Zacks Small-Cap Research

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Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

scr.zacks.com

10 S. Riverside Plaza, Chicago, IL 60606

Semler Scientific (SMLR-NASDAQ)

SMLR: Modeling Rapid Improvement in Profitability

Our 10-yr DCF model, which uses an 11% discount and 2% terminal growth rate, values SMLR at approximately $7.00/share. This equates to a price/sales (2016) multiple of about 3.5x which we think is a fair given the company's high revenue growth rate, scalability of operations and lower-risk business model (i.e. - licensing, outsourced manufacturing and R&D). We also assign real value to the quality of management.

Current Price (04/29/16)	$1.56
Valuation	**$7.00**

OUTLOOK

Highly experienced mgmt team has had early success with strategic marketing plan that leverages recent changes in healthcare reimbursement from pay for service to pay for performance. QuantFlo use benefits providers, patients and insurers which has catalyzed demand for the device.

WellChec, SMLR's wellness testing service launched in Spring 2015 and is already making a significant revenue contribution. WellChec continues to score add'l contracts and is adding new tests to its menu of offerings which should push its sales even higher. Expenses expected to moderate in 2016, should improve operating loss and get closer to profitability. This coupled with QuantaFlo's growing installed base, additional Medicare Advantage plan customers and higher avg revenue per customer on the instruments' side bodes well for continued robust top-line growth for the foreseeable future.

SUMMARY DATA

52-Week High	**$3.90**
52-Week Low	**$1.50**
One-Year Return (%)	**-55.78**
Beta	**-0.84**
Average Daily Volume (sh)	**4,075**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$8**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**15**
Insider Ownership (%)	**22**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**N/A**
Industry	**Med Instruments**

ZACKS ESTIMATES

Revenue
(in '000s of $)

	Q1 (Mar)	**Q2** (Jun)	**Q3** (Sep)	**Q4** (Dec)	**Year** (Dec)
2015	1202 A	1303 A	1562 A	2934 A	7001 A
2016	1501 A	1842 E	3170 E	3717 E	10230 E
2017					13465 E
2018					17467 E

Earnings per Share

	Q1 (Mar)	**Q2** (Jun)	**Q3** (Sep)	**Q4** (Dec)	**Year** (Dec)
2015	-$0.29 A	-$0.27 A	-$0.32 A	-$0.84 A	-$1.73 A
2016	-$0.20 A	-$0.17 E	-$0.15 E	-$0.14 E	-$0.66 E
2017					-$0.39 E
2018					-$0.17 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

WHAT'S NEW…

Q1 2016 Results: Revenue Up 25%, OpEx Falls Significantly. Modeling Rapid Improvement in Profitability

Semler reported financial results for the first quarter ending March 31. Results were very strong with revenue jumping 50% yoy despite negative contribution from WellChec and operating expenses plummeting 13% yoy and 61% from Q4 2015. Compared to our estimates, revenue of $1.50M was just about dead-on with our $1.46M number while operating expenses of $2.02M were much better than our anticipated $2.66M. The net results was a sizeable beat in net loss ($1.00M A vs. $1.60M E) and EPS (-$0.20 A vs. -$0.31 E).

Importantly, several catalysts are expected to continue to push revenue higher, including ongoing migrations from FloChec to the higher priced next-gen QuantaFlo instrument, onboarding of new vascular testing customers, further penetration of the Medicare Advantage market and the Q3 restart of the WellChec business. And with management guiding for operating expenses to stay roughly flat from the level in Q1, we should see a fairly rapid improvement in profitability and cash burn. In fact management believes the current cash balance, which was recently bolstered by almost $2.4M in debt financing, should be sufficient to get the company to a point of cash flow positive generation.

Q1 numbers…

Vascular testing revenue of $1.66M represented yoy and sequential growth of 50% and 12%, respectively. While SMLR does not break out vascular testing revenue by instrument much of the growth appears to be coming from migrating customers from the legacy FloChec over to the premium-priced QuantaFlo instrument which launched in Q3 2015 and has additional functionality. Management noted that customer feedback of QuantaFlo's performance has been excellent. Additional onboarding of customers is also contributing the rapid growth of this segment. SMLR continues to expect sequential revenue growth from the vascular testing business. Q1 vascular testing revenue beat our $1.5M estimate by about 14%. We have since incrementally increased our vascular testing revenue estimates.

