



One Stop Systems, Inc.

First Quarter 2020 Conference Call

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CORPORATE PARTICIPANTS

David Raun, *Interim President, CEO & Director*

John Morrison, *Chief Financial Officer*

Jim Ison, *Chief Sales & Marketing Officer*

CONFERENCE CALL PARTICIPANTS

Scott Searle, *ROTH Capital*

Joe Gomes, *Noble Capital*

Ruben Roy, *The Benchmark Company*

Aman Gulani, *B. Riley, FBR*

Dave Flowers, *Private Investor*

PRESENTATION

Operator

Good afternoon. Thank you for joining us today to discuss One Stop Systems Financial Results for the First Quarter Ended March 31, 2020.

With us today are the Company's Interim 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'll provide some important cautions regarding the forward-looking statements made by the Management during this call. I would 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 Interim CEO, David Raun. Please go ahead, sir.

David Raun

Thank you, James, and good afternoon, everyone.

To begin, I would like to thank all our employees, partners, and customers for their hard work, support, dedication during these uncertain times. On today's call, we will hope to provide a transparent view into our businesses.

On the COVID-19 front, we are pleased to report the Company still does not have any known cases of the virus among the team, and that we've been able to continue to build, process and ship customer orders. As pointed out in March, the medical, military and other critical applications served by our product requires that we remain in operation and continue to provide the essential infrastructure products that we design and manufacture.

Although One Stop Systems, like other companies, has been impacted by COVID-19, our teams acted swiftly in Q1 to secure product early and pivot to a virtual workplace. This, plus a strong close, resulted in a solid topline results above our first quarter expectation with revenues up 33% over last year to \$13.4 million. The growth was largely driven by our expanded product offering and strengthened sales capabilities.

As many of you know, the core of our value proposition is our ability to design and build ultra-high performance edge computing products that leverage our skills in the areas of switch fabric and the ability to manage all the challenges associated with high-performance communication protocols like PCI Express Gen 4. Building off this expertise during the quarter, we introduced new PCI Express Gen 4 expansion systems, adding to our portfolio, AI on the Fly product. By combining our proprietary technology, know-how and design with the latest Nvidia GPUs for example, we are leading the market in Gen 4 technology that powers AI applications at the edge.

Our strength in this arena led to \$2.1 million in orders to-date for OSS AI on the Fly system element for use in next-generation autonomous vehicle. These customers are a great example of how OSS, CDI and the Bressner teams leverage their respective skill sets to provide a compelling solution for both a leading international rideshare company and a European auto manufacturer. Autonomous mobility represents a market segment for us that we anticipate will grow over the coming years to become one of our top markets in term of overall sales.

While COVID-19 has been changing many things around the globe, One Stop Systems has also been changing over the last few months, building a stronger foundation for the future. This all began with the OSS Board of Director's decision in February to make a change in the CEO role to bring on a different skill set. Based on my Public Company CEO experience, plus familiarity with the industry, the Company and the Management team, I was asked to take over as Interim CEO.

With this change, the Management team immediately started working to map out a plan of action on several fronts, which included a reorganization, expense reduction and securing additional capital. I am pleased to report, we have successfully executed on all these objectives.

On the organizational change and expense reduction front, some of the key objectives include improvements in operational efficiency, margins, product value proposition, leadership positioning in specific markets and profitability, as well as better defined higher return product roadmaps.

Other changes included the addition of the VP of Product Marketing, the elimination of two other executive roles, skill set realignment, and the acceleration of the full integration consolidation with CDI organization. While the objectives associated with most of these recently implemented changes will take time to yield the desired effect and propel the Company to the next level, we expect the benefit from the expense reductions to start to show in the current quarter and will be fully realized in the second half.

We removed approximately \$2.5 million to \$3 million in annual spend. These reductions were implemented to help secure sustainability in light of the current uncertainty in the market as well as reduce our expense base to drive higher profitability as the market returns to normal. Although COVID-19 may have influenced these changes, these changes were needed, and most would have been implemented regardless. Our current team is solid and motivated. We will carefully add key fresh talent to organization when appropriate.

