

Semler Scientific, Inc.  
Form 10-Q  
November 03, 2014

**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 1934

For the Quarterly Period Ended September 30, 2014

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**

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

**2330 N.W. Everett  
Portland, Oregon**

**97210**  
(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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)

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

As of October 31, 2014, there were 4,709,217 shares of the issuer's common stock, \$0.001 par value per share, outstanding.

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**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 prospectus.

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 registration statement on Form S-1 filed with the Securities and Exchange Commission (“SEC”) on February 18, 2014. 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, except share and per share amounts)

	(Unaudited) Three months ended September 30,		(Unaudited) <b>Nine months ended September 30,</b>	
	2014	2013	2014	2013
Revenue	\$897	\$589	\$2,580	\$1,493
Operating expenses:				
Cost of revenue	178	133	504	276
Engineering and product development	262	60	906	254
Sales and marketing	1,040	569	2,514	1,585
General and administrative	784	324	1,821	1,003
Total operating expenses	2,264	1,086	5,745	3,118
Loss from operations	(1,367 )	(497 )	(3,165 )	(1,625 )
Other expense:				
Interest expense	(100 )	(27 )	(152 )	(83 )
Other income	1	1	2	1
Other expense	(99 )	(26 )	(150 )	(82 )
Loss before income tax expense	(1,466 )	(523 )	(3,315 )	(1,707 )
Income tax expense	-	-	-	-
Net loss	\$(1,466 )	\$(523 )	\$(3,315 )	\$(1,707 )
Net loss per share, basic and diluted	\$(0.31 )	\$(0.66 )	\$(0.85 )	\$(2.17 )
Weighted average number of shares used in computing basic and diluted loss per share	4,708,162	786,750	3,900,746	786,750

See accompanying notes to unaudited financial statements.

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

	(Unaudited)	
	September 30, 2014	December 31, 2013
Assets		
Current Assets:		
Cash	\$ 5,973	\$ 734
Trade accounts receivable, net of allowance for doubtful accounts of \$31 and \$15, respectively	311	228
Prepaid expenses and other current assets	168	47
Total current assets	6,452	1,009
Assets for lease, net	696	512
Property and equipment, net	6	1
Deferred financing costs	73	202
Total assets	\$ 7,227	\$ 1,724
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities:		
Accounts payable	\$ 217	\$ 255
Accrued expenses	1,472	1,128
Deferred revenue	805	366
Equipment on lease, current portion	-	47
Loans payable, current portion	113	60
Total current liabilities	2,607	1,856
Long-term liabilities:		
Equipment on lease, net of current portion	-	65
Loans payable, net of current portion	-	98
Total long-term liabilities	-	163
Stockholders' equity (deficit):		
Convertible preferred stock series A, \$0.001 par value; 2,800,000 shares authorized; 0 and 1,468,402 shares issued and outstanding, respectively; aggregate liquidation preference of \$0 and \$6,608 respectively	-	6,020
Convertible preferred stock series A-1, \$0.001 par value; 800,000 shares authorized; 0 and 293,750 shares issued and outstanding, respectively; aggregate liquidation preference of \$0 and \$1,175, respectively	-	482

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Convertible preferred stock series A-2, \$0.001 par value; 400,000 shares authorized ;0 and 250,000 issued and outstanding, respectively; aggregate liquidation preference of \$0 and \$500, respectively	-	208
Common stock, \$0.001 par value; 50,000,000 shares authorized; 4,734,217 and 811,750 shares issued, and 4,709,217 and 786,750 outstanding (net of treasury shares of 25,000 and 25,000), respectively	5	1
Additional paid-in capital	17,282	2,346
Accumulated deficit	(12,667 )	(9,352 )
Total stockholders' equity (deficit)	4,620	(295 )
Total liabilities and stockholders' equity (deficit)	\$ 7,227	\$ 1,724

See accompanying notes to the unaudited financial statements.