WellChec, as expected, did not contribute positive revenue in the quarter. As a reminder, management had previously announced that they expected to limit WellChec business until later in 2016 in order to lessen OpEx and conserve cash. The timeout from this business during 1H 2016 allows the company to make preparations to meet what is expected to be greater demand for its WellChec services. This business is expected to come back online in Q3, servicing existing contracts of large customers. The implication is that the $1.5M booked in WellChec revenue in Q4 2015 could be repeatable or even beaten in the coming quarters.

An invoicing as well as another issue in Q4 resulted in a $162k offset in WellChec revenue in Q1 2016. Had it not been for that, total revenue growth would have been 38% yoy. We continue to model no WellChec revenue in Q2 and approximately $2.7M of revenue from this business in the second half of the year.

Gross margin of 72.2% was significantly improved from the 33.2% in Q4 2015. The improvement reflects no revenue from WellChec, which carries a much thinner margin than that of the vascular testing business, compounded by the fact that two of four WellChec customers were unprofitable in Q4 2015. We look for GM of about 74% in Q2 and then slimming to around 50% when the WellChec business restarts in 2H.

Operating expenses were a significant highlight in Q1. As a reminder, Q4 2015 was the opposite – which saw OpEx jump 90% ($2.7M to $5.2M) from the previous quarter. Much of that increase related to stock compensation. Q1 operating expenses were a mere $2.0M, the lowest level since Q4 2014 when SMLR generated just $1.1M in revenue. Management noted on the Q1 earnings call that they expect operating expenses to remain at about this level throughout 2016, with a corresponding increase when WellChec comes back online. Prior to Q1 results we were modeling a much higher rate of OpEx in 2016 but given the significantly lower expense base in Q1 and management's roughly-flat guidance, we have made meaningful downward revisions to our operating expenses estimates. This, coupled with our incremental increase in estimated vascular revenue has resulted in our full year 2016 net loss improving from $5.4M to $3.5M.

SMLR exited Q1 with $1.4M in cash. An additional $160k was raised subsequent to quarter-end. Management believes the current cash balance will be sufficient to get them to a point of profitability and positive cash flow generation.

Valuation
The recurring revenue model means that already established instruments customers should provide a fairly stable base of business. Additional growth will come from expanding the number of customers and increasing order sizes. QuantaFlo appears to be a winner and one we think has the potential to steepen the revenue curve even further. Migration of customers from FloChec to QuantaFlo, which commands as much as 50% or more in premium pricing, has been a catalyst to vascular testing revenue as has onboarding of new customers. And with gross margins of ~70% - 80%, instruments should be a strong driver of operating leverage.

The WellChec business is off to a strong start – at least from a revenue perspective. This segment is much more difficult to model given that contracts can be fairly short term and there is little visibility on length and size of contracts or what may be in the customer pipeline. However, management's comments indicate that they have had a positive reception from customers and view WellChec as having significant potential in not only top-line growth but now with learning-curve related wrinkles being ironed out, in positively contributing to profitability. The current year, particularly the back half when WellChec operations are expected to resume more substantially, may be a better gauge of the viability of this segment.

Importantly SMLR is just scratching the surface of the potential for WellChec. They are currently only concentrating on existing customer accounts, which alone have significant revenue upside potential – possibly to the tune of tens of millions of dollars. SMLR will focus on delivering quality and value-added testing services, making sure that existing accounts are well taken care of before expanding outwards.

We have revenue growing in the mid 30% in 2016 and graduating down to the mid-teens in the out-year (2019) in our model. We think this is reasonable, or perhaps conservative, given the recurring revenue streams of the instruments business and the very strong revenue growth that WellChec could produce. Our revenue estimates, like all of our inputs, are subject to change.

We also expect to see much more scalability in operations as revenue grows and "learning-curve" expenses related to WellChec begin to temper. Q1 was very solid in the operating expense category – if SMLR can maintain this level going forward as they believe they can, profitability should improve very rapidly. Q3, when WellChec is expected to come back online should be revealing in terms of SMLR's ability to control expense growth. We expect operating leverage to improve in 2016 and beyond.

