fair Value Measurements

We measure our cash equivalents and restricted cash at fair value. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Directly or indirectly observable market-based inputs or unobservable inputs used in models or other valuation methodologies.
- Level 3: Unobservable inputs that are not corroborated by market data. The inputs require significant management judgment or estimation.

We classify our cash equivalents and restricted cash within Level 1 or Level 2 because we determine their fair values using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

Assets measured at fair value on a recurring basis as of September 30, 2022 and December 31, 2021 are summarized below (in thousands):

	September 30, 2022			December 31, 2021		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Direct or Indirect Observable Inputs (Level 2)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Direct or Indirect Observable Inputs (Level 2)	Total
Assets						
Cash equivalents:						
Money market funds	\$ 12,651	\$ —	\$ 12,651	\$ 37,023	\$ —	\$ 37,023
U.S. treasury securities	—	11,451	11,451	—	—	—
Total cash equivalents	12,651	11,451	24,102	37,023	—	37,023
Restricted cash:						
Money market funds	221	—	221	557	—	557
Total assets measured at fair value	\$ 12,872	\$ 11,451	\$ 24,323	\$ 37,580	\$ —	\$ 37,580

5. Leases

In December 2019, we entered into an operating lease agreement for a new corporate office facility in Seattle, Washington. The term of the lease is 87 months, with a rent date starting on May 1, 2020 and the lease term ending on July 31, 2027.

In November 2020, we renewed the lease for our office facility in the UK. The term of the lease is 120 months, with rent payments starting on November 30, 2020 and the lease term ending on November 8, 2030. The Company has an opportunity to break the lease at the five-year mark in November 2025. As it is reasonably certain that we will utilize this option, the accounting for this lease utilized November 2025 as the end date. The lease commencement date was November 9, 2020. As a result of entering into this lease agreement, we recorded additional ROU assets and net lease liabilities of \$0.4 million on our consolidated balance sheet as of December 31, 2020. There was no material impact to our statement of operations or statement of cash flows as a result of entering into this lease.

Our leases have remaining terms of four to five years. Both of our leases contain renewal options. Because of changes in our business, we are not able to determine with reasonable certainty whether we will renew our Seattle or Trowbridge, UK leases. As a result, we have not considered renewal options when recording ROU assets, lease liabilities or lease expense.

The following tables present the components of our lease expense and supplemental cash flow information related to our leases for the nine months ended September 30, 2022 and 2021 (in thousands):

	Nine Months Ended September 30, 2022	Nine Months Ended September 30, 2021
Total component lease expense was as follows:		
Operating leases	\$ 271	\$ 311
Supplemental cash flow information related to leases was as follows:		
Cash paid for amounts included in the measurement of lease liabilities	\$ 275	\$ 311

The following table presents supplemental balance sheet information related to our operating leases as of September 30, 2022 and 2021 (dollars in thousands):

	September 30, 2022	September 30, 2021
Right-of-use lease assets	\$ 1,340	\$ 1,660
Current portion of operating lease liability	\$ 351	\$ 354
Operating lease liability, net of current portion	1,107	1,430
Total operating lease liabilities	\$ 1,458	\$ 1,784
Weighted average remaining lease term (years)	4.5	5.4
Weighted average discount rate	8.5%	8.5%

The following table presents the amounts we are obligated to pay, by maturity, under our operating leases liabilities as of September 30, 2022 (in thousands):

Years Ending December 31,	
2022, remainder of year	\$ 88
2023	356
2024	362
2025	352
2026	276
After 2026	164
Total minimum lease payments	1,598
Less: amount representing interest	(140)
Present value of lease liabilities	\$ 1,458

6. Shareholders' Equity

Equity Compensation Plans

We have a stock plan (the "Stock Plan") for equity awards to eligible service providers and an inducement stock plan for newly hired employees (the "Inducement Plan") (collectively the "Plans"). We stopped using the Inducement Plan in 2019, although it continues to govern outstanding awards granted under it. Under the Stock Plan, stock options may be granted with a fixed exercise price that is equivalent to the fair market value of our common stock on the date of grant. These options have a term of up to 10 years and vest over a predetermined period, generally four years. Incentive stock options granted under the Stock Plan may only be granted to our employees. The Stock Plan also allows for awards of non-qualified stock options, stock appreciation rights, restricted and unrestricted stock awards, RSUs and performance-based restricted stock units ("PSUs").

