

BSQUARE CORP /WA
Form 10-Q
August 13, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

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)

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| | |
|---|--|
| Washington (State or other jurisdiction of incorporation or organization) | 91-1650880 (I.R.S. Employer Identification No.) |
| 110 110th Avenue NE, Suite 200, Bellevue WA (Address of principal executive offices) | 98004 (Zip Code) |
| (425) 519-5900 (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 <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input checked="" type="checkbox"/> |

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, 2013: 11,193,693

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BSQUARE CORPORATION

FORM 10-Q

For the Quarterly Period Ended June 30, 2013

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

(In thousands, except share amounts)

| | June 30, 2013 (Unaudited) | December 31, 2012 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 10,771 | \$ 9,903 |
| Short-term investments | 9,331 | 9,826 |
| Accounts receivable, net of allowance for doubtful accounts of \$266 at June 30, 2013 and \$200 at December 31, 2012 | 13,614 | 16,095 |
| Deferred tax assets | 295 | 296 |
| Prepaid expenses and other current assets | 1,069 | 858 |
| Total current assets | 35,080 | 36,978 |
| Equipment, furniture and leasehold improvements, net | 520 | 759 |
| Restricted cash | 875 | 875 |
| Deferred tax assets | 2,255 | 2,255 |
| Intangible assets, net | 952 | 1,069 |
| Goodwill | 3,738 | 3,738 |
| Other non-current assets | 97 | 117 |
| Total assets | \$ 43,517 | \$ 45,791 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Third-party software fees payable | \$ 10,090 | \$ 11,099 |
| Accounts payable | 510 | 553 |
| Accrued compensation | 2,242 | 2,205 |
| Other accrued expenses | 1,772 | 1,732 |
| Deferred revenue | 872 | 837 |
| Total current liabilities | 15,486 | 16,426 |
| Deferred tax liability | 206 | 206 |
| Deferred rent | 116 | 154 |
| 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; 11,175,895 shares issued and outstanding at June 30, 2013 and 11,065,217 shares issued and outstanding at December 31, 2012 | 128,991 | 128,474 |
| Accumulated other comprehensive loss | (879) | (733) |
| Accumulated deficit | (100,403) | (98,736) |
| Total shareholders' equity | 27,709 | 29,005 |

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| | | |
|--|-----------|-----------|
| Total liabilities and shareholders' equity | \$ 43,517 | \$ 45,791 |
|--|-----------|-----------|

See notes to condensed consolidated financial statements.

Table of Contents**BSQUARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|------------------|--------------------------------------|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue: | | | | |
| Software | \$ 16,851 | \$ 17,794 | \$ 33,362 | \$ 36,010 |
| Service | 4,986 | 6,711 | 9,345 | 14,043 |
| Total revenue | 21,837 | 24,505 | 42,707 | 50,053 |
| Cost of revenue: | | | | |
| Software | 13,955 | 14,757 | 27,122 | 29,364 |
| Service | 4,089 | 5,358 | 8,445 | 11,497 |
| Total cost of revenue | 18,044 | 20,115 | 35,567 | 40,861 |
| Gross profit | 3,793 | 4,390 | 7,140 | 9,192 |
| Operating expenses: | | | | |
| Selling, general and administrative | 3,841 | 3,552 | 7,472 | 7,691 |
| Research and development | 738 | 1,108 | 1,401 | 2,048 |
| Total operating expenses | 4,579 | 4,660 | 8,873 | 9,739 |
| Loss from operations | (786) | (270) | (1,733) | (547) |
| Other income, net | 25 | 103 | 115 | 94 |
| Loss before income taxes | (761) | (167) | (1,618) | (453) |
| Income tax benefit (expense) | (44) | (35) | (49) | 63 |
| Net loss | \$ (805) | \$ (202) | \$ (1,667) | \$ (390) |
| Basic loss per share | \$ (0.07) | \$ (0.02) | \$ (0.15) | \$ (0.04) |
| Diluted loss per share | \$ (0.07) | \$ (0.02) | \$ (0.15) | \$ (0.04) |
| Shares used in calculation of loss per share: | | | | |
| Basic | 11,149 | 10,922 | 11,128 | 10,898 |
| Diluted | 11,149 | 10,922 | 11,128 | 10,898 |
| Comprehensive loss: | | | | |
| Net loss | \$ (805) | \$ (202) | \$ (1,667) | \$ (390) |
| Other comprehensive income (expense): | | | | |
| Foreign currency translation, net of tax | (29) | (29) | (91) | (11) |
| Change in unrealized gains on investments, net of tax | (2) | (1) | (3) | 12 |
| Total other comprehensive income (expense) | (31) | (30) | (94) | 1 |

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| | | | | |
|--------------------|----------|----------|------------|----------|
| Comprehensive loss | \$ (836) | \$ (232) | \$ (1,761) | \$ (389) |
|--------------------|----------|----------|------------|----------|

See notes to condensed consolidated financial statements.