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

	<b>(Unaudited)</b>	
	Nine months ended September 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (3,315 )	\$ (1,707 )
Reconciliation of Net Loss to Net Cash Used in Operating Activities:		
Amortization of deferred financing costs	129	66
Depreciation	140	86
Loss on disposal of assets for lease	67	44
Allowance for doubtful accounts	104	48
Stock-based compensation expense	178	141
Changes in Operating Assets and Liabilities:		
Trade accounts receivable	(186 )	(180 )
Prepaid expenses and other current assets	(122 )	(5 )
Accounts payable	(39 )	142
Accrued expenses	345	182
Deferred revenue	439	298
Net Cash Used in Operating Activities	(2,260 )	(885 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to property and equipment	(5 )	-
Purchase of assets for lease	(391 )	(192 )
Net Cash Used in Investing Activities	(396 )	(192 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock	10,010	-
Issuance of convertible preferred stock	-	2,409
Offering costs	(1,959 )	(482 )
Payments of loans payable	(45 )	(45 )
Payments of equipment leases	(111 )	(32 )
Net Cash Provided by Financing Activities	7,895	1,850
<b>INCREASE (DECREASE) IN CASH</b>	<b>5,239</b>	<b>773</b>
<b>CASH, BEGINNING OF PERIOD</b>	<b>734</b>	<b>731</b>
<b>CASH, END OF PERIOD</b>	<b>\$ 5,973</b>	<b>\$ 1,504</b>
Cash paid for interest	\$ 23	\$ 17

Supplemental disclosure of noncash financing activity:

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Conversion of preferred stock into common stock	\$ 6,707	\$ -
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See accompanying notes to unaudited financial statements.

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**Semler Scientific, Inc.**  
**Notes to Financial Statements**

**(In thousands, except share and per share amounts)**

**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 (“U.S. 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 prospectus filed with the SEC pursuant to Rule 424(b) on February 21, 2014 (the “Prospectus”). The balance sheet as of December 31, 2013 included in this report has been derived from the audited financial statements included in the Prospectus. 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. Items in prior year financial statements have been adjusted to conform with the current year presentation.

**Initial Public Offering**

In February 2014, the Company completed its initial public offering (“IPO”) in which it issued and sold 1,430,000 shares of its common stock at a public offering price of \$7.00 per share. The Company received net proceeds of \$7,403 after deducting underwriting discounts and commissions of \$848 and other offering expenses of approximately \$1,759. The Company incurred \$648 of the offering expenses in 2013, and incurred \$1,959 of such expenses in the first quarter of 2014. The Company granted the underwriter an overallotment option to acquire an additional 214,500 shares of its common stock, which expired April 6, 2014 unexercised, and issued the underwriter warrants to acquire an aggregate of 71,500 shares of its common stock at an exercise price of \$8.75 per share, which become exercisable February 20, 2015 and expire February 20, 2019. Upon the closing of the IPO, all shares of the Company’s then-outstanding Series A convertible Preferred Stock (1,468,402), Series A-1 convertible Preferred Stock (293,750) and Series A-2 convertible Preferred Stock (250,000) automatically converted into an aggregate of 2,012,152 shares of common stock. In addition, the Company’s then outstanding warrants to acquire an aggregate of 1,067,210 shares of Series A convertible Preferred Stock and 228,656 shares of Series A-1 convertible Preferred Stock were cashlessly exercised at the IPO price for an aggregate of 479,115 shares of common stock. All other outstanding warrants of the Company became exercisable for common stock effective upon the IPO in accordance with their terms.

**2. Assets for Lease**

Assets for lease consist of the following:

	September 30, 2014	December 31, 2013
Assets for lease	\$ 943	\$ 688
Less: Accumulated Depreciation	(247 )	(176 )
Assets for lease, net	\$ 696	\$ 512

Depreciation expense amounted to \$48 and \$35 for the three months ended September 30, 2014 and September 30, 2013, respectively, and to \$140 and \$86 for the nine months ended September 30, 2014 and September 30, 2013, respectively. Reduction to accumulated depreciation for returned items was \$21 and \$21 for the three months ended September 30, 2014 and September 30, 2013, respectively. Reduction to accumulated depreciation for returned items was \$69 and \$27 for the nine months ended September 30, 2014 and September 30, 2013, respectively.

