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One Stop Systems, Inc.

Second Quarter 2020 Conference Call

August 6, 2020

CORPORATE PARTICIPANTS

David Raun, *President, Chief Executive Officer & Director*

John Morrison, *Chief Financial Officer, Treasurer & Secretary*

Jim Ison, *Chief Sales & Marketing Officer*

CONFERENCE CALL PARTICIPANTS

Christian Bliska, *NOBLE Capital*

Scott Searle, *ROTH Capital Partners*

Rudy Miller, *Miller Capital Corporation*

David Flowers, *Private Investor*

PRESENTATION

Operator

Good afternoon, and thank you for joining us today to discuss One Stop Systems' financial results for the Second Quarter Ended June 30, 2020.

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 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 President and CEO, David Raun.

Please go ahead, sir.

David Raun

Thank you, Scott, and good afternoon, everyone. Thank you for joining us today. I hope everyone is being safe and healthy.

First, I'd like to once again thank all our employees, partners and customers for their dedication, nimbleness and creativity during this pandemic. I would also like to thank the One Stop Systems shareholders for voting at the Annual Shareholder Meeting, especially with so much going on in the market.

At the beginning of July, we had three new independent Directors join our Board. They add valuable experience and knowledge in finance, M&A, marketing, risk management, senior-level Leadership and serving on public boards. Our new Board now consists of four men and three women, and we're truly fortunate to have them now part of our team.

I'm also glad to address you today as One Stop Systems' new President and CEO. The Board announced the appointment on June 24 after I'd been serving as Interim CEO since February.

While we've been challenged by the disruption of COVID-19 during most of this time, which has impacted OSS and its customers, our Management team have made progress across several key areas. This has included keeping our products shipping with manufacturing continuity; a reorganization that put more focus on the development of an improved vision and value proposition, as well as executing on the full integration of CDI, which was completed in June; $2.5 million to $3 million in operating expense reductions with a focus on efficiency; and lastly, strengthening our balance sheet with an additional $4 million in working capital.

While much more work remains to be done, we believe these initiatives have helped to offset the impact of the pandemic and set us up well for the future.

As expected, COVID-19 impacted One Stop Systems in the second quarter after a strong first quarter. We saw revenues down significantly from our top customer by $3.1 million compared to the same quarter last year. This customer serves large gathering events, like concerts and sporting events.

Fortunately, the combination of a strong first quarter and contributions from some of our newer customers from the program wins over the past 18 months offset the overall impact to the first half. This resulted in total revenues year-to-date being on par with last year's same six months.

For today's call, I again invited Jim Ison, our Chief Sales and Marketing Officer, to talk about new opportunities. But next, I'd like to turn it over to our CFO, John Morrison, to take us through the financial details for the quarter and the first half. Then after Jim, I'll return to discuss our outlook for the next 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 second quarter and first half ended June 30, 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 second quarter totaled $11.6 million as compared to $14.9 million in the same year-ago quarter. As previously discussed in our Q1 earnings call and as expected, the majority of the decrease was due to lower sales of custom servers designed for use in media and entertainment production, which was due to the COVID-19 pandemic and the absence of a high-margin data storage unit product sale.

The first half of 2020 was basically even with last year at $25 million. This was achieved despite the reduction in revenue of about $4.1 million from our two largest customers during the period. These reductions were offset by increases in sales of PCI Express Gen 4 products and AI on the Fly technology.

In terms of the revenue breakdown between our operating units, in Q2 our core OSS business contributed $6.9 million or 60% of the consolidated revenue in the second quarter. This was a decrease from the $10 million or 67% consolidated revenue in the same year-ago period.

Our European subsidiary, Bressner, contributed $4.3 million or 37% of consolidated revenue in the second quarter. This compares to the $4 million or 27% of consolidated revenue in the same year-ago period.

Our CDI subsidiary contributed $386,000 or 3% of revenue in Q2 as compared to $895,000 or 6% in the year-ago quarter.

Now looking at the first half of 2020 revenue.

Our core OSS business contributed $14.7 million or 59% of consolidated revenue as compared to 15.2% or 61% of consolidated revenue in the first half of last year.

