UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2024

☐ 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:

SPECTRAL AI, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**85-3987148**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2515 McKinney Avenue,
Suite 1000
Dallas, Texas 75201
(Address of principal executive offices)

(972) 499-4934
(Issuer's telephone number)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $0.0001 per share	MDAI	The Nasdaq Stock Market LLC
Redeemable warrants, each whole warrant exercisable for one share of Class A common stock at an exercise price of $11.50	MDAIW	The Nasdaq Stock Market LLC

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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 definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	☐	Accelerated Filer	☐
Non-Accelerated Filer	☒	Smaller Reporting Company	☒
		Emerging Growth Company	☒

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 ☒

As of November 5, 2024, there were 18,588,073 shares of Common Stock, $0.0001 par value, issued and outstanding.

SPECTRAL AI, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2024

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PART I - FINANCIAL INFORMATION

Item 1. Interim Financial Statements

SPECTRAL AI, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	September 30, 2024	December 31, 2023
Assets		
Current assets:		
Cash	$ 3,702	$ 4,790
Accounts receivable, net	2,834	2,346
Inventory	443	230
Deferred offering costs	-	283
Prepaid expenses	1,506	1,452
Other current assets	1,011	801
Total current assets	9,496	9,902
Non-current assets:		
Property and equipment, net	5	12
Right-of-use assets	2,101	778
Total Assets	$ 11,602	$ 10,692
Commitments and contingencies (Note 8)		
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 2,797	$ 2,683
Accrued expenses	3,253	4,300
Deferred revenue	731	2,311
Lease liabilities, short-term	212	853
Notes payable	597	436
Notes payable - at fair value	4,377	-
Warrant liabilities	1,101	1,818
Total current liabilities	13,068	12,401
Notes payable - related party	1,000	-
Lease liabilities, long-term	1,870	-
Total Liabilities	15,938	12,401
Stockholders' Deficit		
Preferred stock ($0.0001 par value); 1,000,000 shares authorized; no shares issued and outstanding as of September 30, 2024 and December 31, 2023	-	-
Common stock ($0.0001 par value); 80,000,000 shares authorized; 18,513,073 and 16,294,935 shares issued and outstanding as of September 30, 2024 and December 31, 2023, respectively	2	2
Additional paid-in capital	35,998	31,065
Accumulated other comprehensive income	25	12
Accumulated deficit	(40,361)	(32,788)
Total Stockholders' Deficit	(4,336)	(1,709)
Total Liabilities and Stockholders' Deficit	$ 11,602	$ 10,692

The accompanying notes are an integral part of these condensed consolidated financial statements

SPECTRAL AI, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(in thousands, except share and per share data)

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	**2023**	**2024**	**2023**
Research and development revenue	$ 8,173	$ 3,440	$ 21,977	$ 12,769
Cost of revenue	(4,506)	(1,968)	(12,051)	(7,325)
Gross profit	3,667	1,472	9,926	5,444
Operating costs and expenses:				
General and administrative	4,553	5,638	15,397	15,499
Total operating costs and expenses	4,553	5,638	15,397	15,499
Operating loss	(886)	(4,166)	(5,471)	(10,055)
Other income (expense):				
Net interest (expense) income	(8)	42	-	128
Borrowing related costs	(1,059)	-	(2,034)	-
Change in fair value of warrant liability	350	1,069	718	1,004
Change in fair value of notes payable	94	-	(7)	--
Foreign exchange transaction loss, net	(9)	(24)	(34)	(11)
Other income (expenses), including transactions costs	51	(7,604)	(617)	(8,342)
Total other expense, net	(581)	(6,517)	(1,974)	(7,221)
Loss before income taxes	(1,467)	(10,683)	(7,445)	(17,276)
Income tax benefit (provision)	(37)	54	(128)	(32)
Net loss	$ (1,504)	$ (10,629)	$ (7,573)	$ (17,308)
Net loss per share of common stock				
Basic and Diluted	$ (0.08)	$ (0.77)	$ (0.44)	$ (1.29)
Weighted average common shares outstanding				
Basic and Diluted	17,862,240	13,822,990	17,342,203	13,410,287
Other comprehensive income (loss):				
Foreign currency translation adjustments	$ 15	$ (3)	$ 13	$ -
Total comprehensive loss	$ (1,489)	$ (10,632)	$ (7,560)	$ (17,308)

The accompanying notes are an integral part of these condensed consolidated financial statements

SPECTRAL AI, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands, except share data)

	Common Stock		Additional Paid-in	Accumulated Other Comprehensive	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Income	Deficit	Deficit
Balance at December 31, 2023	16,294,935	$ 2	$ 31,065	$ 12	$ (32,788)	$ (1,709)
Stock-based compensation	-	-	283	-	-	283
Sale of common stock	1,187,398	-	2,605	-	-	2,605
Cumulative translation adjustment	-	-	-	(2)	-	(2)
Net loss	-	-	-	-	(3,205)	(3,205)
Balance at March 31, 2024	17,482,333	$ 2	$ 33,953	$ 10	$ (35,993)	$ (2,028)
Stock-based compensation	-	-	402	-	-	402
Issuance of common stock under the SEPA	94,937	-	225	-	-	225
Vesting of restricted stock units	29,097	-	-	-	-	-
Cumulative translation adjustment	-	-	-	-	-	-
Net loss	-	-	-	-	(2,864)	(2,864)
Balance at June 30, 2024	17,606,367	$ 2	$ 34,580	$ 10	$ (38,857)	$ (4,265)
Stock-based compensation	-	-	173	-	-	173
Issuance of common stock under the SEPA	906,706	-	1,245	-	-	1,245
Cumulative translation adjustment	-	-	-	15	-	15
Net loss	-	-	-	-	(1,504)	(1,504)
Balance at September 30, 2024	18,513,073	$ 2	$ 35,998	$ 25	$ (40,361)	$ (4,336)

