

BSQUARE Corporation

Third Quarter 2021 Conference Call

November 10, 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

Thank you Steven. Good afternoon investors and welcome to the Q3 2021 Bsquare quarterly earnings call. As a reminder, 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. You can reach Steven via email at investorrelations@bsquare.com. This email address is monitored for inquiries and you will get a response within 1 business day. We did recently discover a problem with the forwarding of messages sent to this address, but that has been corrected.

Okay let's get started. Joining me on today's call is fellow entrepreneur Chris Wheaton Bsquare's CFO and COO. Chris and I appreciate your interest in Bsquare and thank you for taking the time to be with us this afternoon. If this is your first call – welcome! We are glad to have you. If you have been following us for any length of time, today's call is going to be a little different. As you well know Chris and I have been heavily engaged in business building over the last 2 years. It's been an unglamorous period of time during which we've been internally focused on business fundamentals. The work, however, is paying off and I am pleased with our progress. Today we are a substantially smaller and more entrepreneurial team with a rational and stable expense structure. Additionally, we've worked hard to restore our reputation with our customers and partners. Through that work we've learned a lot about our customers and their needs. These critical insights are driving our strategy and plans for a return to growth. I

will share more about those plans today, but before I go there let me turn things over to Chris to take us through the details of our third quarter results.

Chris, over to you.

Chris Wheaton, Bsquare Chief Financial & Operating Officer

Thank you, Ralph, and good afternoon investors. Today's call is something I've been looking forward to as it represents an important inflection point for Bsquare. We're openly sharing our plans for growth, which we've been investing in for some time now. Ralph will go even further into that after my remarks, but let me start by looking at where we've been.

The third quarter of 2021 marked the sixth full quarter since the effects of the pandemic on our business became apparent. Over those six quarters, we've seen soft demand for our Partner Solutions products in important verticals such as hospitality, gaming, and point-of-sale systems. Supply chain disruptions have continued to hamper our customers' plans and alter their buying behaviors. As is the case for many companies, we've been forced to adapt to new ways of doing business and to find new ways to grow.

And yet, throughout this period, our financial results have shown steady, though inconsistent, improvement. Q3's total revenue of \$10.6 million represents a 3.6% compounded quarterly growth rate since Q2 2020, when the effects of the pandemic really took hold. Our third quarter operating results improved by more than \$400,000 over the second quarter of 2021. We've kept expenses under control with a quarter over quarter decrease of 17% in selling, general and administrative costs. And early in Q3, we raised a significant amount of cash

through our previously announced At-The-Market, or ATM, common stock selling program. This cash puts Bsquare in a stronger financial position now than we've been in years.

Let's take a closer look at the details behind these results.

The third quarter's \$10.6 million in revenue is in-line with the second quarter's results. Edge to Cloud revenue was up \$300,000, or 42%, driven by the completion of a device management project for one of our larger customers. This increase was offset by a \$300,000, or 3%, decrease in Partner Solutions revenue. Despite the small decrease, the \$9.6 million in total revenue for the Partner Solutions segment was the second highest quarterly result since the onset of the pandemic. While Partner Solutions revenue is generally trending upward, our customers' ordering patterns remain unpredictable as they continue to be affected, to varying degrees, by both COVID and global supply chain issues.

Moving to gross profit. Third quarter Partner Solutions gross profit decreased from the second quarter by about \$200,000. Less than \$100,000 of the decrease was due to lower sales volume, while the balance of the decline was driven by shifts in customer and product mix, and a reduction in rebates from Microsoft. As a reminder, Microsoft makes these rebates available to distributors according to achievement of certain volume and product mix targets and they're partially recorded as an offset to our cost of goods sold.

Edge to Cloud gross profit increased \$400,000 compared to Q2 2021 as our labor expenses, which are the dominant factor in this segment's gross profit, were favorable across periods. With this favorability, and an increase in recognized revenue for the segment, both gross profit and gross margin rate improved.

Selling, general and administrative expenses decreased \$400,000 quarter-over-quarter. About a third of this decrease was due to the capitalization of previously expensed stock issuance costs related to our ATM program. The rest of the decrease was driven by a reduction in personnel costs and professional services fees. Our efforts to align our SG&A expenses with the overall performance of the business were largely successful.

Research and development expenses were up slightly in the third quarter of 2021 compared to Q2 2021. Variations in this P&L line item are driven by the rate at which labor costs are capitalized for product development, and the portion of our engineering team resources that we point to R&D efforts rather than current customer projects. As you'll hear from Ralph shortly, we've made advances in product development and we're in a position to begin to show progress from our investment in this area. We've done this work without expanding our engineering headcount, which is something we expect to remain true in the near term.

Overall, our third quarter loss from operations was \$900,000 compared to a loss of \$1.3 million in the second quarter.