Bressner contributed $9.2 million or 37% of consolidated revenue in the first half as compared to $8.5 million or 34% of consolidated revenue in the first half of last year.

CDI, they contributed $1 million or 4% of revenue in the first half as compared to $1.2 million or 5% in last year's first half.

At the beginning of June, we completed the integration of CDI into core OSS operations, which was part of the reorganization that David mentioned. So next quarter, we will report only on our core OSS business and Bressner.

Turning to gross profit.

During the second quarter, our gross profit totaled $3.3 million or 28.6% of revenue, which compares to $5.4 million or 36.4% of revenue in the same year-ago quarter.

Gross margin for our core OSS business declined to 33.7% in the second quarter from 42.9% in the same year-ago quarter. This reduction, which was attributable to reduced sales and change in customer mix, specifically the lack of a high-margin DSU sales, as mentioned earlier.

Bressner's gross margin decreased to 19% in the second quarter as compared to 23.6% in the same year-ago quarter, with CDI contributing to gross margin that improved to 43.5%.

For the first half 2020, gross profit was $6.7 million or 26.9% of revenue, which is compared to $7.8 million or 31.4% of revenue in the same year-ago period. Gross margin for the core OSS business was down to 30.7% in the first half as compared to 38% in the first half of 2019, which again was attributable to reduced sales and changes in customer mix.

Bressner gross margin decreased to 20.5% in the first half compared to 22.3% in the first half of last year. CDI's gross margin improved, contributing 28.9%.

Now speaking of operating expenses. Operating expenses decreased 42% to $3.7 million from $6.4 million in the second quarter of 2019. The decrease was primarily due to the reorganization expense reduction program we implemented in April of this year as well as the year-ago quarter, there was a goodwill impairment charge of $2 million. Overall, operating expenses as a percentage of revenue improved to 32% in the second quarter compared to 43% the same year-ago quarter. This expense reflects a $2.5 million to $3 million anticipated annual savings resulting from our expense reduction program. On a pro forma basis, after adjusting for the goodwill impairment charge in the prior year and the Q2 2020 severance payments resulting from our expense reduction program, our operating expenses decreased 22% to $3.5 million compared to the same year-ago quarter.

For the first half, our total operating expenses decreased 20% to $8.6 million from $10.8 million in the first half of last year. The decrease was primarily due to the reorganization and expense reduction program and the prior year goodwill impairment charge. Overall, operating expenses as a percentage of revenue improved to 35% in the first half of this year as compared to 43% in the prior year. This expense reflects again the $2.5 million to $3 million anticipated annual savings resulting from the expense reduction program, which was introduced in April of this year. On a pro forma basis, after adjusting for last year's goodwill impairment charge and this year's first half severance payments of $815,000, which again was a result from our cost reduction program, our operating expenses decreased 12% to $7.8 million in the first half of 2020 as compared to a year ago.

Losses from operations in Q2 improved by $574,000 from a loss of $980,000 in the year-ago quarter. On a pro forma basis, after adjusting for the prior year goodwill impairment and this year's Q2 severance payments, this year's operating loss was $132,000 compared to a gain from operations of $1 million in the year-ago quarter. For the first half of 2020, our loss from operations decreased $1.1 million from $3 million in the first half of last year. On a pro forma basis, after adjusting for prior year's goodwill impairment charge and the current year first half severance payments, the operating loss was $1.1 million as compared to $1 million in the prior year.

Our net loss on a GAAP basis totaled $12,000 or basically $0.00 per share in Q2, which indicates that we are approaching breakeven. This compares to a loss of $1.6 million or $a loss of $0.11 per share in the same year-ago period. For the first half of 2020, net loss on a GAAP basis totaled $1.1 million or a loss of $0.07 per share. This was also an improvement from a loss of $2.5 million or a loss of $0.18 per share in the first half of last year.

On a non-GAAP basis, net income totaled $248,000 or $0.01 per basic share in Q2—per diluted share, excuse me, in Q2 as compared to $530,000 or $0.04 per basic and diluted share in the same year-ago period. For the first half of 2020, non-GAAP net loss totaled $466,000 or $0.03 per share as compared to our non-GAAP net income of $106,000 or $0.01 per share in the first half of 2019.