On the cash front, we successfully received funding for additional \$4 million this month, which John will provide more color on in his section. Again, for today's call, I invited Jim Ison, our Chief Sales and Marketing Officer to talk about customer activity, design wins and new opportunities. But first, I'd like to turn it over to our CFO, John Morrison, who will take you through the financial details for the quarter. John?

John Morrison

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

Earlier today, we issued a press release with our results for the first quarter ended March 31, 2020. The release is available in the Investor Relations section of our website at onestopsystems.com.

Now starting with our statement of operations, our revenue in the first quarter increased approximately 33% to \$13.4 million, slightly exceeding the top of our quarterly guidance. Our first quarter was not significantly impacted by COVID-19 as our orders were intact and our supply chain had been secured. During the first quarter, our observation was that our customers were not yet feeling the full impact of the pandemic and the economic downturn.

We are now beginning to see the impact of the COVID-19 pandemic with possible disruption to components of our supply chain and some orders pushed out. Every day, we receive new information, which introduces new uncertainty, which may or may not impact our business. Though we make every effort to read and respond to these changes, we are not able to comfortably quantify the potential of their impact on our business.

Now focusing on the results of Q1, the increase in revenue was primarily driven by a diverse set of customers, which included customer server for our core media and entertainment business, which provided over one-third of our growth. Our revenue growth was also driven by PCIe Gen 4 and AI on the Fly technology for autonomous driving vehicle products sourced through OSS Classic, Bressner Technology and Concept Development with each entity producing customers in our top 10 list.

OSS Classic contributed 78.4% of our quarterly growth with total revenue of \$7.8 million for the first quarter. Bressner contributed \$4.9 million, representing a growth rate of 11.8% over the year ago quarter, and CDI had a revenue of \$622,000 with growth of 9.8%. Overall, gross margin was 25.4%, producing \$3.4 million of gross profit. This compares to 24% gross margin generating \$2.4 million in the same year-ago quarter.

Gross margin for the OSS Classic business was down slightly to 28.1% from 28.7%. Both Bressner and CDI's gross margins improved, contributing 21.9% and 19.7%, respectively. As planned, our overall quarterly margins came in lower than our overall annual percentage. This is consistent with the prior year first quarter as our higher margin military-related sales traditionally ramp up in the second half of the year due to the government purchasing cycles.

Our total operating expenses increased 10.4% to \$4.9 million. We would have recorded a decrease in quarterly operating expenses were it not for one-time severance benefits totaling \$545,000 relating to the

departure of our former CEO. Q1 also benefited from some of the initial cost reduction, as David mentioned.

Our total operating expenses decreased as a percentage of revenue to 36.7% in the first quarter of 2020 as compared to 44.2% in the same year-ago quarter. As a result, our loss from operations for the current quarter was reduced by \$521,000 as compared to the loss we incurred in the same year-ago period. This improvement in our operations is offset by a reduction in our tax benefit for the quarter of \$635,000 as compared to the prior year's first quarter.

In Q1, on a GAAP basis, our net loss attributable to common stockholders totaled \$1.1 million or a loss of \$0.07 per share as compared to a loss of \$545,000 or \$0.07 per share in the same year-ago period. On a non-GAAP basis, our net loss attributable to common stockholders totaled \$714,000 or a loss of \$0.04 per share as compared to a loss of \$428,000 or \$0.03 per share in the year-ago period. Adjusted EBITDA, another non-GAAP metric was a negative \$950,000 in Q1 as compared to a negative \$1.4 million in the same year-ago period. We provide definitions of these non-GAAP terms and reconciliation to GAAP in today's earnings release.

