



**One Stop Systems, Inc.**

**First Quarter 2021 Earnings Conference Call**

**May 13, 2021**

## C O R P O R A T E P A R T I C I P A N T S

**David Raun**, *President and Chief Executive Officer*

**John Morrison**, *Chief Financial Officer*

**Jim Ison**, *Chief Sales and Marketing Officer*

## C O N F E R E N C E C A L L P A R T I C I P A N T S

**Scott Searle**, *ROTH Capital Partners*

**Joe Gomes**, *Noble Capital Markets*

## P R E S E N T A T I O N

### Operator

Good afternoon and thank you for joining us today to discuss One Stop Systems' Financial Results for the First Quarter ended March 31, 2021.

With us today are the Company's President and Chief Executive Officer, David Raun, and Chief Financial Officer, John Morrison. Also joining today is the Company's Chief Sales and Marketing Officer, Jim Ison.

Following their remarks, we will open the call to your questions. Before we conclude today's call, I will provide some important cautions regarding the forward-looking statements made by management during the call. I'd also like to remind everyone that today's call will be recorded and will be made available for replay via the instructions in today's press release in the Investors section of the Company's website.

Now, I'd like to turn the call over to OSS's President and CEO, David Raun. Please go ahead, sir.

### David Raun

Thank you, James, and good afternoon, everyone. Thank you for joining us today.

It's been encouraging to see the state of California and the country finally opening up over the last couple of months and life starting to return to normal. Likewise, it's also great to have our business returning to normal, and we have some excellent results for the first quarter of 2021 to share with you today.

First, we drove a \$2 million improvement in Adjusted EBITDA over the first quarter of 2020 on similar revenues. This result was a combination of increased gross margins of 7.9%, percentage points, and decreased expenses of \$749,000, which generated positive Adjusted EBITDA of \$1.1 million, a record for OSS in the first quarter. We also produced first quarter GAAP net income, another first for the Company.

In addition, we exceeded our top line revenue expectations for the first quarter by more than \$300,000, nearly matching last year's first quarter which was a record first quarter for OSS unhindered by the pandemic at the time. This was a direct result of continued improvement with some of our largest customers, as well as progress on the diversification front. This strong performance was tied to the transformative steps we took last year that laid a new foundation for better bottom-line execution and growth. These steps include a new senior leadership and corporate reorganization, reduced spending, focus on margins and enhanced value proposition, while also adding three new independent board members.

As shared with you during our previous earnings call, we were also executing on our new long-term strategic vision and product road map designed to create greater shareholder value. This multi-year plan will strengthen our market position and value proposition in a fast-growing segment of the edge computing market with the intent of clear leadership in what we call AI transportable.

AI transportables are mobile, high-performance computing systems delivering the latest in data acquisitions, storage, and accelerated computing for AI applications, particularly where actionable intelligence is required at the very edge. These tend to be applications that are challenging, in challenging and harsh environments, which plays to our strength. AI transportable solutions are currently the fastest-growing, highest-margin segment of our business, and it contributed over 25% of the revenue in Q1.

A perfect example is our recent win of a long-haul trucking program for our new AI transportable EB4400 solution. This marks our second significant program win for autonomous vehicles, and is an excellent example of the additional products we are developing to address this quickly expanding market.

Earlier today, we posted a 15-minute video presentation to our website where I share more on AI transportable strategy and the market opportunities ahead. After today's call, you can find it on the Investor Relations section of our website at [onestopsystems.com](http://onestopsystems.com). Jim Ison, our Chief Sales and Marketing Officer will be giving you more insight about our AI transportable strategy and related customer activity later in the call.

Before I get into the outlook for the rest of the year, I'd like to turn the call over to our CFO, John Morrison, who will take you through the financial details for the first quarter. John?

**John Morrison**

Thank you, David. Good afternoon, everyone. I appreciate you joining us today.

Earlier today, we issued a press release with our results for the first quarter ended March 31, 2021. The release is available in the Investor Relations section of our website at [onestopsystems.com](http://onestopsystems.com). As David mentioned, we generated strong revenue and improved profitability. We achieved this by realizing improved gross margins on sales of key products while reducing operating expenses through cost-containment and efficiencies. All this resulted in greater profitability and positive cash flow.