Adjusted EBITDA, another non-GAAP metric we follow, was $73,000 in Q2 as compared to $1.3 million in the same year ago quarter. For the first half of 2020, Adjusted EBITDA totaled a negative $885,000 compared to a negative $156,000 in the same year-ago period.

Now turning to our balance sheet.

Cash and cash equivalents totaled $4.7 million at June 30, 2020, as compared to $3 million at March 31, 2020. The increase is primarily due to raising $2.4 million in a senior secured convertible debt offering during the quarter and receiving a Paycheck Protection Plan loan of approximately $1.5 million. As of July 31, we have cash on hand of $3.8 million. We believe our cash position and available funds provides us with sufficient liquidity to meet our cash requirements for current operations.

This completes our financial overview for the quarter and first half of the year. I would now like to turn the call over to Jim.

Jim?

Jim Ison

Thank you, John, and good afternoon, everyone.

First, I would like to talk about some of our industry-leading products announced during the quarter. We introduced the first PCI Express Gen 4 expansion system that fully supports NVIDIA's new A100 Tensor Core GPU. This provides more than 20 times the compute performance of the previous generation expansion systems in GPUs. This product has already contributed to orders for a military radar simulation program shipped in the quarter. In addition to the A100 Gen 4 expansion, we also received a prototype order in the quarter for our new military data center in the sky product from a U.S. Navy prime contractor. This AI on the Fly product combines a state-of-the-art rugged server with A100 GPUs for mission-critical airborne AI threat detection.

Another great example of an OSS AI on the Fly application was the purchase orders we received from two marquee customers for system elements they plan to use in their next generation of autonomous vehicles.

On the new product front, we are planning to introduce three additional PCI Express Gen 4 standard platforms before the end of the year. We are seeing significant interest in these leading-edge standard products and we expect to convert this interest into additional Gen 4 revenue.

Now turning to our pipeline of opportunities. In the first half of 2020, we won eight new major opportunities. Market segments include medical, autonomous driving, industrial applications and, of course, AI on the Fly. As a reminder, we define a major opportunity as a program that is expected to yield nothing less than $1 million of revenue over four years. Our pipeline of additional major opportunities is currently 17. We would expect approximately half of these to turn into a win before the end of the year.

While we have been affected by COVID-19 like other companies, I'm proud to say that our teams have remained focused and have continued to drive positive sales and marketing results despite the challenges. With the expectation that the current work environment will remain the same for the foreseeable future, we have continued to invest in high-touch targeted marketing and virtual events.

In the second quarter, in addition to three virtual trade shows, we hosted the first of three planned webinars, leveraging the partnerships and participation of market leaders NVIDIA and Marvell for AI on the Edge. During the second half, we are planning at least one virtual show per month in addition to the previously mentioned webinars we plan to make available for general viewing on our website at onestopsystems.com.

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

Dave?

David Raun

Thank you, John and Jim.

As expected, COVID-19 impacted our revenue this past quarter. And this will likely continue for the rest of this year. We've been working to minimize the impact while also taking initiatives to build a solid foundation for the future.

Last quarter, in the spirit of transparency and to avoid the prevalent statements about lack of visibility, we elected to provide a minimum baseline revenue of $10 million. As you know, we closed the quarter at $11.6 million. In a similar spirit for our Q3 outlook, we're providing a minimum baseline revenue of $11.8 million. As we did in the previous quarter, we plan to work on several fronts to bring our revenue for Q3 above this minimum baseline. I'd like to add a little color.

First, while our large media and entertainment client is sounding much more optimistic than 90 days ago, we're not counting on much revenue for them this quarter. Fortunately, rather than waiting for the world to come back to what they consider normal, they have applied their market-leading technology to the virtual world. As outlined on their website, this allows musical artists, movie directors, sportscasters and university professors to get back to work but now in the virtual world. This technology was showcased by well-known music artists, Katy Perry, who premiered a virtual music video on *American Idol* a few months ago. We are working closely with our customer to ensure we could support their demand on this new front as it expands.

Second, as usual, we expect the second half of the year to have a stronger, high-margin military component which can drive revenue and margins up at the same time. While we are not aware of any programs being canceled and only know of one delay, some of the funding by the government is taking longer than normal, adding some uncertainty. During the first half, we witnessed some of our new customers develop into a larger portion of our revenue, offsetting the revenue decrease of our two largest accounts, as John and Jim outlined. This underscores the importance of our continued effort to diversify our customer base and reduce our dependency on these few larger accounts.