Stock-Based Compensation

The estimated fair value of stock-based awards is recognized as compensation expense over the vesting period of the award, net of estimated forfeitures. We estimate forfeitures based on historical experience and expected future activity. The fair value of RSUs is determined based on the number of shares granted and the quoted price of our common stock on the date of grant. The fair value of PSUs is estimated at the grant date based on the fair value of each vesting tranche as calculated by a Monte Carlo simulation. The fair value of stock options is estimated at the grant date based on the fair value of each vesting tranche as calculated by the Black-Scholes-Merton ("BSM") option-pricing model. The BSM model requires various highly judgmental assumptions including expected volatility and option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. The fair values of our stock option grants were estimated with the following weighted average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Dividend yield	0%	0%	0%	0%
Expected life (years)	4.9	4.9	4.9	4.9
Expected volatility	110%	111%	110%	111%
Risk-free interest rate	3.3%	0.6%	2.7%	0.6%

The impact on our results of operations from stock-based compensation expense was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Cost of revenue — Edge to Cloud	\$ 4	\$ 6	\$ 13	\$ 30
Selling, general and administrative	178	188	279	515
Research and development	2	24	6	51
Total stock-based compensation expense	\$ 184	\$ 218	\$ 298	\$ 596

Stock Option Activity

The following table summarizes stock option activity under the Plans:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance at December 31, 2021	1,664,014	\$ 2.07	6.64	\$ 405,223
Granted	91,500	1.66		
Exercised	(67,500)	1.16		
Forfeited	(65,604)	1.77		
Expired	(63,213)	3.29		
Balance at September 30, 2022	1,559,197	2.05	6.42	51,822
Vested and expected to vest at September 30, 2022	1,524,158	2.06	6.38	50,527
Exercisable at September 30, 2022	1,097,797	2.26	5.85	31,799

At September 30, 2022, total compensation cost related to stock options granted but not yet recognized, net of estimated forfeitures, was \$169,706. This cost will be amortized on the straight-line method over a weighted-average period of approximately 0.9 years. The following table summarizes certain information about stock options:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Weighted average grant-date fair value of options granted during the period	\$ 1.40	\$ 2.75	\$ 1.66	\$ 2.88
Options in-the-money (in shares)	222,373	629,272	222,373	629,272
Aggregate intrinsic value of options exercised during the period	\$ 1.02	\$ 1.20	\$ 1.16	\$ 1.88

The aggregate intrinsic value represents the difference between the exercise price of the underlying options and the quoted price of our common stock for the number of options exercised during the periods indicated. We issue new shares of common stock upon exercise of stock options.

Restricted Stock Unit Activity

The following table summarizes RSU activity under the Plans:

	Number of Shares	Weighted Average Award Price
Unvested at December 31, 2021	34,614	\$ 2.72
Granted	83,221	3.25
Vested	(51,921)	2.90
Forfeited	—	—
Unvested at September 30, 2022	65,914	3.25
Expected to vest after September 30, 2022	65,914	3.25

At September 30, 2022, total compensation cost not yet recognized related to granted RSUs was approximately \$141,416, net of estimated forfeitures. This cost will be amortized on the straight-line method over a weighted-average period of approximately 0.5 years.

Performance Stock Units

In January 2021, we awarded PSUs to Messrs. Derrickson and Wheaton. The PSUs vest based on a combination of Bsquare's stock price performance and Messrs. Derrickson's and Wheaton's continued service. The first vesting measurement date was January 5, 2022 and the final measurement date is July 5, 2025. We estimated the fair value of the awards utilizing Monte Carlo simulations, and we record the expense in the selling, general and administrative line of our consolidated statement of operations. For the three months ended September 30, 2022 and 2021, we recorded expense of approximately \$8,100 and \$17,000, respectively. For the nine months ended September 30, 2022 and 2021, we recorded expense of approximately \$29,100 and \$51,000, respectively. At September 30, 2022, total compensation cost not yet recognized related to granted PSUs was approximately \$30,200 and will be amortized over a weighted-average period of approximately 2.8 years.