Overall, it was a quarter where the entire Company executed on our CFOs—CEOs—I would like to take credit for it I guess—CEOs focused vision. Now, for the details. Looking at our statement of operations, we achieved revenue in the first quarter of \$13.3 million, similar to the record first quarter of last year, which was not impacted by the pandemic, as mentioned by David. There was a notable change in customer and product mix that contributed to better overall margins in the current year.

For the revenue breakout for our business segments in Q1, our core OSS business increased to \$8.6 million as compared to \$8.4 million in the same year-ago period. Bressner, our European subsidiary, contributed \$4.7 million in the first quarter, as compared to \$4.9 million in the same year-ago period.

Our gross profit in the first quarter of 2021 was \$4.4 million, as compared to the \$3.4 million in the first quarter of 2020, an increase of \$1 million. We have strong gross margins of 33.3%, an increase of 7.9 percentage points versus the same year-ago period. The significant improvements to the quarterly margins were attributable to a higher mix of government business of \$2 million generated by three of our 2020 design wins. These products included the data center in the sky, data storage units, and 4U pro.

Gross margins for our core OSS business increased 10.4 percentage points over the same year-ago quarter to 37.9%. Likewise, Bressner's gross margin increased to 24.9% in the first quarter as compared to 21.9% in the same year-ago period. In both cases, this was attributable to predominance of customers purchasing a product mix that has higher gross margins and has an increased focus through the organization on improving margins. Our overall operating expenses decreased 15.3% to \$4.2 million in the first quarter of 2021.

Our operating expenses as a percentage of revenue decreased to 31.2% in the first quarter compared to 36.7% in the same year-ago quarter. These improvements were primarily due to the cost reduction initiative that we implemented in April 2020, including streamlining and reorganizing the Company and implementing new cost-containment programs. Income from operations grew to \$275,000 compared to loss from operations of \$1.5 million in the same year-ago quarter.

Net income on a GAAP basis totaled \$21,000 in Q1 2021. This compares to net loss of \$1.1 million or \$0.07 per share in the same year-ago period. On a non-GAAP basis, net income improved to \$643,000 or \$0.03 per diluted share in Q1 2021. This is in comparison to our non-GAAP net loss of \$714,000 or \$0.04 per diluted share in the same year-ago period. Adjusted EBITDA, which is another non-GAAP metric, increased to \$1.1 million in Q1 as compared to negative Adjusted EBITDA of \$957,000 in the same year-ago quarter.

Now, turning to our balance sheet, our team worked hard to improve our accounts receivable collections and timed our accounts payable more closely to the day sales outstanding. As a result, \$3.2 million in working capital was freed up in the quarter.

In March of this year, you may recall, we completed a registered direct equity offering that further fortified our cash position. We have also realized significant cash gains through a combination of lower expenses, increasing efficiencies, and improvement in working capital. All of this has resulted in a cash and cash equivalents increasing \$13.3 million as compared to December 31, 2020. At the end of the quarter, the Company had a cash balance of \$19.6 million, the highest in Company's history.

Recently, we also learned that our \$1.5 million PPP loan that we received last year has been forgiven. Our strong cash position is enabling us to execute on our plan, investing wisely in strategic initiatives to fuel growth, including research and development of new products and technologies. This completes our financial review.

I would now like to turn the call over to our Chief Sales and Marketing Officer, Jim Ison. Jim?

**Jim Ison**

Thank you, John, and good afternoon, everyone.

In Q1, we saw both near-record revenue and strong bookings, along with three new major account wins. Major program wins are those expected to yield \$1 million or more of revenue within four years. These three new wins include a mobile command center, a virtualized GPU compute platform, and a rugged tablet point-of-sale system. Two of the three wins are with new customers.

As David mentioned earlier, our main sales focus of 2021 is AI transportable solutions for rugged edge applications. Over one half of the 2021 major accounts we're pursuing are in the AI transportable market. We see this market as directly tied to our customer value proposition and key strengths. For us, AI transportables are typically higher-margin business, where we enjoy an unmatched competitive advantage. We're uniquely capable of providing high-performance AI platforms in the most harsh and challenging environments on the very edge.

Our AI transportable solution deliver data center like performance, using the very latest and high-performance computing and NVMe storage technology, leading-edge applications with no compromise. Our systems provide AI data capture, trading of deep neural networks, and large-scale AI inference for some of the world's most demanding edge AI applications. Our marketing engine is re-energizing as we resume in-person events later this year. Even as we continue to expand our virtual events, which have been very effective targeting AI transportable customers.