	Common Stock		Additional Paid-in	Accumulated Other Comprehensive	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Income	Deficit	Equity
Balance at December 31, 2022, after effect of Business Combination	13,170,148	$ 1	$ 23,929	$ -	$ (11,934)	$ 11,996
Stock-based compensation	18,186	-	300	-	-	300
Stock option exercises	10,129	-	-	-	-	-
Cumulative translation adjustment	-	-	-	1	-	1
Net loss	-	-	-	-	(3,609)	(3,609)
Balance at March 31, 2023	13,198,463	$ 1	$ 24,229	$ 1	$ (15,543)	$ 8,688
Stock-based compensation	12,132	-	396	-	-	396
Stock option exercises	5,819	-	6	-	-	6
Cumulative translation adjustment	-	-	-	2	-	2
Net loss	-	-	-	-	(3,070)	(3,070)
Balance at June 30, 2023	13,216,414	$ 1	$ 24,631	$ 3	$ (18,613)	$ 6,022
Issuance of common stock upon Business Combination	1,154,173	1	(2,375)	-	-	(2,374)
Issuance of common stock to settle accounts payable	33,333	-	150	-	-	150
Issuance of shares for transaction costs	400,000	-	1,800	-	-	1,800
Commitment to issue shares for transaction costs	-	-	2,550	-	-	2,550
Private placement equity issuance	744,667	-	3,351	-	-	3,351
Stock-based compensation	-	-	279	-	-	279
Stock option exercises	139,681	-	310	-	-	310
Cumulative translation adjustment	-	-	-	(3)	-	(3)
Net loss	-	-	-	-	(10,629)	(10,629)
Balance at September 30, 2023	15,688,268	$ 2	$ 30,696	$ -	$ (29,242)	$ 1,456

The accompanying notes are an integral part of these condensed consolidated financial statements

SPECTRAL AI, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine months ended September 30,	
	2024	**2023**
Cash flows from operating activities:		
Net loss	$ (7,573)	$ (17,308)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	7	7
Stock-based compensation	858	975
Amortization of right-of-use assets	448	530
Issuance of shares for transaction costs	-	1,800
Commitment to issue shares for transaction costs	-	2,550
Change in fair value of warrant liabilities	(718)	(1,004)
Change in fair value of notes payable	7	-
Costs from issuance of common stock	372	-
Issuance of shares for borrowing related costs	280	-
Changes in operating assets and liabilities:		
Accounts receivable	(488)	982
Inventory	(213)	(220)
Unbilled revenue	-	491
Prepaid expenses	542	(469)
Other assets	(208)	(197)
Accounts payable	188	(554)
Accrued expenses	(1,047)	1,225
Deferred revenue	(1,580)	795
Lease liabilities	(542)	(468)
Net cash used in operating activities	(9,668)	(10,865)
Cash flows from financing activities:		
Proceeds from issuance of common stock	2,667	3,351
Cash received in Business Combination	-	660
Proceeds from notes payable	11,500	-
Proceeds from notes payable - related party	1,000	-
Payments for notes payable	(6,600)	(288)
Stock option exercises	-	316
Net cash provided by financing activities	8,567	4,039
Effect of exchange rate changes on cash	13	-
Net decrease in cash	(1,088)	(6,826)
Cash, beginning of period	4,790	14,174
Cash, end of period	$ 3,702	$ 7,348
Supplemental cash flow information:		
Cash paid for interest	$ -	$ 6
Cash paid for taxes	$ 20	$ 114
Noncash operating and financing activities disclosure:		
Recognition of Right-of-use assets and related lease liabilities upon lease amendment	$ 1,771	$ 483
Issuance of common stock for net liabilities upon Business Combination	$ -	$ 3,034
Prepaid asset acquired, net of cancellation, for debt and accounts payable	$ 596	$ 955
Issuance of common stock to settle accounts and notes payable	$ 1,245	$ 150

The accompanying notes are an integral part of these condensed consolidated financial statements

1. NATURE OF THE BUSINESS

Business Combination

Spectral AI, Inc., a Delaware corporation formerly known as Rosecliff Acquisition Corp I (“Spectral AI” or the “Company”) was formed as a blank check company on November 17, 2020. The Company was formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or similar business combination with one or more businesses.

On September 11, 2023, the Company consummated a business combination (the “Business Combination”), pursuant to the business combination agreement dated April 11, 2023 by and among the Company, Ghost Merger Sub I, a Delaware Corporation, Ghost Merger Sub II, a Delaware corporation and Spectral MD Holdings, Ltd., a Delaware corporation incorporated on March 9, 2009 and headquartered in Dallas, Texas (“Legacy Spectral”). Upon closing of the Business Combination (the “Closing”), in sequential order: (a) Ghost Merger Sub I merged with and into the Legacy Spectral, with Legacy Spectral continuing as the surviving company as a wholly owned subsidiary of the Company (the “Spectral Merger”) and then, (b) Legacy Spectral merged with and into Ghost Merger Sub II (renamed Spectral MD Holdings LLC) (the “SPAC Merger”, together with the Spectral Merger (the “Business Combination”)), with Ghost Merger Sub II surviving the SPAC Merger as a direct wholly-owned subsidiary of the Company. See Note 3. Upon the Closing, the Company changed its name from Rosecliff Acquisition Corp I to Spectral AI, Inc.

