

BSQUARE CORP.

BSQR: NasdaqGS

Analyst: Peter Ostrowski
Sector: Information
Technology

BUY

Price Target: \$12.63

Key Statistics as of 10/9/2015

Market Price:	\$7.58
Industry:	Software
Market Cap:	\$90.70 million
52-Week Range:	\$3.45-8
Beta:	1.33

Thesis Points:

- Promising financials
- Internet of Things (IOT) and current projects
- Strong Partnerships
- Expectations

Company Description:

BSQUARE Corporation provides software solutions and related engineering services to companies that develop connected systems in North America, Asia, and Europe. The company markets and sells its products to original equipment manufacturers, original design manufacturers, and corporate enterprises, as well as silicon vendors and peripheral vendors. BSQUARE Corporation was founded in 1994 and is headquartered in Bellevue, Washington.



Thesis

BSQUARE offers a wide variety of software technology mainly in the b2b market. With the recent announcement of the upcoming Internet of Things project with GE in September, along with the current partnerships with Microsoft and Aava, Bsquare's Financials such as ROIC/WACC and EBITDA will continue to increase. This will help sustain the current growth and increase the price of the stock. The future expectations as stated in the call transcript also add a further understand of the positive direction BSQUARE is headed in.

IoT and current projects

Bsquare's new project of Internet of Things (IoT) will essentially sell positive business outcomes through data analyzing software. This is what differentiates Internet of Things from the competition, the competition is selling engineering service solutions while Internet of Things is able to input these engineering solutions directly into their products. In simpler terms this project is able to take raw data from a company and make it easier to understand. This has the capability to help companies lower costs, generate additional revenue and even improve customer satisfaction. This product will generate revenue starting this year through perpetual licensing and subscription revenue. The amount of revenue IoT is projected to receive is currently unknown due to the level of privacy GE is pressuring upon BSQUARE. This level of uncertainty is beneficial as it is difficult for the market to adjust to the value of a company when future figures are not being mentioned by the CEO. There is an encouraging customer pipeline due to the historical expertise Bsquare has in this sector. As a result of this, expenses will increase this year due to future investment in DataV technology (the primary software used for IoT) and product offerings.

Bsquare's product of MobileV is another great B2B product that earns through each device sold for Microsoft and Aava, as well as through Bsquare licenses. This product was one of the main reasons 3rd party sales increased 17 million year over year. 3rd party sales made up 81% of the company's revenue in the 2nd quarter this year showing how profitable licensing is for Bsquare.

Partnerships

Bsquare has had many successful partnerships and has worked closely with companies such as Adobe, Aava, Microsoft, Google, Coca Cola, Ford and most recently General Electric. These partnerships have fortified their success and are a good inclination of future growth. The relationship BSQR has kept with Microsoft is largely based on the MobileV product that was previously discussed. Microsoft is obviously one of the most successful companies and is one of the main components of BSQR's 3rd party revenue which made up 77.1% of total revenue in 2014.

Google, Coca Cola, and Ford are extremely valuable to the company due to their ability to make large orders mainly in the engineering sector. This was a huge reason why the stock doubled in the month of April.

Bsquare's relationship with GE is perhaps the most interesting. Harel Kodesh was a former board member of BSQR and is now the head of GE software. Because of this, Bsquare is able to work with GE on the IoT which can potentially increase the publicity of Bsquare as it has little to no coverage by the street analysts on Wall Street.

Financials

Bsquare's financials have been outstanding over the past year. The August earnings call stated that Bsquare has had a \$5.8 million increase in revenue, a \$1.2 million increase in net income, a \$3.2 million increase in EBITDA while subsequently decreasing operating expenses by \$234,000. These numbers of increase in revenue is directly correlated to the success of MobileV. Bsquare's historical expertise has given them such a strong and encouraging customer pipeline that any new future products will have an immediate impact on the growth of the stock.

The ROIC of the company is currently 19.3 and has been hovering around 20 for the past month. This indicates very strong profitability of the company. This is mainly due to the fact that cash and investments increased from 26.6 million to 29.7 million from the beginning of the year to the present.

The increase in ROIC as compared to the WACC is shown on the graph below. This demonstrates that the return exceeds the cost of capital which is a further indicator of the profitability of the company.



