

Cost of revenue	\$	1,968	\$	3,811	\$	(1,843)	(48.4)%	\$	1,525	\$	10,943	\$	(5,618)	(55.1)%
Gross profit		1,472		3,227		(1,755)	(54.4)%		5,444		8,329		(2,885)	(34.6)%
Gross margin		42.8%		45.9%					42.6%		43.2%			

Cost of revenue for the three and nine months ended September 30, 2023 compared to the comparable periods in 2022 decreased by 48.4% and 33.1%, respectively, or approximately \$1.8 million and \$3.6 million, respectively, primarily due to decreased activity to fulfill our U.S. governmental contracts, which is consistent with decreased research and development revenue.

Gross margin for the three months ended September 30, 2023 decreased 3.1% as compared to the comparable period in 2022 primarily due to beginning the MTEC contract, which has a lower gross margin, during 2023. Gross margin was relatively consistent for nine months ended September 30, 2023, as compared to the comparable periods in 2022.

General and Administrative Expense

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in							
	2023	2022	\$	%	2023	2022	\$	%						
(In thousands, except percentages)														
General and administrative expense	\$	5,638	\$	3,478	\$	2,160	62.1%	\$	15,499	\$	9,207	\$	6,292	68.3%

General and administrative expense increased by 62.1% and 68.3%, respectively, or approximately \$2.2 million and \$6.2 million, respectively, for the three and nine months ended September 30, 2023, as compared to the comparable periods in 2022. The increase was primarily due to an increase in our administrative staffing since 2022. Our headcount grew from 63 employees as of September 30, 2022 to 83 full-time employees as of September 30, 2023 resulting in an increase in general and administrative expense of approximately \$0.7 million and \$3.5 million, respectively, for the three and nine months ended September 30, 2023. Additionally, non-revenue generating research and development activities, primarily related to salaries and related costs and consulting fees, have increased by approximately \$1.2 million and \$2.8 million, respectively, in the three and nine months ended September 30, 2023 compared to the comparable periods in 2022.

Other income (expense)

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in				
	2023	2022	\$	%	2023	2022	\$	%			
(In thousands, except percentages)											
Net interest income	\$	42	\$	2	\$	40	128	\$	1	\$	127
Change in fair value of warrant liability		1,069		22		1,047	1,004		50		954
Foreign exchange transaction loss		(24)		(51)		27	(11)		(255)		244
Transaction costs		(7,604)		-		(7,604)	(8,342)		-		(8,342)
Other income		-		(17)		17	-		-		-
Total other expense, net	\$	(6,517)	\$	(44)	\$	(6,473)	(7,221)	\$	(204)	\$	(7,017)

Net interest income for the three and nine months ended September 30, 2023 primarily relates to cash interest received by us from our deposit accounts.

Change in fair value of warrant liability increased by approximately \$1.0 million for each of the three and nine months ended September 30, 2023, as compared to the comparable period in 2022. The income during the three and nine months ended September 30, 2023, was primarily due to the decrease in the fair value of the Public Warrants from the closing of the Business Combination to September 30, 2023.

Foreign exchange transaction loss for the three and nine months ended September 30, 2022 relates to the decreased exchange rate between the U.S. dollar and the British pound sterling during the third quarter of 2022 for our deposit accounts that are denominated in British pound sterling. In addition, this amount includes costs associated with buying British pound sterling for payment of our employees and vendors in the UK. Foreign exchange transaction loss for the three and nine months ended September 30, 2023 is immaterial due to much lower balances in our deposit accounts and accounts payable denominated in British pound sterling and less fluctuation in the exchange rate between the U.S. dollar and the British pound sterling.

Transaction costs for the three and nine months ended September 30, 2023 primarily relate to non-recurring legal, accounting and consulting costs expended for the Business Combination.

Non-GAAP Financial Measures

We use Adjusted EBITDA as a non-GAAP metric when measuring performance, including when measuring current period results against prior periods' Adjusted EBITDA. This non-GAAP financial measure should be considered in addition to results prepared in accordance with GAAP and should not be considered as a substitute for, or superior to, GAAP results. In addition, Adjusted EBITDA should not be construed as an indicator of our operating performance, liquidity or cash flows generated by operating, investing and financing activities, as there may be significant factors or trends that it fails to address.

Because of their non-standardized definitions, non-GAAP measures (unlike GAAP measures) may not be comparable to the calculation of similar measures of other companies. We caution investors that non-GAAP financial information, by its nature, departs from traditional accounting conventions. Supplemental non-GAAP measures are presented solely to permit investors to more fully understand how Spectral AI's management assesses underlying performance.

Adjusted EBITDA

We define Adjusted EBITDA as net loss excluding income taxes, depreciation of property and equipment, net interest income, stock compensation, transaction costs and any non-operating financial income and expense.

The following table presents our Adjusted EBITDA for the three and nine months ended September 30, 2023 and 2022:

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2023	2022	\$	%	2023	2022	\$	%
(In thousands)								
Net loss	\$	(10,629)	\$	(380)	\$	(17,308)	\$	(1,173)
Adjust:								
Depreciation expense		2		-		7		6
Provision for income taxes		(54)		85		32		91
Net interest income		(42)		(2)		(128)		(1)
EBITDA		(10,723)		(297)		(17,397)		(1,077)
Additional adjustments:								
Stock-based compensation		279		247		975		874
Change in fair value of warrant liability		(1,069)		(22)		(1,004)		(50)