

BSQUARE Corporation

Fourth Quarter 2020 Conference Call

March 18, 2021

Steven Gottlieb, Vice President, Corporate Affairs

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. During this call, management will also refer to GAAP and non-GAAP financial measures.

Please refer to the cautionary text regarding forward-looking statements, as well as the Non-GAAP reconciliation to comparable GAAP financial measures contained in Bsquare's earnings release issued today on our website at www.bsquare.com under "Investors". 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

Good afternoon and welcome to the Bsquare quarterly earnings call. Thank you for taking the time to be with us this afternoon. Our plan as usual will be to take you through the Q4 and full year 2020 financial results, provide our perspectives on the business, and answer any questions you may have for us today. For anyone who would like to arrange a follow up conversation, please contact Steven Gottlieb, VP of Corporate Affairs who is responsible for Investor Relations and led off our call today.

Joining me on the call is Chris Wheaton, fellow entrepreneur and Bsquare CFO and COO. I will get us started and then hand things off to Chris.

For people who have been following us for a while, you know that we have been in rebuilding mode since I joined the company two years ago. You can see those rebuilding efforts in our 2020 results, including a \$7.3 million dollar improvement in our net loss over 2019 and an improved balance sheet, with cash growing year over year.

We started 2020 with a plan and expense structure that made sense for the business. But that is not the entire story. In 2020 we also had an entrepreneurial leadership team who acted aggressively in response to rapidly changing business conditions, minimizing cash burn and identifying opportunities to stretch our resources. While our financial results signal that Bsquare is stabilizing, the business building isn't complete. We had hoped to grow revenue in 2020. Our strong Q1 2020 revenue, on the heels of three quarters of improving revenue before that, gave us reason for hope.

Those notions were quickly dispelled, however, with the arrival of the COVID-19 pandemic and the disruption that ensued.

The disruptions did slow our revenue growth but did not slow our work with our large IoT customers. The investment we have been making there started to bear fruit in 2020, including last month's announcement of our expanded relationship with Itron. The experience we are gaining serving them, as well as our other large IoT customers, will result in improvements to our service and software offerings for a long time to come. Personally, I am proud that our technology is contributing to efforts to intelligently manage energy and the resources of our planet.

Before I turn things over to Chris Wheaton to review the quarter and year in detail, I'd like to take a moment to speak to Chris' expanding role, how we are organized, and the entrepreneurial culture we are building. Bsquare today is essentially composed of two integrated teams, an Opportunity Team that I lead, and a Commitment Team that Chris leads. The Opportunity Team, composed of sales, marketing, and business development is responsible for finding new opportunities for revenue and growth. We make promises to our customers creating the opportunity for revenue. The Commitment Team, that Chris leads, includes finance, product development, IoT operations, and engineering services. They deliver on the promises the Opportunity Team made, generating revenue for our business. They are also creating new capabilities as well as looking for ways to improve our business with better services and technology. This

balance of opportunity and commitment, or promise and delivery, has become an essential part of our entrepreneurial culture and is central to our plan to return to growth. It is how we work with each other and how we work with our customers and partners. It also reflects in how we interact with you, our investors.

So, with that, let me turn things over now to my partner Chris Wheaton to take us through our financial results and his insights on the quarter and the year.

Chris Wheaton, Bsquare Chief Financial & Operating Officer

Thank you, Ralph, and good afternoon investors. As Ralph mentioned, he asked me to take on COO responsibilities and leadership of the Commitment Team, which has added a new dimension to my role. But on the call today I'm the CFO, and I've been looking forward to this chance to convey to you our fourth quarter results, and to discuss the financial highlights of 2020, the first full year of my tenure at Bsquare.

2020 was a year marked by macro-economic challenges that no one foresaw and that certainly were not part of our original plans. Despite those challenges, 2020 will also be the year in the Bsquare story that was marked by increasing stability and a return to progress against business fundamentals. It's this kind of steady progress that has allowed us to adapt to the challenges of 2020, and it's the measures of steady progress that I'm eager to share with you today.

Turning now to the financial headlines for fourth quarter and full year results for 2020:

Total revenue for the fourth quarter of 2020 was \$11.1 million, which is 6% higher than the third quarter. Revenue in our Partner Solutions segment, composed primarily of sales of Microsoft software, was flat quarter-over-quarter, reflecting the continuing pressure the pandemic has put on our customers, especially customers in hospitality, casino gaming and point-of-sale systems. For the Partner Solutions segment, a remarkable first quarter was followed by a difficult second quarter and revenue in the second half of the year, while stable, has not returned to its peak.

Soft revenue performance in Partner Solutions was considerably, but not entirely, offset by stable and relatively strong gross profits. Segment gross margins were 15.7% in Q4 2020, down from an unusually high 19.1% in Q3, as large rebates from Microsoft in the third quarter were not repeated in the fourth. The second half of 2020 produced gross margins of 17.4% in the segment, compared to the first half's 16.3% – a modest increase but, more importantly, a relatively stable result.

Turning to the Edge to Cloud segment, fourth quarter 2020 revenue was up \$700,000, or 55%, over the third quarter. Sales of our software and related services delivered strong results in the quarter and propelled our gross margins in the segment to 39%, up from both the third quarter's 12% figure and Q4 2019's result of 35%. Nonetheless, full year gross margins in the segment were \$600,000, or 13%, below the \$2.7 million, or 31%, result for 2019. The year-over-year decline in gross profit was due

primarily to engineering investments made throughout 2020 to meet prior commitments to our largest customers. We expect these investments will continue to taper in 2021.