In conjunction with the Business Combination, the Company cancelled the redeemable warrants that it issued to Rosecliff Acquisition Sponsor I LLC, a Delaware limited liability company (the “Sponsor”), in a private placement in connection with the Company’s initial public offering on February 17, 2021 (the “Initial Public Offering”) at Closing, but the 8,433,333 redeemable warrants issued to the public in the Initial Public Offering (the “Public Warrants”) remain outstanding.

Prior to the Business Combination, Rosecliff Acquisition Corp I (“Rosecliff”) had 280,485 shares of Class A common stock, par value $0.0001 per share, issued and outstanding and held by public shareholders (the “Public Shares”) and 6,325,000 shares of Class B common stock, par value $0.0001 per share, issued and outstanding and held by the Sponsor (the “Sponsor Shares”). Upon the Closing, 5,445,000 of the Sponsor Shares were forfeited, in accordance with a letter agreement with the Sponsor, and the remaining 880,000 Sponsor Shares and 280,485 Public Shares, no longer designated Class A and Class B, were included in shares of the Company’s common stock, par value $0.0001 per share (the “Company Common Stock”).

Prior to the Business Combination, Legacy Spectral’s shares of common stock, par value $0.001 per share (“Legacy Spectral Common Stock”) were listed on the AIM market on the London Stock Exchange (delisted on September 7, 2023). In September 2023, prior to the Closing, Legacy Spectral issued 7,679,198 shares of Legacy Spectral Common Stock to certain investors in a private placement, in exchange for $3.4 million (the “Equity Raise”). Upon the Closing, all of Legacy Spectral’s issued and outstanding 145,380,871 shares of Legacy Spectral Common Stock, including the shares from the Equity Raise, were exchanged for 14,094,450 shares of Company Common Stock at an exchange ratio of 10.31 (the “Exchange Ratio”), meaning that the Company issued one share of Company Common Stock in exchange for 10.31 shares of Legacy Spectral Common Stock.

On September 12, 2023, the Company began trading the Company Common Stock and the Public Warrants on the NASDAQ Capital Market (“NASDAQ”) under the symbols “MDAI” and “MDAIW”, respectively. Prior to the Business Combination, the Company’s shares of Company Common Stock and Public Warrants were listed on the NASDAQ under the symbols “RCLF” and “RCLFW”, respectively.

Nature of Operations

We are an artificial intelligence (“AI”) company focused on predictive medical diagnostics. Our DeepView System uses proprietary AI algorithms to distinguish between fully damaged, partially damaged and healthy human tissue characters invisible to the naked eye, at the initial time point of wound presentation. The DeepView System delivers a binary prediction on the wounds capacity to heal by a specified time point in the future. Our DeepView System’s output is specifically engineered to assist the physician in making a more accurate, timely and informed decision regarding the treatment of the patient’s wounds. Our focus from 2013 through 2021 was on the burn indication. In 2022, we expanded our focus to include the diabetic foot ulcer (“DFU”) indication.

Spectral AI is devoting substantially all of its efforts towards research and development of its DeepView® Wound Imaging System, currently focused on burn wounds and DFU indications, specifically engineered to allow physicians to make a more accurate, timely and informed decision for treatment options. The Company has not generated any product revenue to date. The Company currently generates revenue from contract development and research services by providing such services to governmental agencies, primarily to the Biomedical Advanced Research and Development Authority ("BARDA") and under a contract with the Medical Technology Enterprise Consortium ("MTEC").

In September 2023, the Company executed its third contract with BARDA for a multi-year Project BioShield ("PBS") contract, valued at up to approximately $150.0 million (the "PBS BARDA Contract"). This multi-year contract includes an initial award of nearly $54.9 million to support the clinical validation and FDA clearance of DeepView® for commercial development and distribution purposes. The Company completed the second contract with BARDA, referred to as BARDA Burn II, which was signed in July 2019 and completed in November 2023. Under this contract, the Company furthered the DeepView System design, developed the AI algorithm, and took steps to obtain FDA approval. As of September 30, 2024, the Company has $30.0 million remaining to bill under the initial award.

In April 2023, the Company received a $4.0 million grant from MTEC for a project that is expected to be completed by April 2025 (the "MTEC Agreement"). The MTEC Agreement is for the development of a handheld version of the DeepView System which is to be used to support military battlefield burn evaluation. The project has three phases, beginning with planning, design and testing; followed by development, design modification and buildout of the handheld device; and then the manufacturing of the handheld device. In August 2024, the MTEC award was increased to $4.9 million and is currently intended to run through December 2025 with funding dependent on various milestones. In September 2024, we received an additional award of $0.9 million from MTEC for further development of the handheld device. In March 2024, we received an additional $0.5 million award from the Defense Health Agency to further this development. As of September 30, 2024, the Company has $2.5 million and $0.2 million remaining to bill under the MTEC and DHA awards, respectively.

On March 7, 2024, the Company formed a new wholly-owned subsidiary, Spectral IP, Inc., a Delaware corporation ("Spectral IP"), to be utilized to advance artificial intelligence intellectual property with a specific emphasis on healthcare. On March 19, 2024, the Company announced that Spectral IP received a $1.0 million investment from an affiliate of its largest shareholder for the development of its artificial intelligence intellectual property portfolio. The investment is structured as a note payable with a one-year maturity, an interest rate of 8%, and requiring earlier prepayment if the Company spins off Spectral IP to the Company's shareholders or if Spectral IP is sold to a third party.

