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These prepared remarks should be viewed in conjunction with the related quarter's conference call webcast, earnings press release, and periodic filings with the United States Securities and Exchange Commission (SEC), including Form 10-Q Quarterly Report and Form 10-K Annual Report. The webcast includes the prepared remarks as well as a question and answer session, if applicable. The earnings press release provides summary financial statements and commentary regarding the financial highlights for the periods presented. The Form 10-K Annual Report is the annual financial report that we file with the SEC and the Form 10-Q Quarterly Report is the quarterly financial report we file with the SEC.

The prepared remarks below include "forward-looking statements" within the meaning of the safe-harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as: "expect," "believe," "plan," "strategy," "future," "may," "should," "will," and similar references to future periods. Examples of forward-looking statements include, among others: statements we make regarding expected operating results in future periods, such as anticipated revenue, gross margins, profitability, cash and investments; and strategies for customer retention, growth, new product and service developments, and market position. Forward-looking statements are neither historical facts nor assurances about future performance. Instead, they are based on current beliefs, expectations and assumptions about the future of our business and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks, and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual results and financial condition may differ materially from those indicated in the forward-looking statements. Therefore, you should not rely on any of these forward-looking statements.

Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, among others: our ability to execute our development initiatives and sales and marketing strategies around DataV™, the Internet of Things, and our product and service offerings more generally; the extent to which we are

successful in gaining new long-term customers and retaining existing ones; our success in leveraging strategic partnering initiatives with companies such as Microsoft and Amazon Web Services; whether we are able to maintain our favorable relationship with Microsoft as a systems integrator and distributor; and such other risk factors as discussed in our Annual Report on Form 10-K and other filings with the SEC. Any forward-looking statement made by us in this release is based only on information currently available to us and speaks only as of the date on which it is made. Except as may be required by law, we undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise.

## **BSQUARE Corporation**

Third Quarter 2018 Conference Call

November 12, 2018

### **Leslie Phillips, Investor Relations**

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

Now, I'd like to turn the call over to Andrew Harries, Bsquare Executive Chairman.

## Andrew Harries, Bsquare Executive Chairman

Thank you Leslie.

Before Kevin reviews our strategy and results, I'd like to announce several actions the board is undertaking in order to help Bsquare deliver improved results as quickly as possible. First, as announced last week, we continue to renew our board of directors with the retirement of Kendra VanderMeulen and the appointment of Davin Cushman. We are grateful to Kendra for her many years of service and wish her the best in her future endeavors. We look forward to the addition of Davin, who was engaged in a consulting capacity by the Strategic Review Committee this summer, and has already made an impact on our overall strategy. Since the May earnings release, we have now replaced three of our seven board members.

Next, I'd like to announce the disbandment of the Strategic Review Committee, which was formed by the board at the August board meeting. The SRC helped management develop a revised overall strategy for the company, which Kevin will discuss shortly, and has fulfilled its objectives.

Finally, in light of the fact that we now feel we have a viable go-forward strategy for the company, the board has commenced a search for a permanent CEO. I'd like to personally thank Kevin for his ongoing help in guiding the company through this challenging period. With that I will turn the call over to Kevin.

## Kevin Walsh, Bsquare Acting CEO

Thank you, Andrew, and good afternoon everyone.

Over the past six months we have been conducting a strategic review of our business and believe that we have now identified a path forward that will yield renewed growth and help us return to profitability.

One aspect of that path forward, which we have already undertaken, is to adjust our operating expense levels in order to drive efficiencies throughout the organization. Toward that end, over the past two quarters we have removed approximately 6 million dollars in annualized operating expenses from the business, which has contributed to significantly improved cash flow for the third quarter.

A second and more important aspect is a reassessment of our overall product and services strategy. For roughly the past four years Bsquare has been pursuing a strategic pivot toward a proprietary software offering for the industrial IoT market. While we were able to secure a number of large wins with DataV, the product line has not met its growth objectives. Part of the reason for this applies to the market in general; large-scale digital transformation initiatives in the industrial sector are complex and adoption has been slow. A direct consequence of this complexity is that services play a crucial role in all large IoT implementations. Indeed, we have seen this with DataV—while market traction

for DataV software has been slower than anticipated, professional services associated with DataV and IoT initiatives has been, and continues to be, a strong component of our business. These services include data science consulting, IoT cloud integration, systems integration, and custom application development. The importance of professional services, as well as what we see as a general industry shift toward cloud-anchored IoT infrastructure, are key elements of our go-forward strategy.

As we approach 2019 we see the following changes in our business:

1. We are ramping up our catalog of professional services offerings in response to demand from our customers. Importantly, these services are different than our traditional engineering services business; they are focused entirely on more advanced practice areas relevant to industrial IoT and artificial intelligence. We have a skilled professional services team, and an established delivery process that can be leveraged as we expand this business.
2. We plan to continue carefully calibrated investments in DataV in order to drive this business to profitability as quickly as possible. These investments will be focused on customer deployments for which we have clear line-of-sight.
3. We are implementing new programs in our third-party software distribution unit that will, we believe, allow us to grow this business

while complementing our professional services business. Specifically, this means working closely with Microsoft both in Windows 10 IoT and Azure.

4. And, given the cloud-centric nature of virtually all IoT initiatives, we are expanding our collaboration with both AWS and Microsoft.

Taken together, these changes will result in positioning Bsquare as a trusted IoT solutions provider. We believe these changes will yield growth and will help drive profitability in the second half of 2019.

