

BSQUARE CORP /WA
Form 10-Q
May 07, 2009
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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 March 31, 2009

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
(State or other jurisdiction of
incorporation or organization)

110 110th Avenue NE, Suite 200,
Bellevue WA
(Address of principal executive offices)

(425) 519-5900

(Registrant's telephone number, including area code)

91-1650880
(I.R.S. Employer
Identification No.)

98004
(Zip 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

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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. (Check one):

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 April 30, 2009: 10,104,276

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BSQUARE CORPORATION

FORM 10-Q

For the Quarterly Period Ended March 31, 2009

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EXPLANATORY NOTE

The unaudited financial information for the three months ended March 31, 2008 contained in this Quarterly Report on Form 10-Q has been restated as discussed in Note 2 of the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, filed with the Securities and Exchange Commission on March 26, 2009, and also in Note 8 of the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Our Annual Report on Form 10-K for the year ended December 31, 2008 restated our consolidated financial statements for the fiscal year ended December 31, 2007, for each of the quarterly periods within the fiscal year ended December 31, 2007, and for the first and second quarterly periods of the fiscal year ended December 31, 2008. We have not individually amended our previously filed Annual Report on Form 10-K for the fiscal year ended December 31, 2007, or any of our Quarterly Reports on Form 10-Q for the quarterly periods of the fiscal year ended December 31, 2007. In addition, we have not individually amended our previously filed Quarterly Reports on Form 10-Q for the first and second quarterly periods of the fiscal year ended December 31, 2008. Accordingly, our financial statements for these periods, and all related earnings press releases and communications relating to these periods, that were released prior to the filing of our Annual Report on Form 10-K for the year ended December 31, 2008 on March 26, 2009, should not be relied upon. The unaudited financial information for the three months ended March 31, 2008 contained in this Quarterly Report on Form 10-Q reflects the restated information as discussed in Note 2 of the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and also in Note 8 of the Condensed Consolidated Financial Statements included in this Quarterly Report on this Form 10-Q.

The following sections in this Quarterly Report on Form 10-Q include restated information for the three months ended March 31, 2008:

Part I:

Item 1 Financial Statements

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

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****BSQUARE CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share amounts)

	March 31, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,302	\$ 7,703
Accounts receivable, net of allowance for doubtful accounts of \$195 at March 31, 2009 and \$198 at December 31, 2008	10,123	10,726
Prepaid expenses and other current assets	752	703
Total current assets	20,177	19,132
Long-term investments	4,621	4,679
Equipment, furniture and leasehold improvements, net	933	981
Intangible assets, net	1,850	1,975
Restricted cash	900	900
Other non-current assets	89	91
Total assets	\$ 28,570	\$ 27,758
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,862	\$ 2,925
Other accrued expenses	3,968	3,057
Accrued compensation	2,056	1,636
Accrued legal fees	534	534
Deferred revenue	688	355
Total current liabilities	9,108	8,507
Deferred rent	315	309
Commitments and contingencies (Note 6)		
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; 10,104,276 shares issued and outstanding at March 31, 2009 and 10,082,654 shares issued and outstanding at December 31, 2008	122,892	122,660
Accumulated other comprehensive loss	(985)	(1,048)
Accumulated deficit	(102,760)	(102,670)
Total shareholders' equity	19,147	18,942
Total liabilities and shareholders' equity	\$ 28,570	\$ 27,758

See notes to condensed consolidated financial statements.

Table of Contents**BSQUARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	Three Months Ended March 31, 2008	
	2009	(as restated, see Note 8)
Revenue:		
Software	\$ 8,298	\$ 10,996
Service	8,379	6,062
Total revenue	16,677	17,058
Cost of revenue:		
Software	6,307	8,506
Service ⁽¹⁾	5,938	4,011
Total cost of revenue	12,245	12,517
Gross profit	4,432	4,541
Operating expenses:		
Selling, general and administrative ⁽¹⁾	3,295	3,009
Research and development ⁽¹⁾	1,381	644
Total operating expenses	4,676	3,653
Income (loss) from operations	(244)	888
Interest and other income	114	160
Income (loss) before income taxes	(130)	1,048
Income tax benefit (expense)	40	(117)
Net income (loss)	\$ (90)	\$ 931
Basic income (loss) per share	\$ (0.01)	\$ 0.09
Diluted income (loss) per share	\$ (0.01)	\$ 0.09
Shares used in calculation of income (loss) per share:		
Basic	10,086	9,977
Diluted	10,086	10,149
 (1) Includes the following amounts related to stock-based compensation expense:		
Cost of revenue - service	\$ 74	\$ 125
Selling, general and administrative	154	240

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Research and development	(1)	19
Total stock-based compensation expense	\$ 227	\$ 384

See notes to condensed consolidated financial statements.

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BSQUARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)

	Three Months Ended March 31, 2008	
	2009	(as restated, See Note 8)
Cash flows from operating activities:		
Net income (loss)	\$ (90)	\$ 931
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	244	137
Stock-based compensation	227	384
Changes in operating assets and liabilities:		
Accounts receivable, net	578	(1,558)
Prepaid expenses and other assets	(48)	(369)
Accounts payable and accrued expenses	270	1,609
Deferred revenue	333	(79)
Deferred rent	6	(6)
Net cash provided by operating activities	1,520	1,049
Cash flows from investing activities:		
Purchases of equipment and furniture	(77)	(101)
Maturities of investments	125	1,300
Net cash provided by investing activities	48	1,199
Cash flows from financing activities:		
Proceeds from exercise of stock options	5	33
Net cash provided by financing activities	5	33
Effect of exchange rate changes on cash	26	37
Net increase in cash and cash equivalents	1,599	2,318
Cash and cash equivalents, beginning of period	7,703	4,377
Cash and cash equivalents, end of period	\$ 9,302	\$ 6,695

See notes to condensed consolidated financial statements.