Table of Contents**BSQUARE CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands) (Unaudited)**

| | Six Months Ended June 30, | |
|---|--------------------------------------|-------------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net loss | \$ (1,667) | \$ (390) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 405 | 483 |
| Stock-based compensation | 506 | 892 |
| Deferred income tax benefit | 1 | (58) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 2,481 | (1,608) |
| Prepaid expenses and other assets | (191) | 111 |
| Third-party software fees payable | (1,009) | 2,223 |
| Accounts payable and accrued expenses | 34 | (241) |
| Deferred revenue | 35 | 556 |
| Deferred rent | (38) | (6) |
| Net cash provided by operating activities | 557 | 1,962 |
| Cash flows from investing activities: | | |
| Purchases of equipment and furniture | (49) | (164) |
| Proceeds from maturities of short-term investments | 7,655 | 5,200 |
| Purchases of short-term investments | (7,165) | (4,965) |
| Net cash provided by investing activities | 441 | 71 |
| Cash flows provided by financing activities proceeds from exercise of stock options | 8 | 66 |
| Effect of exchange rate changes on cash | (138) | (89) |
| Net increase in cash and cash equivalents | 868 | 2,010 |
| Cash and cash equivalents, beginning of period | 9,903 | 8,505 |
| Cash and cash equivalents, end of period | \$ 10,771 | \$ 10,515 |

See notes to condensed consolidated financial statements.

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BSQUARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(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, 2013 and our operating results and cash flows for the three and six months ended June 30, 2013 and 2012. The accompanying financial information as of December 31, 2012 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, 2012. All intercompany balances have been eliminated.

Recently Issued Accounting Pronouncements

In February 2013, the FASB issued ASU No. 2013-02, **Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income**. Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income (**AOCI**) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. Our adoption of ASU 2013-02 effective January 1, 2013 did not have any effect on our financial position, results of operations or cash flows.

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 of 978,661 and 913,911 and 1,219,774 and 1,119,688 were excluded from the computations of basic and diluted income per share for the three and six months ended June 30, 2013 and 2012, respectively, because their effect was anti-dilutive. Unvested but outstanding RSUs and RSAs which are forfeitable are included in the diluted income per share calculation. In a period where we are in a net loss position, the diluted loss per share is computed using the basic share count.

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Cash, cash equivalents, short-term investments, and restricted cash consisted of the following at June 30, 2013 and December 31, 2012 (in thousands):

| | June 30, 2013 | December 31, 2012 |
|---|--------------------------|------------------------------|
| Cash | \$ 1,994 | \$ 2,590 |
| Cash equivalents: | | |
| Money market funds | 8,777 | 7,313 |
| Total cash equivalents | 8,777 | 7,313 |
| Total cash and cash equivalents | 10,771 | 9,903 |
| Short-term investments: | | |
| Municipal securities | | 356 |
| Corporate commercial paper | 1,250 | 4,374 |
| Foreign government bonds | 1,001 | 999 |
| Corporate debt securities | 7,080 | 4,097 |
| Total short-term investments | 9,331 | 9,826 |
| Restricted cash - money market fund | 875 | 875 |
| Total cash, cash equivalents, investments and restricted cash | \$ 20,977 | \$ 20,604 |

Gross unrealized gains and losses on our short-term investments were not material as of June 30, 2013 and December 31, 2012. Our restricted cash balance at June 30, 2013 and December 31, 2012 relates to a letter of credit which will continue to secure our corporate headquarter lease obligation to its expiration in 2014.

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.