Risks and Uncertainties

The Company is subject to a number of risks common to development stage companies in the medical technology industry, including, but not limited to, risks of failure of preclinical studies and clinical trials, dependence on key personnel, protection of proprietary technology, reliance on third party organizations, risks of obtaining regulatory approval for any products that it may develop, development by competitors of technological innovations, compliance with government regulations and the need to obtain additional financing.

Liquidity

As of September 30, 2024 and December 31, 2023, the Company had approximately $3.7 million and $4.8 million, respectively, in cash, and an accumulated deficit of $40.4 million and $32.8 million, respectively. As of September 30, 2024 and December 31, 2023, the Company had approximately $5.0 million and $0.4 million, respectively, in short-term notes payable and $1.0 million in long-term debt as of September 30, 2024. See Notes 7 and 15 for further information.

On December 26, 2023, the Company entered into a Common Stock Purchase Agreement (the "Purchase Agreement") and related Registration Rights Agreement with B. Riley Principal Capital II, LLC ("B. Riley"). Upon the terms and subject to the satisfaction of the conditions set forth in the Purchase Agreement, the Company has the right, in our sole discretion, to sell to B. Riley up to $10.0 million in aggregate gross proceeds of newly issued shares of the Company's Common Stock (the "ELOC").

On March 20, 2024, the Company also entered into a Standby Equity Purchase Agreement (“SEPA”) with YA II PN, LTD, a Cayman Islands exempt limited partnership (“Yorkville”) pursuant to which the Company has the right to sell to Yorkville up to $30.0 million in shares of Company Common Stock, subject to certain limitations and conditions set forth in the SEPA (such transaction, the “Yorkville Transaction”). In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of convertible promissory notes an aggregate principal amount of up to $12.5 million (the “Pre-Paid Advance”), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $4.6 million and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million. In addition to the Pre-Paid Advance, the Company has the ability to drawdown an additional $17.5 million under the SEPA. In connection with the execution and delivery of the SEPA, the Company is authorized to drawdown an additional $3.0 million from the ELOC prior to utilizing the SEPA. See Note 7 and Note 10 for further details.

On June 3, 2024, the Company received a letter from the Listing Qualifications Staff of the Nasdaq Stock Market, LLC (“Nasdaq”) that the Company was not in compliance with the listing requirement relating to a minimum market value of its listed securities of $35.0 million. The Company has 180 calendar days from receipt of a notice from Nasdaq to regain compliance with the market value of listed securities requirement. If at any time before December 2, 2024, the closing market capitalization of the Company’s Common Stock closes at or above $35.0 million for a minimum of 10 consecutive business days, subject to Nasdaq’s discretion to extend this period to 20 consecutive business days, Nasdaq will provide written notification that the Company has achieved compliance with the minimum market capitalization requirement, and the matter would be resolved. If the Company does not regain compliance during the review period ending December 2, 2024, the Company may be delisted from Nasdaq. See Part II below for further information.

Based on our current operating plan, we believe that our cash and cash equivalents, together with the PBS BARDA Contract, the MTEC Agreement, the B. Riley ELOC, and the Yorkville Transaction, and certain research and development cost-saving measures, will be sufficient to fund operations for at least one year beyond the release date of these condensed consolidated financial statements. We have based this determination on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect. The Company could utilize cost-savings measures to limit the expenditures of our DFU indication to conserve our working capital and to focus our efforts primarily on the burn indication. Changing circumstances could also cause us to consume capital significantly faster than we currently anticipate, and we may need to raise capital sooner or in greater amounts than currently expected because of circumstances beyond our control. Changes in the current equity markets may also limit our ability to utilize the B. Riley ELOC and Yorkville Transaction as currently structured. To the extent additional capital is necessary, there are no assurances that we will be able to raise additional capital on favorable terms or at all, and therefore we may not be able to execute our business plans and the continued work on indications beyond expanding our burn indication.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Company’s condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) as determined by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) or an Accounting Standards Update (“ASU”).

The Business Combination was accounted for as a reverse recapitalization in accordance with GAAP. Legacy Spectral was determined as the accounting acquirer and the Company as the acquired company for financial reporting purposes. Accordingly, for accounting purposes, the Business Combination is treated as the equivalent of a capital transaction in which Legacy Spectral issued stock for the net assets of the Company. Upon the Closing, the net assets of the Company are stated at fair value, with no goodwill or other intangible assets recorded. See Note 3 – *Recapitalization*.

Legacy Spectral was determined to be the accounting acquiror based on evaluation of the following facts and circumstances:

(i) Legacy Spectral’s former shareholders have a majority of the voting power of Spectral AI;

(ii) Legacy Spectral’s senior management comprises all of the senior management of Spectral AI;

(iii) Legacy Spectral selected five of the six directors for the Board of Directors of Spectral AI;

(iv) Legacy Spectral’s relative size of assets and operations compared to Rosecliff; and

(v) Legacy Spectral’s operations comprise the ongoing operations of Spectral AI.

All historical financial information presented in the condensed consolidated financial statements represents the accounts of Legacy Spectral at their historical values as if Legacy Spectral is the predecessor to the Company. The condensed consolidated financial statements following the Closing reflect the results of the combined entity’s operations.

