

Semler Scientific, Inc.
Form 10-Q
November 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2017

OR

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

For the Transition Period from ____ to ____

Commission File Number 001-36305

SEMLER SCIENTIFIC, INC.

(Exact name of Registrant as specified in its Charter)

Delaware **26-1367393**
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

2330 N.W. Everett
Portland, Oregon **97210**
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(877) 774-4211**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
(Do not check if a smaller reporting company)
Emerging growth company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes
" No x

As of November 2, 2017, there were 5,463,568 shares of the issuer's common stock, \$0.001 par value per share, outstanding.

TABLE OF CONTENTS

	Page
<u>Part I.</u> <u>Financial Information</u>	<u>1</u>
<u>Item 1.</u> <u>Financial Statements</u>	<u>1</u>
<u>Item 2.</u> <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>14</u>
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>19</u>
<u>Item 4.</u> <u>Controls and Procedures</u>	<u>20</u>
<u>Part II.</u> <u>Other Information</u>	<u>21</u>
<u>Item 1.</u> <u>Legal Proceedings</u>	<u>21</u>
<u>Item 1A.</u> <u>Risk Factors</u>	<u>21</u>
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>21</u>
<u>Item 3.</u> <u>Defaults upon Senior Securities</u>	<u>21</u>
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	<u>21</u>
<u>Item 5.</u> <u>Other Information</u>	<u>21</u>
<u>Item 6.</u> <u>Exhibits</u>	<u>21</u>
<u>Signatures</u>	<u>22</u>

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements. Such forward-looking statements include those that express plans, anticipation, intent, contingency, goals, targets or future development and/or otherwise are not statements of historical fact. These forward-looking statements are based on our current expectations and projections about future events and they are subject to risks and uncertainties known and unknown that could cause actual results and developments to differ materially from those expressed or implied in such statements.

In some cases, you can identify forward-looking statements by terminology, such as “expects,” “anticipates,” “intends,” “estimates,” “plans,” “believes,” “seeks,” “may,” “should,” “continue,” “could” or the negative of such terms or other similar expressions. Accordingly, these statements involve estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed in them. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this report.

You should read this quarterly report and the documents that we reference herein and therein and have filed as exhibits to this report, completely and with the understanding that our actual future results may be materially different from what we expect. You should assume that the information appearing in this quarterly report is accurate as of the date of this report only. Because the risk factors referred to above could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us or on our behalf, you should not place undue reliance on any forward-looking statements. These risks and uncertainties, along with others, are described above under the heading “Risk Factors” in our annual report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 17, 2017. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which factors will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We qualify all of the information presented in this quarterly report, and particularly our forward-looking statements, by these cautionary statements.

Table of Contents**PART I—FINANCIAL INFORMATION****Item 1. Financial Statements.****Semler Scientific, Inc.****Condensed Statements of Operations****(In thousands of U.S. Dollars, except share and per share data)**

	<i>(Unaudited)</i> For the three months ended September 30		<i>(Unaudited)</i> For the nine months ended September 30	
	2017	2016	2017	2016
Revenue	\$ 3,607	\$ 1,982	\$ 8,239	\$ 5,118
Operating expenses:				
Cost of revenue	724	398	1,855	1,348
Engineering and product development	432	183	1,345	634
Sales and marketing	1,350	950	3,502	2,952
General and administrative	1,025	706	2,765	2,236
Total operating expenses	3,531	2,237	9,467	7,170
Income (loss) from operations	76	(255)	(1,228)	(2,052)
Interest expense	(42)	(40)	(190)	(81)
Interest expense— related parties	(75)	(65)	(158)	(194)
Loss on extinguishment of loans	-	-	(179)	-
Other expense	-	(2)	(8)	(7)
Other expense	(117)	(107)	(535)	(282)
Net loss	\$ (41)	\$ (362)	\$ (1,763)	\$ (2,334)
Net loss per share, basic and diluted	\$ (0.01)	\$ (0.07)	\$ (0.33)	\$ (0.46)
Weighted average number of shares used in computing basic and diluted loss per share	5,463,568	5,123,568	5,346,178	5,123,568

See accompanying notes to unaudited condensed financial statements.

Table of Contents**Semler Scientific, Inc.****Condensed Balance Sheets****(In thousands of U.S. Dollars, except share and per share data)**

	<i>(Unaudited)</i> September 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash	\$ 578	\$ 622
Trade accounts receivable, net of allowance for doubtful accounts of \$35 and \$87, respectively	1,477	877
Prepaid expenses and other current assets	158	93
Total current assets	2,213	1,592
Assets for lease, net	1,173	875
Property and equipment, net	470	590
Long-term deposits	15	15
Total assets	\$ 3,871	\$ 3,072
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 647	\$ 450
Accrued expenses	2,880	2,185
Deferred revenue	875	513
Accrued interest	143	-
Loans payable net of debt discount of \$23 and \$0, respectively	1,033	81
Total current liabilities	5,578	3,229
Long-term liabilities:		
Deferred rent, less current portion	13	35
Accrued interest, less current portion	-	71
Accrued interest – related parties	22	124
Loans payable net of debt discount of \$0 and \$65, respectively, less current portion	36	938
Related party loans payable net of debt discount of \$17 and \$156, respectively	1,810	1,594
Total long-term liabilities	1,881	2,762
Stockholders' deficit:		
Common stock, \$0.001 par value; 50,000,000 shares authorized; 5,488,568 and 5,148,568 shares issued, and 5,463,568 and 5,123,568 outstanding (treasury shares	5	5

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of 25,000 and 25,000), respectively

Additional paid-in capital	23,093		21,998	
Accumulated deficit	(26,686)	(24,922)
Total stockholders' deficit	(3,588)	(2,919)
Total liabilities and stockholders' deficit	\$ 3,871		\$ 3,072	

See accompanying notes to unaudited condensed financial statements.

Table of Contents**Semler Scientific, Inc.****Condensed Statements of Cash Flows****(In thousands of U.S. Dollars)**

	<i>(Unaudited)</i>	
	Nine months ended September 30	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,763)	\$ (2,334)
Reconciliation of Net Loss to Net Cash Provided by (Used in) Operating Activities:		
Amortization of debt discount	138	133
Accretion of non-cash interest	109	-
Loss on extinguishment of debt	179	-
Depreciation	409	336
Gain on disposal of property and equipment	(1)	-
Loss on disposal of assets for lease	200	149
Allowance for doubtful accounts	7	66
Stock-based compensation expense	253	222
Changes in Operating Assets and Liabilities:		
Trade accounts receivable	(607)	315
Prepaid expenses and other current assets	(65)	(80)
Accounts payable	197	(558)
Accrued expenses	763	130
Deferred revenue	362	(285)
Net Cash Provided by (Used in) Operating Activities	181	(1,906)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(24)	(140)
Proceeds from disposal of property and equipment	2	-
Purchase of assets for lease	(764)	(415)
Net Cash Used in Investing Activities	(786)	(555)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	475	-
Proceeds from stock option exercise	78	-
Proceeds from loans payable	114	2,590
Payments of loans payable	(106)	(17)
Net Cash Provided by Financing Activities	561	2,573
(DECREASE) INCREASE IN CASH	(44)	112
CASH, BEGINNING OF PERIOD	622	405

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CASH, END OF PERIOD	\$ 578	\$ 517
Cash paid for interest	\$ 10	\$ 3
Supplemental disclosure of noncash financing activities:		
Reclassification of accrued interest to debt upon extinguishment	\$ 162	\$ -
Fair value of warrants issued to lenders	\$ 288	\$ 322

See accompanying notes to unaudited condensed financial statements

3

Table of Contents

Semler Scientific, Inc.