We have much further to go. But with the lower operating expenses, improved efficiency, complete reorganization, additional working capital and new seven-member independent Board, we believe we have built a foundation for greater future performance.

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

Scott?

Operator

Thank you. If you would like to ask a question please press the one, followed by the four on your telephone. You will hear a three tone prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration please press the one, followed by the three. Once again that's one, four to register for a question. One moment please for the first question.

And we have a question from Chris Bliska with NOBLE Capital. Please go ahead. Your line is open.

Christian Bliska

Congratulations on a solid quarter in a tough environment. Just—I'm calling in for Joe. And I wanted to just ask about the supply chain situation. I think in last quarter, you talked about some difficulties getting some product, PCB boards. And I wonder if that's been alleviated a little bit.

David Raun

Yes, this is Dave.

On the PCB boards, we worked through those issues. It caused some challenges. But for the most part, they're behind us. In general, the trick is, as always, we're building products that have a lot of different components. We do at times see longer lead times. And so that does require us to be real strategic on how we purchase our products. But there isn't like one outstanding item that we can't get that's impacting our revenue in an overwhelming way.

Christian Bliska

Okay. Thank you.

And then I heard comments that I assume were related to Disguise. Could you just talk about the status of your business with Raytheon in a little more detail?

Jim Ison

Yes. So as John mentioned that last year, we had an order come in earlier in the year than we had expected. So that was reflected in the results. Most of the time, I think we've said that these orders typically come in the back half of the year, which is why our year has been back-end loaded. And that's the case again this year.

Christian Bliska

Okay. And let's see, I'm looking at my notes from this call last quarter. And I think you had 27 RFPs out for $1 million-plus contracts. Of those 27 RFPs that you referenced last quarter, how many of those came in? I heard you say eight of them in the first half. But of those 27 RFPs that you referenced last quarter, how many came in?

Jim Ison

Yes. If you're going from that number, basically, we've resolved 10. We closed—we actually closed five additional wins. So that's where we have the eight wins so far for the year in the first half. Seventeen of those are still open for the second half. But we add some every month or two, and we'll resolve those every quarter and report them here.

Operator

We have a question from the line of Scott Searle with ROTH Capital. Please go ahead. Your line is open.

Scott Searle

Dave, just to dig in, in terms of the baseline number for $11.8 million in the third quarter, I want to understand, are those actual orders that you have in hand, just visibility from customers and to make sure I understand a couple of those levers?

And couple along with that for John, the gross margins typically, as we go into the back half of the year as they're coupled with the military customer, Raytheon, and storage arrays tends to have better gross margins. Is that still what we should be looking for as we're looking at the back half of 2020?

David Raun

Yes. So first of all, on the revenue and the minimum guidance of $11.8 million. Really, what we're looking at there, I've personally gone through line-by-line, the customer base, what's on backlog, probability factors. There's a couple of things with some of the accounts where, although the sales team is very bullish with the current dynamics and uncertainty in the marketplace, I've made a little bit of a judgment on them just based on history. So again, it's a similar kind of spirit as last time, there's a couple of things I view as more on the fence.

John Morrison

With respect to gross margin, Q3 is anticipated to be on an aggregate basis approximately 33%. And for Q4, we're looking at about 36% on an aggregate basis. We anticipate that on an annual basis, we will be approximately 31% to 32% aggregate.

Scott Searle

Great. And maybe to follow up with Jim, in terms of some of those RFPs that have been resolved favorably as well as the ones in the pipeline, can you talk a little bit about how long it's taking for them to transition into revenue-generating opportunities? You've been talking about this pipeline, I think, going back several quarters now to the middle of last year. And so we're starting to see some of that come through. But I'm trying to understand that gestation period before they start to ramp up into more meaningful production.