**3. Deferred Financing Costs**

As of September 30, 2014 and December 31, 2013, deferred financing costs have the gross amounts of \$73 and \$202, respectively. The amounts amortized to interest expense were \$85 and \$22 for the three months ended September 30, 2014 and September 30, 2013, respectively. The amounts amortized to interest expense were \$129 and \$66 for the nine months ended September 30, 2014 and September 30, 2013, respectively. Per details in Note 5, leases were paid off early due to the opening of a new line of credit, resulting in acceleration of the expensing of the outstanding deferred financing costs.

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Notes to Financial Statements**

(In thousands, except share and per share amounts)

**4. Accrued Expenses**

Accrued expenses consist of the following:

	September 30, 2014	December 31, 2013
Offering Costs	\$ 497	\$ 722
Compensation	589	264
Miscellaneous Accruals	386	142
Total Accrued Expenses	\$ 1,472	\$ 1,128

The accumulated offering costs that were accrued pertain to consultant's fees associated with securing equity financing for the Company.

**5. Commitments and Contingencies****Loan Financing Arrangements:**

On February 9, 2011, the Company entered into an Equipment Finance Agreement with U.S. Bancorp Business Equipment Finance Group. Pursuant to the agreement, the Company obtained a \$39 secured loan for a 48-month term that had an annual fixed interest rate of 13%. The loan was secured by the related leased equipment. Under the agreement, the Company made monthly payments consisting of \$1 of principal plus any accrued interest. The agreement provided for customary events of default. This loan was personally guaranteed by a Company director and a principal stockholder of the Company. As of September 30, 2014, the Company has retired this facility. At December 31, 2013, the Company had outstanding borrowings of \$13.

On May 27, 2011, the Company entered into an Equipment Finance Agreement with U.S. Bancorp Business Equipment Finance Group. Pursuant to the Agreement, the Company obtained a \$109 secured loan for a 60-month term that had an annual fixed interest rate of 6%. The loan was secured by the related leased equipment. Under the Agreement, the Company made monthly payments consisting of \$2 of principal plus any accrued interest. The Agreement provided for customary events of default. This loan was personally guaranteed by a Company director and a principal stockholder of the Company. As of September 30, 2014, the Company has retired this facility. At December 31, 2013, the Company had outstanding borrowings of \$57.

At various dates in 2011, the Company entered into Lease Agreements with Lease Corporation of America. Pursuant to these agreements, the Company obtained an aggregate amount of \$66 for a 60-month term that had variable annual interest rates of approximately 14%. The leases were secured by the related leased equipment. Under the agreements, the Company made monthly payments of approximately \$1 of principal plus any accrued interest. The agreements provided for customary events of default. The leases were personally guaranteed by a principal stockholder of the Company. As of September 30, 2014, the Company has retired this facility. At December 31, 2013, the Company had outstanding borrowings of \$42.

On June 17, 2011, the Company entered into a loan agreement with First Republic Bank. Pursuant to the loan agreement, the Company obtained a \$150 secured loan for a 60-month term that had a variable interest rate based on First Republic's Prime plus a spread of 1.75% p.a. and a floor of 3.25% p.a. The initial interest rate was 5% p.a. Under the loan agreement, the Company made monthly payments consisting of \$3 of principal plus any accrued interest. The loan agreement provided for customary events of default. This loan was personally guaranteed by a principal stockholder of the Company. As of September 30, 2014, the Company has retired this loan agreement. At December 31, 2013, the Company had outstanding borrowings of \$75.

On September 13, 2011, the Company entered into an additional loan agreement with First Republic Bank. Pursuant to the loan agreement, the Company obtained a \$150 loan for a 60-month term that had a variable annual interest rate based on First

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Notes to Financial Statements****(In thousands, except share and per share amounts)**

Republic's Prime plus a spread of 1.75% and a floor of 3.25%. The initial interest rate was 5%. Under the loan agreement, the Company made monthly payments consisting of \$3 of principal plus any accrued interest. The loan agreement provided for customary events of default. This loan was personally guaranteed by a principal stockholder of the Company. As of September 30, 2014, the Company has retired this loan agreement. At December 31, 2013, the Company had outstanding borrowings of \$83.