In January 2022, the Compensation Committee of the board of directors (the "Committee") amended the PSU agreements, updating the definition of stock price performance, and reducing the total number of PSUs available to Messrs. Derrickson and Wheaton by 50,000 and 33,333 shares of common stock, respectively (the "2021 Shares"). In lieu of any claim to the 2021 Shares, each of Messrs. Derrickson and Wheaton received in February 2022 a cash settlement in an amount equal to the number of 2021 Shares multiplied by the closing price per share on January 5, 2022. Because the cash settlement was equal to the fair value of the 2021 Shares, we recognized the cash settlement as a charge to equity in the amount paid to repurchase the 2021 Shares.

Common Stock Reserved for Future Issuance

The following table summarizes our shares of common stock reserved for future issuance under the Plans as of September 30, 2022:

	September 30, 2022
Stock options outstanding	1,559,197
Restricted stock units and performance stock units outstanding	482,914
Stock options and restricted stock units available for future grant	926,051
Common stock reserved for future issuance	2,968,162

7. Commitments and Contingencies

Lease and rent obligations

Our commitments include obligations outstanding under operating leases, which expire through 2027. We have lease commitments for office space in Seattle, Washington and Trowbridge, UK. See Note 5 - Leases.

Loss Contingencies

From time to time, we are subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including tax assessments. We defend ourselves vigorously against any such claims. When (i) it is probable that an asset has been impaired or a liability has been incurred and (ii) the amount of the loss can be reasonably estimated, we record the estimated loss. We provide disclosure in the notes to the consolidated financial statements for loss contingencies that do not meet both conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the financial statements. Significant judgment is required to determine the probability that a liability has been incurred and whether such liability is reasonably estimable. We base accruals made on the best information available at the time, which can be highly subjective. As of September 30, 2022, we have not recorded any loss contingency accruals.

8. Information about Operating Segments and Geographical Areas

The Company's operations are conducted in two reportable segments: Partner Solutions and Edge to Cloud. The Company defines its segments as those operations whose results the chief operating decision maker ("CODM") regularly reviews to analyze performance and allocate resources. We operate within a single industry segment of computer software and services.

The Company measures the results of its segments using, among other measures, each segment's revenue and gross profit. Information for the Company's segments is provided in the following table (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Partner Solutions:				
Revenue	\$ 7,557	\$ 9,638	\$ 26,042	\$ 28,393
Cost of revenue	6,574	8,491	22,232	24,528
Segment gross profit	983	1,147	3,810	3,865
Edge to Cloud:				
Revenue	849	1,008	2,490	2,896
Cost of revenue	697	827	2,083	2,648
Segment gross profit	152	181	407	248
Total gross profit	1,135	1,328	4,217	4,113

Revenue by geography is based on the sales region of the customer. See Footnote 2 - Revenue Recognition for a disaggregation of revenue by segment and geographic area.

We do not track assets at the segment level. The following table sets forth total long-lived assets by geographic area (in thousands):

	September 30, 2022	December 31, 2021
Long-lived assets:		
North America	\$ 757	\$ 1,430
Europe	145	177
Total long-lived assets	\$ 902	\$ 1,607

Total long-lived assets decreased due to the removal of fully-depreciated assets in North America.

9. Significant Risk Concentrations

Significant Customers

No customers accounted for 10% or more of total revenue for each of the three and nine months ended September 30, 2022 and 2021.

GES Manufacturing Services (M) Sdn Bhd had accounts receivable balances of \$652,000, or approximately 14.5% of total accounts receivable at September 30, 2022. No customers accounted for more than 10% of total accounts receivable at December 31, 2021.

Significant Supplier

We are authorized to sell Windows IoT operating systems in Canada, the United States, Argentina, Brazil, Chile, Mexico, Peru, Venezuela, Puerto Rico, Columbia, and several Caribbean countries.

We were previously party to certain Original Equipment Manufacturer Distribution Agreements ("ODAs") with Microsoft pursuant to which we were licensed to sell Microsoft Windows Mobile operating systems to customers in North America, South America, Central America (excluding Cuba), Japan, Taiwan, Europe, the Middle East, and Africa. The ODAs to sell Windows Mobile operating systems expired on April 30, 2022 and were not renewed thereafter.

Our current distribution agreements with Microsoft have no automatic renewal provisions and may be terminated unilaterally by Microsoft at any time.

The majority of our revenue continues to be derived from reselling Microsoft Windows Embedded and IoT operating system software to device makers. The sale of Microsoft operating systems has historically accounted for substantially all of our Partner Solutions revenue.