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Assets and liabilities measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012 are summarized below (in thousands):

| | June 30, 2013 | | | Total |
|-------------------------------------|---|---|--|-----------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Direct or Indirect Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 8,777 | \$ | \$ | \$ 8,777 |
| Total cash equivalents | 8,777 | | | 8,777 |
| Short-term investments: | | | | |
| Corporate commercial paper | | 1,250 | | 1,250 |
| Foreign government bonds | | 1,001 | | 1,001 |
| Corporate debt securities | | 7,080 | | 7,080 |
| Total short-term investments | | 9,331 | | 9,331 |
| Restricted cash money market fund | 875 | | | 875 |
| Total assets measured at fair value | \$ 9,652 | \$ 9,331 | \$ | \$ 18,983 |

| | December 31, 2012 | | | Total |
|-------------------------------------|---|---|--|-----------|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Direct or Indirect Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 7,313 | \$ | \$ | \$ 7,313 |
| Total cash equivalents | 7,313 | | | 7,313 |
| Short-term investments: | | | | |
| Municipal securities | | 356 | | 356 |
| Corporate commercial paper | | 4,374 | | 4,374 |
| Foreign government bonds | | 999 | | 999 |
| Corporate debt securities | | 4,097 | | 4,097 |
| Total short-term investments | | 9,826 | | 9,826 |
| Restricted cash money market fund | 875 | | | 875 |
| Total assets measured at fair value | \$ 8,188 | \$ 9,826 | \$ | \$ 18,014 |

4. Goodwill and Intangible Assets

Goodwill relates to our September 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. There was no change in the carrying amount of goodwill during the six months ended June 30, 2013.

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Intangible assets relate to developed technology, trade names and trademarks, customer relationships, and non-compete agreements that we acquired from TestQuest Inc. in November 2008 and from the acquisition of MPC in September 2011.

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Information regarding our intangible assets as of June 30, 2013 and December 31, 2012 is as follows (in thousands):

| | Gross Carrying Amount | June 30, 2013 Accumulated Amortization | Net Carrying Value |
|------------------------|--------------------------------------|---|-----------------------------------|
| Customer relationships | 1,275 | (344) | 931 |
| Non-compete agreements | 196 | (175) | 21 |
| Total | \$ 1,471 | \$ (519) | \$ 952 |

| | Gross Carrying Amount | December 31, 2012 Accumulated Amortization | Net Carrying Value |
|------------------------|--------------------------------------|---|-----------------------------------|
| Customer relationships | 1,275 | (276) | 999 |
| Non-compete agreements | 196 | (126) | 70 |
| Total | \$ 1,471 | \$ (402) | \$ 1,069 |

Amortization expense was \$58,000 and \$116,000 for the three and six months ended June 30, 2013 and 2012, respectively, and \$88,000 and \$176,000 for the three and six months ended June 30, 2012, respectively. Amortization in future periods is expected to be as follows (in thousands):

| | |
|-------------------|---------------|
| Remainder of 2013 | \$ 90 |
| 2014 | 135 |
| 2015 | 135 |
| 2016 | 130 |
| 2017 | 98 |
| Thereafter | 364 |
| Total | \$ 952 |

5. Shareholders' Equity**Stock Options**

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. The Inducement Plan was established in connection with the MPC acquisition. The number of shares available for award under the Inducement Plan may be modified by our Board of Directors, subject to SEC and NASDAQ limitations.

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 of stock-based awards based on historical experience and expected future activity. The fair value of RSAs and 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

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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:

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------|--------------------------------|---------|------------------------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Dividend yield | 0% | 0% | 0% | 0% |
| Expected life | 4 years | 4 years | 4 years | 4 years |
| Expected volatility | 61% | 73% | 64% | 73% |
| Risk-free interest rate | 0.7% | 0.6% | 0.7% | 0.6% |

The impact on our results of operations of recording stock-based compensation expense for the three and six months ended June 30, 2013 and 2012 was as follows (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|---------|
| | 2013 | 2012 | 2013 | 2012 |
| Cost of revenue service | \$ 63 | \$ 100 | \$ 136 | \$ 207 |
| Selling, general and administrative | 162 | 278 | 311 | 622 |
| Research and development | 29 | 30 | 59 | 63 |
| Total stock-based compensation expense | \$ 254 | \$ 408 | \$ 506 | \$ 892 |
| Per diluted share | \$ 0.02 | \$ 0.04 | \$ 0.05 | \$ 0.08 |

Stock Option Activity

The following table summarizes stock option activity under the Plans for the six months ended June 30, 2013:

| Stock Options | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|--|---------------------|--|---|---------------------------------|
| Balance at January 1, 2013 | 1,539,618 | \$ 3.55 | | |
| Granted at fair value | 172,530 | 3.11 | | |
| Exercised | (3,000) | 2.67 | | |
| Forfeited | (30,622) | 3.58 | | |
| Expired | (68,339) | 4.53 | | |
| Balance at June 30, 2013 | 1,610,187 | \$ 3.47 | 3.89 | \$ 251,000 |
| Vested and expected to vest at June 30, 2013 | 1,551,976 | \$ 3.47 | 3.81 | \$ 251,000 |
| Exercisable at June 30, 2013 | 1,200,936 | \$ 3.46 | 3.09 | \$ 247,000 |