I recommend a buy for BSQUARE due to the current growth of the company and the opportunity for future success. This is largely due to the historical expertise and success of past products. I think that Internet of Things has a high probability of success due to the encouraging customer pipeline Bsquare has shown and the large companies that have already taken an interest. The ROIC compared to the WACC is a big indicator of profitability. The company will be stable for the rest of the year and should start to really grow once 2016 hits and IoT has truly set into the market and begins to really start generating revenue.

The liquidity of the company is shown in the current and quick ratios which are 2.66 and 2.62 respectively. The reason of this is because Bsquare has zero net debt.

Lastly, it is important to note the increase in service gross margin. Bsquare was able to increase this due to improved utilization of existing resources and realized rate/hr.

Bsquare's stock doubled from \$3.50 to \$7 in April the exact reason for this is not specifically mentioned as the company has little to no Wall Street analysts covering it. It is quite obvious after research that this substantial increase is due to the announcement of the success of MobileV and the DataV Internet of Things offering. Also as stated earlier the increases in revenues and margins were remarkable 2014-2015.

Expectations

The end of the year expectations as stated in the call transcript are important to identify as they seem to be realistic and follow a trend. The CEO projects total revenue for the year to be around 26-28 million. The gross margin for services to be in the mid 20% range and continued GAAP profitability. Lastly, because of high credit worthy customers' accounts receivable is expected to increase as Bsquare is allotting extensions on receivables to certain customers. This decision to extend accounts receivable will leverage a strong cash position for the upcoming years.