All issued and outstanding shares of Legacy Spectral Common Stock and warrants, stock options, restricted stock units (“RSUs”), and restricted stock awards (“RSAs”) of Legacy Spectral and the per share amounts contained in the condensed consolidated financial statements for the periods presented prior to the Closing have been retroactively restated to reflect the Exchange Ratio (as defined in Note 1).

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Spectral MD Holdings LLC, Spectral MD Inc., Spectral MD UK Limited (“Spectral MD UK”), Spectral DeepView Limited, and Spectral IP. Significant inter-company transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The Company bases its estimates and judgments on historical experience and on various other assumptions that it believes are reasonable under the circumstances. The amounts of assets and liabilities reported in the Company’s balance sheets and the amounts of expenses reported for each of the periods presented are affected by estimates and assumptions, which are used for, but not limited to, revenue recognition, warrant liabilities, the fair value of short term notes payable, fair value of the B. Riley and Yorkville derivative instruments, stock-based compensation expense, stock issued for transaction costs, the net realizable value of inventory, right-of-use assets, and income tax valuation allowances. Actual results could differ from these estimates.

Segments

Operating segments are defined as components of an enterprise for which separate and discrete information is available for evaluation by the chief operating decision-maker in deciding how to allocate resources and assess performance. The Company has one operating segment. The Chairman of the Board in conjunction with the Company’s executive management team manages the Company’s operations for the purposes of allocating resources.

Cash

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. All cash is held in US, UK, & Ireland financial institutions.

Accounts Receivable, Net and Unbilled Revenue

Accounts receivable represent amounts due from US government agencies pursuant to research and development contracts associated with the Company's DeepView® System.

The Company evaluates the collectability of its receivables based on a variety of factors, including the length of time the receivables are past due, the financial health of its customers and historical experience. Based upon the review of these factors, the Company recorded no allowance for doubtful accounts as of September 30, 2024 and December 31, 2023.

Certain third-party costs that are prepaid per the terms of the contract are billable to customers prior to recognition of related expenses. The Company records deferred revenue when the customers have been billed prior to recognizing revenue. The Company records unbilled revenue when revenue is recognized prior to billing customers.

Comprehensive Loss

Comprehensive loss includes net loss, as well as other changes in stockholders' equity (deficit) that result from transactions and economic events other than those with stockholders.

Concentrations of Credit Risk

Financial instruments which potentially subject the Company to credit risk consist principally of cash and accounts receivable. Primarily all cash is held in US financial institutions which, at times, exceed federally insured limits. The Company has not recognized any losses from credit risks on such accounts. The Company believes it is not exposed to significant credit risk on cash.

Additional credit risk is related to the Company's concentration of receivables. As of September 30, 2024 and December 31, 2023, receivables were concentrated from one customer (which is a US. Government agency) representing 98% and 92% of total net receivables, respectively.

One customer (which is a U.S. government agency) accounted for 90% and 93% for the three and nine months ended September 30, 2024, respectively and 89% and 94% for the three and nine months ended September 30, 2023, respectively of the recognized research and development revenue.

Inventory

Inventory is comprised of finished goods, purchased from a third-party manufacturer, and is stated at the lower of cost (average cost) or net realizable value. For the three and nine months ended September 30, 2024 and the three and nine months ended September 30, 2023, the Company did not have write-downs for obsolete inventory.

Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Assets and liabilities that are measured at fair value are reported using a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 Unadjusted quoted prices in active markets that are assessable at the measurement date for identical, unrestricted assets or liabilities.

Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

Foreign Currency

The reporting currency for the condensed consolidated financial statements of the Company is the US dollar. The functional currency of the Company and its wholly-owned subsidiaries Spectral MD Holdings LLC, Spectral MD, Inc., and Spectral IP is the US dollar. The functional currency of Spectral MD UK is its local currency, the British pound. The functional currency of Spectral DeepView Limited is its local currency, the Euro. The assets and liabilities of Spectral MD UK and Spectral DeepView Limited, are translated into US. Dollars at exchange rates in effect at the end of each reporting period, and the revenues and expenses are translated at average exchange rates in effect during the applicable reporting period. Translation adjustments are included in accumulated other comprehensive income as a component of stockholders' equity. As of September 30, 2024 and December 31, 2023, the Company's foreign exchange translation adjustments are not material.

Monetary assets and liabilities denominated in currencies other than the US dollar are translated at exchange rates in effect as of the balance sheet date. Resulting unrealized gains and losses are included in other income (expense), net in the condensed consolidated statements of operations. For the three and nine months ended September 30, 2024, the Company recorded approximately $9,000 and $34,000, respectively of net foreign exchange transaction losses. For the three and nine months ended September 30, 2023, the Company recorded approximately $24,000 and $11,000, respectively, of net foreign exchange transaction losses. These amounts primarily relate to one of the Company's bank accounts being denominated in British Pounds and certain accounts payable denominated in British Pounds.

Property and Equipment, Net

Property and equipment, net is recorded at cost less accumulated depreciation. Depreciation expense is recorded using the straight-line method over the estimated useful lives of the related assets, which are as follows:

	Estimated Useful Life
Computer equipment	3 years
Manufacturing equipment	5 years
Furniture and equipment	5 years
Laboratory equipment	5 years
Leasehold improvements	Shorter of remaining lease term or useful life

Purchased assets that are not yet in service are recorded to construction-in-process and no depreciation expense is recorded. Once they are placed in service, they are reclassified to the appropriate asset class. When assets are retired or otherwise disposed of, the assets and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected in the Company's condensed consolidated statements of operation and comprehensive loss. Expenditures for maintenance and repairs are expensed as incurred.