At June 30, 2013, total compensation cost related to stock options granted but not yet recognized was \$362,000, net of estimated forfeitures. This cost will be amortized on the straight-line method over a weighted-average period of approximately two years. The following table summarizes certain information about stock options for the three and six months ended June 30, 2013 and 2012:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------|------------------------------|------|
| | 2013 | 2012 | 2013 | 2012 |

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| | | | | |
|--|----------|----------|----------|-----------|
| Weighted-average grant-date fair value of option grants for the period | \$ 0 | \$ 1.88 | \$ 1.65 | 2.23 |
| Options in-the-money at period end | 626,000 | 616,000 | 626,000 | 616,000 |
| Aggregate intrinsic value of options exercised | \$ 1,000 | \$ 1,000 | \$ 1,000 | \$ 33,000 |

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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 months ended June 30, 2013:

| | Number of Shares | Weighted Average Grant Date Fair Value |
|--------------------------------------|-----------------------------|---|
| Unvested at December 31, 2012 | 236,513 | \$ 4.95 |
| Granted | 83,383 | 2.75 |
| Vested | (85,725) | 4.39 |
| Forfeited | (4,558) | 6.72 |
| Unvested at June 30, 2013 | 229,613 | \$ 4.75 |
| Expected to vest after June 30, 2013 | 201,161 | \$ 4.33 |

At June 30, 2013, total compensation cost related to RSUs granted but not yet recognized was \$665,000, net of estimated forfeitures. This cost will be amortized on the straight-line method over a period of approximately 3 years.

Common Stock Reserved for Future Issuance

The following table summarizes our shares of common stock reserved for future issuance under the Plans at June 30, 2013:

| | June 30, 2013 |
|--|--------------------------|
| Stock options outstanding | 1,610,187 |
| Restricted stock units outstanding | 229,613 |
| Stock options available for future grant | 1,004,755 |
| Common stock reserved for future issuance | 2,844,555 |

6. Commitments and Contingencies***Lease and rent obligations***

Our commitments include obligations outstanding under operating leases, which expire through 2018. We have lease commitments for office space in Bellevue, Washington; San Diego, California; Chandler, Arizona; Boston, Massachusetts; Taipei, Taiwan; Beijing, China; Seoul, Korea; Tokyo, Japan; Munich, Germany; and Trowbridge, UK. We also lease office space on a month-to-month basis in Akron, Ohio.

Rent expense was \$378,000 and \$754,000 for the three and six months ended June 30, 2013, respectively, and \$423,000 and \$903,000 for the three and six months ended June 30, 2012, respectively. As of June 30, 2013, we had \$875,000 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):

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| | |
|-------------------|----------|
| Remainder of 2013 | \$ 775 |
| 2014 | 1,055 |
| 2015 | 276 |
| 2016 | 276 |
| 2017 | 141 |
| Thereafter | 91 |
| Total commitments | \$ 2,614 |

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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 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 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 in the current or future periods and therefore no provision or reserve has been recorded as of June 30, 2013.

7. Information about Geographic Areas

Our chief operating decision-makers (i.e., 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 June 30, | | Six Months Ended June 30, | |
|----------------|--------------------------------|-----------|------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| Total revenue: | | | | |
| North America | \$ 19,757 | \$ 20,289 | \$ 38,839 | \$ 40,426 |
| Asia | 846 | 3,077 | 1,750 | 7,142 |
| Europe | 1,234 | 1,139 | 2,118 | 2,485 |
| Total revenue | \$ 21,837 | \$ 24,505 | \$ 42,707 | \$ 50,053 |

| | June 30, 2013 | December 31, 2012 |
|-------------------------|------------------|----------------------|
| Long-lived assets: | | |
| North America | \$ 3,408 | \$ 3,663 |
| Asia | 424 | 447 |
| Europe | 4,605 | 4,703 |
| Total long-lived assets | \$ 8,437 | \$ 8,813 |

8. Significant Risk Concentrations**Significant Customer**

No customer accounted for 10% or more of total revenue for the three or six months ended June 30, 2013 or June 30, 2012.

