

BSQUARE CORP /WA
Form 10-Q
August 13, 2015
I

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-27687

BSQUARE CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---------------------|
| Washington | 91-1650880 |
| (State or other jurisdiction of | (I.R.S. Employer |
| incorporation or organization) | Identification No.) |
| 110 110 th Avenue NE, Suite 300, | |
| Bellevue WA | 98004 |
| (Address of principal executive offices) | (Zip Code) |

(425) 519-5900

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of common stock outstanding as of July 31, 2015: 11,937,482

BSQUARE CORPORATION

FORM 10-Q

For the Quarterly Period Ended June 30, 2015

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
BSQUARE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

| | June 30, 2015 (Unaudited) | December 31, 2014 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 11,966 | \$ 13,127 |
| Short-term investments | 17,464 | 13,263 |
| Accounts receivable, net of allowance for doubtful accounts of \$36 at June 30, 2015 and \$125 at December 31, 2014 | 15,418 | 13,626 |
| Deferred tax assets | 11 | 10 |
| Prepaid expenses and other current assets | 698 | 717 |
| Total current assets | 45,557 | 40,743 |
| Equipment, furniture and leasehold improvements, net | 1,159 | 1,336 |
| Restricted cash | 250 | 250 |
| Deferred income taxes | 393 | 391 |
| Intangible assets, net | 661 | 729 |
| Goodwill | 3,738 | 3,738 |
| Other non-current assets | 55 | 54 |
| Total assets | \$ 51,813 | \$ 47,241 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Third-party software fees payable | \$ 12,361 | \$ 12,247 |
| Accounts payable | 191 | 165 |
| Accrued compensation | 2,173 | 2,106 |
| Other accrued expenses | 1,501 | 1,539 |
| Deferred rent, current portion | 287 | 275 |
| Deferred revenue | 634 | 712 |
| Total current liabilities | 17,147 | 17,044 |
| Deferred tax liability | 145 | 144 |
| Deferred rent | 1,332 | 1,476 |
| Shareholders' equity: | | |
| Preferred stock, no par value: 10,000,000 shares authorized; no shares issued and outstanding | — | — |

| | | |
|---|-----------|------------|
| Common stock, no par value: 37,500,000 shares | | |
| authorized; 11,930,441 shares issued and | | |
| outstanding at June 30, 2015 and 11,767,577 | | |
| shares issued and outstanding at December 31, | | |
| 2014 | 131,962 | 131,071 |
| Accumulated other comprehensive loss | (833) | (846) |
| Accumulated deficit | (97,940) | (101,648) |
| Total shareholders' equity | 33,189 | 28,577 |
| Total liabilities and shareholders' equity | \$ 51,813 | \$ 47,241 |

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except per share amounts) (Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | June 30, 2015 | 2014 | June 30, 2015 | 2014 |
| Revenue: | | | | |
| Software | \$23,676 | \$17,413 | \$45,464 | \$35,863 |
| Service | 5,197 | 5,642 | 9,674 | 9,923 |
| Total revenue | 28,873 | 23,055 | 55,138 | 45,786 |
| Cost of revenue: | | | | |
| Software | 19,956 | 14,874 | 37,034 | 30,429 |
| Service | 3,685 | 3,916 | 7,423 | 7,557 |
| Total cost of revenue | 23,641 | 18,790 | 44,457 | 37,986 |
| Gross profit | 5,232 | 4,265 | 10,681 | 7,800 |
| Operating expenses: | | | | |
| Selling, general and administrative | 2,939 | 3,172 | 5,946 | 6,472 |
| Research and development | 422 | 423 | 988 | 855 |
| Total operating expenses | 3,361 | 3,595 | 6,934 | 7,327 |
| Income from operations | 1,871 | 670 | 3,747 | 473 |
| Other income (expense), net | 68 | (11) | 92 | (102) |
| Income before income taxes | 1,939 | 659 | 3,839 | 371 |
| Income tax expense | (54) | (8) | (131) | (113) |
| Net income | \$1,885 | \$651 | \$3,708 | \$258 |
| Basic income per share | \$0.16 | \$0.06 | \$0.31 | \$0.02 |
| Diluted income per share | \$0.15 | \$0.06 | \$0.30 | \$0.02 |
| Shares used in calculation of income per share: | | | | |
| Basic | 11,856 | 11,510 | 11,826 | 11,451 |
| Diluted | 12,295 | 11,715 | 12,195 | 11,681 |
| Comprehensive income: | | | | |
| Net income | \$1,885 | \$651 | \$3,708 | \$258 |
| Other comprehensive income: | | | | |
| Foreign currency translation, net of tax | 88 | 54 | 14 | 131 |
| Change in unrealized gains (losses) on investments, net of tax | 2 | — | (4) | — |
| Total other comprehensive income | 90 | 54 | 10 | 131 |
| Comprehensive income | \$1,975 | \$705 | \$3,718 | \$389 |

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)

| | Six Months Ended | |
|--|------------------|----------|
| | June 30, | |
| | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net income | \$3,708 | \$258 |
| Adjustments to reconcile net income to net | | |
| cash provided by operating activities: | | |
| Depreciation and amortization | 288 | 325 |
| Realized loss on disposal of assets | — | 33 |
| Stock-based compensation | 569 | 463 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (1,792) | 4,658 |
| Prepaid expenses and other assets | 17 | 752 |
| Third-party software fees payable | 114 | (3,218) |
| Accounts payable and accrued expenses | 54 | (384) |
| Deferred revenue | (78) | (169) |
| Deferred rent | (132) | 8 |
| Net cash provided by operating activities | 2,748 | 2,726 |
| Cash flows from investing activities: | | |
| Purchases of equipment and furniture | (44) | (93) |
| Proceeds from maturities of short-term investments | 9,481 | 8,355 |
| Purchases of short-term investments | (13,678) | (14,090) |
| Net cash used in investing | | |
| activities | (4,241) | (5,828) |
| Cash flows provided by financing activities—proceeds | | |
| from exercise of stock options | 322 | 563 |
| Effect of exchange rate changes on cash | 10 | 131 |
| Net decrease in cash and cash | | |
| equivalents | (1,161) | (2,408) |
| Cash and cash equivalents, beginning of period | 13,127 | 13,510 |
| Cash and cash equivalents, end of period | \$11,966 | \$11,102 |
| | Six Months Ended | |
| | June 30, | |
| | 2015 | 2014 |
| Supplemental disclosure of cash flow information: | | |
| Non-cash investing activity-leasehold improvements | \$— | \$1,128 |

and furniture funded by landlord

See notes to condensed consolidated financial statements.

BSQUARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2015

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of BSQUARE Corporation (“BSQUARE”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial reporting and include the accounts of BSQUARE and our wholly owned subsidiaries. Certain information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. In our opinion, the unaudited condensed consolidated financial statements include all material adjustments, all of which are of a normal and recurring nature, necessary to present fairly our financial position as of June 30, 2015 and our operating results and cash flows for the three and six months ended June 30, 2015 and 2014. The accompanying financial information as of December 31, 2014 is derived from audited financial statements. Preparing financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Examples include provisions for bad debts and income taxes, estimates of progress on professional engineering service arrangements and bonus accruals. Actual results may differ from these estimates. Interim results are not necessarily indicative of results for a full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014. All intercompany balances have been eliminated.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers,” amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The guidance, as amended, is effective for annual and interim reporting periods beginning after December 15, 2017, with early adoption permitted for public companies effective for annual and interim reporting periods beginning after December 15, 2016. We are currently evaluating the impact this ASU will have on our consolidated financial statements.

Income (Loss) Per Share

Basic income or loss per share is computed using the weighted average number of common shares outstanding during the period, and excludes any dilutive effects of common stock equivalent shares, such as options, restricted stock awards and restricted stock units. Restricted stock awards (“RSAs”) are considered outstanding and included in the computation of basic income or loss per share when underlying restrictions expire and the awards are no longer forfeitable. Restricted stock units (“RSUs”) are considered outstanding and included in the computation of basic income or loss per share only when vested. Diluted income per share is computed using the weighted average number of common shares outstanding and common stock equivalent shares outstanding during the period using the treasury stock method. Common stock equivalent shares are excluded from the computation if their effect is anti-dilutive.

We excluded an aggregate of 114,270 and 130,159 options and RSUs for the three and six month periods ended June 30, 2015, respectively, from diluted earnings per share because their effect was anti-dilutive. We excluded an aggregate of 939,251 and 850,669 options and RSUs for the three and six month periods ended June 30, 2014, respectively, from diluted earnings per share because their effect was anti-dilutive. In a period where we are in a net loss position, diluted loss per share is computed using the basic share count.

2. Cash and Investments

Cash, cash equivalents, short-term investments, and restricted cash consisted of the following at June 30, 2015 and December 31, 2014 (in thousands):

| | June 30, 2015 | December 31, 2014 |
|--|------------------|-------------------------|
| Cash | \$2,042 | \$ 2,763 |
| Cash equivalents: | | |
| Money market funds | 9,674 | 9,362 |
| Corporate debt securities | 250 | 1,002 |
| Total cash equivalents | 9,924 | 10,364 |
| Total cash and cash equivalents | 11,966 | 13,127 |
| Short-term investments: | | |
| Corporate commercial paper | 1,399 | 550 |
| Corporate debt securities | 16,065 | 12,713 |
| Total short-term investments | 17,464 | 13,263 |
| Restricted cash—money market fund | 250 | 250 |
| Total cash, cash equivalents, short-term investments | | |

and restricted cash \$29,680 \$ 26,640

Gross unrealized gains and losses on our short-term investments were not material as of June 30, 2015 and December 31, 2014. The restricted cash balances at June 30, 2015 and December 31, 2014 relate to a letter of credit securing the lease of our corporate headquarters.

3. Fair Value Measurements

We measure our cash equivalents and short-term investments at fair value. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Directly or indirectly observable market-based inputs or unobservable inputs used in models or other valuation methodologies.

Level 3: Unobservable inputs that are not corroborated by market data. The inputs require significant management judgment or estimation.

We classify our cash equivalents and short-term investments within Level 1 or Level 2 because our cash equivalents and short-term investments are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014 are summarized below (in thousands):

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June 30, 2015

Quoted

Prices

in

Active

Markets

for Direct or

Indirect

Identical

Assets Observable

(Level Inputs

1) (Level 2) Total

| Assets | (Level 1) | Inputs (Level 2) | Total |
|-------------------------------------|-----------|------------------|----------|
| Cash equivalents: | | | |
| Money market funds | \$9,674 | \$ — | \$9,674 |
| Corporate debt securities | — | 250 | 250 |
| Total cash equivalents | 9,674 | 250 | 9,924 |
| Short-term investments: | | | |
| Corporate commercial paper | — | 1,399 | 1,399 |
| Corporate debt securities | — | 16,065 | 16,065 |
| Total short-term investments | — | 17,464 | 17,464 |
| Restricted cash—money market fund | 250 | — | 250 |
| Total assets measured at fair value | \$9,924 | \$ 17,714 | \$27,638 |

7

| | December 31, 2014 | | |
|--|--|---------------------|-----------------|
| | Quoted Prices in | | |
| | Active Markets for Direct or Indirect Identical Assets Observable | | |
| | (Level 1) | Inputs (Level 2) | Total |
| Assets | | | |
| Cash equivalents: | | | |
| Money market funds | \$9,362 | \$ — | \$9,362 |
| Corporate debt securities | — | 1,002 | 1,002 |
| Total cash equivalents | 9,362 | 1,002 | 10,364 |
| Short-term investments: | | | |
| Corporate commercial paper | — | 550 | 550 |
| Corporate debt securities | — | 12,713 | 12,713 |
| Total short-term investments | — | 13,263 | 13,263 |
| Restricted cash—money market fund | 250 | — | 250 |
| Total assets measured at fair value | \$9,612 | \$ 14,265 | \$23,877 |

4. Goodwill and Intangible Assets

Goodwill relates to the 2011 acquisition of MPC Data, Ltd. (“MPC”), a United Kingdom based provider of embedded software engineering services. The excess of the acquisition consideration over the fair value of net assets acquired was recorded as goodwill. We operate as a single reporting unit, and MPC falls within that reporting unit. There were no changes in the carrying amount of goodwill during the three and six month periods ended June 30, 2015.