Notes to Condensed Financial Statements

Unaudited

(In thousands of U.S. Dollars, except share and per share data)

1. Basis of Presentation

Semler Scientific, Inc., a Delaware corporation (“Semler” or “the Company”), prepared the unaudited interim financial statements included in this report in accordance with United States generally accepted accounting principles (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. As such, the information included in this quarterly report on Form 10-Q should be read in conjunction with the audited financial statements and notes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2016 filed with the SEC on March 17, 2017 (the “Annual Report”). In the opinion of management, these financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows for the periods presented. The results of operations for the interim periods shown in this report are not necessarily indicative of the results that may be expected for any future period, including the full year.

Emerging Growth Company Election

The JOBS Act provides that an emerging growth company, such as the Company, can take advantage of an extended transition period for complying with new or revised accounting standards. This allows an emerging growth company to delay the adoption of these accounting standards until they would otherwise apply to private companies. The Company elected to avail itself of this exemption. As a result, its financial statements may not be comparable to other public companies that comply with public company effective dates. In the future, the Company may elect to opt out of the extended period for adopting new accounting standards. If it does so, it would need to disclose such decision and it would be irrevocable.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers*. The amendment in this ASU provides guidance on the revenue

recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The core principle of this update provides guidance to identify the performance obligations under the contract(s) with a customer and how to allocate the transaction price to the performance obligations in the contract. It further provides guidance to recognize revenue when (or as) the entity satisfies a performance obligation. This standard will replace most existing revenue recognition guidance. ASU No. 2014-09 is effective for the Company's year ending December 31, 2018. On August 8, 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU No. 2014-09 by one year, and permits early adoption as long as the adoption date is not before the original public entity effective date. Since the issuance of ASU 2014-09, the FASB has issued several amendments which clarify certain points, including ASU 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, ASU 2016-10, *Identifying Performance Obligations and Licensing*, ASU 2016-11, *Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*, and ASU 2016-12, *Narrow-Scope Improvements and Practical Expedients*. The Company will adopt the new standard in the first quarter of fiscal year 2019. The Company is currently evaluating the method of adoption and effect the new standard will have on its financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. This ASU provides guidance on management's responsibility in evaluating whether there is substantial doubt about a Company's ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about the company's ability to continue as a going concern within one year from the date the financial statements are issued. This standard is effective for annual periods ending after December 15, 2016, and for interim periods within annual periods beginning after December 15, 2016 with early adoption permitted. The Company adopted the new standard in the first quarter of fiscal year 2017. The adoption of this standard has not had a material impact on its financial statements.

Table of Contents

Semler Scientific, Inc.

Notes to Condensed Financial Statements

Unaudited

(In thousands, except share and per share data)

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, to reduce complexity and simplify the reporting of deferred income tax liabilities and assets. Current GAAP requires an entity to separate deferred income tax liabilities into current and noncurrent amounts in a classified balance sheet. The amendments in this update require that deferred tax liabilities and assets be classified as noncurrent in a classified balance sheet. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendment of this Update. This standard is effective for the Company's annual periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2018. The Company will adopt the new standard in fiscal year 2018. The Company maintains full valuation allowances on all deferred tax balances, and therefore, the adoption of this standard is not anticipated to have a material impact on its financial statements.

In January 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ("ASU No. 2016-02"). Under the new guidance in ASU No. 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: 1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and 2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged, however, certain targeted improvements were made. ASU No. 2016-02 also simplifies the accounting for sale and leaseback transactions. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Lessees and lessors may not apply a full retrospective transition approach. ASU No. 2016-02 is effective for the Company's annual periods beginning after December 15, 2019, including interim periods within those fiscal years. The Company will adopt the new standard in the first quarter of fiscal year 2020. The Company is currently evaluating the impact that this new standard will have on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* ("ASU No. 2016-09"). The amendments in ASU No. 2016-09 are intended to simplify several aspects of the accounting for employee share-based payment transactions including requiring excess benefits and deficiencies to be recognized as a component of income tax expense rather than equity, allowing an entity to make an accounting policy election to either estimate expected forfeitures or to account for them as they occur, and classification of certain items in the statement of cash flows. The standard is effective for the Company's annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018, with early adoption permitted. The Company adopted this standard in the first quarter of fiscal year 2017. The adoption of this standard did not have a material impact on its financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting* (“ASU No. 2017-09”). ASU No. 2017-09 is intended to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in ASU No. 2016-09 to a change to the terms or conditions of a share-based payment award. The amendments in ASU No. 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This ASU is the final version of Proposed ASU 2016-360, *Compensation -Stock Compensation (Topic 718) - Scope of Modification Accounting*, which has been deleted. The amendments in ASU No. 2017-09 are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted. This ASU is not expected to have a material impact on the Company’s financial statements.

2. Going Concern

The Company has incurred recurring losses since inception and expects to continue to incur losses as a result of costs and expenses related to the Company’s marketing and other promotional activities, as well as continued research and development of its products. As of September 30, 2017, the Company has negative working capital of \$3,365, cash of \$578 and stockholders’ deficit of \$3,588. The Company’s principal sources of cash have included the issuance of equity securities, and to a lesser extent, borrowings under loan agreements and revenue from leasing its product. To increase revenue, the Company’s operating expenses will continue to grow and, as a result, the Company will need to generate significant additional revenues to achieve profitability. The Company also had \$2,880 of accrued expenses as of September 30, 2017, which includes an aggregate of \$2,412 of deferred fees and compensation payable no later than January 1, 2018.

Table of Contents**Semler Scientific, Inc.****Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)**

The Company's financial statements as of September 30, 2017 have been prepared under the assumption that the Company will continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to attain further operating efficiencies and, ultimately, to generate additional revenue. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. The Company can give no assurances that additional capital that the Company is able to obtain, if any, will be sufficient to meet the Company's needs. The foregoing conditions raise substantial doubt about the Company's ability to continue as a going concern.

3. Assets for Lease, net

Assets for lease consist of the following:

	September 30, 2017 (Unaudited)	December 31, 2016
Assets for lease	\$ 1,804	\$ 1,361
Less: accumulated depreciation	(631)	(486)
Assets for lease, net	\$ 1,173	\$ 875

Depreciation expense amounted to \$81 for each of the three months ended September 30, 2017 and 2016, respectively. Depreciation expense amounted to \$266 and \$243 for the nine months ended September 30, 2017 and 2016, respectively. Reduction to accumulated depreciation for returned items was \$30 and \$91 for the three months ended September 30, 2017 and 2016, respectively. Reduction to accumulated depreciation for returned items was \$121 and \$208 for the nine months ended September 30, 2017 and 2016, respectively.

4. Property and Equipment, net

Capital assets consist of the following:

	September 30, 2017		December 31, 2016
	(Unaudited)		
Capital assets	\$ 783		\$ 760
Less: accumulated depreciation	(313)	(170)
Capital assets, net	\$ 470		\$ 590

Depreciation expense amounted to \$47 and \$33 for the three months ended September 30, 2017 and 2016, respectively. Depreciation expense amounted to \$143 and \$92 for the nine months ended September 30, 2017 and 2016, respectively.

Semler Scientific, Inc.**Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)****5. Accrued Expenses**

Accrued expenses consist of the following:

	September 30, 2017	December 31, 2016
	(Unaudited)	
Offering costs ⁽¹⁾	\$ 172	\$ 227
Compensation ⁽²⁾	2,240	1,481
Board of directors fees ⁽³⁾	132	191
Miscellaneous accruals	336	286
Total accrued expenses	\$ 2,880	\$ 2,185

Accumulated offering costs accrued pertain to consulting fees associated with securing equity financing for the Company prior to the initial public offering. Prior to becoming Chief Executive Officer (“CEO”), the Company’s current CEO performed consulting services for the Company, which included managing finance, sales, marketing, (1) operational and strategic planning for the Company, as well as assistance and strategic guidance in securing financing. The Company agreed to further delay and continue to accrue these amounts and increase the balance owed by 1% per month beginning January 1, 2017 to be paid no later than January 1, 2018. The Company began making monthly payments on these delayed consulting fees during the quarter ended September 30, 2017.