The juxtaposition of 2020 results for our two business segments provides a concise summary of our experience as the year unfolded. Partner Solutions fell short of our revenue expectations, but delivered higher-than-anticipated gross margins. Edge to Cloud provided more predictable and consistent revenue, but the gross margins were compressed by customer investments that required more resources than expected.

We met the emergence of these patterns with close attention to our spending, particularly in sales and marketing costs and in our administrative expenses. Our overall results show this attention. Net loss for the fourth quarter of 2020 was \$200,000 or \$0.02 per diluted share, which was virtually flat when compared to the third quarter net loss of \$100,000 or \$0.01 per diluted share. While our modest losses in Q3 and Q4 of 2020 do reflect the frequently challenging conditions created by the pandemic, comparative results for the full year demonstrate the return to business fundamentals that I mentioned at the outset of my remarks. For the full year 2020, net loss was \$1.9 million, or \$0.14 per diluted share, compared to a 2019 net loss of \$9.2 million, or \$0.71 per diluted share. Our ongoing attention to operating discipline has helped us create a more sustainable and adaptive cost structure.

Adjusted EBITDAS, a non-GAAP measure of our operating performance, was another bright spot in Q4 and 2020 as a whole. Fourth quarter adjusted EBITDAS was

\$100,000 lower in than it was in the third quarter, but adjusted EDITDAS for the year was \$5.1 million better than it was in 2019. As a reminder, Adjusted EBITDAS provides another perspective on our ongoing operations by excluding certain non-cash and irregular expenses, including some amortization expenses, stock-based compensation expense and restructuring charges.

Finally: cash; our cash balance on December 31, 2020 was \$2.4 million higher than on the same date in 2019. The last time that Bsquare added cash over a fiscal year was long before either Ralph or I joined the company. Our efforts to conserve cash, combined with careful decisions on new spending, and on opportunities to obtain cash, have set us up well for continued business building in 2021. However, that business building is likely in the near-term to consume, rather than create, cash. While we do not intend to return to the days of heavy cash burn, we do anticipate some increased investment in the opportunities we have to grow the business. Cash, cash equivalents, restricted cash, and short-term investments totaled \$13 million on December 31, 2020.

With the close of 2020 and looking to 2021, the emphasis on steady progress will remain. Our march continues. Ralph will speak momentarily about that journey and the assets we can and will deploy along the way. However, uncertainty remains and the grip of the pandemic has not yet fully released. We still see some unevenness and unpredictability in the Partner Solutions segment, in particular. As a result, we will not be

providing guidance at this time and we will refrain from providing any additional future-focused commentary about the business.

Thank you for your time and attention and I look forward to answering your questions at the end of the call. Let me turn things back over to Ralph.

Ralph C. Derrickson, Bsquare President & Chief Executive Officer

Thank you Chris. During our earnings calls last year, you heard me speak of the increasing alignment between our Partner Solutions and Edge-to-Cloud business segments. I would like to expand on that and share how our customers' experiences will enhance that alignment and shape our strategy moving forward. What we're finding is that our customers' product strategies are increasingly heterogenous – that is to say they have different versions of their product with different operating systems and different operating environments – and they need our help.

This year Microsoft is introducing their next generation embedded OS and that will create new opportunities for our customers and for Bsquare to assist them. Linux and Android are increasingly prevalent in the world of IoT and bring their own set of challenges. At the same time, our customers' products are being deployed into multi-cloud environments – AWS, Azure, and Google cloud creating new complexities, and again Bsquare is a natural partner. The next step in our customers' progression is to operate and manage their devices centrally as a fleet and for that they need 24/7

operations support, a skill set that is not their core competence but something we can offer.

The reality in 2021 is that for our customers, and for Bsquare, the definition of system software is expanding beyond the Operating System. It now includes device settings, configuration, monitoring information, firmware and rules engines. Our customers are transforming their business as they progress to ubiquitous device connectivity and true IoT. This progression is clearly arriving in phases and Bsquare will be there with services and software to support them in their journey. From the OS to the cloud to 24/7 operations to data-driven operations Bsquare is there. We are fortunate to have such a rich customer base in such a wide set of verticals, a strong technology partner in Microsoft, and real-life experience with large IoT operations.

I would like to close by saying, how proud I am of the work the Bsquare team has done to stabilize the business and embrace an operating discipline based on customer service and entrepreneurship. Chris and I joined at a difficult time for Bsquare. We took some bitter medicine and began the unglamorous work of rebuilding our business foundation. In 2020 we continued that work but with the added challenge of doing it remotely. COVID made collaboration with our customers and each other that much more difficult, yet we pushed to rationalize our product offering and make good on promises made. We are starting 2021 in a better position than we started 2020. We have a renewed focus on services and software that address our customers' problems,

the operating discipline to invest our resources wisely, and the entrepreneurial instincts to identify the opportunities that will allow us to exploit the market potential of IoT.

Before we open the line for questions, I would like to acknowledge that we filed a Form S-3 after the markets closed today. A Form S-3 is a registration statement that, if it becomes effective with the SEC, would generally allow the company to offer and sell securities to the public from time to time. For additional information I refer you to the Form S-3 filing which you can access on the SEC's EDGAR site or via the investor section of our web site. As a matter of policy, we generally decline to comment on financing matters and that will be true today.

With that out of the way, operator would you please open the line for questions? While that is happening, let me remind you that if you would like to arrange a follow up discussion with Chris and me, please contact Steven Gottlieb. Thank you.