

BSQUARE Corporation

Third Quarter 2022 Conference Call

November 10, 2022

Ralph C Derrickson, Bsquare President and Chief Executive Officer

Thank you. Good afternoon investors and welcome to the Q3 2022 Bsquare quarterly earnings call. Joining me on today's call is Bsquare's CFO and COO Chris Wheaton. Chris and I appreciate your interest in Bsquare and thank you for taking the time to be with us this afternoon. 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 the Bsquare website.

During the 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. In our commentary, we may also refer to GAAP and non-GAAP financial measures. Please refer to the cautionary text regarding forward-looking statements contained in Bsquare's earnings release issued today and on our website at www.bsquare.com under "Investors". All per share amounts discussed today are fully diluted numbers where applicable.

We will be taking questions after our prepared remarks. For anyone who would like to arrange a follow up conversation with us, please send an email to investorrelations@bsquare.com. This mailbox is monitored regularly, and you will get a response within 1 business day.

Okay with that out of the way let's get started. There are four items on the agenda for our call today. The first item is the Q3 results. Chris will take us through what was a tough revenue quarter for us. After that, I'll discuss the rationale for our planning priorities for 2023, and our shift from growing revenue to achieving breakeven business operations. I'll also cover a question that several shareholders have asked me to address, and that is what we intend to do with our cash reserves. Finally, we will close with a couple governance and administrative matters. And, of course, we'll have time for questions at the end.

Chris let's get into the Q3 results.

[Chris Wheaton, Bsquare Chief Financial & Operating Officer](#)

Thank you, Ralph, and good afternoon investors. I'm going to take you relatively quickly through the most relevant financial highlights of the quarter. While these results are not what we had anticipated, they provide an important backdrop for the change in operating priorities that Ralph just mentioned.

Most of my financial comparisons on the call today will be to the second quarter of this year and, if not, I'll indicate where I'm comparing to other periods. I'll start with a review of our income statement and then move to a discussion of our balance sheet, specifically changes in our cash balance and recent short-term investments.

Total revenue for the third quarter of 2022 decreased \$2.0 million or 19 percent. Partner Solutions decreased \$1.8 million and Edge to Cloud decreased \$200,000. We'll first take a closer look at the results in Partner Solutions.

Revenue in that segment decreased 19% quarter over quarter. A few large orders in each of the first two quarters bolstered our first half results, but we did not close similarly large orders in the third quarter. Our OS licensing customers continue to cite struggles with their supply chains, causing delays in product launches and purchasing decisions. Further, the threat of recession and increasing interest rates seem to have affected ordering patterns as our customers have become exceptionally cautious about inventories and near-term demand for their products.

In the Edge to Cloud segment, total revenue in the quarter was \$800,000, down \$200,000, or 20%. The second quarter included one-time revenue stemming from a contract amendment that renewed the relationship with one of our largest customers. As we noted last quarter, this contract amendment both extended our relationship and stabilized revenue recognition with this customer – albeit at a quarterly rate lower than was recorded in the second quarter. Overall, we have strong relationships with the customers in this segment and have clear visibility to their needs and plans.

Turning now to gross profit...commensurate with the quarterly revenue decline, total gross profit decreased \$500,000, driven again by the Partner Solutions segment. Gross margin rate for that segment was 13.0%, roughly in-line with the second quarter, indicating that the \$300,000 decrease in gross profit dollars was fundamentally driven by the 19% revenue decline rather than by pricing or mix changes.

As we've discussed previously, the cost of revenue in the Edge to Cloud segment tends to be fairly stable, resulting in gross profit dollars moving in correlation with

revenue. This remained true for the third quarter of 2022 as both segment revenue and gross profit decreased \$200,000 compared to the prior quarter.

In better news, operating expense controls remain a relative bright spot in our financial picture. Total operating expenses in the third quarter were \$2.3 million, which was essentially flat to the second quarter. Both of the expense categories on our income statement were flat quarter-over-quarter.

Overall, loss from operations for the quarter was \$1.2 million compared to the second quarter loss from operations of \$700,000. Net loss for the quarter was \$1.1 million, or \$0.05 per diluted share, which was more than the second quarter net loss of \$600,000, or \$0.03 per diluted share. The increased loss was directly attributable to the decrease in revenue.

Turning now to the balance sheet, I want to call your attention to an investment strategy we implemented during the quarter. We purchased \$22.1 million in treasury bills to take advantage of rising interest rates while maintaining a focus on liquidity. Approximately \$11.4 million was invested in T-bills with a maturity of less than 90 days 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. This laddered investment strategy will continue into the foreseeable future. The true liquidity of the business – and our ability to deploy cash as needed and warranted – has not changed.

In total, cash, cash equivalents, restricted cash and short-term investments totaled \$37.1 million on September 30, 2022. While this reflects a net cash use of \$3.0 million since December 31, 2021, our liquidity position remains healthy, as is the rest of our balance sheet with mostly current receivables and no debt.

I'll turn it back to Ralph now, to discuss how these financial results have influenced our plans and priorities for 2023.