Three employees agreed to further defer amounts accrued to them as of December 31, 2016. The Company agreed (2) to further delay and continue to accrue these amounts and increase the balance owed by 1% per month beginning January 1, 2017 to be paid no later than January 1, 2018.

(3) Two members of the Company’s board of directors agreed to further defer fees earned from August 2016 to July 2017. The Company agreed to further delay and continue to accrue these amounts and increase the balance owed

by 1% per month beginning January 1, 2017 to be paid no later than January 1, 2018.

6. Facilities Leases

The Company recognized facilities lease expenses of \$17 and \$16 for the three months ended September 30, 2017 and 2016, respectively. The Company recognized facilities lease expenses of \$50 and \$53 for the nine months ended September 30, 2017 and 2016, respectively.

On September 23, 2014, the Company entered into a 36-month lease agreement for office space for the sales and marketing team located in Menlo Park, CA. The lease term commenced February 1, 2015 and is effective through January 31, 2018. Payments required under the terms of the lease are \$17.0 per month from February 2015 to January 2016, \$17.5 per month from February 2016 to January 2017, and \$18.0 per month from February 2017 to January 2018. The Company anticipates total future lease payments of \$54.0 for the year ended December 31, 2017 and \$18.0 for the year ended December 31, 2018. On July 15, 2015, the Company entered into a 30-month sublease agreement for the Menlo Park office space, which commenced August 1, 2015 and is effective through the term of the lease, January 31, 2018. Payments required to the Company under the terms of the sublease are \$15.5 per month from August 2015 to July 2016, \$16.0 per month from August 2016 to July 2017, and \$16.5 per month from August 2017 to January 2018. The Company anticipates receipt of total future sublease payments of \$49.5 for the year ended December 31, 2017 and \$16.5 for the year ended December 31, 2018.

Semler Scientific, Inc.**Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)****7. Loans Payable**

Lender	September 30, 2017		December 31, 2016	
	Long-term	Short-term	Long-term	Short-term
Loans from Related Parties				
Chang Family Trust	1,082		1,000	
Chang Family Trust	495		500	
Glenhill Concentrated Long Master Fund, LLC	250		250	
Other Loans				
Accredited Investor		700	700	
Accredited Investor		160	160	
Accredited Investor		80	80	
Ascentium Capital, LLC		37		22
Ascentium Capital, LLC	23	25	42	24
Royal Bank America Leasing, L.P.		43		25
Ascentium Capital, LLC	13	11	21	10
Total	1,863	1,056	2,753	81
Debt Discounts	(17)	(23)	(221)	-
Total, net of debt discounts	1,846	1,033	2,532	81

Loans from Related Parties

On January 15, 2016, the Company entered into a loan agreement with the Chang Family Trust, one of its significant stockholders, is co-trustee. Pursuant to the loan agreement, the Company obtained a \$1,000 unsecured loan, which initially had a 24-month term, at a fixed interest rate of 10% per annum. Under the loan agreement, the Company will pay \$1,000 of principal plus all accrued and unpaid interest at maturity. The Company may prepay the notes at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default, and the Company agreed not to incur additional indebtedness in excess of \$50 without the lender's prior consent, which is not to be unreasonably withheld. In connection therewith, the Company issued the Chang Family Trust a two-year warrant to purchase 114,286 shares of its common stock at an exercise price of \$1.75 per share. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for

loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

On January 21, 2016, the Company entered into a second loan agreement with the Chang Family Trust. Pursuant to this loan agreement, the Company obtained a \$500 unsecured loan, which initially had a 24-month term at a fixed interest rate of 5% per annum. Under this loan agreement, the Company will pay \$500 of principal plus all accrued and unpaid interest at maturity. The Company may prepay the notes at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default, and the Company agreed not to incur additional indebtedness in excess of \$50 without the lender's prior consent, which is not to be unreasonably withheld. In connection therewith, the Company issued the Chang Family Trust a two-year warrant to purchase 114,286 shares of its common stock at an exercise price of \$1.75 per share. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

On May 2, 2017, the Company entered into an amendment regarding the outstanding promissory notes and warrants issued in January 2016 to the Chang Family Trust. As amended, the maturity date for each note has now been extended by 12 months to January 2019, and the interest rate on the \$500 note has been increased to 10.0% per annum for the final 12 months of its term. In each case, interest will accrue on the unpaid principal and accrued interest as of the original two-year maturity date in the final year term of the notes. The other terms of the notes remain unchanged. Additionally, as issued, the warrants were not exercisable, absent receipt of stockholder approval, if after such exercise the holder would be the beneficial owner of more than 19.99% of the Company's common stock. This condition was removed by the amendments, and accordingly, stockholder approval is no longer required. In connection with the foregoing amendment, the Company issued the Chang Family Trust a warrant to purchase 134,616 shares of its common stock at an exercise price of \$2.60 per share. In accordance with FASB Accounting Standards Codification ("ASC") 815, these warrants were classified within permanent equity. The warrant expires January 21, 2022, three years after the latest maturity date of the promissory notes, as amended. As part of the amendment, the fair value of the warrants are considered in the calculation when determining whether an amendment resulted in a modification or extinguishment of the original loans and in accordance with FASB ASC 470, the Company recorded the amendment as an extinguishment of the original loans which resulted in a loss on extinguishment of \$179 as recorded in the statements of operations.

On November 21, 2016, the Company entered into a loan agreement with Glenhill Concentrated Long Master Fund, LLC, one of its significant stockholders. Pursuant to the loan agreement, the Company obtained a \$250 unsecured loan for a 24-month term at a fixed interest rate of 10% per annum. Under the loan agreement, the Company will pay \$250 of principal plus all accrued but unpaid interest at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, the Company issued the accredited investor a two-year warrant to purchase 28,378 shares of common stock at an exercise price of \$1.85 per share. The warrants may not be exercised absent receipt of stockholder approval if after such exercise the holder would be the beneficial owner of more than 4.99% of the Company's common stock. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

Other Loans

On March 31, 2016, the Company entered into a loan agreement with an accredited investor. Pursuant to the loan agreement, the Company obtained a \$700 unsecured loan for a 24-month term at a fixed interest rate of 10% per annum. Under the loan agreement, the Company will pay \$700 of principal plus all accrued but unpaid interest at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, the Company issued the accredited investor a two-year warrant to purchase 79,459 shares of common stock at an exercise price of \$1.85 per share. The warrants may not be exercised absent receipt of stockholder approval if after such exercise the holder would be the beneficial owner of more than 4.99% of the Company's common stock. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

Table of Contents**Semler Scientific, Inc.****Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)**

On April 5, 2016, the Company entered into a loan agreement with an accredited investor. Pursuant to the loan agreement, the Company obtained a \$160 unsecured loan for a 24-month term at a fixed interest rate of 10% per annum. Under the loan agreement, the Company will pay \$160 of principal plus all accrued but unpaid interest at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, the Company issued the accredited investor a two-year warrant to purchase 18,162 shares of common stock at an exercise price of \$1.85 per share. The warrants may not be exercised absent receipt of stockholder approval if after such exercise the holder would be the beneficial owner of more than 4.99% of the Company's common stock. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

On May 20, 2016, the Company entered into a loan agreement with an accredited investor. Pursuant to the loan agreement, the Company obtained a \$80 unsecured loan for a 24-month term at a fixed interest rate of 10% per annum. Under the loan agreement, the Company will pay \$80 of principal plus all accrued but unpaid interest at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, the Company issued the accredited investor a two-year warrant to purchase 9,081 shares of common stock at an exercise price of \$1.85 per share. The warrants may not be exercised absent receipt of stockholder approval if after such exercise the holder would be the beneficial owner of more than 4.99% of the Company's common stock. The relative fair value of this warrant was recorded as a debt discount on the Company's balance sheet and partially offsets the total balance due for loans payable. As of the date of this filing, the Company is in compliance with all terms of this loan.