Now turning to the balance sheet, cash and cash equivalents totaled approximately \$3 million at March 31, 2020, as compared to \$5.2 million at December 31, 2019. The decrease was primarily due to cash used in operations and financing activities. Subsequent to the end of the quarter, we have raised approximately \$2.5 million in a convertible debt offering, which has stabilized our cash position. We also recently received a Paycheck Protection Plan loan of approximately \$1.5 million for total proceeds of \$4 million. Inclusive of these financing proceeds, we currently have cash on hand today of approximately \$5 million.

We believe our cash position and available funds provide the Company with the sufficient liquidity to meet our cash requirements for current operations. We have continued to work closely with our customers to ensure collections and properly manage our liquidity and still have about \$4.5 million of the previous \$5.8 million in outstanding receivables due from our major media and entertainment customer who is paying down their balance currently agreed upon payment terms.

Now this completes our financial overview for the quarter. I would like to turn the call over to Jim. Jim?

Jim Ison

Thank you, John. While COVID-19 has created many challenges, I'm pleased with how the sales team has embraced operating in the virtual environment. Activity has been strong and the customers continue to be very engaged. Evidence of our continued engagement includes premium program wins, exceeding \$1 million each that we secured in the first quarter of 2020. Two of these three wins are with new customers, one military and one industrial OEM. As of today, we have 27 large opportunities in our pipeline. Eight of these involve our leadership in our PCI Express Gen 4 product.

It is important to note that as of today, we have not seen the virus impact our ability to identify and close new opportunities, and we remain optimistic about our future. While 2019 was the year of Gen 4 development and customer prototyping, 2020 has transitioned into a production year. As we announced earlier this week, we have received over \$3.5 million of production orders for our Gen 4 PCI Express products from multiple OEM customers for delivery in 2020. These OEM orders represent the highly desirable sticky engagements we like to focus on, where our technology is built into the OEM design leading to repeat orders.

These orders fit both our product focus of NVMe flash storage and GPU accelerators, as well as our market focus of specialized high-performance edge computing for military, instrumentation, and

Composable Infrastructure solution. We generated over \$0.5 million in Gen 4 revenue in the first quarter of 2020 compared to about \$380,000 for all of last year. For our AI on the Fly solution as Dave mentioned, we received more than \$2.1 million in purchase orders from two customers for products to be used in next-generation autonomous vehicles. We shipped \$390,000 to those customers in the first quarter and have bookings for an additional \$1 million to ship by the end of 2020.

As we mentioned in the March 2020 call, we have shifted the portion of our marketing budget normally reserved for trade shows to more digital marketing as most of our customers are working from home. For example, we hosted a successful webinar last week, the first in our planned 2020 webinar series. I'm pleased to say, yielded a similar number and quality of leads as we would expect from our in-person trade show. The high-performance edge computing webinar included participation in joint marketing efforts with NVIDIA and Marvell. We have provided a recording, which is available for download on the main banner on our homepage at onestopsystems.com.

Now with that, I'd like to turn the call back over to Dave.

David Raun

Thank you, John, and Jim.

The full impact on the economy from COVID-19 is yet to be done. We believe we have taken the appropriate action to prepare OSS for a range of possibilities as we continue to book and ship business. As the world economy eventually improves following the eventual defeat of the global pandemic, we stand to benefit from our recent internal transformation and continued leadership in high-performance computing at the edge. While we feel uncertain about the current quarter, like many companies who have elected not to provide guidance, in the spirit of transparency, we are providing a minimum baseline or expected revenue of \$10 million for Q2.

For the first six months of 2020, given our first quarter revenue results, the baseline at \$10 million would put us at par with last year. While we are diligently working multiple challenges in parallel to bring our performance up above this baseline, we want to be realistic in terms of setting expectations giving the market variables. The impact and uncertainty are primarily in two areas.

First, although our large media and entertainment customer came in close to forecast in Q1, our shipments in the current quarter are down significantly. The Management teams from both companies are in constant contact and it appears the customer's product offering is well-positioned to capitalize on the market return.