Jim Ison

Yes, exactly. The typical sales cycle for these on the commercial side is the six to nine months before they kick in. On the military side, it's the 12 to 18 months. And that's been pretty consistent. So just for reference, we closed in—of the five additional we closed this quarter, two of those were military, three were commercial. So you can kind of gauge from there where they would kick in, in the six- to 12-month time frame from here. That's what we experienced in the first half with being able to stay flat as we were, were the wins from the previous 12 to 18 months that have been kicking in. Especially around some of the things we've announced, which were the Gen 4 products, which was pretty significant in Gen 2; that made up some ground from the media and entertainment customer. That gives you an idea. And that one was a commercial win from about nine months previously.

Scott Searle

And Jim, maybe just to follow up in terms of your win rate, I'm kind of wondering who's showing up on the shortlist now against you guys. And when you're not winning, why are you not winning? Are the opportunities going away? Or who's winning that business right now?

Jim Ison

On several different fronts, we generally see it's a make versus buy, especially when you're dealing with some military contractors where they can do this product internally, but they look to us to be an expert from the outside that can do the product and also provide consulting services for them. So those—on the military side, we're usually competing against internal resources.

On the commercial side, it's really the unique position that we put ourselves in with AI on the Fly, where we have taken a different approach from the competitors may have embedded product that they put in the trunk of a car or try to put in a military aircraft, which is a lower-performance product, you generally scale back in order to meet heat and airflow requirements, where we take AI on the Fly and use the fully commercial, full-powered systems and put those into these critical applications. And that's really what the difference is. So we don't see a lot of people doing exactly that. That's where that niche is.

Scott Searle

Got you. And lastly, if I could, Dave, you've been busy in your first several months in office in terms of Op ex, integration, balance sheet and directing the product strategy. But I'm wondering, as you're looking forward now, what are going to be some of the key milestones that you're focused on in the back half of this year into 2021?

And if you could kind of help us understand a little bit better where the road map is going and maybe some of the end markets and verticals and what we could expect from OSS in 2021.

David Raun

Yes. I'll take the road map, vision and all that. The one dynamic there, if you think about some of the stuff we've been doing, we build really good expansion of boxes. We're really good at the PC Express. And many times, we loaded up with additional things like GPUs and memory and all the stuff. One of the dynamics we face on a margin standpoint, for example, is it's too easy to add up the components inside.

So one of the things we're looking at very strongly is partnering with different people and getting out maybe more to an appliance-level product, leveraging our software expertise more so that you're valued on really what you can do and how you do it versus competitors. So that's kind of a theme going on, and we don't have all the answers. But that's the one path.

As far as the rest of this year, that's a big part of it is to make sure we get that vision and those products defined and we get all aligned and we know how to get there. We're in a mode right now where we're talking about concepts, new technologies and we want to go out and start sharing them more with the customer base to get feedback.

Operator

We have a question from Rudy Miller with Miller Capital Corp. Please go ahead. Your line is open.

Rudy Miller

David. Rudy Miller. How are you sir?

Just so I'd like to make a statement as a shareholder first that pretty disappointed at the company and the past Board of Directors and their actions, very pleased to see that you accepted the position as President and you've brought in some outstanding Board members. And you actually have a (inaudible) that equates to (inaudible) can actually vote today. So that's very nice. I sold majority of my position out some time ago because of frustration with management and the actions of the mergers, etc. And I am reviewing becoming a still small position, but I'm feeling a more major position.

I'd like to thank the two previous people who asked you questions and their firms because mine was supply chain and as well as the China issue on your supply chain. You did address that on a macro level that seemed to be being handled. We know that the situation with China as of currently, it's even more so that things could get more difficult there. So one of the questions is do you have other options? And what percent of your supply chain is being developed in China and that you have options that you've been working on or looking at strategically for your supply chain?

That's a helicopter going by, the sound of freedom. I'm in Coronado, California.

So I just want to check on that. And then a couple of follow-up things on objectives. And one of the previous questions to you was kind of where you look at 2021. What I'm trying to understand, I know the reorg you've been doing and what you've done to stabilize and try to bring it together then with the CV-19, double challenge—triple challenge in reality. Is your short term, is it six months year-end? Twenty-twenty-one was addressed. Where is this company trying to go? And what is the strategic objective on this hopefully much improved with, more sophisticated management and the current active Board? Where are you trying to go with the business?

And then I have a little smaller detail, a dollar-and-sense question to ask and a concept combined with CV-19. So if you could give me any color on that, I'd appreciate it.