Intangible assets relate to customer relationships acquired from TestQuest Inc. in 2008 and from the acquisition of MPC in 2011, the vast majority of which relates to the MPC acquisition.

Information regarding our intangible assets as of June 30, 2015 and December 31, 2014 is as follows (in thousands):

| | June 30, 2015 | |
|------------------------|-----------------|----------------------|
| | Gross | Net |
| | Carrying Amount | Accumulated Carrying |
| | Amount | Amortization Value |
| Customer relationships | \$ 1,275 | \$ (614) \$ 661 |

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| | December 31, 2014 | |
|------------------------|-------------------|------------------|
| | Gross | Net |
| | Accumulated | |
| | Carrying | Carrying |
| | Amortization | |
| | Amount | Value |
| Customer relationships | \$ 1,275 | \$ (546) \$ 729 |

Amortization expense was \$34,000 and \$68,000 for the three and six month periods ended June 30, 2015, respectively, and \$34,000 and \$67,000 for the three and six month periods ended June 30, 2014, respectively. Amortization in future periods is expected to be as follows (in thousands):

| | |
|-------------------|-------|
| Remainder of 2015 | \$68 |
| 2016 | 130 |
| 2017 | 98 |
| 2018 | 98 |
| 2019 | 98 |
| 2020 | 98 |
| 2021 | 71 |
| Total | \$661 |

5. Shareholders' Equity

Equity Compensation Plans

We have a stock plan (the "Stock Plan") and an inducement stock plan for newly hired employees (the "Inducement Plan") (collectively, the "Plans"). Under the Plans, stock options may be granted with a fixed exercise price that is equivalent to fair market value on the date of grant. These options have a term of up to 10 years and vest over a predetermined period, generally four years. Incentive stock options granted under the Stock Plan may only be granted to our employees. The Plans also allow for awards of non-qualified stock options, stock appreciation rights, RSAs and unrestricted stock awards, and RSUs.

Stock-Based Compensation

The estimated fair value of stock-based awards is recognized as compensation expense over the vesting period of the award, net of estimated forfeitures. We estimate forfeitures based on historical experience and expected future activity. The fair value of RSUs is determined based on the number of shares granted and the quoted price of our common stock on the date of grant. The fair value of stock option awards is estimated at the grant date based on the fair value of each vesting tranche as calculated by the Black-Scholes-Merton ("BSM") option-pricing model. The BSM model requires various highly judgmental assumptions including expected volatility and option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. The fair values of our stock option grants were estimated with the following weighted average assumptions:

| | Three Months Ended | | Six Months Ended | |
|-------------------------|--------------------------|-------|-----------------------|-------|
| | June 30, 2015 2014 | | June 30, 2015 2014 | |
| Dividend yield | 0 % | 0 % | 0 % | 0 % |
| Expected life | 3.3 | 3.3 | 3.3 | 3.2 |
| | years | years | years | years |
| Expected volatility | 52 % | 59 % | 52 % | 60 % |
| Risk-free interest rate | 1.3 % | 1.3 % | 1.2 % | 1.2 % |

The impact on our results of operations of stock-based compensation expense for the three and six month periods ended June 30, 2015 and 2014 was as follows (in thousands, except per share amounts):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------------|-------|-----------------------|-------|
| | June 30, 2015 2014 | | June 30, 2015 2014 | |
| Cost of revenue — service | \$105 | \$36 | \$218 | \$77 |
| Selling, general and administrative | 182 | 191 | 320 | 366 |
| Research and development | 18 | (8) | 31 | 20 |
| Total stock-based compensation expense | \$305 | \$219 | \$569 | \$463 |

| | | | | |
|-------------------|--------|--------|--------|--------|
| Per diluted share | \$0.02 | \$0.02 | \$0.05 | \$0.04 |
|-------------------|--------|--------|--------|--------|

Stock Option Activity

The following table summarizes stock option activity under the Plans for the six month period ended June 30, 2015:

| | Number of | Exercise | Weighted | |
|--|------------|----------|------------|-------------|
| | | | Average | Remaining |
| | Shares | Price | Life | Aggregate |
| Stock Options | | | (in years) | Intrinsic |
| | | | | Value |
| Balance at January 1, 2015 | 1,553,360 | \$ 3.50 | | |
| Granted | 24,725 | 4.33 | | |
| Exercised | (117,056) | 2.95 | | |
| Forfeited | (58,429) | 3.29 | | |
| Expired | (6,376) | 2.62 | | |
| Balance at June 30, 2015 | 1,396,224 | \$ 3.57 | 6.83 | \$4,497,910 |
| Vested and expected to vest at June 30, 2015 | 1,324,724 | \$ 3.57 | 6.73 | \$4,270,113 |
| Exercisable at June 30, 2015 | 623,582 | \$ 3.58 | 4.71 | \$2,011,909 |

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At June 30, 2015, total compensation cost related to stock options granted but not yet recognized was \$517,752, net of estimated forfeitures. This cost will be amortized on the straight-line method over a weighted-average period of approximately 1.0 year. The following table summarizes certain information about stock options for the three and six month periods ended June 30, 2015 and 2014:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------|------------------|-----------|
| | June 30, 2015 | 2014 | June 30, 2015 | 2014 |
| Weighted-average grant-date fair value of option grants for the period | \$ 1.88 | \$ 1.88 | \$ 1.92 | \$ 1.68 |
| Options in-the-money at period end | 1,390,199 | 450,914 | 1,390,199 | 450,914 |
| Aggregate intrinsic value of options exercised | \$302,895 | \$ 110,347 | \$350,776 | \$241,224 |

The aggregate intrinsic value represents the difference between the exercise price of the underlying options and the quoted price of our common stock for the number of options that were in-the-money at period end or that were exercised during the period. We issue new shares of common stock upon exercise of stock options.