On September 30, 2014, the Company entered into a revolving line of credit with First Republic Bank. Pursuant to the line of credit agreement, the Company may borrow up to \$2,000 for a 12-month term that has a variable annual interest rate based on First Republic's Prime less a spread of 2.0% p.a. The initial interest rate is 1.25% p.a. Under the line of credit agreement, the Company will make monthly payments consisting of \$2 of interest, and an annual payment consisting of \$2,002 principal plus any accrued interest. The line of credit agreement provides for customary events of default. This line of credit is secured by a collateral cash account in the Company's name at First Republic. As of September 30, 2014, the Company was in compliance with the material terms of this facility. At September 30, 2014, the Company had outstanding borrowings of \$113. Subsequent to the close of the quarter, the Company drew down on the remaining balance of this facility.

**6. 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:

	<b>Three Months ended</b>	
	<b>September 30,</b>	
	2014	2013
Weighted average shares outstanding:		
Convertible preferred stock	-	1,480,042
Convertible preferred stock warrants	-	1,285,838
Common stock warrants	359,714	-
Options	389,663	337,500
Total	749,377	3,103,380

**Nine Months ended**  
**September 30,**  
2014          2013

Weighted average shares outstanding:	2014	2013
Convertible preferred stock	414,267	1,480,042
Convertible preferred stock warrants	326,134	1,285,838
Common stock warrants	285,655	-
Options	354,951	337,500
Total	1,381,007	3,103,380

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Notes to Financial Statements****(In thousands, except share and per share amounts)****7. Stock Based Compensation**

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"). Following stockholder approval of the 2014 Plan, the Company will no longer grant equity awards under the 2007 Plan. Stock-based compensation expense for the three months ended September 30, 2014 and 2013 was \$178 and \$0, respectively. Stock-based compensation expense for the nine months ended September 30, 2014 and 2013 was \$178 and \$141, respectively. As of September 30, 2014, 0 shares of an aggregate total of 407,500 shares were available for future stock-based compensation grants under the 2007 Plan and 450,000 shares of an aggregate total of 450,000 shares were available for future stock-based compensation grants under the 2014 Plan.

The Company accounts for its employee stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock option expense at the date of grant. All stock option grants have an exercise price equal to the fair market value of the Company's common stock on the date of grant and generally have a 10-year term. The fair value of stock option grants is amortized to expense over the vesting period. The grant date fair value of the 2014 stock options granted under the 2007 Plan were immediately expensed as the options were fully vested upon the grant date.

The Company's weighted-average Black-Scholes fair value assumptions for 2014 are as follows:

	<b>2014</b>
Expected Life in years	5
Risk free interest rate	1.67%
Expected volatility	82.8%
Expected dividend yield	0.0 %

The expected life is the period over which its employee groups are expected to hold their options. The risk-free interest rate is based on the expected U.S. Treasury rate at the time of grant. Volatility reflects movements in the stock price of comparable companies over the most recent historical period equivalent to the expected life. Dividend yield is estimated over the expected life based on our stated dividend policy.

A summary of the Company's stock-based compensation activity for the nine months ended September 30, 2014 is presented below:

	<b>Options</b>	<b>Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (in years)</b>	<b>Intrinsic Value</b>
Outstanding at December 31, 2013	337,500	\$ 0.52		
Granted	70,000	\$ 3.85		
Exercised	(1,200 )	\$ 0.52		
Forfeited/expired	-	\$ -		
Outstanding and Exercisable at September 30, 2014	406,300	\$ 1.09	6.17	\$ 844,113

As of September 30, 2014, there was \$0 of total unrecognized compensation cost related to non-vested share-based compensation grants. There were no share-based compensation grants in 2013.