We use a 10-year DCF model to value SMLR. We model 10-year revenue CAGR of 25%, which again we think is reasonable if not conservative given the historical much higher rate of growth along with the recurring revenue model and strong start to WellChec. We show gross margins slightly contracting in 2016 with steepening growth of WellChec but then leveling out, scaling operating expenses consistent with growing revenues and efficiencies in SG&A. Our 10-yr DCF model, which uses an 11% discount and 2% terminal growth rate, values SMLR at approximately $7.00/share. This equates to a price/sales (2016) multiple of about 3.5x which we think is a fair given the company's high revenue growth rate, scalability of operations and lower-risk business model (i.e. - licensing, outsourced manufacturing and R&D). We also assign real value to the quality of management.

FINANCIAL MODEL

Semler Scientific, Inc

	2015 A	Q1A	Q2E	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Total Revenues	$7,001.0	$1,501.0	$1,842.0	$3,170.0	$3,717.0	$10,230.0	$13,465.0	$17,467.4	$21,401.9
YOY Growth	*92.6%*	*24.9%*	*41.4%*	*102.9%*	*26.7%*	*36.1%*	*31.5%*	*28.0%*	*16.5%*
Cost of Revenues	$2,809.0	$417.0	$482.6	$1,508.4	$1,856.1	$4,264.1	$4,859.0	$6,158.1	$7,544.8
Gross Income	$4,192.0	$1,084.0	$1,359.4	$1,661.6	$1,860.9	$5,965.9	$8,606.0	$11,309.3	$13,857.1
Gross Margin	*59.9%*	*72.2%*	*73.8%*	*52.4%*	*50.1%*	*58.3%*	*63.9%*	*64.7%*	*64.7%*
R&D	$1,436.0	$270.0	$282.0	$307.0	$325.0	$1,184.0	$1,116.0	$1,087.0	$1,284.1
% R&D	*20.5%*	*18.0%*	*15.3%*	*9.7%*	*8.7%*	*11.6%*	*8.3%*	*10.0%*	*6.0%*
Selling & Mktg	$6,304.0	$974.0	$1,102.0	$1,316.0	$1,388.0	$4,780.0	$6,260.0	$7,253.0	$7,747.5
% Sell&Mktg	*90.0%*	*64.9%*	*59.8%*	*41.5%*	*37.3%*	*46.7%*	*46.5%*	*47.2%*	*36.2%*
G&A	$4,871.0	$772.0	$804.0	$810.0	$841.0	$3,227.0	$3,591.0	$4,218.0	$5,157.9
% G&A	*69.6%*	*51.4%*	*43.6%*	*25.6%*	*22.6%*	*31.5%*	*26.7%*	*27.4%*	*24.1%*
Operating Income	($8,419.0)	($932.0)	($828.6)	($771.4)	($693.1)	($3,225.1)	($2,361.0)	($1,248.7)	($332.3)
Operating Margin	*-120.3%*	*-62.1%*	*-45.0%*	*-24.3%*	*-18.6%*	*-31.5%*	*-17.5%*	*-7.1%*	*-1.6%*
Interest expense (income)	$82.0	$74.0	$78.0	$78.0	$78.0	$308.0	$312.0	$25.0	$25.0
Other Expense total	$82.0	$74.0	$78.0	$78.0	$78.0	$308.0	$312.0	$25.0	$25.0
Pre-Tax Income	($8,501.0)	($1,006.0)	($906.6)	($849.4)	($771.1)	($3,533.1)	($2,673.0)	($1,273.7)	($357.3)
Taxes	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	($8,501.0)	($1,006.0)	($906.6)	($849.4)	($771.1)	($3,533.1)	($2,673.0)	($1,273.7)	($357.3)
YOY Growth	*-88.3%*	*26.7%*	*32.4%*	*46.2%*	*81.7%*	*58.4%*	*24.3%*	*52.3%*	*71.9%*
Net Margin	*-121.4%*	*-67.0%*	*-49.2%*	*-26.8%*	*-20.7%*	*-34.5%*	*-19.9%*	*-7.3%*	*-1.7%*
EPS	($1.73)	($0.20)	($0.17)	($0.15)	($0.14)	($0.66)	($0.39)	($0.17)	($0.05)
YOY Growth	*-56.3%*	*31.8%*	*35.3%*	*51.3%*	*84.0%*	*61.9%*	*40.1%*	*56.8%*	*72.7%*
Diluted Shares O/S	4,928	5,124	5,200	5,500	5,700	5,381	6,800	7,500	7,700