Microsoft currently offers a distributor incentives program through which we earn rebates pursuant to predefined objectives related to sales of Microsoft Windows IoT operating systems. In accordance with program rules, we allocate a portion of the incentive earnings to reduce cost of revenue with the remaining portion utilized to offset qualified marketing expenses in the period the expenditures are claimed and approved.

Under this rebate program, we recorded rebate credits as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
Reductions to cost of revenue	\$ 2	\$ 26	\$ 232	\$ 236
Reductions to marketing expense	95	110	269	287

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our condensed consolidated financial statements and related notes. Some statements and information contained in this discussion are not historical facts but are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In some cases, readers can identify forward-looking statements by terms such as "may," "will," "should," "expect," "plan," "intend," "forecast," "anticipate," "believe," "estimate," "predict," "potential," "continue," or the negative of these terms or other comparable terminology, which when used are meant to signify the statement as forward-looking. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions and other statements that are not historical facts. These forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and situations that are difficult to predict and that may cause our own, or our industry's actual results, to be materially different from the future results that are expressed or implied by these statements. Accordingly, actual results may differ materially from those anticipated or expressed in such statements as a result of a variety of factors, including those discussed in the sections entitled "Risk Factors" in this Quarterly Report on Form 10-Q and in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2021 as well as similar discussions contained in our periodic reports, and other documents or filings and documents that we may from time to time file or furnish with the SEC. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date made. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Overview

Bsquare develops and deploys technologies for the makers and operators of connected devices. These fleets of business-oriented devices, often called the Internet of Things ("IoT"), offer a powerful means to connect organizations, people, information, and ideas. Hundreds of millions of connected devices have already been deployed and it is estimated that billions more will be. Despite their growing prevalence, these devices and the systems in which they operate remain a significant source of complexity, unplanned and often uncontrolled expense, and operational risk. Our customers are undergoing a massive change in their business practices and Bsquare provides technology that helps them capture the value of connected devices and reduces the cost and risk of doing so.

Since our founding in 1994, Bsquare has helped embedded device manufacturers ("Original Equipment Manufacturers" or "OEMs") design and build cost-effective products. For most of our history, we operated at the intersection of hardware and software, helping our customers select, develop, and configure system software for a variety of purpose-built devices, from mobile computing to point-of-sale systems to healthcare equipment to hospitality, gaming, and more. Our expertise in hardware, device configuration, and operating systems became essential to our customers' design cycles and purchasing decisions. As our customers deployed ever-larger fleets of devices, our understanding of the requirements for large-scale device operations increased.

More recently, our expertise and business prospects have shifted to cloud-connected devices that have been connected to create intelligent systems. This shift coincides with the overall growth of IoT technologies and with our customers' recognition that connected intelligent devices create significant business opportunities. Device makers have increasingly specified their products not only to be connection-ready, but also to be enhanced by the breadth and depth of functionality that connection creates. We have taken to market a portfolio of products and services that we believe meets the needs of connected device makers. This portfolio captures our experience and our expertise can enable our customers to be more productive, flexible, and financially successful. And, in turn, our customers can then help make people and organizations more productive, improve quality of life, and reduce demands on the limited resources of our planet.

Key Highlights

Partner Solutions revenue was lower than anticipated in the third quarter as our customers continue to face supply chain issues. In addition, a few Microsoft products reached end of life and our customers did not elect to continue their product programs with new versions of Windows. The decrease also reflects lower sales in Asia.

We believe our Partner Solutions revenue is affected by other Microsoft distributors offering deep discounts on Windows IoT OS software as part of hardware/software bundles. We expect this market trend may continue in future quarters. We are working to retain and attract customers with superior service and technical support, pricing that rewards loyalty, and a path to IoT operations.

In our Edge to Cloud segment, we continue to focus our efforts on a relatively small number of key customers that help us gain credibility as a reliable technology partner. For example, we support Itron, Inc. with its intelligent utility grid. We believe our experience serving Itron and our other large IoT customers positions us to improve our IoT software and services in 2022 and beyond.

Our focus on expense discipline has continued. Our selling, general and administrative expenses for the nine-month period ended September 30, 2022 were flat compared to the same period in 2021.