Second, although we continue to work the issues daily, we have been impacted by supply chain issues, especially for high-end PCB boards that affect multiple customer orders. Fortunately, other than these dynamics, customers want our product and the demand remains solid. In terms of the second half of this year, we see it being consistent with prior years, producing stronger revenue and margins as compared to the first. While the impact of the Coronavirus continues to create uncertainty, the programs that we expect to drive higher revenue and margins appear to be on track. We believe the combination of lower spend from the implemented cost reduction, higher margin and increased revenues should start to materialize into more attractive financial performance.

When I stepped into this role of Interim CEO, on February 15, I saw the need for change and expected many challenges. But COVID-19 added urgency. Our teams have responded amazingly well and are working hard to minimize the disruption, but also taking important steps needed for OSS to become stronger and get to the next level.

What should One Stop Systems look like when we get to this next level? OSS should emerge as a clear leader in high-performance edge computing with an enhanced value proposition that focuses on specific markets that command higher margin. We should have a greater level of recurring business with a more balanced top 10 customers. This should be driven by our current team plus fresh talent, being challenged to discover innovative ways to increase our efficiency, IT stickiness and along the way, create greater barriers of entry for our competitor.

This should include a greater flow of scalable standard product while increasing our value with our key customers who need our custom products. While not easy, we have taken the first steps towards this future, and I am confident in our evolving vision and capabilities and proud to be part of the OSS team.

Now with that, I'd like to open up the call to your questions.

Operator

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star, one to ask a question.

We'll take our first question today from Scott Searle with ROTH Capital.

Scott Searle

Hey, good afternoon. Thanks for taking my questions. Dave and John, thanks so much. We appreciate the increased transparency on the call and additional color that you provided with the business segments.

Maybe diving into the \$10 million outlook, I just want to clarify, is that a baseline number that you have visibility to today? Or maybe help us understand what incremental business you need to win to get to a number like that? Then help us understand some of the moving parts. You talked about certainly, Disguise is seeing some sequential headwinds, but this is typically a quarter when you see Raytheon, I think, bounce up a little bit in terms of the military contribution. What are the puts and takes? What are you expecting to grow a little bit sequentially? What are facing some of those headwinds?

You've had some other design wins that you've talked about as well in terms of the PCIe Gen 4 wins as well as autonomous vehicle. How should that start to ramp up in this quarter? Is that, I guess, long-winded, is the \$10 million a baseline and there's some other leverage to the upside?

David Raun

Yes. We debated long on how we wanted to position this, but we wanted to be able to provide some kind of minimum baseline. We feel very solid with the minimum baseline at the bottom line. We have good visibility into that. But we have some dynamics of other things, which are basically challenges that we're working through. If some of them materialized and we're able to accomplish what we can, then that number should go up. It is viewed as a safe minimum number.

Scott Searle

Got you, and in terms of, I guess some of the upside levers, I would imagine you probably have pretty good visibility on Raytheon, but where are some of the other opportunities that would drive you above that? I assume Disguise is part of that, and there's a baseline number in there? Or is Disguise completely removed from the June quarter numbers? Also if you could give us some idea in terms of the gross margins going into the June quarter. Again, I think mix would probably be a little bit more favorable this

quarter given the contribution from Raytheon, but just to confirm that and your early thoughts on that front?

David Raun

Some of the variables above that \$10 million number actually include—one of it is—one can be our media account and what will actually happen through the quarter. We're not anticipating a lot, but there's still some activity there. There's some new opportunities with PCIe Gen 4, whether they're going to fall into the quarter, which always helps in the margin front. The military exposure in the quarter is limited. The military is really going to be in the second half of the year, although, we may pick up a little bit of it. But what's secure in the \$10 million doesn't have military in it.

Scott Searle

Got you, and then maybe if I could as well just follow-up on some of your comments around edge compute, it's nice to hear you're articulating the longer term vision and strategy there. How are you thinking about approaching that in terms of different sales channels, different markets, different verticals, and how you chase it? Maybe to follow-up, I think the number you threw out there was 27 large RFPs that are out there kind of circulating around. Can you give us an idea how that maybe breaks down in terms of different verticals? Thanks.

