
These prepared remarks should be viewed in conjunction with the related quarter's conference call webcast, earnings press release, 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 United States Securities and Exchange Commission (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 most recent Annual Report on Form 10-K and other filings with the Securities and Exchange Commission. 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 2017 Conference Call

November 7, 2017

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, 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 Jerry Chase, Bsquare president and CEO. Jerry?



Jerry Chase—Bsquare Chief Executive Officer

Thank you Leslie, and good afternoon everyone.

We continue to be pleased with the performance of DataV, our Industrial Internet of Things software offering. Our market positioning, product offering, go-to-market strategy, and key partnerships all point toward increased momentum. In addition to pilots, conversions, and renewals, which I will cover shortly, we believe the market for offerings such as ours—specifically Industrial IoT and applied data analytics—is reaching the point of maturity where customers more readily understand the range of possibilities and are eager to move forward more quickly. We believe we are well positioned with a product offering that is performing well and highly differentiated to take advantage of this growing market, and we are investing accordingly.

From the standpoint of customer traction, we closed four new paid pilots in Q2 and seven additional paid pilots in Q3. We will be working closely with customers to complete those pilots in a timely manner. The newest customers are in the Oil & Gas, Transportation, and Manufacturing industries where we believe DataV can yield positive business outcomes. In late 2016 we decided to offer DataV to customers via applications. Customers who make or operate capital intensive, mission-critical equipment easily understand the need for our business



applications. This positive move has helped expand the number of customers in our pipeline as well as the speed through which they are moving.

As I've reported in the past, virtually all customer engagements begin with paid pilots that are expected to last several months, although timing can vary. A key to success for Bsquare and DataV is to get customers in, then out of, strictly defined, narrowly scoped, cleanly delivered pilots as efficiently as possible. These pilots are important not only to show the value of DataV, but also to allow customers to undertake work required on their end, such as data collection and cleansing.

We expect that after successful completion of these pilots, the majority of customers will move into production deployments, although timing will depend on each customer's specific goals and budgets. All of our pilots are delivered as cloud-based Software-as-a-Service, or SaaS, implementations. And, we expect that the majority of our customer deployments in the future will be SaaS deliveries. This provides a more scalable delivery mechanism, facilitates rapid pilot conversion, and, we believe, will result in a recurring revenue stream that will provide greater revenue predictability going forward.

I am pleased to report that one of the earlier pilots commenced during second quarter has now completed, and we expect will move into production in



the near future. This customer is a multi-billion dollar global manufacturer that is using DataV Manage to control and monitor remote, difficult-to-access machinery. The initial SaaS contract involves a single DataV application and a subset of addressable devices. We believe that as DataV continues to prove valuable to the customer, there will be ample opportunity to expand the number of devices and potentially the number of apps.

Also, after the close of the third quarter we booked our first major contract renewal. Itron, a global developer of smart energy distribution and smart city systems, renewed its DataV subscription for an additional four years. In this case, DataV enables Itron's customers to download apps to individual meters, thereby continuously adding functionality that can drive down costs, improve grid reliability, and add new services. We view this \$2.9 million renewal as a strong endorsement of DataV and anticipate customer acceptance and full deployment in early 2018.

DataV continues to perform well at our customer, Paccar and we continue to explore with them new opportunities for DataV to add business value throughout the company.



Further, in the fourth quarter of 2016 we announced a win in the smart vending space with a global provider of candy, food, and beverages. This customer has continued to expand into multiple markets across Europe.

Given our strong and growing pipeline, and the progress our customers are making through the pilot stage , we are continuing targeted investments in sales, marketing, customer solutions, and research and development. We have been able to successfully attract sales talent from Fortune 50 companies within our market, giving us better competitive visibility while enhancing the strength of our team.

Now let me turn to our traditional revenue drivers.

With regard to our embedded software resale business and in-line with our expectations, our Microsoft Windows embedded business was slightly higher sequentially, and is showing signs of stabilization. As we have discussed, this is due to end of 2016 changes in Microsoft's distribution agreements. Gross margins on this business have remained steady.

Our Customer Solutions organization consists of two parts. Our traditional professional engineering services business remains profitable at lower revenue levels and continues to generate cash. Our DataV services business has leveraged

our traditional strength to offer DataV Pilot and Integration capabilities as well as DevOps. We view our Customer Services organization as a competitive differentiator.

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

Peter Biere, Bsquare Chief Financial Officer

Thank you, Jerry.

First, let's review our Revenues for the Third quarter.

Our revenue during the third quarter totaled \$19.7 million, in the upper end of the \$18.5-\$20.0 million range we announced in our last earnings call.

Compared to the prior year quarter, revenue was down 13% from \$22.5 million, but up 4% from \$18.8 million in this year's Q2.

I'll break down the changes by revenue grouping for the quarter:

Third-party software revenue totaled \$16.2 million, slightly above our expectations; year over year, third-party revenue declined 11%. Over the past several quarters we've discussed the expected decline in Microsoft resales. During our last call, I mentioned that we believed our account activity had found



its level and our Q3 results bear that out. This doesn't mean we won't experience some continued variability, but we believe we've seen the bulk of any competitive fallout. In fact, we're succeeding to win back some business that was lost earlier in the year and continue to push for new opportunities.