Throughout 2021 and through the third quarter of 2022, we invested in the development of new product offerings for our customers. We recently updated our SquareOne product to include two pricing packages. SquareOne Essentials is an entry-level package available to those customers who do not require the full-suite of connected services, but still want to take advantage of SquareOne's core functions. Devices that are enabled with SquareOne Essentials can be recovered in the event of a security breach or system failure and an in-place upgrade of the OS can be easily performed. SquareOne Premier is the full-suite, configurable IoT device management solution designed to remotely manage device fleets at scale. This multi-OS, end-to-end solution can be configured to securely monitor key device telemetry, set alerts, diagnose issues and deploy fixes—all remotely and in real-time.

In the first nine months of 2022, our product development investment totaled over \$1.2 million, of which \$0.4 million was capitalized on the balance sheet as internally developed software and the remainder is captured on the statement of operations as research and development expense.

During the quarter, we invested \$22.1 million in treasury bills to take advantage of rising interest rates. Approximately \$11.4 million of the investment had a maturity of less than 90 days as of September 30, 2022 and is classified as a cash equivalent on the balance sheet. The remaining investment of \$10.7 million had a maturity of just over 90 days and is classified as a short-term investment.

Cash, cash equivalents, restricted cash and short-term investments totaled \$37.1 million on September 30, 2022, a decrease of \$3.0 million since December 31, 2021.



Critical Accounting Estimates

Revenue recognition

Our revenue recognition accounting methodology contains uncertainties because it requires us to make significant estimates and assumptions, and to apply judgment. For example, for arrangements that have multiple performance obligations, we must exercise judgment and use estimates in order to (1) determine whether performance obligations are distinct and should be accounted for separately; (2) determine the standalone selling price of each performance obligation; (3) allocate the transaction price among the various performance obligations on a relative standalone selling price basis; and (4) determine whether revenue for each performance obligation should be recognized at a point in time or over time.

Triggered by a contract modification, in June 2022, we updated the standalone selling price estimates for the identified performance obligations of a contract within our Edge to Cloud segment. We have not made any other material changes to the significant estimates utilized to determine the total transaction price and stand-alone selling prices at contract inception. Our customer contracts that involve perpetual licenses are less sensitive to changes in estimates than contracts involving SaaS as those arrangements require us to estimate customer usage. Changes to our customer usage estimates could have a material impact on the total transaction price.

In addition, we exercise judgment in certain transactions when determining whether we should recognize revenue based on the gross amount billed to a customer (as a principal) or the net amount retained (as an agent). These judgments are based on our determination of whether or not we control the service before it is transferred to the customer.

Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate income taxes in each of the countries and other jurisdictions in which we operate. This process involves estimating our current tax expense together with assessing temporary differences resulting from the differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Net operating losses and tax credits, to the extent not already utilized to offset taxable income or income taxes, also give rise to deferred tax assets. We must then assess the likelihood that any deferred tax assets will be realized from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. We are required to use judgment as to the appropriate weighting of all available evidence when assessing the need for the establishment or the release of valuation allowances. As part of this analysis, we examine all available evidence on a jurisdiction-by-jurisdiction basis and weigh the positive and negative information when determining the need for full or partial valuation allowances. The evidence considered for each jurisdiction includes, among other items, (i) the historical levels of income or loss over a range of time periods that extends beyond the two years presented, (ii) the historical sources of income and losses, (iii) the expectations and risk associated with underlying estimates of future taxable income, (iv) the expectations and risk associated with new product offerings and uncertainties with the timing of future taxable income, and (v) prudent and feasible tax planning strategies. Significant judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. We estimate the valuation allowance related to our deferred tax assets on a quarterly basis.

Our sales may be subject to other taxes, particularly withholding taxes, due to our sales to customers in countries other than the United States. The tax regulations governing withholding taxes are complex, causing us to have to make assumptions about the appropriate tax treatment. Further, we make sales in many jurisdictions across the United States, where tax regulations are varied and complex. We must therefore continue to analyze our state tax exposure and determine what the appropriate tax treatments are, and make estimates for sales, franchise, income and other state taxes.

The Inflation Reduction Act of 2022 (the "Act") was signed into U.S. law on August 16, 2022. The Act includes various tax provisions, including an excise tax on stock repurchases, expanded tax credits for clean energy incentives, and a corporate alternative minimum tax that generally applies to U.S. corporations with average adjusted financial statement income over a three year period in excess of \$1 billion. We do not expect the Act to have a material impact on our consolidated financial statements.