Turning to results for the third quarter, revenue came in slightly lower than our guidance range. This shortfall was attributable to unanticipated variability in our third-party software distribution business; recall that the second quarter was significantly higher than expected. We do not believe that the third-party software business, is weakening. In fact, we are taking steps to maintain and even grow that business.

As mentioned earlier, net cash usage for the quarter was reduced to 590 thousand dollars due to a reduction in operating expenses and improved cash collections. We maintain the second-half guidance for cash utilization that we provided during our second quarter earnings call, specifically that second-half net cash usage would fall between 1 and 2 million dollars.

Now, I would like to turn the call over to our CFO, Peter Biere, to address our financial performance for the third quarter.

**Peter Biere, Bsquare Chief Financial Officer**

***Thank you, Kevin.***

***First, we'll review our revenue for the third quarter.***

Total revenue was 16.7 million dollars, slightly below the lower end of the 17.0 million to 19.0 million-dollar guidance announced in our Q2'18 earnings call. Compared to the prior year quarter, total revenue was down 15% from 19.7 million dollars, and down 13% sequentially from 19.2 million dollars.

Reviewing results by revenue grouping:

Third-party software revenue was 14.2 million dollars, lower year-over-year and sequentially. The year-over-year decline was largely due to the previously-announced loss of Honeywell's EMEA business. The sequential decline was in large part due to timing of purchases – Q2 included stronger than expected demand for Microsoft Windows embedded products. In Q3 we saw softer buying across the entire portfolio, which we attribute to the normal, quarterly variability we've experienced over the past 2 years.

Proprietary Software revenue was 796,000 dollars, down 404,000 dollars year-over-year and up 515,000 dollars sequentially. Sales of non-DataV

proprietary software tend to be seasonal purchases, which reflects in both comparative periods. Going forward, we expect revenue from both DataV and our other proprietary software will continue to fluctuate in both timing and amount.

Professional engineering services revenue, which include our DataV and traditional services contracts, totaled 1.7 million dollars, down 556,000 dollars year-over-year and 273,000 dollars sequentially. Both year-over-year and sequential declines are explained by a number of traditional services contracts reaching their final delivery point. Going forward, as Kevin mentioned, we expect to grow our Services revenue in 2019 as we seek to deliver more IoT related services and solutions.

Revenues for DataV which include both proprietary software and professional engineering services totaled 333,000 dollars for Q3.

***Next, I'd like to discuss gross profit and margins in the third quarter:***

Gross profit totaled 3.4 million dollars, or 20.1% of revenue, exceeding the upper end of the 16% - 18% guidance announced in our last earnings call. The year-over-year and sequential changes in gross profit are due to mix shifts between our three business units. Going forward, we expect gross margins on the

new IoT Services which- Kevin mentioned to fall in-line with or slightly exceed our current Professional Engineering Services gross margin.

***Turning to Operating Expenses and our bottom line results in the third quarter:***

Total operating expenses for the third quarter were 5.5 million dollars, an improvement of 1.4 million dollars from the prior year quarter and 1.5 million dollars sequentially. The majority of the cost reductions we've made over the past two quarters are reflected in Quarter 3 results and year-over-year and sequential improvements in operating expenses reflect those efforts.

We recorded a net loss of approximately 2.1 million dollars, or (\$0.16) per share for the third quarter of 2018, compared to a net loss of 2.5 million dollars, or (\$0.20) per share in the year-ago quarter and a net loss of 3.7 million dollars, or (\$0.29) per share for the second quarter of 2018.

Adjusted EBITDAS, a non-GAAP financial measure defined as operating income before depreciation, amortization and stock-based compensation, was negative 1.7 million dollars in the third quarter of 2018, compared to negative 1.8 million dollars in the year-ago quarter, primarily due to lower third-party software and proprietary software revenue, partially offset by lower operating expenses from the cost reductions we took in 2018. Please refer to the reconciliation to the

comparable GAAP financial measures in our earnings release issued today and posted on our website at [bsquare.com](http://bsquare.com) under “Investors.”

### **Moving to the balance sheet**

Cash and investments totaled 17.3 million dollars as of September 30, 2018, down 590,000 dollars from June 30, 2018. The net cash change in Q3 included approximately \$1.4 million in collections stemming from the loss of Honeywell’s EMEA business. We expect cash usage will continue to moderate in Q4 as well as in 2019. We believe we have sufficient cash and profits from legacy businesses to execute our plans.

Our accounts receivable balance totaled approximately 13.1 million dollars at September 30, 2018, about \$5.1 million of which is due from Honeywell. We extend 270-day terms to Honeywell and we pay Microsoft for these products in 45 days, so approximately 4.6 million dollars of this receivable will convert to cash. Related to the loss of Honeywell’s EMEA business, we expect approximately 2.0 million dollars of cash conversion for the remainder of 2018. I will now turn the call back to Kevin to provide an outlook for the fourth quarter and closing remarks.

**Kevin Walsh, Bsquare Acting CEO**

Thank you, Peter.

As noted in today's press release, we currently have the following expectations for Q4 2018:

- Revenue in the range of 15.5 million to 17.5 million dollars;
- Blended gross margin will be in the 18% to 22% range; and
- We expect net cash usage of 500 thousand to 1.5 million dollars.

**Moderator, please open the call for questions.**

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

Thank you for joining us.