

BSQUARE Corporation

Third Quarter 2020 Conference Call

November 12, 2020

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 and welcome to the Bsquare Q3 2020 earnings call. Thank you for taking the time to participate in today's review of Bsquare's Q3 financial results. Joining me on today's call is Chris Wheaton, fellow entrepreneur and Bsquare's Chief Financial Officer. The plan, as usual, is to take you through the Q3 2020 financial results, provide our perspectives on the business, and answer any questions you may have for us today. For the people who would like to arrange a follow up conversation, please contact Steven Gottlieb, VP of Corporate Affairs who is responsible for Investor Relations and lead off our call today. You can reach Steven via email at steveng@bsquare.com.

Let's turn our attention to Bsquare's Q3 results. Starting with revenue, we saw healthy increases over Q2 2020 in both the Partner Solutions and Edge-to-Cloud business segments. Total revenue was up 17% over last quarter. It is not clear if this is the beginning of a sustained recovery. We have over 600 active Partner Solutions customers who in turn sell their products into a diverse set of markets. Clearly some of our customers and markets have thrived in the current environment while others have faltered. We continue to work closely with all our customers as they seek to adapt to the changing market conditions.

Edge-to-cloud revenue improved as well during the quarter. The heavy investments we made to address issues with prior deliveries to our large customers are easing and as a result billable activity has increased. In addition to improving our customer relationships, this work is

helping us improve our product offering. I am confident these investments in our large customers will pay dividends as we look to grow the business in 2021.

In both business segments we benefited from our renewed commitment to partnerships. I firmly believe that we win by serving our customers, their success is our success, and I am proud of the progress we've made restoring our customers' confidence in Bsquare.

Turning next to operations, I am pleased to share that we saw continued improvement this quarter. As you know, I have been laser focused on managing costs and shifting the company to a more appropriate expense structure. That effort played a significant role in delivering the smallest net quarterly loss since I joined the company and in keeping our cash utilization to breakeven.

While I realize there is more to making Bsquare successful than managing expense, without careful and deliberate attention to it, we would not have created the breathing room we needed to pursue new opportunities or financial upside. That is why I have placed such a heavy emphasis on it, especially during the early phases of our business rebuilding.

Let me turn things over to Chris now to take us through the quarter's financial results in detail.

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

Thank you, Ralph, and good afternoon investors.

As Ralph noted, our third quarter results contain relatively good news and I'm eager to share the highlights with you. I believe these financial results represent both great progress and a stable basis from which we can turn our attention to profitable growth.

Perhaps most importantly, our cash and cash equivalents, including restricted cash, totaled \$12.6 million on September 30, 2020, an amount virtually unchanged from June 30, 2020. Ongoing cash management, a now well-established discipline throughout the company, has allowed us to migrate our operations to a more sustainable balance between cash inflows and outflows. Importantly, our more sustainable stance gives us room to maneuver and a degree of freedom to invest that has not been present at Bsquare for quite some time.

Turning to revenue performance: we recognized \$10.4 million in revenue in Q3 2020, an amount up \$1.5 million or 17% over the second quarter of 2020. What's notable is that this overall revenue increase was driven by higher sales in both the Partner Solutions segment and the Edge-to-Cloud segment.

Partner Solutions revenue in Q3 was \$9.1 million compared to \$8.1 million in Q2. While it's not clear that the shock delivered by the initial days of the COVID-19 pandemic has fully dissipated, we are noticing generally more stable ordering patterns.

Furthermore, Partner Solutions gross margins in Q3 2020 were 19%, up from 14% in the second quarter. An unusually favorable mix of product SKUs, combined with changes in key rebate programs that have always been present in our Microsoft partnership, reduced our cost of revenue significantly. We are not counting on the rebates to continue at Q3 levels. The

ongoing value we deliver to our customers in this segment is reflected in the relatively stable gross margins we have enjoyed in 2020.

In Edge-to-Cloud, the customer investments we made throughout 2020 are now winding down and providing a return. Segment revenue in Q3 was \$1.3 million, an increase of more than 57 percent compared to last quarter. Gross margins for Q3 turned positive, a result we have not posted since the fourth quarter of last year. We will continue to seek and drive growth in this segment, using the positive outcomes we have delivered for our customers as a springboard for deeper and even more valuable relationships.

Net loss for the current quarter was only \$100,000, or \$0.01 per diluted share, compared to a net loss of \$1.1 million, or \$0.08 per diluted share, in the second quarter of 2020. As Ralph said, the last time Bsquare delivered such a small net loss was well before his time at the company. In fact, it was the first quarter of 2017, nearly four years ago, when the company delivered better net income results than those we've provided today.

Finally, adjusted EBITDAS, a key measure of performance that we believe represents the core operations of the company, was approximately \$300,000, a \$1.1 million improvement over the negative \$800,000 result in the second quarter of 2020. We are finding ways to make each segment more profitable even as we reduce and right size our operational expenses. In future quarters, we will actively seek methods to continue that trend by pursuing greater convergence between our two business segments. Ralph will provide more on that in a moment.