Results of Operations

The following table presents our summarized results of operations for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

(In thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2022	2021	\$ Change	% Change	2022	2021	\$ Change	% Change
Total revenue	\$ 8,406	\$ 10,646	\$ (2,240)	(21)	\$ 28,532	\$ 31,289	\$ (2,757)	(9)
Total cost of revenue	7,271	9,318	(2,047)	(22)	24,315	27,176	(2,861)	(11)
Gross profit	1,135	1,328	(193)	(15)	4,217	4,113	104	3
Operating expenses	2,289	2,194	95	4	6,971	7,150	(179)	(3)
Loss from operations	(1,154)	(866)	(288)	33	(2,754)	(3,037)	282	(9)
Other income, net	29	(29)	58	(200)	116	1,575	(1,459)	(93)
(Loss) income before income taxes	(1,125)	(895)	(230)	26	(2,638)	(1,462)	(1,176)	80
Income taxes	—	—	—	—	—	—	—	—
Net (loss) income	\$ (1,125)	\$ (895)	\$ (230)	26	\$ (2,638)	\$ (1,462)	\$ (1,176)	80

Revenue

We generate revenue from the sale of software, both embedded operating system software that we resell and our own proprietary software, and related professional services.

Total revenue for the three months ended September 30, 2022 decreased compared to the same period in 2021, primarily due to decreased sales in our Partner Solutions segment in North America and Asia, as well as decreased revenue in our the Edge to Cloud segment.

Total revenue for the nine months ended September 30, 2022 decreased compared to the same period in 2021 due to decreased sales in our Partner Solutions segment in Asia and a decrease in the Edge to Cloud segment.

Additional revenue details are as follows:

(In thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2022	2021	\$ Change	% Change	2022	2021	\$ Change	% Change
Revenue								
Partner Solutions	\$ 7,557	\$ 9,638	\$ (2,081)	(22)	\$ 26,042	\$ 28,393	\$ (2,351)	(8)
Edge to Cloud	849	1,008	(159)	(16)	2,490	2,896	(406)	(14)
Total revenue	\$ 8,406	\$ 10,646	\$ (2,240)	(21)	\$ 28,532	\$ 31,289	\$ (2,757)	(9)
As a percentage of total revenue:								
Partner Solutions	90%	91%			91%	91%		
Edge to Cloud	10%	9%			9%	9%		

Partner Solutions revenue

Partner Solutions revenue decreased \$2.1 million or 22% for the three months ended September 30, 2022 compared to the same period in 2021. Partner Solutions revenue decreased \$2.4 million or 8% for the nine months ended September 30, 2022 compared to the same period in 2021. The decrease in revenue for both periods is primarily attributable to lower sales in Asia. It also reflects that our customers continue to face supply chain issues, have not continued with new versions of Microsoft products that have reached end of life, and discounted pricing structures by various Microsoft distributors.

Edge to Cloud revenue

Edge to Cloud revenue decreased \$0.2 million or 16% for the three months ended September 30, 2022 compared to the same period in 2021. The decrease is primarily due to non-recurring professional services revenue recognized in the third quarter of 2021.

Edge to Cloud revenue decreased \$0.4 million or 14% for the nine months ended September 30, 2022 compared to the same period in 2021. The year-over-year decrease is driven by the conclusion of our relationships with several smaller customers as we have strategically shifted our focus to larger customers and product development opportunities, partially offset by a large, one-time revenue recognition event that occurred in June 2022.

Gross profit and gross margin

Cost of revenue for the Partner Solutions segment consists primarily of embedded operating system software product costs payable to third-party vendors, net of rebate credits earned through Microsoft's distributor incentive program. Cost of revenue for the Edge to Cloud segment consists primarily of salaries, benefits and re-billable expenses. Gross profit and gross margin were as follows:

(In thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2022	2021	\$ Change	% Change	2022	2021	\$ Change	% Change
Partner Solutions	\$ 983	\$ 1,147	\$ (164)	(14)%	\$ 3,810	\$ 3,865	\$ (55)	(1)%
Partner Solutions gross margin	13%	12%		1.0	15%	14%		1.0
Edge to Cloud	\$ 152	\$ 181	\$ (29)	(16)%	\$ 407	\$ 248	\$ 159	64%
Edge to Cloud gross margin	18%	18%		—	16%	9%		8.0
Total gross profit	\$ 1,135	\$ 1,328	\$ (193)	(15)%	\$ 4,217	\$ 4,113	\$ 104	3%
Total gross margin	14%	13%		1.0	15%	13%		2.0

Partner Solutions gross profit and gross margin

Partner Solutions gross margin rate increased for the three and nine months ended September 30, 2022 compared to the same period in 2021 primarily due to customer and product mix. Partner Solutions gross profit dollars decreased in both the three and nine month periods, commensurate with the revenue decreases in those periods.