David Raun

Yes. So let me try to hit those first. But thanks for your comments, and it's nice to talk to you, it's been a while.

On the supply chain, we started seeing in Q1, although they didn't hit us hard, in Q1, we started seeing the dynamic. So the team worked well to get additional sources, especially on things like PCB boards, which tend to hit us. And part of the expense and cost reduction plan that we implemented had a lot to do with adding additional sustaining engineering so that we could do cost reductions of components and really put a lot more focus on that. That also forces us into looking at different suppliers and working with our customers to do that.

Our China dependence isn't overwhelming. But we do have some products coming from China, but more so from Taiwan. So that's kind of the summary there. I actually—it's kind of interesting. I personally would rather have supply issues and a lot more orders and try to figure out the supply issues than finding out how to get more orders in this kind of time frame. But we just—we're getting more our customers are impacted by the revenue, primarily the one guy.

Objectives with the reorg and strategic, yes, I mean, first of all, we did cut back, we did a reorg. But as I've told other people, there was a sense of urgency because of COVID. But it needed to be done anyway. But we're making sure we watch cash carefully. And what we really have to do is go from a company that is on the edge and we have products and we're serving there, but we need to be able to dominate particular segments within that space with a very clear value proposition. And so that we're looking at it and say, "Okay, we need to go out to the top five guys in that marketplace and we're going to get four out of five." That's the kind of path we have to be on. I'm not going to say I have the answers, but the intent there. And that's what we're working through to figure that out and get away from, "Hey, let's just go find the next opportunity on the edge somewhere." Because it's a big space, and we need to be more focused.

Hopefully, I've answered your question. If not, please let me know.

Rudy Miller

No, that's gave me some color. Just before looking at putting in any capital or buying any major stock positions again, is it—I've got to make sure I understand where you're trying to go and how long can take you to get there? And on some lesser deals, what's your headcount of your employees now?

David Raun

We're at just under 90. Is that right, John?

John Morrison

Yes. About 85.

David Raun

Yes.

Rudy Miller

Okay. If you had any—(inaudible) happening with some other investments—and since I've been on three calls the last two days and one with an insurance Company and one with an engineering-related services and other products and services - and it was interesting, some of the things that they were having - and one is a manufacturer that is having a problem. And I don't think you have the headcount to have some of the problems. But I'll ask you what—out of your 90-plus people there, how many people have you found positive or you've had to send home or had problems with as far as CV-19?

David Raun

So our situation, we've had no cases on the manufacturing line, which is the key because that's hard to take home and do. So we've had no issues of it. The only activity we've had is a little bit of people that are remote locations and they were isolated. So they didn't pick it up from being here and they were isolated, so we didn't have an issue where it's spread to another person. So we've been fortunate. But I will also say that due to the efforts a lot within John's organization and others, we've done a really good job of following CDC guidelines. People are disciplined. We're spread out. Everybody is working as a team to make sure we stay healthy.

Rudy Miller

Well, that's great. It's good to hear that. And we certainly—I wish everybody on the call and all people will be concerned with that. It's actually happened to one person in my family. So it's like everything else you see on the news, it still touches as you personally or someone you know.

But on a business perspective, with that on your future—let me see where I had the note here. That won't equate since you haven't had the people. A couple of other problems came, one with a manufacturing company, one with the insurance company, their claims for reserves went up for their insurance for CV-19 and one manufacturer had a shortage of people and people want to work. So it didn't apply where they were having a problem getting things manufactured. And their accrued system for vacation was a problem. But you don't have the headcount of people on that.

I did want to get a little color on that. And you gave that to me. But I appreciate the insight. I'm watching you very closely. And we have the ability, as you know, David, to be equity investors and/or just stock investors, period. So thank you for your time.

David Raun

Thank you, Rudy.

John Morrison

Rudy, thank you very much. It's good to hear your voice.

Rudy Miller

John, that's not you. You sound too much younger. I just had recent throat surgery, so I'm a little gravelly. I can't holler at you like I used to and say, "Hey, John."

John Morrison

Well, it's nice to hear your voice.