Restricted Stock Unit Activity

The following table summarizes RSU activity for the six month period ended June 30, 2015:

| | Number of Shares | Weighted |
|--------------------------------------|------------------------|--|
| | | Average Grant Date Fair Value |
| Unvested at December 31, 2014 | 80,179 | \$ 3.40 |
| Granted | 50,728 | 6.32 |
| Vested | (50,391) | 3.42 |
| Forfeited | (8,976) | 3.15 |
| Unvested at June 30, 2015 | 71,540 | \$ 5.48 |
| Expected to vest after June 30, 2015 | 68,810 | \$ 5.51 |

At June 30, 2015, total compensation cost related to RSUs granted but not yet recognized was \$318,008, net of estimated forfeitures. This cost will be amortized on the straight-line method over a period of approximately 1.0 year.

Common Stock Reserved for Future Issuance

The following table summarizes our shares of common stock reserved for future issuance under the Plans as of June 30, 2015:

| | |
|---|-----------|
| Stock options outstanding | 1,396,224 |
| RSUs outstanding | 71,540 |
| Stock awards available for future grant | 1,602,411 |
| Common stock reserved for future issuance | 3,070,175 |

On June 16, 2015, our shareholders approved an amendment to the Stock Plan increasing the number of shares reserved and available for issuance by 750,000 shares. On June 26, 2015 our Board of Directors approved an increase in the number of shares reserved and available for issuance under the Inducement Plan by 200,000 shares. These additional shares reserved under both of the Plans are included in the “Stock awards available for future grant” total in the preceding table.

6. Commitments and Contingencies

Lease and rent obligations

Our commitments include obligations outstanding under operating leases, which expire through 2020. We have lease commitments for office space in Bellevue, Washington; San Diego, California; Boston, Massachusetts; Taipei, Taiwan; Tokyo, Japan; and Trowbridge, UK. We also lease office space on a month-to-month basis in Akron, Ohio.

In August 2013, we amended the lease agreement for our Bellevue, Washington headquarters, which was initially scheduled to expire in August 2014, and extended the lease term to May 2020. The amendment to the headquarters lease provided that no cash lease payments were to be made for a seven-month period from June 1, 2013 to December 31, 2013. In conjunction with the amended lease agreement, the landlord provided lease incentives totaling \$1,128,000 for leasehold improvements and furniture related to new space in the same building, which were capitalized and are reflected in the deferred rent liability. We are amortizing these assets over the shorter of their economic life or the lease term. We are recognizing rent expense, including the effect of the deferred rent, on the straight-line basis over the lease term.

Rent expense was \$257,000 and \$521,000 for the three and six month periods ended June 30, 2015, respectively. Rent expense was \$313,000 and \$637,000 for the three and six month periods ended June 30, 2014, respectively.

As of June 30, 2015, we had \$250,000 pledged as collateral for a bank letter of credit under the terms of our headquarters facility lease. The pledged cash supporting the outstanding letter of credit is classified as restricted cash.

Future operating lease commitments are as follows by calendar year (in thousands):

| | |
|--------------------------|----------------|
| Remainder of 2015 | \$661 |
| 2016 | 1,308 |
| 2017 | 1,194 |
| 2018 | 1,108 |
| 2019 | 1,038 |
| 2020 | 437 |
| Total commitments | \$5,746 |

Loss Contingencies

From time to time, we are subject to legal proceedings, claims, and litigation arising in the ordinary course of business including tax assessments. We defend ourselves vigorously against any such claims. When (i) it is probable that an asset has been impaired or a liability has been incurred and (ii) the amount of the loss can be reasonably estimated, we record the estimated loss. We provide disclosure in the notes to the consolidated financial statements for loss contingencies that do not meet both of these conditions if there is a reasonable possibility that a loss may have been incurred that would be material to the financial statements. Significant judgment is required to determine the probability that a liability has been incurred and whether such liability is reasonably estimable. We base accruals made on the best information available at the time which can be highly subjective. The final outcome of these matters could vary significantly from the amounts included in the accompanying consolidated financial statements.

A third-party software vendor invoiced us a total of \$934,000 for certain licensed software that was lost in transit by a common carrier during the second quarter of 2014. We accrued a liability of \$100,000 in the second quarter of 2014 as an estimate of our potential liability for legal and insurance deductible expenses. During the first quarter of 2015, the vendor credited our account for the full \$934,000 as the licenses had been deactivated and there was no indication of counterfeit use. Accordingly, we reversed approximately \$85,000 of the accrual after payment of legal expenses in the

first quarter of 2015.

Volume Pricing Agreements

In conjunction with our activities under our OEM Distribution Agreements (“ODAs”) with Microsoft Corporation (“Microsoft”), as further described in Note 8, we enter into OEM Volume Royalty Pricing (“OVRP”) commitments with Microsoft. Under these OVRPs, we are provided with volume pricing on a customer-by-customer basis assuming certain minimum unit volumes are met. The OVRP terms are 12 months. In the event we do not meet the committed minimum unit volumes, we are obligated to pay the difference between the committed per-unit volume rate and the actual per-unit rate we achieved based upon actual units purchased. The OVRP arrangements do not equate to a minimum purchase commitment, but rather, the arrangements are a volume pricing arrangement based upon actual volume purchased. In substantially all significant instances, we have reciprocal agreements with our customers such that we will receive per-unit price adjustments, similar to the amounts we would subsequently owe to Microsoft if such OVRP volumes are not met. However, in the event a customer is unwilling or unable to pay us, we would be negatively impacted. Based upon the credit-worthiness of our customers, our historical OVRP experience with our customers and OVRP arrangements in general, we do not believe we will incur any material liability relating to active agreements, and, therefore, no provision or reserve has been recorded as of June 30, 2015.