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No customer had an accounts receivable balance which was 10% or more of the total accounts receivable at June 30, 2013. Bluebird Soft, Inc., a designer and manufacturer of handheld mobile devices, had an accounts receivable balance of \$2.1 million, or 13% of total accounts receivable, as of December 31, 2012, all of which was subsequently collected. No other customer accounted for 10% or more of total accounts receivable at December 31, 2012.

Table of Contents***Significant Supplier***

We have ODAs with Microsoft which enable us to sell Microsoft Windows Embedded operating systems to our customers in the United States, Canada, the Caribbean (excluding Cuba), Mexico, the European Union and the European Free Trade Association, which expire on June 30, 2014. We also have ODAs with Microsoft which allow us to sell Microsoft Windows Mobile operating systems in the Americas, Japan, Taiwan, Europe, the Middle East, and Africa. Our current distribution agreements related to Windows Mobile expire in June 2014. Our rights to distribute Windows Mobile operating systems in Korea ended on October 31, 2012. We sold \$494,000 and \$1.7 million of Windows Mobile operating systems in Korea during the three and six months ended June 30, 2012.

Software sales under these agreements constitute a significant portion of our software revenue and total revenue. These agreements are typically renewed 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 earned \$349,000 and \$569,000 during the three and six months ended June 30, 2013, respectively, and \$184,000 and \$413,000 during the three and six months ended June 30 2012, respectively. These rebates are accounted for as a reduction in software cost of revenue.

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, intend, forecast, anticipate, believe, estimate, predict, potential, continue, or the negative of these terms or other comparable terminology 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, 2012 entitled Risk Factors, similar discussions in subsequently filed Quarterly Reports on 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 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® CE or Google Android) 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 and in-vehicle telematics and entertainment devices. We focus on smart, connected systems that utilize various Microsoft Windows Embedded and Windows Mobile operating systems, specifically Windows Embedded Compact, Windows Embedded Standard 7 and 8, Windows Mobile, Windows Phone 8 and Windows Embedded 8 Handheld as well as devices running other popular operating systems such as Android, Linux, and QNX.

We have been providing software solutions to the smart, connected systems marketplace since our inception. Our customers include world class original equipment manufacturers (OEMs), original design manufacturers (ODMs) and enterprises, as well as silicon vendors and peripheral vendors which purchase our software solutions for purposes of facilitating processor and peripheral sales to the aforementioned customer categories. In the case of enterprises, our customers include those who develop, market and distribute smart devices on their own behalf as well as those that purchase devices from OEMs or ODMs and require additional device software 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.

Table of Contents**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, 2012.

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 Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|--------------------------------|------|------------------------------|------|
| | 2013 (unaudited) | 2012 | 2013 (unaudited) | 2012 |
| Revenue: | | | | |
| Software | 77% | 73% | 78% | 72% |
| Service | 23 | 27 | 22 | 28 |
| Total revenue | 100 | 100 | 100 | 100 |
| Cost of revenue: | | | | |
| Software | 64 | 60 | 63 | 59 |
| Service | 19 | 22 | 20 | 23 |
| Total cost of revenue | 83 | 82 | 83 | 82 |
| Gross profit | 17 | 18 | 17 | 18 |
| Operating expenses: | | | | |
| Selling, general and administrative | 18 | 15 | 18 | 15 |
| Research and development | 3 | 4 | 3 | 4 |
| Total operating expenses | 21 | 19 | 21 | 19 |
| Loss from operations | (4) | (1) | (4) | (1) |
| Other income, net | 0 | 0 | 0 | 0 |
| Loss before income taxes | (4) | (1) | (4) | (1) |
| Income tax benefit (expense) | 0 | 0 | 0 | 0 |
| Net loss | (4)% | (1)% | (4)% | (1)% |

Revenue

Our revenue is generated from the sale of software, both our own proprietary software and software of third parties that we resell, and the sale of engineering services. Total revenue decreased \$2.7 million, or 11%, to \$21.8 million for the three months ended June 30, 2013, from \$24.5 million in the year-ago period. Total revenue decreased \$7.3 million, or 15%, to \$42.7 million for the six months ended June 30, 2013, from \$50.0 million in the year-ago period. These decreases were driven by lower service revenue and lower sales of Microsoft Windows Mobile

operating systems.