The Company uses the Black-Scholes pricing model to determine the fair value of warrants. The fair value of each warrant is estimated on the date of grant. The fair value of warrants issued in conjunction with the related party loans during 2017 was \$288. The fair value of all warrants issued in conjunction with the related party loans and other loans during 2016 was \$407. The fair value of the warrants granted is estimated on the date of grant using the Black-Scholes pricing model and the following assumptions for the periods presented:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Expected term (in years)	-	2	4.75	2
Risk-free interest rate	- %	0.73 – 0.89	1.27	% 0.73 – 0.89

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Expected volatility	- %	98.1 – 99.0	104.6	%	97.7 – 99.0
Expected dividend rate	- %	0	0	%	0

The assumptions are based on the following for each of the years presented:

Valuation Method — The Company estimates the fair value of warrants using the Black-Scholes pricing model.

Expected Term — The Company uses the amount of time the warrants are exercisable per the contractual terms of the award.

Volatility — The Company derives this number from the historical stock volatility of the Company's stock over a period approximately equal to the expected term of the warrants.

Risk-free Interest Rate — The risk-free interest rate is based on median U.S. Treasury zero coupon issues with remaining terms similar to the expected term on the warrants.

Expected Dividend — The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and therefore, used an expected dividend yield of zero in the valuation model.

Table of Contents

Semler Scientific, Inc.

Notes to Condensed Financial Statements

Unaudited

(In thousands, except share and per share data)

On July 1, 2016, the Company entered into a software license financing agreement with Ascentium Capital, LLC. Pursuant to the agreement, the Company obtained a \$39 loan for a 12-month term at a fixed interest rate of 8.9% per annum. to finance its upfront software licensing fee. The Company had no obligation to make any payments during the first three months, and agreed to pay \$4.6 of principal and accrued interest for each of the last 9 months of the term. The loan was prepayable at any time prior to maturity without penalty. The agreement provided for customary events of default. This loan was paid in full by maturity in accordance with its terms and is no longer outstanding.

On July 8, 2016, the Company entered into an additional software license financing agreement with Ascentium Capital, LLC. Pursuant to the agreement, the Company obtained a \$74 loan for a 36-month term at a fixed interest rate of 8.9% per annum. Under the loan agreement, the Company agreed to make monthly payments of \$2.4 of principal and accrued interest. The loan may be prepaid at any time prior to maturity without penalty. The agreement provides for customary events of default. As of the date of this filing, the Company is in compliance with all terms of this loan.

On July 11, 2016, the Company entered into a secured equipment financing agreement with Royal Bank America Leasing, L.P. Pursuant to the agreement, the Company obtained a \$160 loan for a 36-month term at a fixed interest rate of 7.3% per annum, which is secured by related equipment. The loan is to be disbursed in three installments. The first installment was for \$41. The second installment was for \$54, and the third installment for \$65 will be disbursed in July 2018. Under the loan agreement, the Company paid \$3.5 of principal and accrued interest for each of the first 12 months, will pay \$4.8 of principal and accrued interest for each of months 13-24, and will pay \$5.7 of principal and accrued interest for each of months 25-36. The loan may be prepaid at any time only in accordance with the agreement. The agreement provides for customary events of default. As of the date of this filing, the Company is in compliance with all terms of this loan.

On October 2, 2016, the Company entered into a secured equipment financing agreement with Ascentium Capital, LLC. Pursuant to the agreement, the Company obtained a \$33 loan for a 36-month term at a fixed interest rate of 9.1% per annum. Under the loan agreement, the Company agreed to make monthly payments of \$1.0 of principal and accrued interest. The loan may be prepaid at any time prior to maturity without penalty. The agreement provides for customary events of default. As of the date of this filing, the Company is in compliance with all terms of this loan.

On April 1, 2017, the Company entered into a software license financing agreement with Ascentium Capital, LLC. Pursuant to the agreement, the Company obtained a \$63 loan for a 12-month term at a fixed interest rate of 10.3% per annum. to finance its upfront software licensing fee. The Company agreed to pay \$5.6 of principal and accrued interest for each month of the term. The loan may be prepaid at any time prior to maturity without penalty. The agreement provides for customary events of default. As of the date of this filing, the Company is in compliance with all terms of this loan.

For the three months ended September 30, 2017 and 2016, interest expense was \$117 and \$105, respectively, which included amortization of the debt discount of \$17 and \$50, respectively. For the nine months ended September 30, 2017 and 2016, interest expense was \$348 and \$275, respectively, which included amortization of the debt discount of \$138 and \$133, respectively.

Indemnification Obligations

The Company enters into agreements with customers, partners, lenders, consultants, lessors, contractors, sales representatives and parties to certain transactions in the ordinary course of the Company's business. These agreements may require the Company to indemnify the other party against third party claims alleging that its product infringes a patent or copyright. Certain of these agreements require the Company to indemnify the other party against losses arising from: a breach of representations or covenants, claims relating to property damage, personal injury or acts or omissions of the Company, its employees, agents or representatives. The Company has also agreed to indemnify the directors and certain of the officers and employees in accordance with the by-laws of the Company. These indemnification provisions will vary based upon the nature and terms of the agreements. In many cases, these indemnification provisions do not contain limits on the Company's liability, and the occurrence of contingent events that will trigger payment under these indemnities is difficult to predict. As a result, the Company cannot estimate its potential liability under these indemnities. The Company believes that the likelihood of conditions arising that would trigger these indemnities is remote and, historically, the Company had not made any significant payments under such indemnification provisions. Accordingly, the Company has not recorded any liabilities relating to these agreements. In certain cases, the Company has recourse against third parties with respect to the aforesaid indemnities, and the Company believes it maintains adequate levels of insurance coverage to protect the Company with respect to potential claims arising from such agreements.

Table of Contents**Semler Scientific, Inc.****Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)****8. Net Loss Per Common Share**

Because the Company was in a loss position for each of the periods presented, diluted net loss per share is the same as basic net loss per share for each period as the inclusion of all potential common shares outstanding would have been anti-dilutive. The following outstanding shares of common stock equivalents were excluded from the computation of diluted net loss per share for the periods presented because including them would have been anti-dilutive:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Weighted average shares outstanding:				
Common stock warrants	885,982	722,988	780,566	671,516
Options	1,919,100	2,069,517	2,105,235	2,041,515
Total	2,805,082	2,792,505	2,885,801	2,713,031

9. Stock Option Plan

The Company's stock-based compensation program is designed to attract and retain employees while also aligning employees' interests with the interests of its stockholders. Stock options have been granted to employees under the stockholder-approved 2007 Key Person Stock Option Plan ("2007 Plan") or the stockholder-approved 2014 Stock Incentive Plan ("2014 Plan"). Stockholder approval of the 2014 Plan became effective in September 2014. The 2014 Plan originally provided that the aggregate number of shares of common stock that may be issued pursuant to awards granted under the 2014 Plan may not exceed 450,000 shares (the "Share Reserve"), however in October 2015, the stockholders approved a 1,500,000 increase to the Share Reserve. In addition, the Share Reserve automatically increases on January 1st of each year, for a period of not more than 10 years, beginning on January 1st of the year following the year in which the 2014 Plan became effective and ending on (and including) January 1, 2024, in an amount equal to 4% of the total number of shares of common stock outstanding on December 31st of the preceding calendar year. The Company's Board of Directors may act prior to January 1st of a given year to provide that there will be no January 1st increase in the Share Reserve for such year or that the increase in the Share Reserve for such year will be a lesser number of shares of common stock than would otherwise occur. On January 1, 2015, the Share Reserve increased by 188,640 shares due to the automatic 4% increase. On January 1, 2016, the Share Reserve increased by 204,943 shares due to the automatic 4% increase. On January 1, 2017, the Share Reserve increased by 204,943 shares due to the automatic 4% increase. The Share Reserve is currently 2,548,526 shares for the year ending December 31, 2017.