Table of Contents**BSQUARE CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****March 31, 2009****(Unaudited)****1. Summary of Significant Accounting Policies*****Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared by BSQUARE Corporation (the Company or BSQUARE) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial reporting and include the accounts of the Company and its subsidiaries. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles, or GAAP, have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited financial statements reflect all material adjustments, which consist solely of normal recurring adjustments, necessary to present fairly the Company's financial position as of March 31, 2009 and its operating results and cash flows for the three months ended March 31, 2009 and 2008. The accompanying financial information as of December 31, 2008 is derived from audited financial statements. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Examples include provision for bad debts and income taxes and estimates of progress on professional service arrangements. 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 the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC. All intercompany balances have been eliminated.

Income (Loss) Per Share

Income (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 and warrants. Diluted income (loss) 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 and if-converted method in the case of stock options and warrants, respectively. Restricted stock and restricted stock units are considered outstanding and included in the computation of both the basic and diluted income (loss) per share calculations. Common stock equivalent shares are excluded from the computation if their effect is anti-dilutive. Shares excluded from the calculation of diluted income (loss) per share because the effect would have been anti-dilutive were 1,997,000 for the three months ended March 31, 2009 and 1,251,000 for the three months ended March 31, 2008.

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted income (loss) per share (in thousands):

	Three Months Ended March 31,	
	2009	2008
Weighted average shares outstanding for basic income (loss) per share	10,086	9,977
Dilutive effect of common stock equivalent shares		172
Weighted average shares outstanding for diluted income (loss) per share	10,086	10,149

2. Investments

The Company's long-term investments consist entirely of auction rate securities (ARS). ARS are securities whose interest or dividend rate was historically reset through a Dutch Auction process, usually every 7, 28 or 35 days. ARS trade at par and are callable at par on any interest payment date at the option of the issuer. Although ARS were issued and rated as long-term, they were generally priced, traded and classified as

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short-term instruments because of the interest rate reset mechanism and the ability of the holders to sell their position at a reset date. During February 2008, the ARS auction process began to fail broadly throughout the market. These investments are currently illiquid and the Company is unable to determine with any certainty when these investments will become liquid. Liquidity of these investments is contingent on redemption of the investments by the issuers, settlement by the underwriters and/or secondary offerors, or sales of the securities in a secondary market. Redemptions of the Company's ARS portfolio balance were \$125,000 for the three months ended March 31, 2009.

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The Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157) as of January 1, 2008 to measure the fair value of its ARS. Under SFAS 157, the Company is required rank the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

- Level 1: Quoted prices (unadjusted) 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.

The Company adopted Financial Accounting Standards Board Staff Position No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP 157-3), which was issued in October 2008 and became effective immediately for any unissued financial statements. FSP 157-3 clarifies the application of SFAS 157 to financial assets for which an active market does not exist. Specifically, FSP 157-3 addresses the following SFAS 157 application issues:

How the reporting entity's own assumptions (expected cash flows and appropriately risk-adjusted discount rates) should be considered when measuring fair value when relevant observable inputs do not exist;

How available observable inputs in a market that is not active should be considered when measuring fair value; and

How the use of market quotes (for example, broker quotes or pricing services for the same or similar financial assets) should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value.

FSP 157-3 applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurement in accordance with SFAS 157.

Historically, the fair value of the Company's ARS has approximated par value due to the frequent resets through the auction process. While the ARS continue to earn interest at the maximum contractual rate, there is no active market for these investments, and therefore these investments do not currently have a readily determinable market value.

Due to lack of observable market quotes on the ARS, the fair value measurements have been estimated using Level 3 inputs. The fair value was based on factors that reflect assumptions market participants would use in pricing, including, among others: relevant future market conditions including those that are based on the expected cash flow streams, the underlying financial condition and credit quality of the issuer, and the maturity of the securities, as well as the market activity of similar securities.

The Company obtained an independent valuation of its ARS as of March 31, 2009, and determined the fair value to be \$4.6 million, as compared to par value of \$5.5 million. As a result, the Company recorded a valuation allowance of \$879,000 as of March 31, 2009. Of this amount, \$378,000 was deemed to be other-than-temporary during the three months ended December 31, 2008, and was recorded as a charge to interest and other income, net during that period. The remainder of the impairment charge has been deemed to be temporary and recorded in accumulated other comprehensive loss. Factors considered in determining whether a loss is temporary include the length of time and extent to which the investment's fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

ARS have been classified as long-term investments due to the uncertainty as to when these investments will be liquidated.

The following table presents the Company's fair value hierarchy for its financial assets measured at fair value on a recurring basis as of March 31, 2009:

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	Quoted Prices in Active Markets for			Total
	Identical Assets (Level 1)	Direct or Indirect Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	(in thousands)			
Auction rate securities:				
Student loan backed	\$	\$	\$ 3,632	\$ 3,632
Closed-end funds			851	851
Corporate collateral			138	138
Total auction rate securities	\$	\$	\$ 4,621	\$ 4,621

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The following table reconciles the beginning and ending balances for our ARS using significant unobservable inputs (Level 3) (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3):			
	Student Loan Backed	Closed-end Funds	Corporate Collateral	Total
Balance at December 31, 2008	\$ 3,603	\$ 954	\$ 122	\$ 4,679
Redemptions		(125)		(125)
Reversal of unrealized loss due to sale of security		14		14
Unrealized gains included in accumulated other comprehensive loss	29	8	16	53