Revenue from our customers outside of North America decreased \$2.1 million, or 51%, to \$2.1 million or 10% of total revenue, for the three months ended June 30, 2013 compared to \$4.2 million or 17% of total revenue in the year-ago period. Revenue from our customers outside of North America decreased \$5.8 million, or 60%, to \$3.9 million or 9% of total revenue for the six months ended June 30, 2013 compared to \$9.6 million or 19% of total revenue in the year-ago period. These decreases were primarily driven by lower sales of Windows Mobile operating systems and lower service revenue in Japan primarily due to the year-ago quarter benefiting from higher revenue per project. A portion of the Window Mobile sales decline resulted from the termination of our Korea distribution rights on October 31, 2012. Korea contributed \$494,000 and \$1.7 million of Windows Mobile operating systems in Korea during the three and six months ended June 30, 2012.

Table of Contents**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 months ended June 30, 2013 and 2012 was as follows (dollars in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|-----------|
| | 2013 (unaudited) | 2012 | 2013 (unaudited) | 2012 |
| Software revenue: | | | | |
| Third-party software | \$ 16,254 | \$ 17,006 | \$ 31,745 | \$ 34,085 |
| Proprietary software | 597 | 788 | 1,617 | 1,925 |
| Total software revenue | \$ 16,851 | \$ 17,794 | \$ 33,362 | \$ 36,010 |
| Software revenue as a percentage of total revenue | 77% | 73% | 78% | 72% |
| Third-party software revenue as a percentage of total software revenue | 96% | 96% | 95% | 95% |

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 decreased \$752,000, or 4%, for the three months ended June 30, 2013, from the year-ago period. The decrease was driven by a \$2.1 million decrease in sales of Windows Mobile operating systems, \$1.2 million of which occurred internationally, while the rest of the drop occurred in North America. Of the international decline, \$494,000 relates to the end of our Korea distribution rights, while the remainder and the North American decline are driven by declining demand from existing customers. The Windows Mobile decline was offset by a \$1.2 million increase in sales of Windows Embedded operating systems which was driven by higher demand at our large customers.

Third-party software revenue decreased \$2.3 million, or 7%, for the six months ended June 30, 2013, compared to the year-ago period. The decrease was driven by a \$3.6 million decrease in sales of Windows Mobile operating systems, \$2.8 million of which occurred internationally, while the rest of the drop occurred in North America. Of the international decline, \$1.7 million relates to the end of our Korea distribution rights, while the remainder and the North American decline are driven by demand issues at our customers. The Windows Mobile decline was offset by a \$1.1 million increase in sales of Microsoft Windows Embedded operating systems which was driven by higher demand at our large customers.

Proprietary software revenue decreased \$191,000, or 24%, to \$597,000 for the three months ended June 30, 2013, from \$788,000 in the year-ago period driven primarily by a decline in Handset Certification Platform revenue from our customers in China as customers chose not to renew their subscription contracts.

Proprietary software revenue decreased \$308,000, or 16%, for the six months ended June 30, 2013, compared to the year-ago period, driven largely by the same factor which accounted for the three-month decrease.

Service revenue

Service revenue for the three and six months ended June 30, 2013 and 2012 was as follows (dollars in thousands):

| | Three Months ended June 30, | | Six Months ended June 30, | |
|--|--------------------------------|------|------------------------------|------|
| | 2013 (unaudited) | 2012 | 2013 (unaudited) | 2012 |

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| | | | | |
|--|----------|----------|----------|-----------|
| Service revenue | \$ 4,986 | \$ 6,711 | \$ 9,345 | \$ 14,043 |
| Service revenue as a percentage of total revenue | 23% | 27% | 22% | 28% |

Service revenue decreased \$1.7 million, or 26%, for the three months ended June 30, 2013, from the year-ago period. This decrease was primarily due to an \$879,000 decline in North American service revenue driven by a \$460,000 decrease associated with the MyFord Touch program and a decline at two other significant customers with whom we currently have no active programs. We also experienced a decline of \$711,000 in Japan, attributable to project transitions as we continue to do business with our customer base but the level of project activity in the current quarter was lower than the year-ago quarter. Our billed hours decreased 24% quarter over prior-year quarter offset, partially by a 1% increase in our realized rate per hour.

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Service revenue decreased \$4.7 million, or 33%, for the six months ended June 30, 2013, compared to the year-ago period. The decrease was the result of a \$2.3 million decline in North America and a \$1.5 million decline in Japan for the same reasons outlined above. Further, EMEA service revenue declined \$661,000 as a result of several large accounts reducing their project activity levels. Our billed hours decreased 35% but this was partially offset by a 4% increase in our realized rate per hour for the six months ended June 30, 2013, compared to the year-ago period.