In light of stockholder approval of the 2014 Plan, the Company no longer grants equity awards under the 2007 Plan. As of September 30, 2017, 0 shares of an aggregate total of 407,500 shares were available for future stock-based compensation grants under the 2007 Plan and 871,875 shares of an aggregate total of 2,548,526 shares were available for future stock-based compensation grants under the 2014 Plan.

Aggregate intrinsic value represents the difference between the closing market value as of September 30, 2017 of the underlying common stock and the exercise price of outstanding, in-the-money options. A summary of the Company's stock option activity and related information for the nine months ended September 30, 2017 is as follows:

	Options Outstanding		Weighted	Aggregate
	Number of	Weighted	Average	Intrinsic Value
	Stock	Average	Remaining	(in thousands)
	Options	Exercise Price	Contractual	
	Outstanding		Term (In Years)	
Balance, January 1, 2017	2,049,517	\$ 2.58	7.66	\$ 306
Options granted	175,000	2.00		
Options exercised	(150,000)	0.52		
Options forfeited/canceled	(155,417)	3.46		
Balance, September 30, 2017	1,919,100	\$ 2.62	7.61	\$ 3,125
Exercisable as of September 30, 2017	1,468,831	\$ 2.71	7.36	\$ 2,262

Table of Contents**Semler Scientific, Inc.****Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)**

The total compensation cost related to unvested stock option awards not yet recognized was \$715 as of September 30, 2017. The weighted average period over which the total unrecognized compensation cost related to these unvested stock awards will be recognized is 2.5 years. The estimated grant date fair value of option shares vested during the three months ended September 30, 2017 and 2016 was \$89 and \$87, respectively. The estimated grant date fair value of option shares vested during the nine months ended September 30, 2017 and 2016 was \$253 and \$222, respectively. There were no options granted during the three months ended September 30, 2017 or 2016. The weighted average grant date fair value of options granted during the nine months ended September 30, 2017 and 2016 was \$1.54 and \$1.43, respectively, or an aggregate grant date fair value of \$269 and 229, respectively

On January 20, 2017, the Compensation Committee of the Company's Board of Directors granted, and the full Board ratified, an option to acquire an aggregate of 125,000 shares under the 2014 Plan to the Company's CEO. This option vests 25% on the one-year anniversary of the grant date and monthly thereafter for 36 months, such that the option is vested in full on the four-year anniversary of the grant date. Also on January 20, 2017, the Company's Compensation Committee granted, and the full Board ratified, options to each of the then-seated non-employee Directors to acquire 5,000 shares, for an aggregate of 15,000 shares, under the 2014 Plan. These options vest on the one-year anniversary of their grant date. On January 20, 2016, the Company's Compensation Committee granted, and the full Board ratified, options to each of the then-seated non-employee Directors to acquire 5,000 shares, for an aggregate of 15,000 shares, under the 2014 Plan. These options vested on the one-year anniversary of their grant date.

Determining the Fair Value of Stock Options

The Company uses the Black-Scholes pricing model to determine the fair value of stock options. The fair value of each option grant is estimated on the date of the grant. The following assumptions for the periods presented were:

	Three months ended September 30,		Nine months ended September 30,			
	2017	2016	2017		2016	
Expected term (in years)	-	-	5		5	
Risk-free interest rate	- %	-	% 1.94 – 2.02	%	1.21	%
Expected volatility	- %	-	% 104.0 – 106.2	%	80.4	%
Expected dividend rate	- %	-	% 0	%	0	%

The assumptions are based on the following for each of the periods presented:

Valuation Method — The Company estimates the fair value of its stock options using the Black-Scholes option pricing model.

Expected Term — The Company estimates the expected term consistent with the simplified method identified by the SEC. The Company elected to use the simplified method because of its limited history of stock option exercise activity and its stock options meet the criteria of the “plain-vanilla” options as defined by the SEC. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award.

Volatility — The Company derives this number from the historical stock volatility of the Company’s stock over a period approximately equal to the expected term of the options.

Risk-free Interest Rate — The risk-free interest rate is based on median U.S. Treasury zero coupon issues with remaining terms similar to the expected term on the options.

Expected Dividend — The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and therefore, used an expected dividend yield of zero in the valuation model.

Forfeiture — Beginning in the first quarter of 2017, the Company implemented ASU 2016-09 as described in Note 1, and elected to true-up calculations at the time of forfeiture, rather than creating an estimate at the time of option issuance.

Table of Contents**Semler Scientific, Inc.****Notes to Condensed Financial Statements****Unaudited****(In thousands, except share and per share data)**

The Company has recorded an expense of \$89 and \$87 as it relates to stock-based compensation for the three months ended September 30, 2017 and 2016, respectively. The Company has recorded an expense of \$253 and \$222 as it relates to stock-based compensation for the nine months ended September 30, 2017 and 2016, respectively:

	Three months ended September 30,		Nine months ended September 30	
	2017	2016	2017	2016
Cost of Revenue	\$ 1	\$ 1	\$ 1	\$ 1
Engineering and Product Development	12	16	36	35
Sales and Marketing	24	27	70	70
General and Administrative	52	43	146	116
Total	\$ 89	\$ 87	\$ 253	\$ 222

10. Issuance of Common Stock

On January 23, 2017, the Company issued and sold 40,000 shares of its common stock to Glenhill Concentrated Long Master Fund, LLC, one of its significant stockholders, pursuant to a stock purchase agreement for \$100,000, which was paid in cash. On February 13, 2017, the Company issued and sold an aggregate of 150,000 shares of its common stock to two accredited investors, including GPG RM Investment, LLC, an affiliate of one of its significant stockholders, pursuant to separate stock purchase agreements for an aggregate purchase price of \$375,000, which was paid in cash.

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read together with our condensed unaudited financial statements and the related notes appearing elsewhere in this quarterly report on Form 10-Q and with the audited financial statements and notes for the fiscal year ended December 31, 2016, and the information under the headings “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K filed with the SEC on March 17, 2017, or the Annual Report. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. See “Cautionary Note Regarding Forward-Looking Statements” for a discussion of the uncertainties, risks and assumptions associated with these statements. Actual results and the timing of events could differ materially from those discussed in our forward-looking statements as a result of many factors, including those set forth under “Risk Factors” in our Annual Report.

Overview

We are an emerging growth company providing technology solutions to improve the clinical effectiveness and efficiency of healthcare providers. Our mission is to develop, manufacture and market innovative proprietary products and services that assist our customers in evaluating and treating chronic diseases. In 2011, we began commercializing our first patented and U.S. Food and Drug Administration, or FDA, cleared product, which measured arterial blood flow in the extremities to aid in the diagnosis of peripheral arterial disease, or PAD. In March 2015, we received FDA 510(k) clearance for the next generation version of our product, QuantaFlo™, which we began commercializing in August 2015. In April 2015, we launched our multi-test service platform, WellChec™, to more comprehensively evaluate our customers’ patients for chronic disease. In October 2016, we shifted our marketing focus for WellChec™ from direct contracts as the primary WellChec™ service provider to contracts to supply our software and equipment to vendors who employ medical professionals to do annual wellness visits for health insurance plans. We believe our products and services position us to provide valuable information to our customer base of healthcare professionals, which in turn permit them to better guide patient care.