Impairment of Long-Lived Assets

Long-lived assets consist of property and equipment. The Company continually evaluates whether events or circumstances have occurred that indicate that the estimated remaining useful life of its long-lived assets may warrant revision or that the carrying value of these assets may not be recoverable. If circumstances require that a long-lived asset or asset group be tested for impairment, the Company first compares the estimated undiscounted future cash flows expected to result from the use or disposition of that asset or asset group to its carrying amount. If the carrying amount of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment loss would be recognized to the extent the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market prices and third-party independent appraisals, as considered necessary.

Leases

Under lease guidance, arrangements meeting the definition of a lease are classified as operating or financing leases. Operating leases are recorded in the condensed consolidated balance sheets as both a right-of-use asset and a lease liability, calculated by discounting fixed lease payments at the rate implicit in the lease or the Company's incremental borrowing rate factoring the term of the lease. The incremental borrowing rate used by the Company is an estimate of the interest rate the Company would incur to borrow an amount equal to the lease payments on a collateralized basis over the term of the lease. Because the Company does not generally borrow on a collateralized basis, it uses the interest rate it pays on its noncollateralized borrowings as an input to deriving an appropriate incremental borrowing rate, adjusted for the amount of lease payments, the lease term and the effect on that rate of designating specific collateral with a value equal to the unpaid lease payments for that lease. Lease liabilities are increased by interest and reduced by payments each period, and the right-of-use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right-of-use asset results in straight-line rent expense over the lease term. Variable lease expenses are recorded when incurred. In calculating the right-of-use assets and lease liabilities, the Company has elected to combine lease and non-lease components. The Company excludes short-term leases having initial terms of 12 months or less from the requirement to capitalize right-of-use assets and liabilities as an accounting policy election.

During the three and nine months ended September 30, 2024 and 2023, the Company did not have any financing leases.

Warrant Liabilities

On September 11, 2023, in conjunction with the Business Combination, the Company assumed the Public Warrants which have an exercise price of $11.50 per share, are exercisable 30 days after the Business Combination and expire five years after the Business Combination or upon redemption. The Company may redeem the Public Warrants if the Company's Common Stock equals or exceeds $18.00 per share for 20 trading days within a 30-trading day period ending on the third trading day prior to the date on which the Company sends the notice of redemption to the holders of Public Warrants. As of September 30, 2024, there are 8,433,333 Public Warrants Outstanding. Each warrant entitles the registered holder to purchase one share of Company Common Stock at an exercise price of $11.50 per full share. Pursuant to the Warrant Agreement, a holder of Public Warrants may exercise its Public Warrants only for a whole number of shares of Company Common Stock. This means that only a whole warrant may be exercised at any given time by a holder of Public Warrants. The Company maintains a redemption right with respect to the Public Warrants in that the Company can redeem some or all of the Public Warrants for $0.10 per Public Warrant based on certain market conditions and the market price of the Company Common Stock.

In September 2021, Legacy Spectral issued 73,978 warrants, with a strike price of $7.32 and a five-year life, to SP Angel Corporate Finance LLP, who acted as nominated adviser and broker to the Company for the purposes of the AIM Rules ("SP Angel Warrants"). In conjunction with the Business Combination, the SP Angel Warrants were converted into warrants to purchase Company Common Stock based on the Exchange Ratio. As of September 30, 2024, there are 73,978 SP Angel Warrants to purchase Company Common Stock outstanding.

The Company accounts for its Public Warrants and the SP Angel Warrants as derivative liabilities. Accordingly, the Company recognizes the instruments as liabilities at fair value, determined using the closing price of the observable market quote in an active market (the NASDAQ) for the Public Warrants and the Black-Scholes option-pricing model for the SP Angel Warrants, and adjusts the instruments to fair value at the end of each reporting period. The liabilities are subject to re-measurement at each balance sheet date until exercised, redeemed or expired, and any change in fair value is recognized in the Company's condensed consolidated statements of operations within other income (expense).

Research and Development Revenue

The Company recognizes revenue when the Company's customers obtain control of promised goods or services, in an amount that reflects the consideration which the Company expects to receive in exchange for those goods or services by analyzing the following five steps: (1) identify the contract with a customer(s); (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the Company satisfies a performance obligation.

The Company generates research and development revenue, primarily from the contracts with BARDA and MTEC. Each contract for BARDA and MTEC has a single performance obligation.

The contracts with BARDA are cost-plus-fee contracts associated with development of certain product candidates. BARDA reimburses the Company based on allowable costs plus any recognizable earned fee. Revenues from these reimbursable costs are recognized as the costs are incurred.

The MTEC Agreement provides for installment payments after the completion of milestone events. The installment payments are considered variable consideration as the entitlement depends on successful completion of research. However, the payments are not constrained from inclusion in the transaction price as it is not probable that a significant reversal of cumulative revenue will be reversed when the underlying uncertainty is resolved. Revenue for the MTEC Agreement is recognized over time based upon the cost-to-cost measure of progress, using this input method to measure progress as the customer has the benefit of access to the development research under these projects and therefore benefits from the Company's performance incrementally as research and development activities occur under each project. The Company measures progress of performance by comparing the actual costs incurred to-date to the total estimated cost of the project. The Company will adjust the measure of progress at the end of each reporting period and reflect any changes to the estimated cost of the project on a prospective basis.