In fact, we recently co-hosted a well-received webinar called Turning Large Data Set IP into AI Gold with a guest speaker from KIOXIA, our flash memory partner. The recording is available on our website. KIOXIA was formerly a division of TOSHIBA, and is well-aligned with our AI transportable strategy, as they provide the highest performance PCIe Gen four NVMe storage, which meets the certified encryption security requirements at the edge.

In August, we plan to participate in live demo exhibits at SA Aerospace (phon) defense and security equipment international, AI summit and supercomputing. Looking ahead, we continue to have our sights set on driving high-margin strategic sales, further diversifying our customer base, and executing on our new AI transportable market initiatives. We expect this focus to drive revenue growth and industry expansion opportunities for OSS.

With that, I'd like to turn the call back over to David for our Q2 outlook.

### **David Raun**

Thank you, John and Jim.

During a challenging 2020, we focused on making the Company stronger and better positioned for growth. We have made excellent progress in this regard, and we expect to continue to see improvements in overall market conditions. In all, it was a robust first-quarter where our revenues were restored to pre-COVID levels while producing much better bottom line results and setting multiple new OSS records for the first quarter of the year. This includes the positive swing of over \$2 million in Adjusted EBITDA and delivering our first positive net income for our first-quarter.

Even our largest customer in the media and entertainment space has started to rebound nicely for the second quarter in a row with increased sales of their new virtual product line. Our cash position has grown from about \$3 million a year ago to over \$19 million today providing us the strength and opportunity to invest in our future. Looking ahead, we'll continue to use our expertise and industry-leading capabilities to bring the performance of the data center to the very edge without compromise.

As I mentioned earlier in the call, I encourage you to listen to my video presentation posted earlier today which outlines how we plan to aggressively capitalize on this growing market and further carve out a leadership position in AI transportable. I look forward to updating you with our progress in this exciting fast-growing space that leverages our greatest strengths.

Now that we're halfway through the quarter, we can provide a revenue expectation of about \$14.4 million for the second quarter. This represents 24% growth over the second quarter of last year. We also expect

fundamental improvements we've made throughout the organization to continue to drive positive bottom-line results and generate greater shareholder value. Assuming continued industry restoration, we see our progress gaining momentum on all fronts, including revenue growth.

With that, I'd like to open it up to the call for questions. James?

**Operator**

Thank you.

I will go first to Scott Searle with ROTH Capital.

**Scott Searle**

Hey, good afternoon. Thanks for taking my questions.

Nice job, guys, in a very difficult operating environment. Maybe for starters, could you just calibrate us in terms of your largest customer, how big they were in the quarter. Maybe give us some updated thoughts as well on component availability particularly memory and GPUs. How you're positioned going into the second quarter and second half of this year. It sounds like Disguise has stabilized and started to recover. I think last year it was about an \$8 million headwind. I wonder if you could give us some thoughts in terms of what that's looking like for 2021.

**David Raun**

First of all, our largest accounts, we have one in the military space and then Disguise. Disguise, let's talk about that first. They have, for the second quarter in row, produce greater—we produce greater revenue with them. This is coming through their virtual product line, which is doing really well. We recently talked to them, and they are expecting this product line to be bigger than their large gathering product line. That's what we're seeing, and we expect that to continue to grow through the year. Sometime in the second half for the large gathering part of the business to kick in which is not part of this number, but these good numbers are growing and significantly different than what we saw at the bottom during last year.

The component supply matter. Fortunately, the team has done an excellent job of, one way or another, finding components, so it has not hit our revenue in any significant way. One of the comments is one of the biggest shortages in the market are GPUs, this tends to be more of the mid and tight GPUs we're planning at the very high-end, so it doesn't impact us as much. That doesn't go without saying the fact we've got a plan ahead; we may take a little bit more inventory in place, but we seem to be making the right decisions so far.

**Scott Searle**

Great. Dave, how big was your largest customer in the quarter?

**David Raun**

Is that something we normally share? We did \$3.3 million with them.

**Scott Searle**

Okay. Great. Thank you. Maybe, Jim, it sounds like you continue to get wins, particularly in new area of AI transportable. I am wondering if you could talk a little bit about the pipeline. I think in the past you've given a number; I want to say in the fourth quarter there were 24 various RFPs out there in different stages. Kind of how that's looking and how that's shaping up.