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**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 consolidated financial statements and notes for the fiscal year ended December 31, 2013, and the information under the headings “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Registration Statement on Form S-1 filed with the SEC on February 18, 2014 (“Form S-1”). This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. See “Cautionary Note Regarding Forward-Looking Statements and Industry Data” 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 Form S-1.*

**Overview**

We are an emerging medical risk-assessment company. Our mission is to develop, manufacture and market patented products that identify the risk profile of medical patients to allow healthcare providers to capture full reimbursement potential for their services. Our first patented and U.S. Food and Drug Administration, or FDA, cleared product, is FloChec®. FloChec® is used in the office setting to allow providers to measure arterial blood flow in the extremities and is a useful tool for internists and primary care physicians for whom it was previously impractical to conduct blood flow measurements. We received FDA 510(k) clearance for FloChec® in February 2010, began Beta testing in the third quarter of 2010, and began commercially leasing FloChec® in January 2011. We closed the initial public offering of our common stock on February 26, 2014 and our common stock is now listed on the NASDAQ Capital Market under the ticker symbol “SMLR.”

In the three months ended September 30, 2014 we had total revenue of \$897,000 and a net loss of \$1,466,000 compared to total revenue of \$589,000 and a net loss of \$523,000 in the same period in 2013.

In the nine months ended September 30, 2014 we had total revenue of \$2,580,000 and a net loss of \$3,315,000 compared to total revenue of \$1,493,000 and a net loss of \$1,707,000 in the same period in 2013.

**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.

### **Results of Operations - Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013**

#### ***Revenue***

We had revenue of \$897,000 for the three months ended September 30, 2014, an increase of \$308,000, or 52%, compared to \$589,000 in the same period in 2013. We recognize rental 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 revenue grew 53%, partially offset by the fact that the average amount of revenue recognized per unit was 1% less compared to the same

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period in 2013 due to changes in the mix of customers renting units. We believe that growth in the number of monthly invoices is predominately due to our sales and marketing efforts, which add new customers to an established customer base.

*Operating expenses*

We had total operating expenses of \$2,264,000 for the three months ended September 30, 2014, an increase of \$1,178,000, or 108%, compared to \$1,086,000 in the same period in 2013. The primary reasons for the increase were increased general and administrative expense, sales and marketing expense, engineering and product development 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 \$178,000 for the three months ended September 30, 2014, an increase of \$45,000, or 34%, from \$133,000 for the same period in 2013. The primary reason for the increase was \$77,000 of additional cost in the third quarter of 2014 associated with employees who oversee manufacturing operations, which persons were not employed in the prior year period. A portion of the increase is also due to the fact that aggregate depreciation of our FloChec® systems for lease increased \$13,000, or 37%, in the third quarter of 2014 compared to the same period in 2013 as there was a 53% increase in the number of monthly depreciation charges corresponding to the 53% increase in the number of installed units in the field generating monthly revenue, partially offset by a decrease in average depreciation per unit per month of 10%. Other cost of revenue items, such as freight and other miscellaneous items, which are not associated with FloChec® system production, were \$4,000 lower and cost of units that were retired were \$44,000 lower in the third quarter of 2014 compared to the same period in 2013.

*Engineering and product development expense*

We had engineering and product development expense of \$262,000 for the three months ended September 30, 2014, an increase of \$202,000, or 337%, compared to \$60,000 in the same period in 2013. The increase was primarily due to increased consulting costs for new product development of \$168,000, increased salary expense of \$32,000, and increased clinical study expense of \$7,000, which were partially offset by lower costs of \$4,000 for other consulting services.

*Sales and marketing expense*

We had sales and marketing expense of \$1,040,000 for the three months ended September 30, 2014, an increase of \$471,000, or 83%, compared to \$569,000 in the same period in 2013. The increase was primarily due to higher salary expense of \$384,000 associated with having an expanded sales team as compared to the prior period, higher travel expense of \$78,000, and increased commissions of \$16,000, all of which were partially offset by \$4,000 in lower trade show and other expenses as compared to the same period in 2013. During the quarter, we primarily focused sales activity on insurance plans with Medicare Advantage members. Accordingly, we incurred costs associated with establishing these relationships prior to generating any product revenue.