Rudy Miller

Well, that's okay. We're back. We might be a little gravelly, but we're still executing in—with the program. Guys, thanks for your time. I appreciate it. I like the turnaround and congratulations on the Board.

And by the way, how about travel cost? One last little question. Travel costs should have cut down and conferences tremendously with the CV-19 as it has with most companies we've invested with. And we're all doing...

John Morrison

Rudy, that has come to a screeching halt. There is basically no travel going on. Every conference has been canceled. And that is one of the sources of our reduced expenses.

Rudy Miller

Well, we're all seeing that with our clients, but we're Zooming or etc., with different things. And I'm just saying in the future, you're going to learn from this, and I just want to know how you're looking forward to it. I assume that was that way. Because we all know that there's no conferences, and I only get on a private plane. So that's it.

Well, listen, I'll let you guys go. Thanks for the time. And I am watching you closely and I appreciate the time.

Operator

If you would like to register for a question please press the one, followed by the four on your telephone.

We have a question from David Flowers, Private Investor.

David Flowers

Good presentation. The $1.5 million PPP loan, are there circumstances under which that must not be repaid?

John Morrison

Right now, it's Management's belief that, that will be forgiven. Now as you know, we have a 26-week period of time in which to absorb those funds. And we did absorb those. So it is our anticipation that that will be fully forgiven.

David Flowers

Great. With regard to the expenses, congratulations on the reductions. What are your expectations in Q3 versus Q2 as far as dollar expenses?

John Morrison

Yes. We had some extra benefits in Q2. There were some positives and some negatives. In Q2, we did have some severance expense as a result of the risk that we did have in Q2. But also, as we come into the Q3 and Q4, we are going to see an uptick in our revenue and there's also some additional expenses that come in towards year-end, such as audits and other things like that, that we incurred that normally is not incurred in a second quarter. So you'll see that the expenses will be fairly flat to up a little bit. In addition, you'll see some additional charges for noncash expenses, for example, associated with stock compensation expense. It's a noncash item, but it will increase in Q3 and Q4 as a result of the onboarding of a new CEO.

David Flowers

Okay. Great. The medical and entertainment customers, does that cause any inventory problems?

John Morrison

We are always controlling that inventory. That is with our largest customer. And we try to manage on a total basis, the amount of accounts receivable as well as inventory that is invested into that account. And right now, we're a little high on the inventory side. But based upon the production plan that we have for Q3 and Q4, we'll be able to bring that down.

David Flowers

That's great. I guess the final question is when do you think the company will be profitable on a GAAP basis?

John Morrison

There are some things we're putting behind us. So as you know, some of the things that are impairing our ability to be profitable is the amortization of intangibles associated with acquisitions; that gets charged against GAAP income with CDI now winding down on their purchase accounting. We also have Bressner that is coming to the end of its amortization period. We'll see some of those expenses go away on the noncash side. As I said, we still are going to see some initial start-up costs on the stock comp side that's noncash. It will impair the ability to be profitable on the GAAP side. But hopefully, at the end of the day, if you're looking at a proxy for cash of EBITDA, I think you're going to start seeing some profitability here in the quarters moving forward.

Operator

And we have no more questions at this time. I'd like to turn the conference back to our speakers for closing remarks.

David Raun

Thank you, Scott, and thank you, everyone, for joining us today. We look forward to talking to you in the future and reporting on our progress. Meanwhile, feel free to reach out to John, Jim or me at any time.

Scott, please go ahead and wrap up the call.

Operator

Thank you. Before we conclude today's call, I'd 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 to the 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 operations, customers or source material, or sell products that may affect such markets; our operating results may fluctuate significantly, which would make our future operating results difficult to predict, and that could cause operating results to fall below expectations or guidance; our ability to successfully integrate the operation 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 for 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 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 to the characteristics of such needs and functions may shift in such a way as to cause such products to no longer fulfill such needs or functions; the new entrants into our market may harm our competitive position; we rely on the limited number of suppliers to support a 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 operation 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 thereof. All forward-looking statements are qualified in the entirety of this cautionary statement, which is made under the Safe Harbor provision under Private Securities Litigation Reform Act of 1995.

Before we end today's conference, I would like to remind everyone this call will be available for replay starting later this evening through August 20. 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 the conference. You may now disconnect.