7. Information about Geographic Areas

Our chief operating decision-makers (i.e., our Chief Executive Officer and certain direct reports) review financial information presented on a consolidated basis, accompanied by disaggregated information for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable by our chief operating decision-makers, or anyone else, for operations, operating results, or planning for levels or components below the consolidated unit level. Accordingly, we consider ourselves to be in a single reporting segment and operating unit structure.

Revenue by geography is based on the sales region of the customer. The following table sets forth revenue and long-lived assets by geographic area (in thousands):

| | Three Months Ended | | Six Months Ended | |
|----------------|--------------------|----------|------------------|----------|
| | June 30, 2015 | 2014 | June 30, 2015 | 2014 |
| Total revenue: | | | | |
| North America | \$27,015 | \$19,910 | \$50,761 | \$40,501 |
| Asia | 603 | 1,666 | 1,988 | 2,750 |
| Europe | 1,255 | 1,479 | 2,389 | 2,535 |
| Total revenue | \$28,873 | \$23,055 | \$55,138 | \$45,786 |

| | June 30, 2015 | December 31, 2014 |
|-------------------------|---------------|-------------------|
| Long-lived assets: | | |
| North America | \$1,361 | \$1,597 |
| Asia | 482 | 360 |
| Europe | 4,413 | 4,453 |
| Total long-lived assets | \$6,256 | \$6,410 |

8. Significant Risk Concentrations

Significant Customer

One customer accounted for \$3.9 million, or 13% of total revenue for the three months ended June 30, 2015 and that same customer accounted for \$7.9 million, or 14% of total revenue for the six months ended June 30, 2014. No other single customer accounted for more than 10% of our total revenue for the three or six month periods ended June 30, 2015 and 2014.

One customer had an accounts receivable balance greater than 10% of the total accounts receivable at June 30, 2015. No customers had accounts receivable balances greater than 10% of the total accounts receivable at December 31, 2014.

Significant Supplier

We have two ODAs with Microsoft which enable us to sell Microsoft Windows Embedded operating systems to our customers in the United States, Canada, Argentina, Brazil, Chile, Columbia, Mexico, Peru, Puerto Rico, the Caribbean, the European Union, the European Free Trade Association, Turkey and Africa, which expire on June 30, 2016. We also have four ODAs with Microsoft which allow us to sell Microsoft Windows Mobile operating systems in the Americas (excluding Cuba), Japan, Taiwan, Europe, the Middle East, and Africa, which also expire on June 30, 2016.

Software sales under these agreements constitute a significant portion of our software revenue and total revenue. These agreements are typically renewed bi-annually, annually or semi-annually; however, there is no automatic renewal provision in any of these agreements. Further, these agreements can be terminated unilaterally by Microsoft at any time. Microsoft currently offers a rebate program to sell Microsoft Windows Embedded operating systems pursuant to which we earn money for achieving certain predefined objectives. Under this rebate program, we recognized \$103,000 and \$166,000 during the three and six month periods ended June 30, 2015, respectively, compared to \$105,000 and \$169,000 during the three and six month periods ended June 30, 2014, respectively. These rebates were treated as reductions in cost of sales. Additionally, during the three and six month periods ended June 30, 2015, we qualified for \$240,000 and \$387,000 in rebate credits, respectively, compared to \$245,000 and \$394,000 in rebate credits for the three and six month periods ended June 30, 2014, respectively. These are accounted for as reductions in marketing expense if and when qualified program expenditures are made.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

As used in this Quarterly Report on Form 10-Q, "we," "us," "our" and "the Company" refer to BSQUARE Corporation, a Washington corporation, and its subsidiaries.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our condensed consolidated financial statements and related notes. Some statements and information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations are not historical facts but are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In some cases, readers can identify forward-looking statements by terms such as "may," "will," "should," "expect," "plan," "intend," "forecast," "anticipate," "believe," "estimate," "predict," "potential," "continue," or the negative of or other comparable terminology, which when used are meant to signify the statement as forward-looking. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions and other statements that are not historical facts. These forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and situations that are difficult to predict and that may cause our own, or our industry's actual results, to be materially different from the future results that are expressed or implied by these statements. Accordingly, actual results may differ materially from those anticipated or expressed in such statements as a result of a variety of factors, including those discussed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2014 entitled "Risk Factors," similar discussions in subsequently filed Quarterly Reports on Form 10-Q, including this Form 10-Q, as applicable, and those contained from time to time in our other filings with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date made. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Overview

We provide software solutions and related engineering services to companies that develop smart, connected systems. A smart, connected system is a dedicated purpose computing device that typically has a display, runs an operating system (e.g., Microsoft® Windows® Embedded Compact) and is usually connected to a network or data cloud via a wired or wireless connection. Examples of smart, connected systems include set-top boxes, home gateways, point-of-sale terminals, kiosks, voting machines, gaming platforms, tablets, handheld data collection devices, personal media players, smart phones, smart vending machines, in-vehicle telematics and entertainment devices. We primarily focus on smart, connected systems that utilize Microsoft Windows Embedded and Windows Mobile operating systems as well as devices running other popular operating systems such as Android, Linux and QNX.

We have been providing software solutions for smart, connected systems since our inception. Our customers include world class original equipment manufacturers ("OEMs"), original design manufacturers ("ODMs") and enterprises, as well as silicon vendors ("SVs") and peripheral vendors which purchase our software solutions for purposes of facilitating processor and peripheral sales. In the case of enterprises, our customers include those who develop, market and distribute smart, connected systems on their own behalf as well as those that purchase systems from OEMs or ODMs and require additional software, integration and/or testing. The software solutions we provide are utilized and deployed throughout various phases of our customers' device life cycle, including design, development, customization, quality assurance and deployment.