***General and administrative expense***

We had general and administrative expense of \$784,000 for the three months ended September 30 2014, an increase of \$460,000, or 142%, compared to \$324,000 in the same period in 2013. The increase was primarily due to higher stock compensation expense of \$178,000, higher salaries and fees for employees, directors, and consultants of \$134,000, added costs associated with being a publicly traded company of \$91,000, higher medical device excise tax, state and local tax, audit and tax preparation expense of \$38,000, higher insurance premiums of \$20,000, higher travel costs of \$15,000 and higher other expenses of \$18,000, which increases were partially offset by lower patent and legal expenses of \$20,000 and a decrease in uncollectible accounts of \$10,000.

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*Other expense*

We had other expense of \$99,000 for the three months ended September 30, 2014, an increase of \$73,000, or 281%, compared to \$26,000 in the same period in 2013. The increase was primarily due to higher interest expense of \$73,000. As described in Note 5 to the financial statements, early retirement of leases associated with the opening of a new line of credit, resulted in acceleration of the expensing of deferred financing costs.

*Net loss*

For the foregoing reasons, we had a net loss of \$1,466,000 for the three months ended September 30, 2014, an increase of \$943,000, or 180%, compared to a net loss of \$523,000 for the same period in 2013.

**Results of Operations - Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013**

*Revenue*

We had revenue of \$2,580,000 for the nine months ended September 30, 2014, an increase of \$1,087,000, or 73%, compared to \$1,493,000 in the same period in 2013. We recognize rental 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 reasons for the increase in revenue were that the total number of installed units in the field generating monthly revenue grew 71% and the average amount of revenue recognized per unit was 1% more compared to the same period in 2013. We believe that growth in the number of monthly invoices is predominately due to our sales and marketing efforts, which add new customers to an established customer base.

*Operating expenses*

We had total operating expenses of \$5,745,000 for the nine months ended September 30, 2014, an increase of \$2,627,000, or 84%, compared to \$3,118,000 in the same period in 2013. The primary reasons for the increase were increased sales and marketing expense, general and administrative expense, engineering and product development 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 \$504,000 for the nine months ended September 30, 2014, an increase of \$228,000, or 83%, from \$276,000 for the same period in 2013. The primary reason for the increase was \$224,000 of additional cost in the first nine months of 2014 associated with employees who oversee manufacturing operations, which persons were not employed in the prior year period. A portion of the increase is also due to the fact that aggregate depreciation of our FloChec® systems for lease increased \$54,000, or 62%, in the first nine months of 2014 compared to the same period in 2013 as there was a 62% increase in the number of monthly depreciation charges corresponding to the 71% increase in number of installed units in the field generating monthly revenue, partially offset by a decrease in average depreciation per unit per month of 5%. Other cost of revenue items, such as freight and other miscellaneous items, which are not associated with FloChec® system production, were \$16,000 lower and cost of units that were retired were \$33,000 lower in the nine months of 2014 compared to the same period in 2013.

***Engineering and product development expense***

We had engineering and product development expense of \$906,000 for the nine months ended September 30, 2014, an increase of \$652,000, or 257%, compared to \$254,000 in the same period in 2013. The increase was primarily due to higher consulting costs for new product development of \$644,000, higher salaries of \$39,000 and other expenses of \$2,000, partially offset by lower costs of \$31,000 for clinical studies.

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***Sales and marketing expense***

We had sales and marketing expense of \$2,514,000 for the nine months ended September 30, 2014, an increase of \$929,000, or 59%, compared to \$1,585,000 in the same period in 2013. The increase was primarily due to higher salary expense of \$832,000 associated with having an expanded sales team as compared to the prior period, higher travel expenses of \$139,000, and higher sales commissions of \$31,000, partially offset by \$52,000 in lower trade show and other expenses. During the quarter, we primarily focused sales activity on insurance plans with Medicare Advantage members. Accordingly, we incurred costs associated with establishing these relationships prior to generating any product revenue.