David Raun

I'll let Jim get into a little more specific there. But I would say in general, last year the Company started to win new customers and new applications. That was good, and we're carrying that through this year. As far as different sales channels and anything, I don't think much has changed on that front. Jim, has it?

Jim Ison

No, on the sales channel side of things, we're pretty rock steady with the combination of our domestic and European direct sales channel as well as adding in the channel partners and distributors in key countries and also in the U.S. That part hasn't changed. Of the 27 large opportunities in the pipeline, eight of those involving PCI Express Gen 4, nine of those are in the Military and Aerospace segment. About one-third of the current \$1 million plus opportunities fall into that space. But that should give a pretty good breakdown. The best part about it is, they're not slowing down on COVID. The activity is strong on all those fronts.

Scott Searle

Got you, and Jim, what's the timeline on resolution for some of these RFPs? Will most of them be concluded this year? Or some of them going to extend? Assuming that you guys are getting your historic win rate, what would we expect in terms of contribution and ramp up then into the 2021 time period?

Jim Ison

Yes. Our historic win rate has oscillated quite a bit. We were in the 30%, 40% range. Last year, we closed 76%, which was 16 of 21. This year we have at this point 27, which is a little bit more than we have at this point last year in the pipeline. Timeline is always based on these type of projects. The bigger military is 12 to 18 months before production after we get the win. The commercial tends to be six to nine months, after we get the win. That's where the—all of that falls, and I give you the breakdown. We're up probably, I think 20% in our year-to-date opportunities that we have today versus this time last year.

Scott Searle

Great. Thank you.

David Raun

Thank you, Scott.

Jim Ison

Thank you, Scott.

Operator

As a reminder, press star, one if you have a question. We'll hear from Joe Gomes with Noble Capital.

Joe Gomes

Good afternoon. Thanks for taking the call. (Inaudible) on the Disguise payment, outstanding balance there, just can you provide any more detail or color there as to what kind of terms are there? When do you expect them to pay that? How frequently are they paying? Any additional color there would be appreciated?

David Raun

Right now, Joe, the agreement that we have with them is that they pay \$100,000 per week, plus 150% of any product that they take.

Joe Gomes

Okay, and on the supply chain issues, have you guys think you hit the bottom there? Have you seen any improvement in any of the supply chain issues that you were talking about?

David Raun

No, no. PCB Board, because we're using—these are primarily for the highest end type products. There's some shortages in the marketplace, and then also, frankly, we've got some issues where some board showed up that weren't working properly, and we had to scramble to replace the Board, so you get some different dynamic there. It's not just COVID-19 supply issue that we're dealing with. That's kind of built into the numbers we're talking about. That's been the main area.

The team's done a good job of getting semiconductor components and things like that and on time, and for the most part it's really isolated to that.

Joe Gomes

Okay, and one last one, and I'll go back (phon) I know I asked this last quarter, I'll ask it again. Dave, you're interim—I mean, when do we think we're going to have a decision here on a permanent CEO? I think you're doing a great job, so it would be nice to, I guess, have the permanent CEO name?

David Raun

Well, thanks for the compliment, first of all. Obviously, I think you should talk to the Board, but I'm part of the Board. I think you'll see a decision relatively soon. I am, as I stated last time, one of the strong candidates for the role and but we've talked to other people too. I don't think you'll have to wait that much longer for you to get additional visibility on that. How is that?

Joe Gomes

Okay, good luck. Thanks.

David Raun

Thank you.

John Morrison

Thank you, Joe. Appreciate the questions.

Operator

Once again, press star, one if you have a question. We'll hear from Ruben Roy with Benchmark.