Moving to the balance sheet. The dominant story here is our available cash and restricted cash, which totaled \$41.4 million on September 30, 2021. This is an increase of \$32.1 million over the June 30 balance of \$9.2 million. The majority of this increase, or \$31.6 million, was driven by the July sales of 6.8 million shares of the Company's common stock through our ATM program. This important cash inflow was supplemented by \$500,000 in cash from operations, which resulted primarily from strong customer collections during the third quarter.

The ATM proceeds have created an important turning point for Bsquare. At the same moment in our history where we've stabilized our business after a long period of decline, we have ready access to capital that can help us grow and, in due course, return us to profitability. We have entered the phase of Bsquare's turnaround that will require thoughtful and measured investments, and we now have the means to make those investments. We'll seek new opportunities while continuing to drive efficiency in our operations.

Let me now turn things back over to Ralph to provide additional perspective on where those opportunities lie and how we will go after them.

Ralph C. Derrickson, Bsquare President & Chief Executive Officer

Thank you, Chris. Q3 was another example of the disciplined and deliberate approach that Chris and I utilize in our management of Bsquare.

Let's switch gears now and turn our attention to our plans for growth. I'd like to start with a discussion of our customers. Bsquare's customers generally fall into two categories: businesses that design and sell purpose-built devices and businesses that rely on a system of devices.

The first category of customers we refer to as "device makers." Historically our work with device makers has been limited to selling them Microsoft Operating System licenses for their devices. Our revenue has been a function of their success – if they sell more devices, they need more licenses, and our revenue grows. However, as we've seen with the pandemic, if they sell less devices, they need less licenses and our revenue slows.

Our other set of customers are what we call system builders. They rely on a collection of devices to run their business. Historically we've engaged with them to develop custom software, to build the glue between existing systems and/or to manage and operate their business systems. Our dealings with these customers have helped us to develop a deep expertise in the IoT space, but revenue growth has been constrained given the custom nature of that work.

It is clear to us that the way we currently interact with, and serve, device makers and system builders does not provide the profitability or scalability that will drive a healthy, growing business. So, our focus has become: how do we leverage the knowledge and expertise that we possess to provide new and different value to our customers?

All our customers operate in a world where value is created from the technology-enabled connections between people, devices, organizations, and ideas. However, the number of connections, the speed of their operation, and the complexity of these connected systems are challenging traditional people-centric approaches to building, deploying, and operating these systems and devices. The fact is the devices themselves have to participate in the management and security of the system, and that is where Bsquare has been focused.

Moving forward, our product solutions will be based on a set of five pillars, or requirements, that were derived from work with our customers. They also capture the opportunities we've identified to use technology to create unique and compelling solutions. At the core of these pillars is the concept that devices can and must be part of the solution not the problem. Today's security and management challenges require a new approach that is captured in our pillars of scale, speed, always-on, always-learning, and shared intelligence. That is to say:

the solutions need to scale effortlessly, they must operate at the speed of the devices, they must always be on, they must always be learning and adapting. And they need to share information such that the intelligence of the many informs the individual, and the intelligence of the individual informs the many.

This month, we will introduce two solutions that meet the critical requirements outlined in these pillars.

The first is SquareOne - a system for deploying, operating, and managing systems of devices. SquareOne's capabilities grew out of our experience successfully building and operating large IoT systems. We'll be starting with an Early Adopter Program or EAP. The EAP is an opportunity for system builders to evaluate the product before it is widely available and for us to get feedback on SquareOne's initial feature set.

Later this month we'll introduce a system hardening solution for device makers that will ensure the operating system is configured securely and is recoverable in the event of a hardware failure or breach. Like SquareOne, our system hardening solution is rooted in the expertise gained through our previous work with customers.

One important note about both of these products: our customers have shared that running multi-OS environments is critical. As a result, both SquareOne and our system hardening solution will support any combination of Windows, Linux and Android devices.

We believe the solution pillars and related products that we discussed today form the basis for growing our business and returning Bsquare to relevance in the rapidly evolving technology market. The products we've described derive from our experience serving

customers, they play to our core engineering competencies, they create cross-selling opportunities that can expand our relationships with current customers, and they are relevant to new customers.

Taking these products to market will require investing in sales and marketing at higher levels than we have recently. That said we will continue to manage our expense structure carefully, making rational investments as necessary to grow the business. We will manage our cash prudently, tapping into our reserves if and when opportunities arise to substantially accelerate or bend our growth curve.

We are anxious to begin executing our plans. We have products that are relevant for our customers today and in the future. We have a strong, entrepreneurial and disciplined leadership team. We have the financial resources to succeed. Like a coach on Sunday morning, we can't predict the score of the game, but we have a plan and the confidence that we can win.

Chris and I look forward to sharing more with you as we move forward. Thank you for your time today. 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.