Ralph C. Derrickson, Bsquare President & Chief Executive Officer

Thank you Chris. There are no two ways about it, Q3 was a difficult quarter. But, as I like to say to my team, facts are friendly. So, let's talk about those facts and what we're going to do about them.

Partner Solutions remains our primary cash generating business segment and as such it will continue to be a focus. The segment has been significantly impacted by supply chain issues and economic conditions that we expect will continue into Q4 and 2023. Earlier this year we invested in strengthening our customer account management team. For reasons we've covered, these investments haven't yet paid off in top line revenue, but they have allowed us to deepen our customer relationships giving us better visibility into customers' issues, future product development plans, and their requirements. Bsquare has a reputation as the premier provider of technical support and customer service, and we will continue to build on that reputation in 2023.

Our Edge-to-Cloud business provides an important validation of our IoT operating abilities. We have continued to work closely with our large customers this

year to build a profitable, sustainable business. In addition to on-going consulting work, we provide critical IoT operation services for these customers. The segment is also an important source of revenue and cash for us.

On our last call in August, Chris took you through an in-depth discussion of our SquareOne offering and I reviewed our plans for investing in marketing SquareOne. Unfortunately, sales pipeline development has been slower than we modeled in our plan for 2022. We believe there are a combination of factors at play. First, there were delays in our marketing which we have now resolved, including launching a new website that reflects our enhanced branding and product messaging. Second, we have encountered challenges unseating internally developed, but less robust, solutions. And lastly, we are finding that prospective customers require longer evaluation cycles for a product that will become a part of their critical operating infrastructure. We are addressing these issues on a case-by-case basis but the net result is that sales are taking longer than we assumed in our 2022 planning.

Based on early selling experience, we continue to refine our sales and marketing strategy. With our existing OS licensing customers, we are shifting to a partnership selling model. We believe SquareOne creates a new revenue opportunity for our OS licensing customers and, in turn, improves their offering to their customers who are the ones operating and managing systems of devices. For customers new to Bsquare, those who are not running Windows IoT, or those who are operating devices themselves, we will sell SquareOne directly, emphasizing our multi-OS capabilities as a key differentiator.

Given this set of facts our plans need to change and so we are shifting our priorities for next year. Our planning priority for 2023 is to achieve breakeven business operations. This shift doesn't mean we will stop investing in marketing or revenue growth in 2023. But, it does mean that the timing and amount of the investment will be subject to both the business opportunity and our financial results. Establishing a breakeven posture will require changes, both in the way we acquire new revenue and how we manage our costs. We are working on those changes now, as a leadership team, to prepare ourselves for the more challenging economic environment we expect in 2023.

I am a pilot, I fly planes and as a pilot, I like to have a plan for the worst case scenario so I'm ready for any eventuality. Fortunately we don't have a cash problem. Our challenge is being ready to operate successfully with potentially lower and slower growing revenue than we had previously planned. Emerging as a company that can operate within our means will put us in control of our own destiny and position us to exploit opportunities at the intersection of preparation and discipline.

Turning our attention now to another question that I know is on shareholders' minds, and that is what we intend to do with our large cash reserve. We believe that cash and liquidity will be an increasingly scarce commodity as the economic uncertainty continues into 2023. Adopting break-even as a planning requirement will allow us to preserve cash for investing in organic growth as it is merited. It will also allow us to consider other opportunities for building value. Earlier in 2022 the board formed a Mergers & Acquisitions committee to consider strategic alternatives on a case-by-case

basis. That effort will continue in Q4 and 2023, running in parallel with our efforts to grow the business organically. Several shareholders have asked me, to consider a stock repurchase or special dividend. I want to assure you that the Board has been, and will continue to, consider carefully all options for capital allocation. Decisions regarding capital allocation will be informed by our 2023 plan that is in development, and I have no decisions to report today.

Before we close out the call there are a couple of governance and administrative matters that I would like to cover.

Our 2022 annual shareholder meeting will take place later this month on Tuesday, November 29th. We will return to a June meeting cadence next year with the 2023 annual shareholder meeting scheduled for Thursday, June 15, 2023 as was announced in our press release and 8-K filed today.

On October 18th we announced that we had entered into a Cooperation Agreement with Richard Karp, a large shareholder. As a part of that we agreed to put forth a plan to declassify the board of directors. The plan will seek to eliminate board classes in a phased manner over 3 years resulting in one-year terms for all directors. We will present that plan at the 2023 annual meeting of shareholders. It is not being presented at, and has no effect on, the annual meeting of shareholders scheduled to occur later this month. Also as a part of the Agreement, Mr. Karp has withdrawn his director nominees for the 2022 Annual Meeting. Declassification of the board will bring us in line with governance best practices and I am optimistic we will succeed where prior efforts failed to get sufficient shareholder support.

Okay with that, Operator please open the line for questions. Because we don't often get many questions on our calls I will remind you that if you would like to arrange a follow up conversation, please send an email to investorrelations@bsquare.com.

Operator please open the line.

Thank you and thank you investors for taking the time to participate in our call. We appreciate your interest in Bsquare. We look forward to seeing you at the Shareholder meeting on November 29th.