***General and administrative expense***

We had general and administrative expense of \$1,821,000 for the nine months ended September 30, 2014, an increase of \$818,000, or 82%, compared to \$1,003,000 in the same period in 2013. The increase was primarily due to higher salaries and fees for employees, directors, and consultants of \$233,000, added costs associated with being a publicly traded company of \$230,000, medical device excise tax, state and local tax, higher audit and tax preparation expenses of \$130,000, higher stock compensation expense of \$61,000, higher insurance premiums of \$59,000, an increase in uncollectible accounts of \$43,000, higher travel costs of \$31,000, higher patent and legal expenses of \$5,000, as well as \$26,000 due to merchant fees and other expenses.

***Other expense***

We had other expense of \$150,000 for the three months ended September 30, 2014, an increase of \$68,000, or 83%, compared to \$82,000 in the same period in 2013. The increase was primarily due to higher interest expense of \$68,000. As described in Note 5 to the financial statements, early retirement of leases associated with the opening of a new line of credit, resulted in acceleration of the expensing of deferred financing costs.

***Net loss***

For the foregoing reasons, we had a net loss of \$3,315,000 for the nine months ended September 30, 2014, an increase of \$1,608,000, or 94%, compared to a net loss of \$1,707,000 for the same period in 2013.

## **Liquidity and Capital Resources**

We had cash of \$5,973,000 at September 30, 2014 compared to \$734,000 at December 31, 2013, and total current liabilities of \$2,607,000 at September 30, 2014 compared to \$1,856,000 at December 31, 2013. As of September 30, 2014 we had working capital of approximately \$3,845,000. On February 26, 2014, we closed the initial public offering of our common stock, pursuant to which we sold an aggregate 1,430,000 shares of our common stock at a price to the public of \$7.00 per share, and received gross proceeds of approximately \$10,010,000 before deducting underwriting discounts and commissions and other offering expenses.

Our principal sources of cash have included the issuance of equity, most recently our February 2014 initial public offering of common stock, and to a lesser extent, borrowings under loan agreements. We expect that as our revenues grow, our operating expenses will continue to grow and, as a result, we will need to generate significant additional net revenues to achieve profitability. We believe that cash on hand plus cash from our operating activities will be sufficient to fund our operations for at least the next 12 months.

Although we do not have any current capital commitments, we expect that we will increase our expenditures to continue our efforts to grow our business and commercialize FloChec<sup>®</sup>. Accordingly, we currently expect to make additional expenditures in both sales and marketing, as well as general and administrative to address the material weaknesses in our internal control over financial reporting, and invest in our corporate infrastructure. We also expect to invest in our research and development efforts. However, 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.

### ***Operating activities***

We used \$2,260,000 of net cash in operating activities for the nine months ended September 30, 2014. Non-cash adjustments to reconcile net loss to net cash used in operating activities plus changes in operating assets and liabilities provided \$1,055,000 of cash in the nine months ended September 30, 2014. These non-cash

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adjustments primarily reflect stock-based compensation expense of \$178,000, depreciation of \$140,000, amortization of deferred financing costs of \$129,000, allowance for doubtful accounts of \$104,000, and loss on disposal of assets for lease of \$67,000. Cash provided in operating activities was primarily from deferred revenue of \$439,000 and accrued expenses of \$345,000, partially offset by net cash used due to trade accounts receivable of \$186,000, prepaid expenses and other current assets of \$122,000, and accounts payable of \$39,000.

For the same period in 2013, we used \$885,000 of cash in operating activities. Non-cash adjustments to reconcile net loss to net cash provided by operating activities plus changes in operating assets and liabilities provided \$822,000 of cash in the nine months ended September 30, 2013. These non-cash adjustments primarily reflect stock-based compensation expense of \$141,000, depreciation of \$86,000, deferred financing costs of \$66,000, allowance for doubtful accounts of \$48,000, and loss on disposal of assets for lease of \$44,000. Cash used in operating activities was primarily due to trade accounts receivable of \$180,000 and prepaid expenses and other current assets of \$5,000, offset by deferred revenue of \$298,000, accrued expenses of \$182,000 and net cash provided from trade accounts payable of \$142,000.