**Jim Ison**

Those come and go. We generally are pretty conservative with those. They're ones that we think we have a 60% or better chance to close. We're in the, right now, in the 24 range. We've closed three of those in the first quarter and have already closed two in the second quarter, and we'll report on that, the details, later on next quarter. The wins are continuing to add up, they're layering on. That's where we're seeing some of the successes. Like we said, about half of those, little more than half actually, are in the AI transportable space, where we tend to have a better chance of winning at a better margin.

**David Raun**

I would add to that, Scott, that one of the trends is because of our focus on margins and the focus on AI transportable, and just the general culture of the Company shifting. The quality of these wins is increasing. That's going to continue to pay dividends for us.

**Jim Ison**

Lastly, if I could, from a high level, Dave, as you are looking at some of these newer opportunities, you've gone through the strategic review of AI transportables. You've been running things very tightly over the last 12 months. Do you have to spend a little bit more now? Are there some different channels that you need to go after, and/or technologies that are not currently part of the portfolio?

Then maybe as part of that as well, to wrap it up, what is the financial model looking like for you guys now? You did a great job from a gross margin perspective in the first quarter. Should we be expecting the long-term targets in terms of gross margins and operating margins to be somewhat higher than we've seen historically? Thanks.

**David Raun**

Definitely, our intent is to increase our overall gross margins year-over-year, as well as our operating margins. The spending, we're watching very closely. We continue to be in a mode that we're willing to make investments, but I sit down with the exec staff, and I want to see what the contribution of adding this additional person.

We're currently in the search for a senior sales person to focus more on the military, and we're currently, because of new programs coming in, looking for some additional engineering talent. We're going to run it tight, but we will not do it in a way where it puts at risk revenue. I'm willing to make those investments along as it ties and people can justify it. That's how we're going to move forward. In saying that, I believe we can grow nice in the future years and continue to be profitable in the process.

**Scott Searle**

Great. Thank you.

**Operator**

Next, we'll hear from Joe Gomes with Noble Capital.



**Joe Gomes**

Good afternoon. Thanks for taking the questions.

**David Raun**

Good afternoon, Joe.

**John Morrison**

Hi, Joe.

**Joe Gomes**

One of the things I think that everyone would like to get their arms around a little bit better; we see all of the million-dollar-plus revenue opportunity wins, but we're trying to get a little better handle on what they could all mean going forward. If I just look at your defense, you got the five-year \$36 million contract for the Poseidon.

Then you mentioned a number of other military type of contracts that you've won in awards. Can you size the ultimate potential of those? Are they in the same range as the Poseidon win? Anything you could give on that would be great.

Also, you had mentioned in the fourth quarter, on the military side, that about a million dollars of revenue had slipped from the fourth quarter into the first quarter of this year. Excluding that million dollars, did this military come in where you expected, or hopefully better than expected? If you can answer those, it would be great.

**David Raun**

Let me take a stab at it first and then I'll let Jim. The wins are mixed; we definitely have other very large ones like you just talked about. You asked about the military portion of business, we believe goes from being in the 30% area to 40%, or 50% over the next few years. Because we're focused there, and that's where a lot of activity is.

The margins are stronger in that area. Also, on just the general revenue, what our objective, as we've stated before, I believe, is that we want to get this year out in the double-digits, but strengthen that in future years to be more in the 20% growth rate. We think the pipeline that we're putting together allows us to do that.

There was another part of your question I dropped that one. What was the other one? (Multiple Speakers). Go ahead.

**Jim Ison**

I think you were just trying to size the military business piece of it. Just as a Q1 point of reference, it was about 25% of our overall revenue, about 37% of OSS's revenue was military in Q1, which is higher than it's been in the past. That can give you some indications there.

As far as the size of each win, they do vary. Just as a word contract, as we get a lot of purchase orders, single type purchase orders from some of these programs, and then when you are locked into a multi-year win is when you get the contracts when it's a pricing contract. We're still working towards—some of



these aren't even hitting production yet, which has a large potential when we do announce those larger contracts.

**David Raun**

Let me add to that. Thanks for catching what I missed. Part of your question was about the \$1 million moving into the quarter. Based on what Jim just said, we had other military businesses show up in Q1. I think what you're going to see is we'll still be the strongest in the second half, but because we have more accounts, and a bigger percentage of that, and growing, it will smooth out a little bit more, and we're enjoying some of that now.