Building on the traditional focus of our business described above, increasingly we intend to focus on developing and offering our own products such as DataV™ to address the emerging Internet of Things ("IoT") market, which is the interconnection of uniquely identifiable embedded computing devices within the existing Internet infrastructure. Similarly, we intend to focus on increasing the amount of our own intellectual property and know-how, including in our MobileV™ product, a complete hardware and software reference solution for OEMs building durable and rugged handhelds and industrial tablets.

Critical Accounting Judgments

Management's discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales, cost of sales and expenses and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. There have been no significant changes to our critical accounting judgments, policies and estimates as described in our Annual Report on Form 10-K for the year ended December 31, 2014.

Results of Operations

The following table presents certain financial data as a percentage of total revenue for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

| | Three Months | | Six Months | |
|-------------------------------------|---------------------------|-------|---------------------------|-------|
| | Ended June 30, 2015 | | Ended June 30, 2014 | |
| | (unaudited) | | (unaudited) | |
| Revenue: | | | | |
| Software | 82 % | 76 % | 82 % | 78 % |
| Service | 18 % | 24 % | 18 % | 22 % |
| Total revenue | 100% | 100 % | 100% | 100 % |
| Cost of revenue: | | | | |
| Software | 69 % | 64 % | 67 % | 66 % |
| Service | 13 % | 17 % | 13 % | 17 % |
| Total cost of revenue | 82 % | 81 % | 80 % | 83 % |
| Gross profit | 18 % | 19 % | 20 % | 17 % |
| Operating expenses: | | | | |
| Selling, general and administrative | 10 % | 14 % | 11 % | 14 % |
| Research and development | 1 % | 2 % | 2 % | 2 % |
| Total operating expenses | 11 % | 16 % | 13 % | 16 % |
| Income from operations | 7 % | 3 % | 7 % | 1 % |
| Other income, net | 0 % | 0 % | 0 % | 0 % |
| Income before income taxes | 7 % | 3 % | 7 % | 1 % |
| Income tax expense | 0 % | 0 % | 0 % | 0 % |
| Net income | 7 % | 3 % | 7 % | 1 % |

Revenue

Our revenue is generated from the sale of software, primarily third-party software that we resell and our own proprietary software, and the sale of engineering services. Total revenue increased \$5.8 million, or 25%, to \$28.9 million for the three months ended June 30, 2015, from \$23.1 million in the year-ago period, and increased \$9.4 million, or 20%, to \$55.1 million for the six months ended June 30, 2015, from \$45.8 million in the year-ago period. The increases were driven by higher sales of both third-party and proprietary software, partially offset by lower engineering services revenue.

Revenue from customers outside of North America decreased \$1.3 million, or 41%, to \$1.9 million for the three months ended June 30, 2015 compared to \$3.1 million in the year-ago period and decreased \$0.9 million, or 17%, to \$4.4 million for the six months ended June 30, 2015 compared to \$5.3 million in the year-ago period, primarily due to the recognition of \$0.5 million in revenue from the completion of a large handheld project in Japan in the second quarter of 2014.

Software revenue

Software revenue consists of sales of third-party software and revenue realized from our own proprietary software products, which include software license sales, royalties from our software products, and support and maintenance

revenue. Software revenue for the three and six month periods ended June 30, 2015 and 2014 was as follows (dollars in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|------------------------------|----------|------------------------------|----------|
| | June 30, 2015 (unaudited) | 2014 | June 30, 2015 (unaudited) | 2014 |
| Software revenue: | | | | |
| Third-party software | \$23,316 | \$16,965 | \$43,124 | \$34,660 |
| Proprietary software | 360 | 448 | 2,340 | 1,203 |
| Total software revenue | \$23,676 | \$17,413 | \$45,464 | \$35,863 |
| Software revenue as a percentage of total revenue | 82 | % 76 | % 82 | % 78 |
| Third-party software revenue as a percentage of total | | | | |

| | | | | | | | | |
|------------------|----|---|----|---|----|---|----|---|
| software revenue | 98 | % | 97 | % | 95 | % | 97 | % |
|------------------|----|---|----|---|----|---|----|---|

The vast majority of our third-party software revenue is comprised of sales of Microsoft Windows Embedded and Windows Mobile operating systems.

Third-party software revenue increased \$6.4 million, or 37%, for the three months ended June 30, 2015, from the year-ago period. The increase was driven by a \$3.5 million increase in sales of Windows Mobile operating systems and a \$2.8 million increase in Windows Embedded operating system sales. For the six months ended June 30, 2015, third-party software revenue increased \$8.5 million, or 24%, from the year-ago period. This increase was primarily due to a \$6.9 million increase in sales of Windows Mobile operating systems sales as well as a \$1.2 million increase in Windows Embedded operating systems sales. For both the three and six month periods, the increases in Windows Mobile operating systems were driven by increased volume to an existing customer and the increases in Windows Embedded systems sales were from a variety of customers.

Proprietary software revenue decreased \$88,000, or 20%, to \$360,000 for the three months ended June 30, 2015, from \$448,000 in the year-ago period, driven by declines in sales of a number of our legacy products. Proprietary software revenue increased \$1.1 million, or 95%, to \$2.3 million for the six months ended June 30, 2015, from \$1.2 million in the year-ago period, primarily driven by larger than expected sales of our legacy products completed during the first quarter of 2015.

Service revenue

Service revenue for the three and six month periods ended June 30, 2015 and 2014 was as follows (dollars in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|-----------------------|---------|---------------------|---------|
| | June 30, 2015 | 2014 | June 30, 2015 | 2014 |
| | (unaudited) | | (unaudited) | |
| Service revenue | \$5,197 | \$5,642 | \$9,674 | \$9,923 |
| Service revenue as a percentage of total revenue | 18 % | 24 % | 18 % | 22 % |

Service revenue decreased \$445,000, or 8%, for the three months ended June 30, 2015, from the year-ago period. Service revenue decreased \$249,000, or 3%, for the six months ended June 30, 2015, from the year-ago period. These decreases were driven by the recognition of \$478,000 in revenue from the completion of a large handheld project in Japan in the second quarter of 2014, partially offset by increases in services revenue from some of our larger North American accounts.