Ruben Roy

Thanks. I want to start with a question for Jim. Jim, congrats on getting the design activity or continuing with the design activity, I should say, with all the challenges, with folks working at home, et cetera. But in terms of the 27 opportunity then given the environment that we have here, what's your sense of risk of either push out of those design wins maybe taking a little longer than the typical cycle time to get the revenue, whether it's military or otherwise? Or even maybe is there more risk now of cancellations of some projects because of delays or things like that? Or do you think these are design wins that are pretty solid for ramp within the timeframe that you had in mind when you kind of mark them office design?

Jim Ison

Yes. Thanks for the question. We generally run in that 60% to 70% range in the closing. We can't count all 27 on the books yet, I wish we could. But of that, some of them might push, but see what the level of activity that I'm talking about is that we're being able to very well structure the meetings with the customers to get them to the close and then get them into production fast, because there's a lot less distractions in office work and travel and things like that in the way of either of our teams.

From that aspect that's where it's been kind of nice that most people's calendars are moving these things along rather well. But yes, I keep the same win rate percentage in there without any significant changes.

Ruben Roy

Got it, and then—I'm sorry, go ahead, David.

David Raun

I just put always the caution there with all the things going on with the economy and potential ripple effects, but you just have to read the newspaper, watch the news, I guess we don't read newspapers anymore. With the political environment and all this stimulus funding, I always wonder if that's going to

impact it. We're not seeing it, but there's some threads of that out there right now in the marketplace where people are talking about that.

Ruben Roy

Okay, excellent, and then I think you did a good job, David, on an earlier question around how you're thinking about near-term guidance and the baseline versus the second half of the year and potentially some levers coming along, et cetera. When you think about the military contribution in the second half of the year, how do you think about any potential impacts from administration changes or anything like that? Is there anything that could change from the designs that you have on the books today? Things you're working on, that type of thing, if we were to add some budget cuts for whatever reason or things like that, at least in the medium term, let's call it the next 12 to 18 months?

David Raun

Well, I would go back to just the comment I made. That was what I was alluding to. We're not seeing that kind of visibility. We don't have it. Let's say there's a change in leadership and we believe it's a change in leadership, at the government results in less spending. I don't know if it really impacted this year, really. I think most people are talking about how that's going to impact us in 2021 and 2022. I sure don't have more of a crystal ball than anyone else on the topic. But we're watching it and staying aware of it is what we want to make sure we do.

Ruben Roy

Got it. Okay. Well, that's all I have today. Thank you very much.

David Raun

Thank you. Appreciate that.

Operator

Once again, press star, one if you have a question. We'll hear from Aman Gulani with B. Riley.

Aman Gulani

Hey, guys. Thanks for taking the question. I just wondered, can you comment on what most of the lead times you're seeing on those high-end PCB?

David Raun

Yes. The lead times of the PCB is actually varied by the term that we want to get them in. What we've seen is, we can get PCBs anywhere from four to six weeks on a premium turnaround time, but typically eight to ten weeks would be overall type of—for run rate OEM where we have a good forecast type of a number to keep the costs down, margins up type of thing.

We've probably seen, if it wasn't for some vendor, I guess, machine troubles or things like that that we've seen, most of them are still coming in that timeframe, but we could see that push out an extra four to five weeks at some time.

Aman Gulani

Okay, and you mentioned in a prior press release, you expect to generate \$4 million to \$5 million in sales over the next two years from the autonomous vehicle and ride-sharing segment. Can you comment on where you expect the growth to come from? Is that from existing customers you're engaged with? Or are you looking to actively engage new customers?

David Raun

The answer is both. Active customers have provided—this is actually deploying on the vehicles themselves. As they build the fleet with our current customers, that will benefit from that additional business. Then there are several of the—I think three of the 27 customers currently have in the pipeline that are in the large trackable range, are also in that segment because of our expertise at the AI at the Edge type products that they need.

Aman Gulani

Got it. Okay, and can you talk about your current capacity utilization that you sort of implement the social distancing guidelines? Where are you relative to more normalized operations?

David Raun

I mean, was that the COVID social guidelines?