**Joe Gomes**

Thanks for that. You mentioned about all the cash on the balance sheet and the forgiveness of the PPE loan. You still have some other debt on the balance sheet, any thoughts of using some of that cash to clean that up, or are you comfortable with the other debt that's on the balance sheet at this point?

**John Morrison**

So, there are two pieces of debt. The first part, that is domestic debt is the \$2.5 million on our senior secured debt. As you know, that converts at a price of \$2.50 a share as disclosed in the financial statements. It is unlikely that we'll ever be—most likely scenario is that will be converted to equity upon maturity. With respect to any other debt that is foreign debt associated with Bressner is purely working capital to finance inventory, and we received those loans. They are government-subsidized at a very minimal interest rate.

**David Raun**

The total (multiple speakers).

**John Morrison**

The 2.5 domestic and then the difference is foreign.

**Joe Gomes**

Thanks for taking the questions, guys. Again, nice quarter. Thank you.

**David Raun**

Thank you.

**John Morrison**

Thank you.

**Operator**

We have no more questions. I'd like to turn the conference back to our speakers for closing remarks.

**David Raun**

Thank you, James, and thank you, everyone, for joining us today. I'd like to express appreciation to all our team members for their dedication to success of OSS and the commitment to quality and productivity, especially during the challenges OSS has faced over the past year.

I'd also like to thank all our stockholders for their support and joining us on this journey of growth and innovation. We believe that the best is yet to come, and we look forward to talk to you again in the near future and reporting our progress as we pursue the many great opportunities ahead. Meanwhile, feel free to reach out to John, Jim, or me at any time.

James, go ahead and wrap up the call.

### **Operator**

Thank you.

Before we conclude today's call, I would like to provide the Company's Safe Harbor statement that includes important cautions regarding forward-looking statements made during today's call. One Stop Systems cautions you that statements in the presentation are not a description of historical facts, are forward-looking statements. These savings are based on the Company's current beliefs and expectations. Such forward-looking statements include those regarding the Company's expectations for revenue growth generated by new products, design wins, or M&A activity. Inclusion of such forward-looking statements and others should not be regarded as a representation by OSS that any of its plans will be achieved.

Actual results may differ from those set forth in the presentation due to the risks and uncertainties inherent in our business, including without limitation, that the market for our products is developing, and may not develop as we expect. Global pandemics, or other disasters, or public health concerns, including COVID-19, and regions of the world where we have operations, customers, or source material or sell products may affect such market. Our operating results may fluctuate significantly, which would make our future operating results difficult to predict and could cause operating results to fall below expectations or guidance. Our ability to successfully integrate the operations systems, technologies, product offerings, and personnel with acquired companies may prove difficult and adversely affect our financial results. Our products are subject to competition, including competition from the customers to whom we may sell, and competitive pressure from new and existing companies may harm our business sales, growth rates, and market share. Our future success depends on our ability to develop and successfully introduce new and enhanced products that meet the needs of our customers.

The likelihood of our design proposals becoming design wins is uncertain and revenue may never be realized. Our products fulfill specialized needs and functions within the technology industry and such needs or functions may become unnecessary, or the characteristics of such needs and functions may shift in such a way as to cause our products to no longer fulfill such needs or functions. New entrance into our market may harm our competitive position. We rely on the limited number of suppliers to support a manufacturer design process. If we cannot protect our proprietary design rights and intellectual property rights, our competitive position could be harmed, or we could incur significant expenses to enforce our rights. Our international sales and operations subject us to additional risks that can adversely affect our operating results and financial condition, and if we fail (phon) remedy material weaknesses in our internal controls or financial reporting, we may not be able to accurately report our financial results, and other risks described in our prior press release and in our filings with the Securities and Exchange Commission, SEC, including under the risk heading risk factors in our annual report on Form 10-K and any subsequent filings with the SEC.

You are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date of the conference call, and we undertake no obligation to revise or update this information to

reflect events or circumstances after this date hereof. All forward-looking statements are qualified in their entirety by this cautionary statement, which is made under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Before we end today's conference, I would like to remind everyone that this call will be available for replay starting later this evening through May 27. Please refer to today's press release for dial-in and replay instructions available via the Company's website at [ir.onestopsystems.com](http://ir.onestopsystems.com).

Thank you for joining us today. This concludes our conference. You may now disconnect.