The Company elected the practical expedient not to adjust the transaction price for the effects of a significant financing component as the period between performance (satisfaction of a performance obligation) and payment is one year or less. Payments from customers are generally received within 30 days of when the invoice is sent.

Research and Development Expense

The Company expenses research and development costs as incurred. These expenses include salaries for research and development personnel, consulting fees, product development, pre-clinical studies, clinical trial costs, and other fees and costs related to the development of the technology. For the three months ended September 30, 2024 and 2023, research and development expense was $5.2 million and $3.6 million, respectively, of which $4.5 million and $2.0 million, respectively, is related to the BARDA and MTEC contracts and included in cost of revenue and $0.7 million and $1.6 million, respectively, is included in general and administrative expenses. For the nine months ended September 30, 2024 and 2023, research and development expense was $14.9 million and $11.3 million, respectively, of which $12.0 million and $7.3 million, respectively, is related to the BARDA and MTEC contracts and included in cost of revenue and $2.9 million and $4.0 million, respectively, is included in general and administrative expenses.

Stock-Based Compensation

The Company accounts for all stock-based payments to employees and non-employees, including grants of stock options and RSUs based on their respective grant date fair values. The Company estimates the fair value of stock option grants using the Black-Scholes option pricing model. The RSUs are valued based on the fair value of the Company's common stock on the date of grant. The fair value of RSUs with market based vesting conditions were determined using a Monte-Carlo Simulation to reflect the effects of the market conditions. The assumptions used in calculating the fair value of the Company's stock-based awards represent management's best estimates and involve inherent uncertainties and the application of management's judgment. The Company expenses stock-based compensation related to stock options and RSUs over the requisite service period. Forfeitures are recorded as they occur. Compensation previously recorded for unvested equity awards that are forfeited is reversed upon forfeiture. The Company expenses stock-based compensation to employees over the requisite service period, on a straight-line basis, based on the estimated grant-date fair value of the awards. For RSUs with market-based conditions, compensation is not reversed if these awards are forfeited based solely on failing to meet such market-based conditions.

Income Taxes

The Company records its deferred taxes using an asset and liability approach. The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the condensed consolidated financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are provided, if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

When uncertain tax positions exist, the Company recognizes the tax benefit of tax positions to the extent that the benefit would more likely than not be realized assuming examination by the taxing authority. The determination as to whether the tax benefit will more likely than not be realized is based upon the technical merits of the tax position as well as consideration of the available facts and circumstances. The Company has no uncertain tax positions as of September 30, 2024 and December 31, 2023 that qualify for either recognition or disclosure in the condensed consolidated financial statements under this guidance.

The Company's policy is to classify assessments, if any, for tax related interest as interest expense and penalties as general and administrative expenses in the condensed consolidated statements of operations. The Company did not have any interest and penalties during the three and nine months ended September 30, 2024 and 2023 and did not have any interest or penalties accrued as of September 30, 2024.

Net Loss per Share of Common Stock

Basic net loss per share of common stock is computed by dividing the net loss attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share of common stock adjusts basic earnings per share for the potentially dilutive impact of unvested restricted stock, stock options and warrants. Securities having an anti-dilutive effect on diluted net earnings per share are excluded from the calculation. The dilutive effect of the unvested restricted stock and stock options is calculated using the treasury stock method. For warrants that are liability-classified, during periods when the impact is dilutive, the Company assumes share settlement of the instruments as of the beginning of the reporting period and adjusts the numerator to remove the change in fair value of the warrant liability and adjusts the denominator to include the dilutive shares calculated using the treasury stock method.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss), which includes foreign currency translation adjustments. For the purposes of comprehensive income (loss) disclosures, the Company does not record tax provisions or benefits for the net changes in the foreign currency translation adjustment, as it intends to indefinitely reinvest undistributed earnings of its foreign subsidiaries. Accumulated other comprehensive income (loss) is reported as a component of stockholders' equity.

Recently Adopted Accounting Standards

In September 2016, the FASB issued ASU No. 2016-13, Financial Instruments — Credit Losses, which was subsequently amended by ASU No. 2018-19, ASU No. 2019-04, ASU No. 2019-05, ASU 2019-10, ASU No. 2019-11, ASU No. 2020-03, and ASU No. 2022-02. These ASUs have provided for various minor technical corrections and improvements to the codification as well as other transition matters. Smaller reporting companies who file with the SEC are required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. This standard requires the measurement of expected credit losses for financial instruments carried at amortized cost held at the reporting date based on historical experience, current conditions and reasonable forecasts. The updated guidance also amends the current other-than-temporary impairment model for available-for-sale debt securities by requiring the recognition of impairments relating to credit losses through an allowance account and limits the amount of credit loss to the difference between a security's amortized cost basis and its fair value. In addition, the length of time a security has been in an unrealized loss position will no longer impact the determination of whether a credit loss exists. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The Company adopted this standard on January 1, 2023, with no impact on its condensed consolidated financial statements and related disclosures.

In August 2020, the FASB issued ASU No. 2020-06, Debt — Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity, which simplifies accounting for convertible instruments by removing major separation models required under current GAAP. The ASU removes certain settlement conditions that are required for equity contracts to qualify for the derivative scope exception, and it also simplifies the diluted earnings per share calculation in certain areas. The Company adopted this standard on January 1, 2024, with no impact on its condensed consolidated financial statements and related disclosures.