Partner Solutions gross profit is impacted by rebate credits earned through Microsoft's distributor incentives program. In accordance with program rules, we allocate 50% of the incentive earnings to reduce Partner Solutions cost of revenue with the remaining 50% utilized to offset qualified marketing expenses in the period the expenditures are approved. See Footnote 9 – Significant Risk Concentrations for further information about these rebates.

Edge to Cloud gross profit and gross margin

Edge to Cloud gross profit dollars and gross margin rate for the three months ended September 30, 2022 were essentially flat compared to the same period in 2021.

Edge to Cloud gross profit dollars and gross margin rate increased for the nine months ended September 30, 2022 compared to the same period in 2021 driven primarily by decreased costs of revenue. The prior period included amortization expense related to intangible assets that were fully amortized as of December 31, 2021.

Operating expenses

The following table presents our operating expenses for the periods indicated:

(In thousands, except percentages)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2022	2021	\$ Change	% Change	2022	2021	\$ Change	% Change
Operating expenses:								
Selling, general and administrative	\$ 2,030	\$ 1,786	\$ 244	14	\$ 6,195	\$ 6,209	\$ (14)	(0)
Research and development	259	408	(149)	(37)	776	941	(165)	(18)
Total operating expenses	\$ 2,289	\$ 2,194	\$ 95	4	\$ 6,971	\$ 7,150	\$ (179)	(3)
As a percentage of total revenue:								
Selling, general and administrative	24%	17%			22%	20%		
Research and development	3%	4%			3%	3%		

Selling, general and administrative

Selling, general and administrative ("SG&A") expenses consist primarily of salaries and related benefits, commissions and bonuses for our sales, marketing and administrative personnel, facilities and depreciation costs, as well as professional services fees (e.g., consulting, legal, audit and tax). SG&A expenses for the three months ended September 30, 2022 increased compared to the same period in 2021 driven by increased marketing costs. SG&A expenses for the nine months ended September 30, 2022 were essentially flat to the same period in 2021.

Research and development

Research and development ("R&D") expenses consist primarily of salaries and related benefits for software development and quality assurance personnel, contractor and consultant costs. R&D expenses decreased for the three and nine months ended September 30, 2022 compared to the same periods in 2021 primarily due to increased capitalization of personnel costs partially offset by new product amortization expense.

Other income (expense), net

Other income (expense), net consists primarily of interest income on our cash and investments, gains and losses we may recognize on our investments, and gains and losses on foreign exchange transactions and other items. Other income (expense), net was essentially flat for the three months ended September 30, 2022 compared to the same period in 2021. The year-over-year decrease for the nine months ended September 30, 2022 compared to the same period in 2021 is due to the forgiveness of our Paycheck Protection Program ("PPP") loan in the second quarter of 2021, which was accounted for as a \$1.6 million gain from extinguishment that did not reoccur in 2022.

Income taxes

Income taxes were not recorded for the quarterly and year-to-date periods ended September 30, 2022 and September 30, 2021, respectively.

Liquidity and Capital Resources

As of September 30, 2022, we had \$37.1 million of cash, cash equivalents, restricted cash, and short-term investments, reflecting a decrease of \$3.0 million from December 31, 2021. We generally invest our excess cash in high quality marketable investments. These investments typically include corporate notes and bonds, commercial paper, and money market funds, although specific holdings can vary from period to period depending upon our cash requirements. Cash equivalent investments held at September 30, 2022 totaled \$11.4 million.

We believe that our existing cash and cash equivalents will be sufficient to meet our needs for working capital and capital expenditures for at least the next 12 months.