We continued to work on the MyFord Touch program during the three and six month periods ended June 30, 2015, a project we began with Ford Motor Company (“Ford”) during the second quarter of 2008 and which has been significant for us since its inception. We now perform these services through agreements with Ford, Microsoft and another customer. Service revenue from the MyFord Touch program was \$695,000 and \$1.4 million for the three and six months ended June 30, 2015, respectively, and \$821,000 and \$1.5 million for the three and six month periods ended June 30, 2014, respectively.

Gross profit and gross margin

Cost of software revenue consists primarily of the cost of third-party software products payable to third-party vendors and support costs associated with our proprietary software products. Cost of service revenue consists primarily of salaries and benefits, contractor costs and re-billable expenses, related facilities and depreciation costs, and amortization of certain intangible assets related to acquisitions. Gross profit on the sale of third-party software products is also positively affected by rebate credits we receive from Microsoft for the sale of Windows Embedded operating systems earned through the achievement of defined objectives.

Under this rebate program, we recognized \$103,000 and \$166,000 during the three and six month periods ended June 30, 2015, respectively, compared to \$105,000 and \$169,000 during the three and six month periods ended June 30, 2014, respectively. These rebates were treated as reductions in cost of sales. Additionally, during the three and six month periods ended June 30, 2015, we qualified for \$240,000 and \$387,000 in rebate credits, respectively, compared to \$245,000 and \$394,000 in rebate credits for the three and six month periods ended June 30, 2014, respectively. These are accounted for as reductions in marketing expense if and when qualified program expenditures are made.

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Gross profit and related gross margin for the three and six month periods ended June 30, 2015 and 2014 were as follows (dollars in thousands):

| | Three Months | | | | Six Months Ended | | | |
|-----------------------|--------------|---------|-------------|---------|------------------|------|-------------|------|
| | Ended | | | | June 30, | | 2014 | |
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| | (unaudited) | | (unaudited) | | (unaudited) | | (unaudited) | |
| Software gross profit | \$3,720 | \$2,539 | \$8,430 | \$5,435 | | | | |
| Software gross margin | 16 % | 15 % | 19 % | 15 % | | | | |
| Service gross profit | \$1,512 | \$1,726 | \$2,251 | \$2,366 | | | | |
| Service gross margin | 29 % | 31 % | 23 % | 24 % | | | | |
| Total gross profit | \$5,232 | \$4,265 | \$10,681 | \$7,800 | | | | |
| Total gross margin | 18 % | 18 % | 19 % | 17 % | | | | |

Software gross profit and gross margin

Software gross profit increased by \$1.2 million, or 47%, for the three months ended June 30, 2015, from the year-ago period and increased by \$3.0 million, or 55%, for the six months ended June 30, 2015, compared to the year-ago period. Our software gross margin increased by one percentage point to 16% for the three month period ended June 30, 2015 compared to the year-ago period, and increased by four percentage points to 19% for the six month period ended June 30, 2015 compared to the year-ago period. The increases in software gross profit were driven by increases in proprietary software revenue compared to a relatively fixed cost base as well as increased revenue from sales of Microsoft software. Third-party software gross margin increased to 15% for the three months ended June 30, 2015 and to 15% for the six months ended June 30, 2015, compared to 13% for both year-ago periods, with the increases driven by higher sales of the higher margin Windows Mobile operating systems. Proprietary software gross margin was 64% for the three months and 89% for the six months ended June 30, 2015, compared to 58% and 71% in the year-ago periods, respectively, with the increases due to higher revenue in both periods on a relatively fixed cost base.

Service gross profit and gross margin

Service gross profit decreased by \$214,000, or 12%, for the three months ended June 30, 2015, and \$115,000, or 5%, for the six months ended June 30, 2015, from the respective year-ago periods. Service gross margin decreased by two percentage points to 29% for the three months ended June 30, 2015 compared to the year-ago period and by one percentage point to 23% for the six months ended June 30, 2015 compared to the year-ago period. The decreases in service gross profit were driven by the \$445,000 and \$249,000 decreases in service revenue for the three and six month periods ended June 30, 2015, respectively, compared to the prior year periods, primarily as a result of completion of a large hand-held terminal project in Japan resulting in the recognition of \$478,000 of revenue and gross profit in the second quarter of 2014.

Operating expenses

Selling, general and administrative

Selling, general and administrative expenses (“SG&A”) consist primarily of salaries and related benefits, commissions for our sales teams, marketing and administrative personnel and related facilities and depreciation costs, as well as professional services fees (e.g., consulting, legal, tax and audit). SG&A expenses decreased by approximately \$0.2 million, or 7%, to \$2.9 million for the three months ended June 30, 2015, from \$3.2 million in the year-ago period. SG&A expenses decreased approximately \$0.5 million, or 8%, to \$5.9 million for the six months ended June 30,

2015, from \$6.5 million in the year-ago period. The decreases were driven primarily by lower general and administrative costs and timing of reimbursement for marketing expenses, and were partially offset by higher bonus and commissions resulting from increased revenue and profitability. SG&A expenses represented 10% and 11% of our total revenue for the three and six month periods ended June 30, 2015, respectively, and 14% for each of the three and six month periods ended June 30, 2014. The percentage decreases for both of the current year periods resulted from a combination of lower expenses and higher revenue compared to the prior year periods.