Microsoft Corporation (Microsoft) became our largest engineering services customer during the first quarter of 2012, replacing Ford Motor Company (Ford), as Microsoft replaced Ford as the invoiced customer on the MyFord Touch program. We continue to work on the MyFord Touch, a project we began with Ford during the second quarter of 2008; however, we now conduct these services through an agreement with Microsoft. During the initial project with Ford, we provided hardware design and implementation, platform level software development, application level software development, quality assurance services and systems integration services. The project has transitioned since the initial project such that we are now primarily focused on developing and integrating new user applications for the MyFord Touch, enhancing existing applications and customizing the MyFord Touch platform for additional vehicle models. Service revenue from the MyFord Touch program declined \$460,000 to \$1.3 million, or 25% of total service revenue, for the three months ended June 30, 2013, compared to \$1.7 million, or 26% of total service revenue, in the year-ago period. Service revenue from the MyFord Touch program declined \$938,000 to \$2.5 million, or 27% of total service revenue, for the six months ended June 30, 2013, compared to \$3.5 million, or 25% of total service revenue, in the year-ago period. The decline is primarily attributable to a reduction in the number of engineers working on the MyFord Touch project.

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 and treated as a reduction in the cost of software revenue. Under this rebate program we earned \$349,000 and \$569,000 for the three and six months ended June 30, 2013, respectively, compared to \$184,000 and \$413,000 for the three and six months ended June 30, 2012, respectively.

Gross profit and related gross margin for the three and six months ended June 30, 2013 and 2012 were as follows (dollars in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|--------------------------------|---------------------|------------------------------|---------------------|
| | 2013 (unaudited) | 2012 (unaudited) | 2013 (unaudited) | 2012 (unaudited) |
| Software gross profit | \$ 2,896 | \$ 3,037 | \$ 6,240 | \$ 6,646 |
| Software gross margin | 17% | 17% | 19% | 18% |
| Service gross profit | \$ 897 | \$ 1,353 | \$ 900 | \$ 2,546 |
| Service gross margin | 18% | 20% | 10% | 18% |
| Total gross profit | \$ 3,793 | \$ 4,390 | \$ 7,140 | \$ 9,192 |
| Total gross margin | 17% | 18% | 17% | 18% |

Software gross profit and gross margin

Software gross profit decreased by \$141,000, or 5%, for the three months ended June 30, 2013, from the year-ago period, while software gross margin was unchanged. The decrease in gross profit was primarily the result of lower Microsoft Windows Mobile operating system sales. Third-party software gross margin was 16% for the three months ended June 30, 2013, and 15% for the year-ago period. Proprietary software gross margin was 63% for the three months ended June 30, 2013, compared to 61% in the year-ago period, with the increase driven by reductions in cost of sales as a result of cost reduction efforts which occurred in the third quarter of 2012.

Software gross profit decreased by \$406,000, or 6%, for the six months ended June 30, 2013, from the year-ago period, while software gross margin remained flat. The decrease in software gross profit was driven by the same factor that accounted for the three-month decline. Third-party software margin was 16% and 15% for the six months ended June 30, 2013 and June 30, 2012, respectively. Proprietary software margin was 75% for the six months ended June 30, 2013, compared to 71% in the year-ago period. This increase was due to the same factors that accounted for the three-month improvement in proprietary software gross margin.

Table of Contents***Service gross profit and gross margin***

Service gross profit decreased \$456,000, or 34%, for the three months ended June 30, 2013, from the year-ago period. Service gross margin decreased by two percentage points to 18% for the three months ended June 30, 2013, compared to the year-ago period. The decrease in service gross profit was driven by a \$1.7 million decline in service revenue without a commensurate decline in service cost of sales. The gross margin decline primarily resulted from a 4% increase in our cost per billable hour resulting from wage increases.

Service gross profit decreased \$1.6 million, or 65%, for the six months ended June 30, 2013, from \$2.5 million in the year-ago period driven by a \$4.7 million decline in service revenue without a commensurate decline in service cost of sales. Service gross margin was 10% for the six months ended June 30, 2013, an eight percentage point decrease from 18% in the year-ago period. The margin decline was driven by a 15% increase in our cost per billable hour due to lower utilization and wage increases.