Conclusion

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BSQUARE Corp.		bsqr	Analyst Peter Ostrowski	Current Price \$7.61	Intrinsic Value \$11.63	Target Value \$12.63	Divident Yield 0%	L-y Return: 65.9%	BULLISH
General Info		Peers	Market Cap.	Professional		Management			
Sector	Information Technology	Avnet, Inc.	\$6,012.23	Chase, Jerry	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014	
Industry	Software	SYNNEX Corp.	\$3,619.06	Heimbigner, Martin	Chief Executive Officer, President and Director	\$0	\$149,968	\$792,824	
Last Guidance	August 13, 2015	ISB Corporation	\$3,890.14	Whiteside, Mark	Chief Financial Officer, Secretary and Treasurer	\$0	\$0	\$248,987	
Next earnings date	November 12, 2015	Model N, Inc.	\$266.28	Caldwell, Scott	Vice President of Solutions	\$379,896	\$212,425	\$495,323	
Market Data		Axow Electronics, Inc.	\$3,511.32	Walsh, Kevin	Vice President of Worldwide OEM Sales	\$0	\$351,691	\$520,124	
Enterprise value	\$61.41	Japan System Techniques Co., Ltd.	\$4,046.22	Wagstaff, Dave	Vice President of Marketing	\$0	\$0	\$0	
Market Capitalization	\$624,448.06	Talkweb Information System Co., Ltd.	\$12,597.72	Past Earning Surprises					
Daily volume	8.34	Softing AG	\$79.73	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"		
Shares outstanding	11.94	Monotype Imaging Holdings Inc.	\$909.56	Last Quarter	0.00%	0.00%	0.00%		
Diluted shares outstanding	12.05	NJK Corporation	\$8,553.62	Last Quarter-1	0.00%	0.00%	0.00%		
% shares held by institutions	60.72%	Current Capital Structure			Last Quarter-2	0.00%	0.00%	0.00%	
% shares held by insiders	4.91%	Total debt/Common Equity (LTM)	0.25	Last Quarter-3	0.00%	0.00%	0.00%		
Short interest	0.40%	Cost of Borrowing (LTM)	0.00%	Last Quarter-4	0.00%	0.00%	0.00%		
Days to cover short interest	0.40	Estimated Cost of new Borrowing	0.00%	Standard error	0.0%	0.0%	0.0%		
52 week high	\$8.00	Altman's Z	2.10	Standard Error of Revenues prediction	0.0%				
52-week low	\$3.45	Estimated Debt Rating	AAA	Imputed Standard Error of Op. Cost prediction	0.0%				
5y Beta	1.65	Current levered Beta	4.72%	Imputed Standard Error of Op. Cost prediction	0.0%				
6-month volatility	66.35%	LTM WACC	4.72%	Proforma Assumptions					
Convergence Assumptions		General Assumptions		Items' Forecast Assumptions			Other Assumptions		
Money market rate (as of today)		0.25%	Operating Cash/Rev.	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year	Tobin's Q	80%	
Risk-Free rate (long term estimate)		2.96%	NWV/Rev.	0.97%	8.63%	0.8%	Excess cash reinvestment	Money market rate	
Annual increase (decrease) in interest rates		0.0%	NPPE/Rev.	0.00%	6.45%	0.6%	Other claims on the firm's assets	\$0.00	
Marginal Tax Rate		34.0%	Dpr/NPPE	1.10%	9.91%	0.9%	Capitalization		
Country Risk Premium		5.5%	NET MARGIN	39.00%	37.21%	-0.2%	100% of all rent expenses are capitalized and amortized 'straightline' over 10 years		
Forecast Year		Revenue Growth Forecast		Op. Exp./Rev.	10.58%	0.5%	100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years		
LTM		Revenue (\$) Forecast		SG&A/Rev.	74.14%	-1.9%	E&P expenses are not capitalized		
FY2015	3.6%	\$105.27	SBC/Rev.	1.03%	2.70%	0.2%	SG&A expenses are not capitalized		
FY2016	3.3%	\$109.02	Rent Exp./Rev.	1.14%	2.48%	0.1%	Valuation Focus		
FY2017	3.1%	\$112.60	R&D/Rev.	1.67%	13.88%	1.2%	DCF Valuation	100%	
FY2018	3.1%	\$116.14	E&D/Rev.	0.00%	0.00%	0.0%	Relative valuation	0%	
FY2019	3.0%	\$119.71	ROE	10.61%	34.23%	2.4%	Distress Valuation	0%	
FY2020	3.0%	\$123.34	P/E	16%	16.93%	0.05%	Monte Carlo Simulation Assumptions		
FY2021	3.0%	\$127.06	P/BV	14.96x	11.62x	-0.33x	Revenue Growth deviation	Normal (0%, 1%)	
FY2022	3.0%	\$130.89	Debt/Equity	2.11x	1.97x	-0.01x	Operating expense deviation	Normal (0%, 1%)	
FY2023	3.0%	\$134.82	Unlevered beta	25%	60%	3.5%	Continuing Period growth	Triangular (5.335%, 5.5%, 5.665%)	
FY2024	3.0%	\$138.87	Cost of Borrowing	0.40	1.15	0.08	Country risk premium	Triangular (2.91%, 3%, 3.09%)	
Continuing Period	3.0%	\$143.03	Dividends/REV	2%	6%	0.4%	Intrinsic value $\sigma(t)$	\$0.02	
		\$147.32		0%	2%	0.2%	1-year target price $\sigma(t)$	\$0.02	
Valuation									
Forecast Year	ROE	Ke	Common Equity	Enterprise Value	Net Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share	Monte Carlo Simulation Results	
LTM	16.2%	5.5%	\$37.92	\$163.25	\$16.23	11.94	\$11.41		
FY2015	23.8%	5.9%	\$49.87	\$178.86	\$16.03	11.94	\$12.39		
FY2016	19.2%	6.3%	\$67.76	\$197.72	\$15.79	11.94	\$13.44		
FY2017	16.9%	6.8%	\$87.98	\$219.86	\$15.49	11.94	\$14.65		
FY2018	15.3%	7.2%	\$110.65	\$244.59	\$15.12	11.94	\$15.98		
FY2019	14.1%	7.6%	\$135.00	\$271.38	\$14.68	11.94	\$17.42		
FY2020	13.2%	8.0%	\$156.06	\$295.60	\$14.14	11.94	\$18.77		
FY2021	12.9%	8.5%	\$179.06	\$322.81	\$13.86	11.94	\$20.26		
FY2022	12.7%	8.9%	\$204.11	\$353.03	\$4.21	11.94	\$22.28		
FY2023	12.4%	9.3%	\$231.31	\$386.75	\$0.00	11.94	\$24.06		
FY2024	12.1%	9.8%	\$260.77	\$424.52	\$0.00	11.94	\$25.81		
Continuing Period	16.9%	10.1%	\$156.12						
Sensitivity Analysis									
Revenue growth variations account for 95.9% of total variance									
Risk premium's variations account for 2.5% of total variance									
Operating expenses' variations account for 1.4% of total variance									
Continuing period growth variations account for 0.2% of total variance									

The 3 σ (s)-adjusted intrinsic value is \$11.63; the 3 σ (s)-adjusted target price is \$12.63; and the analysts' median target price is \$0