In preparing today's remarks, I found myself frequently looking back on the four quarters of hard work that have passed since I first spoke with you. I hope that the quality of today's results also gives you the same sense of accomplishment that I know I feel. I'm proud of how far Bsquare has come, both financially and operationally. The team we have assembled is built for an exciting future. And they'll be operating from a position of stability created by the quality of our business fundamentals. A year ago, we reported cash burn of approximately \$1 million, compared to cashflow breakeven today. A year ago, we had \$3.8 million in operating expenses, compared to \$2 million today. Simply put, Bsquare is a different company than it was just twelve months ago.

We've come a long way over this past year and have done so in a business environment unlike any other. The confidence I have in our ability to create and manage opportunities for profitable growth has been bolstered, rather than diminished, by the pandemic-induced challenges of these last two quarters. Ralph and I are here to use entrepreneurial muscle to find opportunities through innovation, and COVID has not slowed that intent or reduced our confidence.

Nonetheless, our fortunes are of course tied to those of our customers'. The uncertainty surrounding the speed and slope of economic recovery remains present and meaningful. Until the disruptions caused by the pandemic have fully receded, we cannot accurately predict our customer's buying behaviors. Predicting revenue and other key performance indicators is difficult at best. As a result, we are not providing guidance at this time.

With that, let me turn the call back to Ralph.

Ralph C. Derrickson, Bsquare President & Chief Executive Officer

Thank you, for those remarks Chris.

Since my arrival at Bsquare we have pursued a series of initiatives designed to rebuild the business. Of those initiatives, operating excellence has dominated the last 5 quarters and much of our reporting to you. As Chris described, that foundation of operational excellence is now in place, so I'd like to focus on some of the other critical business rebuilding activities that are well underway.

As you recall, the other initiatives I announced back in May of last year included revising our go-to-market strategy, strengthening our strategic partnerships, and offering customers an edge-to-cloud software and services solution. I am pleased with the progress we made on all fronts. By its nature some of that progress is faster and more visible, while other progress has been more deliberate and for now, behind the scenes.

Let's start with the first initiative, revising our go-to-market strategy. You have no doubt seen substantial changes to our strategy, messaging, and even our look, on our website. On prior calls you've heard me describe a growing synergy between the needs of our Partner Solutions and our Edge-to-Cloud customers. Customers in both segments are encountering a common complication at the heart of IoT, specifically the challenge of deploying and operating devices securely in a widely heterogenous, persistently connected system. As we've seen working with our large IoT customers this isn't a software only problem, it's equally a service

and operation problem. For these customers, we built large components of their system and are we're now playing a key role in operating it. Our Partner Solutions customers encounter the same challenge but arrive at it from the individual device. For these customers we're helping them design and prepare their products to operate as part of a system. Once again this is as much an operations service challenge as it is a software problem. This commonality in our customer base is what inspired the statement on our website and that we use to frame every customer conversation: "Our technology is powering the next generation of intelligent devices and systems."

Turning next to the initiative to improve our partnerships, that work has been two-fold, our technology partnerships and our customer partnerships. First we have doubled down on our Microsoft technology partnership. Why? Because today the bulk of our revenue comes from licensing Microsoft's OS technology to purpose-built device makers. This generates cash for us and provides an on-ramp for our legacy customers to the intelligent device and system business I just described. That partnership isn't limited to just OS software, we support Azure and other technologies that are part of Microsoft's IoT solutions. We also continue to operate some of our largest customers on the AWS platform and that relationship is critical to us and to our customers.

Turning to our customer partnerships, a highlight from market research work this quarter revealed Bsquare has a reputation for consistently creative technical support and service. In the Partner Solutions segment we have helped customers get their products to

market faster and reduce their unit costs. In the Edge-to-Cloud segment we invested aggressively to address issues with prior commitments. In both segments we are forging strong relationships that are improving our products and helping our customers meet their goals.

The last initiative I would like to touch on today, is improving our product and service offering. This work takes more time because it can only happen as a result from collaboration with customers and our engineering and operation services teams. We have made great strides in harvesting software components and operations expertise that we can deploy and operate at scale.

What you have not yet heard me talk a lot about is new customers or new products. In this area, I have intentionally chosen to wait to be certain that what we're doing is something that we can sell, deliver, and operate at scale. We don't want to be just another company hyping some future technology. We want to be able to speak to what we are already doing successfully and repeatably, and when we do speak, we want our customers to speak alongside us. Until then, we will continue to work methodically to refine our offering, in collaboration with our customers and our technology partners to prepare Bsquare for accelerated growth.

I will close my remarks with this: We have the potential to be an important company in the rapidly evolving world of intelligent devices and systems and I look forward to sharing more as we transition from rebuilding to growth.

Thank you very much. Moderator please open the line for questions now.