Operating expenses***Selling, general and administrative***

Selling, general and administrative expenses 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). Selling, general and administrative expenses increased \$289,000, or 8%, to \$3.8 million for the three months ended June 30, 2013, from \$3.6 million in the year-ago period. The increase was driven by higher sales expense due to increased travel primarily associated with a world-wide sales conference and increased facilities costs. Higher marketing expense driven by an increase in marketing programs to support new sales initiatives also contributed to the increase. Selling, general and administrative expenses represented 18% of our total revenue for the three months ended June 30, 2013 and 15% in the year-ago period.

Selling, general and administrative expenses decreased \$219,000, or 3%, to \$7.5 million for the six months ended June 30, 2013, from \$7.7 million in the year-ago period. This decrease was driven by lower sales incentive compensation costs. Selling, general and administrative expenses represented 18% of our total revenue for the six months ended June 30, 2013 and 15% for the year-ago period.

Research and development

Research and development expenses consist primarily of salaries and benefits for software development and quality assurance personnel, contractor and consultant costs and related facilities and depreciation costs. Research and development expenses decreased \$370,000, or 33%, to \$738,000 for the three months ended June 30, 2013, from \$1.1 million in the year-ago period due primarily to headcount reductions and an office closure which took place in the third quarter of 2012. Research and development expenses represented 3% of our total revenue for the three months ended June 30, 2013 and 4% in the year-ago period.

Research and development expenses decreased \$647,000, or 32%, to \$1.4 million for the six months ended June 30, 2013, from \$2.0 million in the year-ago period. This decrease was driven by the same factors that accounted for the three-month increase. Research and development expenses represented 3% of our total revenue for the six months ended June 30, 2013 and 4% for the year-ago period.

Other income (expense), net

Other income or 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 decreased \$78,000 to \$25,000 for the three months ended June 30, 2013, from \$103,000 in the year-ago period due to lower interest income and foreign currency gains.

Other income increased \$21,000, or 22%, to \$115,000 for the six months ended June 30, 2013, from \$94,000 in the year-ago period due to higher interest income.

Income tax benefit (expense)

Income tax expense was \$44,000 for the three months ended June 30, 2013, compared to \$35,000 in the year-ago period, a change of \$9,000.

Income tax expense increased \$112,000 to \$49,000 for the six months ended June 30, 2013, compared to a benefit of \$63,000 in the year-ago period primarily related to a provision for taxes on non-U.S. entities during the six months ended June 30, 2013.

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Liquidity and Capital Resources

As of June 30, 2013, we had \$21.0 million of cash, cash equivalents, short-term and long-term investments and restricted cash, compared to \$20.6 million at December 31, 2012. Of these amounts, \$10.8 million and \$9.9 million were classified as cash and cash equivalents at June 30, 2013 and December 31, 2012, respectively, and \$875,000 was classified as long-term at both June 30, 2013 and December 31, 2012.

Net cash provided by operating activities was \$557,000 for the six months ended June 30, 2013, driven by positive net working capital changes of \$1.3 million and non-cash expenses of \$911,000, which were offset in part by our net loss of \$1.7 million. Net cash provided by operating activities was \$2.0 million for the six months ended June 30, 2012, driven by \$977,000 of positive net working capital changes and non-cash charges of \$1.4 million for the period, which were offset in part by our \$390,000 net loss.

Investing activities provided cash of \$441,000 for the six months ended June 30, 2013, due primarily to net proceeds of short-term investments of \$490,000. Investing activities provided cash of \$71,000 for the six months ended June 30, 2012, primarily due to net proceeds of short-term investments of \$235,000 offset by \$164,000 in equipment purchases.

Financing activities generated \$8,000 during the six months ended June 30, 2013, and \$66,000 during the six months ended June 30, 2012, 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.

Cash Commitments

We have the following future or potential cash commitments:

Minimum rents payable under operating leases total \$775,000 for the remainder of 2013, \$1.1 million in 2014, \$276,000 in 2015 and 2016, \$141,000 in 2017 and \$91,000 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 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 in the current or future periods.

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

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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 to our disclosure controls during the three months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1A. Risk Factors

There has been no material change 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, 2012.

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.

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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, 2013

By: **/s/ BRIAN T. CROWLEY**
Brian T. Crowley
President and Chief Executive Officer

Date: August 13, 2013

By: **/s/ SCOTT C. MAHAN**
Scott C. Mahan
Senior Vice President, Operations and Chief Financial Officer

Table of Contents**BSQUARE CORPORATION****INDEX TO EXHIBITS**

| Exhibit Number | Description | Filed Here with | Incorporated by Reference | | | |
|---------------------------|---|--------------------------------|----------------------------------|--------------------|----------------|-----------------|
| | | | 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 | | | | |

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.