Cash Flows from Operating Activities

Operating activities used cash of approximately \$2.5 million for the nine months ended September 30, 2022. The operating cash use was driven by the period's net loss of \$2.6 million, increased by non-cash adjustments of \$0.6 million, and reduced by \$0.5 million of changes in working capital items. The largest working capital change was a decrease of deferred revenue, reflecting revenue recognition for which payment had been received in a prior period. Additionally, accounts receivable decreased, reflecting a source of cash for the period. Accounts receivable changes are largely driven by the timing of customer payments.

Cash Flows from Investing Activities

Investing activities used cash of approximately \$11.1 million for the nine months ended September 30, 2022. During the quarter, we invested \$10.7 million in treasuries with a maturity date of December 31, 2022. These are reflected as short-term investments on the balance sheet. The remaining cash used in investing activities relates to additions to our property, plant and equipment in the form of internally-developed software.

Cash Flows from Financing Activities

Financing activities used cash of approximately \$0.1 million for the nine months ended September 30, 2022. Cash use was due to the PSU cash settlement, partially offset by proceeds from the exercise of stock options.

Material cash requirements and sources of liquidity

Cash requirements arising from contractual obligations relate to our office leases. See Footnote 5 – Leases for further information. Other significant cash requirements include software royalties, which become a liability at the point we sell third-party software to our customers, and salary and benefit expenditures related to our personnel. Our sources of liquidity include cash and cash equivalents currently on-hand, short-term investments, and cash generated from operations. We believe that our existing cash, cash equivalents and short-term investments are sufficient to meet our cash requirements for the foreseeable future.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that the information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes in our internal control over financial reporting during the three months ended September 30, 2022 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in the risk factors set forth in Part I, Item 1A, “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2021.

Item 6. Exhibits

**(b)
Exhibits**

Exhibit Number	Description	Filed or Furnished Herewith	Incorporated by Reference			
			Form	Filing Date	Exhibit	File No.
3.1	Amended and Restated Articles of Incorporation		S-1	August 17, 1999	3.1(a)	333-85351
3.1(a)	Articles of Amendment to Amended and Restated Articles of Incorporation		10-Q	August 7, 2000	3.1	000-27687
3.1(b)	Articles of Amendment to Amended and Restated Articles of Incorporation		8-K	October 11, 2005	3.1	000-27687
3.2	Amended and Restated Bylaws, effective August 6, 2020		8-K	August 10, 2020	3.1	000-27687
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) under the Securities and Exchange Act of 1934	X				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) under the Securities and Exchange Act of 1934	X				
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	Inline XBRL Instance Document - the instance does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document	X				
101.SCH	Inline XBRL Taxonomy Extension Schema Document	X				
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	X				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	X				
101.LAB	Inline XBRL Taxonomy Extension Presentation Linkbase Document	X				
101.PRE	Inline XBRL Taxonomy Extension Presentation Document	X				
104	Cover Page Interactive Data File (formatted in Inline XBRL and included in Exhibit 101)	X				

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 10, 2022

BSQUARE CORPORATION
(Registrant)

By: /s/ Christopher Wheaton
Christopher Wheaton
Chief Financial and Operating Officer,
Secretary and Treasurer
(Principal Financial and Accounting Officer
and Duly
Authorized Signatory)



**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO
RULE 13(a)-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Ralph C. Derrickson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BSQUARE Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2022

/s/ Ralph C. Derrickson

Ralph C. Derrickson
President and Chief Executive Officer
(Principal Executive Officer)



**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO
RULE 13(a)-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Christopher Wheaton, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of BSQUARE Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2022

/s/ Christopher Wheaton

Christopher Wheaton
Chief Financial and Operating Officer, Secretary and
Treasurer
(Principal Financial and Accounting Officer)



CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002,

I, Ralph C. Derrickson, President and Chief Executive Officer, certify that:

1. To my knowledge, this report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of BSQUARE Corporation.

Dated: November 10, 2022

/s/ Ralph C. Derrickson

Ralph C. Derrickson
President and Chief Executive Officer
(Principal Executive Officer)



CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002,

I, Christopher Wheaton, Chief Financial and Operating Officer, Secretary and Treasurer, certify that:

1. To my knowledge, this report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. To my knowledge, the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of BSQUARE Corporation.

Dated: November 10, 2022

/s/ Christopher Wheaton

Christopher Wheaton
Chief Financial and Operating Officer, Secretary and
Treasurer
(Principal Financial and Accounting Officer)