Aman Gulani

Yes. The social distancing, like your capacity utilization with the social distancing guidelines that you are implementing?

David Raun

Yes. We've done a number of things. I'll let John add to it. But basically, we do have the six feet space thing. We have enough room in our production facility to do it. Anybody that can work from home is working from home. That's worked pretty good. There's other different dynamics, we take the temperature every morning when people come in, and we're all wearing facemasks now. These are the types of things we're doing. Still, as I reported, we do not have any cases of it. It has not impacted, correct me if I'm wrong, John, has not impacted our ability to ship product that I know of.

John Morrison

No. It has not.

David Raun

No. It has not. We don't expect that to be an issue in the short-term.

Aman Gulani

Thank you. Glad to hear that no one been infected in your operations. I'll pass it on.

Operator

Once again, press star, one if we have a question. We'll now hear from Dave Flowers.

Dave Flowers

Thanks, fellas. Thanks for taking the call.

David Raun

Hi, Dave.

Dave Flowers

If you answered it earlier, I apologize. But were all the costs for your expense reductions factored in Q1?

John Morrison

No, sir. They actually took place on April 8 so the accruals associated with any severance and discontinuation with the previous personnel will be reflected in the second quarter, and then obviously cost savings will also then be rolled out through the remainder of the year.

David Raun

Yes. We alluded to some stuff in Q1, and that was really more just watching, spending not with a formal plan in place and then also dynamics like less travel and all of that. We implemented a plan, which went into effect right away, but you have a little bit of the hangover effect because of severance and things like that of course, since April 8 in the current quarter. That's why I say we'll see some of the benefits this quarter, but most of it comes through the second half and beyond.

Dave Flowers

How much of the expense reductions do you think will be realized in Q2?

John Morrison

Our annual run—we believe, we're going to—between \$2.5 million and \$3 million on an annual run rate.

David Raun

He's wondering about Q2.

John Morrison

On Q2?

David Raun

You probably take that at a quarterly level and probably take about half of it. What do you think, John?

John Morrison

That's probably right.

David Raun

That would be about right.

Dave Flowers

Then 100% in Q3?

David Raun

Q3 and Q4, yes.

Dave Flowers

Good job. Final question is, the revenue sequentially from Q1 to Q2, it's about a \$3 million drop and it's not really clear in my mind exactly what was driving that. I've heard COVID-19 and I've heard some program reschedules. I think, I wonder if you could clarify that for me.

David Raun

Yes. I think the biggest one there is our largest customer, which is the media entertainment customer, which we refer to as the Sky, where they were at a good run rate at forecast in Q1. The dynamic of the industry they serve, which just as a reminder, they do all the graphics and lightings for concerts, sporting events and although they were doing extremely well, and they're the guy to go to, whether you're doing the Super Bowl or the Olympics or whatever, since all those events got put on hold that just ran their business down to a standstill at least in the short-term.

I am pleased to say we've been in constant contact with them, including the (inaudible) and just the mood and the activity in the last month has turned much more positive over there.

Dave Flowers

That's great. Thanks, fellas. You're doing a good job.

David Raun

Thank you, sir.

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

Sorry for the disruption. I didn't realize I had a closing comment. But here it is. Thank you. Thanks, everybody, for joining us today. We look forward to talking to each of you in the future and reporting our progress. Meanwhile, feel free to reach out to John, Jim or myself anytime. We look forward to talking to you in the future. Thank you.

Operator

Thank you. Now 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 and are forward-looking statements. These statements 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.

The 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 in regions of the world where we have operation, customers or source material or sell products may affect such market.

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 operating systems, technologies, product offerings and personnel with acquired companies may prove difficult and adversely affect our financial results; our products 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 abilities 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 entrants into our market may harm our competitive position.

We rely on a limited number of suppliers to support our manufacturer design process, and 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 conditions and we fail to 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 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 provision 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 28. Please refer to today's press release for dial-in and replay instructions available via the Company's website at ir.onestopsystems.com.

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