In the three months ended September 30, 2017, we had total revenue of \$3,607,000 and a net loss of \$41,000 compared to total revenue of \$1,982,000 and a net loss of \$362,000 in the same period in 2016. In the nine months ended September 30, 2017, we had total revenue of \$8,239,000 and a net loss of \$1,763,000 compared to total revenue of \$5,118,000 and a net loss of \$2,334,000 in the same period in 2016.

Emerging Growth Company Elections

The JOBS Act provides that an emerging growth company, such as our company, can take advantage of an extended transition period for complying with new or revised accounting standards. This allows an emerging growth company to delay the adoption of these accounting standards until they would otherwise apply to private companies. We have elected to avail ourselves of this exemption. As a result, our financial statements may not be comparable to other public companies that comply with public company effective dates. In the future, we may elect to opt out of the extended period for adopting new accounting standards. If we do so, we would need to disclose such decision and it would be irrevocable.

Factors Affecting Future Results

We have not identified any factors that have a recurring effect that are necessary to understand period to period comparisons as appropriate, nor any one-time events that have an effect on the financials. Also, given our relatively limited operating history, we have not yet definitively identified any seasonality. Our customer base has recently expanded to include home risk assessment service providers, almost all of whom compensate us on a fee-per-test model. Our revenues may be affected by seasonality in their business as we only generate revenues when such customers use our vascular testing devices. Although we believe such customers perform more services in the latter half of the year than the first half, we have not yet identified any true seasonality arising from the use of our QuantaFlo™ device on a fee-per-test model by such customers.

Table of Contents

Results of Operations

Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016

Revenue

We had revenue of \$3,607,000 for the three months ended September 30, 2017, an increase of \$1,625,000, or 82%, compared to \$1,982,000 in the same period in 2016. Our revenue is primarily generated from our vascular testing systems, which we license to customers for a fixed fee, or receive fees based on usage. For licenses, we recognize revenue monthly for each unit installed with a customer. The average amount recognized each month per unit of product in the field is affected by the mix of units rented by direct customers or distributors, by price changes and by discounts. The primary reason for the increase in revenue was that the total number of installed units in the field generating monthly license revenue grew 31%, and the average amount of revenue recognized per unit increased 15% as compared to the same period in 2016. We believe that growth in the number of monthly invoices is predominately due to our sales and marketing efforts, which added new customers to an established customer base. The change in the average amount of revenue recognized per unit was due to changes in the mix of customers licensing units and the migration to QuantaFlo™ from its lower-priced, predecessor product. We recognized \$772,000 of revenue from per-use fees, testing services and other sales during the three months ended September 30, 2017, an increase of \$677,000, compared to \$95,000 in the same period in 2016.

Operating expenses

We had total operating expenses of \$3,531,000 for the three months ended September 30, 2017, an increase of \$1,294,000, or 58%, compared to \$2,237,000 in the same period in 2016. The primary reasons for the increase were higher sales and marketing expenses, cost of revenue, general and administrative expense and engineering and product development expense. The changes in the various components of our operating expenses are described below.

Cost of revenue

We had cost of revenue of \$724,000 for the three months ended September 30, 2017, an increase of \$326,000, or 82%, from \$398,000 for the same period in the previous year. The change was primarily due to an increase of \$109,000 in aggregate depreciation of our vascular testing systems in the field, which corresponds to an increase in the total number of monthly depreciation charges for vascular testing systems of 31% and an increase in average depreciation per unit per month of 34%, an increase of \$101,000 associated with employees who oversee manufacturing and

fulfillment operations as we increased headcount to fulfill increased orders, an increase of \$64,000 due to re-allocation of customer support costs from general and administrative expense to cost of revenue, a higher cost of units that were retired of \$44,000 and an increase in the aggregate of building lease, freight, and other miscellaneous items of \$31,000, partially offset by a decrease in event expenses of \$23,000.

Engineering and product development expense

We had engineering and product development expense of \$432,000 for the three months ended September 30, 2017, an increase of \$249,000, or 136%, compared to \$183,000 in the same period in 2016. We continued to focus our efforts on enhancing product capabilities and customizing software and equipment for our clients to meet their cybersecurity and data analysis needs, which led to increased consulting costs of \$154,000, and increased headcount of \$95,000.

Sales and marketing expense

We had sales and marketing expense of \$1,350,000 for the three months ended September 30, 2017, an increase of \$400,000, or 42%, compared to \$950,000 in the same period in 2016. The change was primarily due to higher personnel related expenses (including sales commissions) of \$397,000 as we increased customer orders as well as higher miscellaneous expense of \$8,000, partially offset by lower stock-based compensation expense of \$3,000 and lower expenses for trade shows of \$2,000, as compared to the same period in 2016.

General and administrative expense

We had general and administrative expense of \$1,025,000 for the three months ended September 30, 2017, an increase of \$319,000, or 45%, compared to \$706,000 in the same period in 2016. The change was primarily due to higher salaries and fees for employees, directors, and consultants of \$115,000, higher patent and legal expenses of \$111,000, higher costs for merchant fees and other expenses of \$69,000, higher public company expenses of \$29,000, higher insurance premium fees of \$28,000, higher audit, taxes and associated expense of \$24,000, and higher costs associated with stock-based compensation expense of \$8,000, which changes were partially offset by lower expense for uncollectable accounts of \$46,000, lower technical support costs of \$17,000, and lower travel expenses of \$2,000.

Other expense

We had total other expense of \$117,000 for the three months ended September 30, 2017, an increase of \$10,000, or 9%, compared to \$107,000 in the same period in 2016. The change was primarily due increased interest expense of

\$12,000, partially offset by lower other expense of \$2,000.

Table of Contents

Net loss

For the foregoing reasons, we had a net loss of \$41,000, or \$0.01 per share, for the three months ended September 30, 2017, a decrease of \$321,000, or 89%, compared to a net loss of \$362,000, or \$0.07 per share, for the same period in 2016.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

Revenue

We had revenue of \$8,239,000 for the nine months ended September 30, 2017, an increase of \$3,121,000, or 61%, compared to \$5,118,000 in the same period in 2016. The primary reason for the increase in revenue was that the total number of installed units in the field generating monthly license revenue grew 22%, and the average amount of revenue recognized per unit increased 14% as compared to the same period in 2016. We believe that growth in the number of monthly invoices is predominately due to our sales and marketing efforts, which added new customers to an established customer base. Change in the average amount of revenue recognized per unit was due to changes in the mix of customers licensing units and the migration to QuantaFlo™ from its lower-priced, predecessor product. We recognized \$1,158,000 of revenue from per-use fees, testing services and other sales during the nine months ended September 30, 2017, an increase of \$976,000, compared to \$182,000 in the same period in 2016. We did not recognize any revenue from WellChec™ during the nine months ended September 30, 2017, compared to a reduction in revenue of \$162,000 in the same period in 2016.

Operating expenses

We had total operating expenses of \$9,467,000 for the nine months ended September 30, 2017, an increase of \$2,297,000, or 32%, compared to \$7,170,000 in the same period in 2016. The primary reasons for the increase were higher engineering and product development expense, general and administrative expense, sales and marketing expense and cost of revenue. The changes in the various components of our operating expenses are described below.

Cost of revenue

We had cost of revenue of \$1,855,000 for the nine months ended September 30, 2017, an increase of \$507,000, or 38%, from \$1,348,000 for the same period in the previous year. The change was primarily due to an increase of \$238,000 associated with employees who oversee manufacturing and fulfillment operations as we increased headcount to fulfill increased orders, an increase of \$185,000 in aggregate depreciation of our vascular testing systems in the field, which corresponds to an increase in the total number of monthly depreciation charges for vascular testing systems of 22% and an increase in average depreciation per unit per month of 18%, an increase in the aggregate of building lease, freight, and other miscellaneous items of \$69,000, an increase of \$64,000 due to re-allocation of customer support costs from general and administrative expense to cost of revenue, and a higher cost of units that were retired of \$51,000, partially offset by a decrease in event expenses of \$100,000.