Research and development

Research and development expenses (“R&D”) consist primarily of salaries and benefits for software development and quality assurance personnel, contractor and consultant costs and related facilities and depreciation costs. R&D expenses decreased \$1,000, or 0%, to \$422,000 for the three months ended June 30, 2015, from \$423,000 in the year-ago period. R&D expenses increased \$133,000, or 16%, to \$988,000 for the six months ended June 30, 2015, from \$855,000 in the year-ago period due primarily to increased investments in our new DataV and MobileV product initiatives. R&D expenses represented 1% and 2% of our total revenue for the three and six month periods ended June 30, 2015, respectively, and 2% for both the three and six month periods ended June 30, 2014.

Other income (expense), net

Net other income (expense) consists of interest income on our cash, cash equivalents and investments, gains and/or losses recognized on our investments, as well as gains or losses on foreign exchange transactions. Other income (expense), net, increased by \$79,000 to \$68,000 in net other income for the three months ended June 30, 2015, compared to a net other expense of \$11,000 in the year-ago period, due primarily to changes in the results of foreign currency transaction losses. Other income (expense), net, increased by \$194,000 to \$92,000 in net other income for the six months ended June 30, 2015, compared to a net other expense of \$102,000 in the year-ago period, due primarily to changes in the results of foreign currency transaction losses and increased interest income.

Income tax expense

Income tax expense was \$54,000 for the three months ended June 30, 2015, compared to \$8,000 in the year-ago period, an increase of \$46,000. The 2015 expense is primarily comprised of alternative minimum tax obligations not offset by net operating loss carryforwards.

Income tax expense was \$131,000 for the six months ended June 30, 2015, compared to \$113,000 in the year-ago period. The 2015 amount is primarily comprised of alternative minimum tax obligations not offset by net operating loss carryforwards. The 2014 amount primarily related to income taxes due related to the closure of our Taiwan subsidiary in the first quarter of 2014.

The effective tax rates for both the three and six months ended June 30, 2015 of 3% were lower than the U.S. statutory rate of 34% because of net operating losses available to offset current year taxable income and a full valuation allowance on deferred tax assets, offset by alternative minimum tax accruals.

Liquidity and Capital Resources

As of June 30, 2015, we had \$29.7 million of cash, cash equivalents, investments and restricted cash, compared to \$26.6 million at December 31, 2014.

Net cash provided by operating activities was \$2.7 million for the six months ended June 30, 2015, driven primarily by net income, offset by a \$1.8 million increase in net accounts receivable. Net cash provided by operating activities was \$2.7 million for the six months ended June 30, 2014, driven by positive net working capital changes.

Investing activities used cash of \$4.2 million for the six months ended June 30, 2015, due to a net increase in short-term investments of \$4.2 million. Investing activities used cash of \$5.8 million for the six months ended June 30, 2014 due to a \$5.7 million net increase in short-term investments, in addition to \$93,000 of capital expenditures.

Financing activities generated \$322,000 during the six months ended June 30, 2015, and \$563,000 during the six months ended June 30, 2014, as a result of employees' exercise of stock options.

We believe that our existing cash, cash equivalents and investments will be sufficient to meet our needs for working capital and capital expenditures for at least the next 12 months. We expect our accounts receivable balance to increase for the remainder of 2015 as a result of extended payment terms we have agreed to with a customer, with a commensurate decrease in cash and/or short-term investments balances.

Cash Commitments

We have the following future or potential cash commitments:

Minimum rents payable under operating leases total \$0.7 million for the remainder of 2015, \$1.3 million in 2016, \$1.2 million in 2017, \$1.1 million in 2018, \$1.0 million in 2019 and \$0.4 million thereafter; and

In conjunction with our activities under our ODAs with Microsoft, we enter OVRP commitments with Microsoft. Under these OVRPs, we are provided with volume pricing on a customer-by-customer basis assuming certain minimum unit volumes are met. The OVRP terms are 12 months. In the event we don't meet the committed minimum unit volumes, we are obligated to pay the difference between the committed per-unit volume rate and the actual per-unit rate we achieved based upon actual units purchased. The OVRP arrangements do not equate to a minimum purchase commitment but rather, the arrangements are a volume pricing arrangement based upon actual volume purchased. In substantially all significant instances, we have reciprocal agreements with our customers such that we will receive per-unit price adjustments, similar to the amounts we would subsequently owe to Microsoft if such OVRP volumes are not met. However, in the event a customer is unwilling or unable to pay us, we would be negatively impacted. Based upon the credit-worthiness of our customers, our historical OVRP experience with our customers and OVRP arrangements in general, we do not believe we will incur any material liability relating to active agreements.

Recently Issued Accounting Standards

See Note 1, "Summary of Significant Accounting Policies" in the Notes to Condensed Consolidated Financial Statements in Item 1.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that the information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes in our internal control over financial reporting during the three month period ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in the risk factors set forth in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BSQUARE CORPORATION

(Registrant)

Date: August 13, 2015 By: /s/ Martin L. Heimbigner
Martin L. Heimbigner
Chief Financial Officer, Secretary and Treasurer

BSQUARE CORPORATION

INDEX TO EXHIBITS

| Exhibit Number | Description | Filed or Furnished Incorporated by Reference | | | | |
|-------------------|---|---|------|-------------|---------|-----------|
| | | Herewith | Form | Filing Date | Exhibit | File No. |
| 3.1 | Amended and Restated Articles of Incorporation | | S-1 | 8/17/1999 | 3.1 (a) | 333-85351 |
| 3.1(a) | Articles of Amendment to Amended and Restated Articles of Incorporation | | 10-Q | 8/7/2000 | 3.1 | 000-27687 |
| 3.1(b) | Articles of Amendment to Amended and Restated Articles of Incorporation | | 8-K | 10/11/2005 | 3.1 | 000-27687 |
| 3.2 | Bylaws and all amendments thereto | | 10-K | 3/19/2003 | 3.2 | 000-27687 |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 | X | | | | |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 | X | | | | |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | | |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X | | | | |
| 101.INS | XBRL Instance Document | X | | | | |
| 101.SCH | XBRL Taxonomy Extension Schema | X | | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase | X | | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase | X | | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase | X | | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase | X | | | | |