Professional engineering service revenue totaled \$2.2 million this quarter, 32% below the third quarter of 2016 and 23% lower than the sequential quarter. In Q3, a number of traditional service contracts reached their final delivery point, which explains both the year-over-year and sequential declines. A year ago, we began to focus our selling efforts on DataV, so that when traditional contracts wind up, we align staff to the going-forward requirements.

In Q3, we recognized \$1.2 million in proprietary software revenue, 21% above the third quarter of 2016. The majority of this revenue is related to a seasonal purchase of non-DataV, legacy software.

As many of you know, we early adopted new revenue recognition accounting rules, or Topic 606, effective January 1, 2017, one year before the mandatory adoption deadline. The new rules clarify methodologies for measuring various contract performance obligations and then determining the periods in which to recognize revenue. The switch to new rules had little impact on our legacy software and services businesses but materially affected our DataV

contracts, which contain differing license types and multiple performance obligations.

During the third quarter, with the majority of our DataV pilots still in progress, we recorded \$236,000 in DataV revenue under the new Topic 606 rules.

Next, I will turn to our gross profit and margins:

Gross profit totaled \$4.4 million in the third quarter, or 22% of revenue, above our expected range of 19-21%. Total gross margin was boosted by third-party software and proprietary software margins. Gross profit was \$3.7 million in the year-ago quarter, and was lower primarily due to an \$800,000 severance charge taken to restructure our Services business; gross profit from our third-party software business was lower in the current quarter with the decline in revenues. While our third-party revenue has declined from prior year, many of the customers we lost were relatively lower margin accounts, so our blended rates for continuing customers are higher than historical margins.

Gross profit and average margins will continue to vary for some time as our mix of higher margin DataV revenues becomes a larger part of overall revenues.

Next, I'll speak to Operating Expenses and our bottom line results:

Total operating expenses were \$6.9 million this quarter, up from \$4.1 million in Q3 2016 and \$6.5 million in Q2 2017. In line with our expectations, the sequential increase reflects our steady investment in product development, sales, marketing and customer support teams critical for the success and scaling of DataV.

We recorded a net loss of approximately \$2.5 million, or (\$0.20) per share for the third quarter of 2017, compared to a net loss of \$106,000, or (\$0.01) per share, in the year-ago quarter. The sequential quarter showed a net loss of \$2.6 million, or (\$0.20) per share.

Cash and investments totaled \$26.8 million as of September 30, 2017. Including profits from both of our legacy businesses, we invested a net amount of approximately \$540,000 in Q3 and \$6.4 million in the first three quarters of 2017 to grow our DataV business. Cash used over the first 3 quarters of 2017 has varied due to DataV project timing.

Our high-quality accounts receivable balance totaled \$16.6 million at September 30, 2017, about \$9.1 million of which is from Honeywell; net of

payments due to Microsoft, about \$7.7 million of this receivable will convert to cash.

I'll next discuss several non-GAAP metrics we will be providing on a regular basis to help investors better understand our Cash flows and DataV business.

We use Adjusted EBITDAS, defined as operating income before depreciation, amortization and stock based compensation, as a non-GAAP measure to monitor our ability to generate cash from the operations of our business. We use Bookings, Backlog and Unbilled Deferred Revenue as non-GAAP measures that we believe provide meaningful information related to our new DataV product sales, since revenue will often be recognized in different periods than those in which orders have been received or cash has been collected.

- Our Adjusted EBITDAS was a negative \$1.8 million this quarter, compared to approximately breakeven in the year-ago quarter, primarily due to lower engineering services revenue and higher DataV expenses compared to last year.
- *Several measures we are using to describe **DataV include:***

- **Bookings** is a non-GAAP measure defined as the contract value of new agreements signed with customers. We recorded \$318,000 in DataV bookings during the third quarter of 2017. We collected approximately \$2.1 million in cash from DataV contracts in the first nine months of 2017.
- **Backlog** is a non-GAAP measure defined as total DataV bookings less DataV revenue recognized to date, and was approximately \$3.5 million at September 30, 2017 compared to \$5.7 million at the prior year-end; of the September 30 balance, \$1.5 million is **Unbilled deferred revenue** and \$2.0 million is reflected on our Balance Sheet as Deferred revenue.

I will now turn the call back to Jerry to provide an outlook for the fourth quarter and closing remarks.

Jerry Chase—Bsquare Chief Executive Officer

Thank you, Peter.

As noted in today's press release, we currently have the following expectations for Q4 2017:

- Revenue will be in the range of \$19 to \$21 million; blended gross margin is expected to be in the range of 18%-20%;

- We expect to close additional paid pilots in the quarter;
- As I mentioned earlier, Itron renewed its license agreement for an additional 4 years and \$2.9 million, which we will book in Q4. We currently expect the associated license revenue to be recognized in Q1 of 2018.
- Commensurate with the success we are having in the market with DataV, we will be increasing our level of investment in Q4. Though we will incur losses for the near term, we expect cash flow from DataV, our traditional businesses, and cash on hand will be sufficient to fund these investments.

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.