Brian Marckx, CFA

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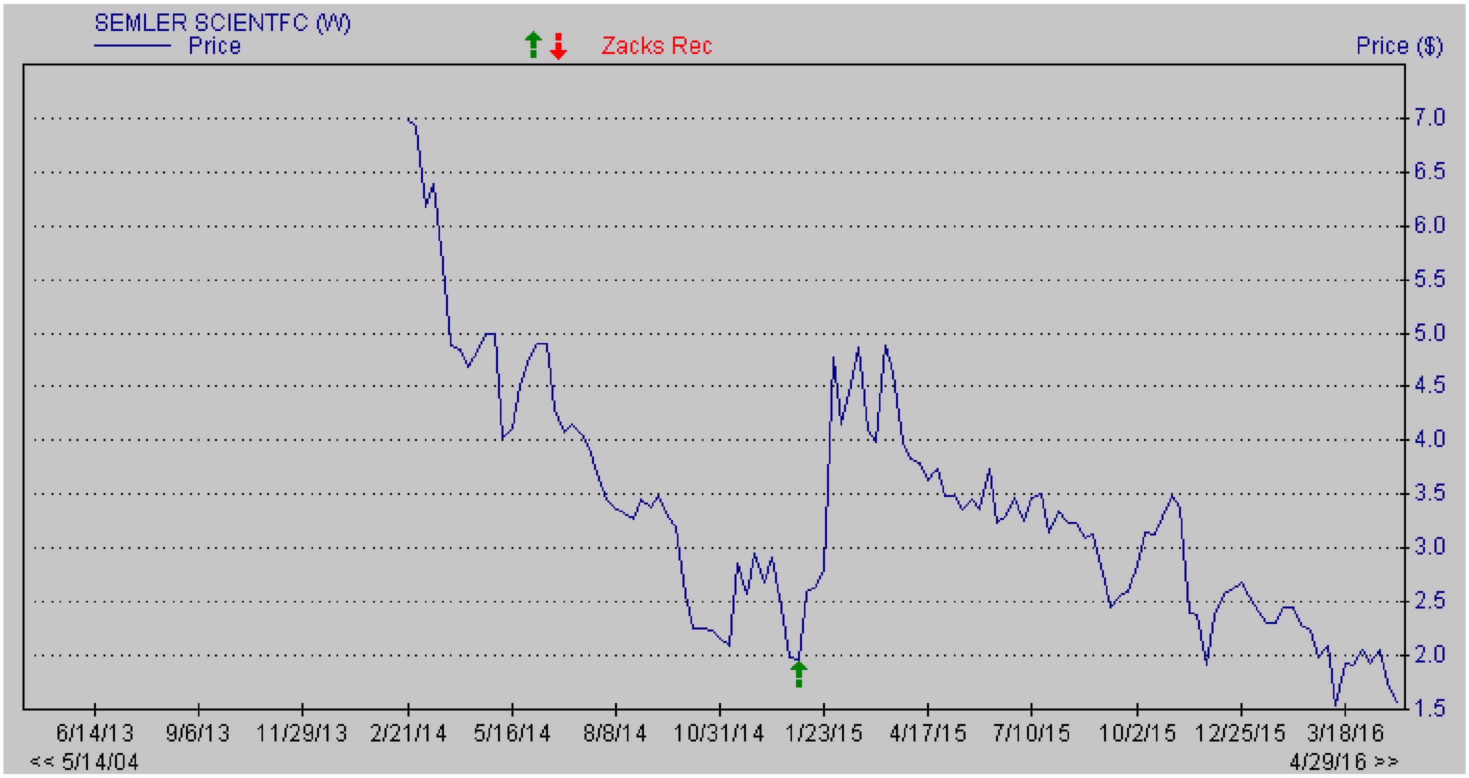

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