### *Investing activities*

We used \$396,000 of net cash in investing activities for the nine months ended September 30, 2014, primarily for purchases of our FloChec® systems for lease. We used \$192,000 of net cash in investing activities for the same period in 2013, primarily for purchases of our FloChec® systems for lease.

### *Financing activities*

We generated \$7,895,000 of net cash from financing activities during the nine months ended September 30, 2014, primarily from proceeds from the sale of shares of our common stock in our February 2014 initial public offering, which proceeds were partially offset by offering costs and payment of the current portion of our long-term liabilities. We generated \$1,850,000 of net cash in financing activities in the same period in 2013, primarily due to proceeds from advances from investors, partially offset by payments on our outstanding indebtedness and equipment leases.

### **Description of Indebtedness**

On September 30, 2014 we entered into a revolving credit line with First Republic Bank. We may borrow up to \$2.0 million for a 12-month term at a variable annual interest rate based on First Republic's Prime less a spread of 2.0% p.a. The initial interest rate is 1.25% p.a. We agreed to make monthly payments consisting of \$2,000 of interest, and an

annual payment consisting of \$2.0 million principle plus any accrued by unpaid interest. The line of credit agreement provides for customary events of default and is secured by a collateral cash account at First Republic. As of September 30, 2014, we had borrowed \$113,000 under the revolving line of credit. Subsequently, we drew down the remainder.

See Note 5 to our unaudited condensed financial statements for a description of our indebtedness.

### **Off-Balance Sheet Arrangements**

As of each of September 30, 2014 and December 31, 2013, we had no off-balance sheet arrangements.

### **Commitments and Contingencies**

As of each of September 30, 2014 and December 31, 2013, other than employment/consulting agreements with key executive officers, we had no material commitments other than the liabilities reflected in our financial statements.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**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 Chief Financial Officer, 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 Chief Financial Officer 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 Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure because of the existence of material weaknesses in our internal control over financial reporting described below under “—Internal Control Over Financing Reporting.”

**Internal Control Over Financial Reporting**

We are not required to comply with Section 404 of the Sarbanes-Oxley Act under applicable rules for newly public companies and are therefore not required to make an assessment of the effectiveness of our internal control over financial reporting. As a result, our management has not yet performed an evaluation of our internal control over financial reporting. Further, our independent registered public accounting firm is not yet required to, nor have they been engaged to express, nor have they expressed, an opinion on the effectiveness of our internal control over financial reporting. However, in connection with the audits of our financial statements for the years ended December 31, 2013 and 2012, our management and independent registered public accounting firm identified certain material weaknesses in our internal control over financial reporting. These material weaknesses related to our lack of a sufficient complement of personnel with an appropriate level of knowledge and experience in the application of U.S. generally accepted accounting principles, or GAAP, commensurate with our financial reporting requirements and the fact that policies and procedures with respect to the review, supervision, and monitoring of our accounting and reporting functions were either not designed and in place or not operating effectively. As a result, numerous audit

adjustments to our financial statements were identified during the course of the audit. Had we and our independent registered public accounting firm performed an evaluation of our internal control over financial reporting in accordance with the provisions of the Sarbanes-Oxley Act, additional control deficiencies may have been identified by management or our independent registered public accounting firm, and those control deficiencies could have also represented one or more material weaknesses.

In an effort to remediate these material weaknesses, we increased the number of our finance and accounting personnel, and recently hired a Chief Financial Officer with public company experience. We have also adopted and implemented policies and procedures with respect to the review, supervision, and monitoring of our accounting and reporting functions. We will continue assessing our procedures to improve our internal control over financial reporting so that we are in a position to perform the necessary evaluation, when required.

### **Changes in Internal Control Over Financial Reporting**

Other than the changes described above to remediate our material weaknesses in internal control over financial reporting, there were 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 the period covered by this Quarterly Report on Form 10-Q.

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**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.**

<b>Exh. No.</b>	<b>Exhibit Name</b>
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	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

*\* Pursuant to Rule 406T of Regulation S-T, the XBRL (Extensible Business Reporting Language) information included in Exhibit 101 hereto is deemed furnished and not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.*

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**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, 2014 **SEMLER SCIENTIFIC, INC.**

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