Engineering and product development expense

We had engineering and product development expense of \$1,345,000 for the nine months ended September 30, 2017, an increase of \$711,000, or 112%, compared to \$634,000 in the same period in 2016. In 2017, we began focusing our efforts on enhancing product capabilities and customizing software and equipment for our clients to meet their cybersecurity and data analysis needs. This change in focus led to increased consulting costs of \$628,000, increased headcount of \$72,000 and increased other expense of \$11,000.

Sales and marketing expense

We had sales and marketing expense of \$3,502,000 for the nine months ended September 30, 2017, an increase of \$550,000, or 19%, compared to \$2,952,000 in the same period in 2016. The change was primarily due to higher personnel related expenses (including sales commissions) of \$567,000 commensurate with increased orders and \$50,000 in other expense, partially offset by lower travel expenses of \$56,000 and lower trade show expense of \$11,000, as compared to the same period in 2016.

General and administrative expense

We had general and administrative expense of \$2,765,000 for the nine months ended September 30, 2017, an increase of \$529,000, or 24%, compared to \$2,236,000 in the same period in 2016. The change was primarily due to higher salaries and fees for employees, directors and consultants of \$155,000, higher merchant fees and other expenses of \$128,000, higher patent and legal expenses of \$124,000, higher insurance premium fees of \$94,000, higher technical support costs of \$61,000, higher audit, taxes and associated expense of \$43,000, higher costs associated with stock-based compensation expense of \$30,000, which changes were partially offset by lower expense for uncollectable accounts of \$59,000, lower public company expenses of \$43,000 and lower travel expenses of \$4,000.

Table of Contents

Other expense

We had total other expense of \$535,000 for the nine months ended September 30, 2017, an increase of \$253,000, or 90%, compared to \$282,000 in the same period in 2016. This increase was primarily due to inclusion of a loss on the extinguishment of loans payable of \$179,000, as well as increased interest expense of \$73,000. The loss on the extinguishment of loans payable arose due to the May 2017 amendment of our loans from Mr. Chang, which was treated as an extinguishment for accounting purposes. The increase in interest expense was primarily due to an increase in our outstanding indebtedness, as we had \$2,328,000 of loans payable net of debt discount (including \$1,336,000 due to a related party) at September 30, 2016, compared to \$1,846,000 of long-term loans payable, net of debt discount (including \$1,810,000, net of debt discount due to related parties) and \$1,033,000 of loans payable, net of debt discount, current portion (including \$0 due to related parties) at September 30, 2017.

Net loss

For the foregoing reasons, we had a net loss of \$1,763,000, or \$0.33 per share, for the nine months ended September 30, 2017, a decrease of \$571,000, or 24%, compared to a net loss of \$2,334,000, or \$0.46 per share, for the same period in 2016.

Liquidity and Capital Resources

We had cash of \$578,000 at September 30, 2017 compared to \$622,000 at December 31, 2016, and total current liabilities of \$5,578,000 at September 30, 2017 compared to \$3,229,000 at December 31, 2016. As of September 30, 2017 we had negative working capital of approximately \$3,365,000.

In January 2016, we borrowed an aggregate of \$1,500,000 from the Chang Family Trust, one of our significant stockholders and the family trust of one of our former Directors, Mr. William H.C. Chang, pursuant to two separate promissory notes and also issued two 2-year warrants to acquire an aggregate 228,572 shares of our common stock at an exercise price of \$1.75 per share. In May 2017 we amended the terms of these loans to extend their maturity dates and issued an additional warrant to acquire an additional 134,616 shares, which expires three years after the last maturity date of the loans as amended. On March 31, 2016, we borrowed \$700,000 from an accredited investor pursuant to a promissory note and also issued a 2-year warrant to acquire an aggregate 79,459 shares of our common stock at \$1.85 per share. On April 5, 2016, we borrowed \$160,000 from the same accredited investor pursuant to a promissory note and also issued a 2-year warrant to acquire an aggregate of 18,162 shares of our common stock at \$1.85 per share. On May 20, 2016, we borrowed \$80,000 from the same accredited investor pursuant to a promissory note and also issued a 2-year warrant to acquire an aggregate of 9,081 shares of our common stock at \$1.85 per share. In July 2016 and November 2016 we entered into software and equipment financing arrangements. On November 21,

2016, we borrowed \$250,000 from an accredited investor pursuant to a promissory note and also issued a 2-year warrant to acquire an aggregate of 28,378 shares of our common stock at \$1.85 per share (see “—Description of Indebtedness”).

On January 23, 2017, we issued and sold 40,000 shares of our common stock to Glenhill Concentrated Long Master Fund, LLC, one of our significant stockholders, pursuant to a stock purchase agreement for \$100,000, which was paid in cash. On February 13, 2017, we issued and sold an aggregate of 150,000 shares of our common stock to two accredited investors, including GPG RM Investment, LLC, an affiliate of one of our significant stockholders, pursuant to separate stock purchase agreements for an aggregate purchase price of \$375,000, which was paid in cash.

We have incurred recurring losses since inception and expect to continue to incur losses as a result of costs and expenses related to our marketing and other promotional activities, continued research and development of our products and services. Our principal sources of cash have included the issuance of equity, including our February 2014 initial public offering of common stock, and to a lesser extent, recent private placement offerings of common stock, borrowings under loan agreements, the issuance of promissory notes, and revenue from leasing our product and selling our testing services. We expect that our operating expenses will continue to grow in order to grow our revenues and, as a result, we will need to generate significant additional net revenues to achieve profitability. For these reasons, our independent registered public accountants’ report for the year ended December 31, 2016 includes an explanatory paragraph that expresses substantial doubt about our ability to continue as a “going concern.”

Table of Contents

Although we do not have any current capital commitments, we expect that we may increase our expenditures to continue our efforts to grow our business and commercialize our products and services. Accordingly, we currently expect to make additional expenditures in both sales and marketing, and invest in our corporate infrastructure. We also expect to invest in our research and development efforts. We do not have any definitive plans as to the exact amounts or particular uses at this time, and the exact amounts and timing of any expenditure may vary significantly from our current intentions. However, in order to execute on our business plan, and given our current available cash, we anticipate that we will need to raise additional capital. To improve operating cash flow, in 2015, we implemented measures to reduce expenses and renegotiated longer payment terms in our existing contracts, which carried through 2016. There is no assurance that additional financing will be available when needed or that management will be able to obtain financing on acceptable terms or whether or not we will generate sufficient revenues to become profitable and have positive operating cash flow. If we are unable to raise sufficient additional funds when necessary, we may need to curtail making additional expenditures and could be required to scale back our business plans, or make other changes until sufficient additional capital is raised to support further operations. There can be no assurance that such a plan will be successful.

Operating activities

We generated \$181,000 of net cash from operating activities for the nine months ended September 30, 2017. Non-cash adjustments to reconcile net loss to net cash provided by operating activities were \$1,294,000 in the nine months ended September 30, 2017. These non-cash adjustments primarily reflect depreciation of \$409,000, stock-based compensation expense of \$253,000, loss on disposal of assets for lease of \$200,000, loss on extinguishment of debt of \$179,000, amortization of debt discount costs of \$138,000, accretion of non-cash interest of \$109,000, and allowance for doubtful accounts of \$7,000, all partially offset by gain on disposal of asset for lease of \$1,000. Cash provided by changes in operating assets and liabilities was \$650,000 in the nine months ended September 30, 2017. These changes in operating assets and liabilities included cash provided by accrued expenses of \$763,000, deferred revenue of \$362,000, and trade accounts payable of \$197,000, partially offset by cash used in trade accounts receivable of \$607,000, prepaid expenses and other current assets of \$65,000.

For the same period in 2016, we used \$1,906,000 of net cash in operating activities. Non-cash adjustments to reconcile net loss to net cash used in operating activities were \$906,000 in the nine months ended September 30, 2016. These non-cash adjustments primarily reflect depreciation of \$336,000, loss on disposal of assets for lease of \$149,000, stock-based compensation expense of \$222,000, amortization of deferred financing costs and debt discounts of \$133,000, and allowance for doubtful accounts of \$66,000. Cash used by changes in operating assets and liabilities was \$478,000 in the nine months ended September 30, 2016. These changes in operating assets and liabilities included cash used in primarily from trade accounts payable of \$558,000, deferred revenue of \$285,000 and prepaid expenses and other current assets of \$80,000, partially offset by net cash provided by trade accounts receivable of \$315,000 and accrued expenses of \$130,000.

Investing activities

We used \$786,000 of net cash in investing activities for the nine months ended September 30, 2017, primarily from purchases of assets for lease of \$764,000, fixed asset purchases of \$24,000, partially offset by proceeds from disposal of fixed assets of \$2,000. We used \$555,000 of net cash in investing activities for the same period in 2016, primarily from purchases of assets for lease of \$415,000 and fixed asset purchases of \$140,000.

Financing activities

We generated \$561,000 in net cash from financing activities during the nine months ended September 30, 2017 due to proceeds from sales of common stock of \$553,000 (\$78,000 of which was related to proceeds from exercise of stock options), and proceeds from loans payable of \$114,000, partially offset by payments of loans payable of \$106,000. We generated \$2,573,000 in net cash from financing activities in the same period of 2016 due to proceeds from loans payable of \$2,590,000, partially offset by payments of loans payable of \$17,000.

Description of Indebtedness

In January 2016, we borrowed an aggregate of \$1.5 million from the Chang Family Trust, one of our significant stockholders and the family trust of our former director, William H.C. Chang, pursuant to two separate 2-year promissory notes. We amended the terms of the notes in May 2017 to extend the maturity date by one year. The notes bear simple interest (\$1.0 million at a rate of 10% per annum, and \$0.5 million at 5% per annum) and mature January 21, 2019, as amended, with all interest payable at maturity. We may prepay the notes at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default, and we agreed not to incur additional indebtedness in excess of \$50,000 without the lender's prior consent, which is not to be unreasonably withheld. In connection therewith, we issued the Chang Family Trust a two-year warrant to purchase an aggregate of 228,372 shares of our common stock at an exercise price of \$1.75 per share. We amended the warrants in May 2017 to remove the requirement that stockholder approval be obtained if such exercise would result in beneficial ownership of more than 19.99%. In connection with the May 2017 amendment of such notes and warrants, we issued the Chang Family Trust warrants to acquire an aggregate of 134,616 shares of our common stock at \$2.60 per share, which warrants expire January 21, 2022, three years after the maturity date of the notes, as amended.

Table of Contents

In March 2016, we borrowed an aggregate of \$700,000 from an accredited investor, pursuant to a two-year promissory note. The note bears simple interest at a rate of 10% per annum and matures in two years, with all principal and accrued but unpaid interest payable at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, we issued a two-year warrant to purchase an aggregate of 79,459 shares of our common stock at an exercise price of \$1.85 per share. The warrants may not be exercised, however, absent receipt of stockholder approval, if after such exercise the holder would be the beneficial owner of more than 4.99% of our common stock.

In April 2016, we borrowed an aggregate of \$160,000 from an accredited investor, pursuant to a two-year promissory note. The note bears simple interest at a rate of 10% per annum and matures in two years, with all principal and accrued but unpaid interest payable at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, we issued a two-year warrant to purchase an aggregate of 18,162 shares of our common stock at an exercise price of \$1.85 per share. The warrants may not be exercised, however, absent receipt of stockholder approval, if after such exercise the holder would be the beneficial owner of more than 4.99% of our common stock.

In May 2016, we borrowed an aggregate of \$80,000 from an accredited investor, pursuant to a two-year promissory note. The note bears simple interest at a rate of 10% per annum and matures in two years, with all principal and accrued but unpaid interest payable at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, we issued a two-year warrant to purchase an aggregate of 9,081 shares of our common stock at an exercise price of \$1.85 per share. The warrants may not be exercised, however, absent receipt of stockholder approval, if after such exercise the holder would be the beneficial owner of more than 4.99% of our common stock.

In November 2016, we borrowed an aggregate of \$250,000 from an accredited investor, pursuant to a two-year promissory note. The note bears a simple interest rate of 10% per annum and matures in two years, with all principal and accrued but unpaid interest payable at maturity. The notes may be prepaid at any time prior to maturity without penalty. The notes must be repaid prior to maturity in the event of default. In connection therewith, we issued a two-year warrant to purchase an aggregate of 28,378 shares of our common stock at an exercise price of \$1.85 per share. The warrants may not be exercised, however, absent receipt of stockholder approval, if after such exercise the holder would be the beneficial owner of more than 4.99% of our common stock.

In addition to the above, we have also entered into other debt financing arrangements, including equipment and software financing arrangements. See Note 7 to our financial statements appearing elsewhere in this interim report on Form 10-Q for description of our outstanding indebtedness.

Off-Balance Sheet Arrangements

As of each of September 30, 2017 and December 31, 2016, we had no off-balance sheet arrangements.

Commitments and Contingencies

As of each of September 30, 2017 and December 31, 2016, other than employment/consulting agreements with key executive officers and our facilities lease obligation, we had no material commitments other than the liabilities reflected in our financial statements.

JOBS Act

In April 2012, the JOBS Act was enacted. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of an extended transition period for complying with new or revised accounting standards. Thus, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected to avail ourselves of this extended transition period, and, as a result, we will not adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Table of Contents

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

In evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our management, with the participation of our chief executive officer and our vice president, finance, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, our chief executive officer and our vice president, finance concluded that our disclosure controls and procedures were not effective, at the reasonable assurance level, as of the end of the period covered by this report to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (1) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) is accumulated and communicated to management, including our chief executive officer and our vice president, finance as appropriate to allow timely decisions regarding required disclosure, due to the existence of the material weaknesses in our internal control over financial reporting.

Changes in Internal Control over Financial Reporting

In an effort to remediate the material weaknesses in our internal control over financial reporting, in both 2016 and early 2017, we adopted and implemented further policies and procedures with respect to the review, supervision, and monitoring of our accounting and reporting functions. We continue to assess our procedures to improve our internal control over financial reporting. Other than these changes, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during our third fiscal quarter ended September 30, 2017.

Table of Contents

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

Not applicable.

Item 1A. Risk Factors.

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

Exh. No. Exhibit Name

31.1 Rule 13a-14(a) Certification of Principal Executive Officer of Registrant
31.2 Rule 13a-14(a) Certification of Principal Financial Officer of Registrant
32.1 Section 1350 Certification

101.INS XBRL Instance Document
101.SCH XBRL Taxonomy Extension Schema
101.CAL XBRL Taxonomy Extension Calculation Linkbase
101.DEF XBRL Taxonomy Extension Definition Linkbase
101.LAB XBRL Taxonomy Extension Label Linkbase
101.PRE XBRL Taxonomy Extension Presentation Linkbase

21

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 3, 2017 **SEMLER SCIENTIFIC, INC.**

By: /s/ Douglas Murphy-Chutorian, M.D.
Douglas Murphy-Chutorian, M.D.
Chief Executive Officer

By: /s/ Daniel Conger
Daniel Conger
Vice President, Finance
Principal Accounting Officer