In June 2022, the FASB issued ASU 2022-03, ASC Subtopic 820 Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions ("ASU 2022-03"). The FASB issued this update (1) to clarify the guidance in Topic 820, Fair Value Measurement, when measuring the fair value of an equity security subject to contractual restrictions that prohibit the sale of an equity security, (2) to amend a related illustrative example, and (3) to introduce new disclosure requirements for equity securities subject to contractual sale restrictions that are measured at fair value in accordance with Topic 820. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. The Company adopted this standard on January 1, 2024, with no impact on its condensed consolidated financial statements and related disclosures.

In March 2023, the FASB issued ASU 2023-01, Leases (Topic 842) — Common Control Arrangements, which require that leasehold improvements associated with common control leases be amortized by the lessee over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset. It also requires such leasehold improvements to be accounted for as a transfer between entities under common control through an adjustment to entity if, and when, the lessee no longer controls the use of the underlying asset. ASU 2023-01 is effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. The Company adopted this standard on January 1, 2024, with no impact on its condensed consolidated financial statements and related disclosures.

Recently Issued Accounting Standards

In October 2023, the FASB issued ASU 2023-06 Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative ("ASU 2023-06"), which modifies certain disclosure and presentation requirements of a variety of Topics in the Codification and is intended to both clarify or improve such requirements and align the requirements with the SEC's regulations. The effective date for each amendment is the effective date of the removal of the related disclosure from Regulation S-X or Regulation S-K, with early adoption prohibited. The Company will apply the provisions prospectively as such provisions become effective and does not expect ASU 2023-06 to have a material impact on the condensed consolidated financial statements.

In November 2023, the FASB issued ASU 2023-07, Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures ("ASU 2023-07"). ASU 2023-07 updates reportable segment disclosure requirements, primarily through enhanced disclosures about significant segment expenses and information used to assess segment performance. This update is effective for the Company in the consolidated financial statements for the year ending December 31, 2024, and interim periods beginning after January 1, 2025. The Company is currently evaluating the impact that the adoption of this standard will have on its condensed consolidated financial statements and disclosures.

In December 2023, the FASB issued ASU 2023-09, Income Taxes (Topic 740): Improvements to Income Tax Disclosures ("ASU 2023-09"). ASU 2023-09 requires more detailed income tax disclosures, requiring entities to disclose disaggregated information about their effective tax rate reconciliation as well as expanded information on income taxes paid by jurisdiction. The disclosure requirements will be applied on a prospective basis, with the option to apply them retrospectively. This update will be effective for annual periods beginning after December 15, 2024, with early adoption permitted. The Company is currently evaluating the impact that the adoption of this standard will have on its condensed consolidated financial statements and disclosures.

In November 2024, the FASB issued ASU No. 2024-03, Income Statement- Reporting Comprehensive Income- Expense Disaggregation Disclosures (Subtopic 220-40), requiring public business entities to disclose additional information about specific expense categories in the notes to financial statements at interim and annual reporting periods. ASU 2024-03 is effective for fiscal years beginning after December 15, 2026, and interim reporting periods beginning after December 15, 2027, with early adoption permitted. The disclosures required under the guidance can be applied either prospectively to financial statements issued for reporting periods after the effective date or retrospectively to any or all periods presented in the financial statements. The Company is currently evaluating the impact of adopting this guidance on its consolidated financial statements and disclosures.

3. RECAPITALIZATION

As discussed in Note 1, on September 11, 2023, the Company consummated the Business Combination, with Legacy Spectral surviving the merger as a wholly-owned subsidiary of the Company.

On the date of the Business Combination, the Company recorded net liabilities of $2.4 million, with an offsetting decrease to additional paid-in capital. The following table provides the elements of the Business Combination:

Cash	$ 660
Other current assets	127
Accounts payable	(860)
Accrued expenses	(277)
Warrant liabilities	(2,024)
Net liabilities assumed in exchange for common stock	(2,374)
Less: Cash	(660)
Non-cash net liabilities assumed in exchange for common stock	$ (3,034)

Upon the Closing, the Company issued 33,333 shares of Company Common Stock, with a fair value of $0.2 million, to settle an assumed liability to the Sponsor as a payment for an administrative fee.

The Company recorded transaction costs, consisting of legal, accounting and other professional services incurred by Legacy Spectral related to the Business Combination, of $7.6 million (the "Transaction Costs"), in other income (expense) in the consolidated statement of operations for the year ended December 31, 2023 and no costs were capitalized. During the year ended December 31, 2023, the Company paid $1.9 million of Transaction Costs in cash and issued 966,667 shares of Company Common Stock with a fair value of $4.4 million.

Prior to the Business Combination, the Company incurred $0.7 million of transaction costs, included in other income (expense) in the consolidated statement of operations for the year ended December 31, 2023, for professional services incurred by Legacy Spectral that were related to potential business combinations that did not occur.

4. FAIR VALUE MEASUREMENTS

The following table presents information about the Company's financial liabilities that are measured at fair value on a recurring basis as of September 30, 2024 and December 31, 2023, by level within the fair value hierarchy (in thousands):

	Fair value measured as of September 30, 2024			
	Fair value at September 30, 2024	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant liabilities	$ 1,101	$ 1,096	$ -	$ 5
Short-term notes payable – Yorkville	4,377	-	-	4,377
	$ 5,478	$ 1,096	$ -	$ 4,382

	Fair value measured as of December 31, 2023			
	Fair value at December 31, 2023	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Warrant liabilities	$ 1,818	$ 1,771	$ -	$ 47

There were no transfers between Level 1, 2 or 3 during the nine months ended September 30, 2024.

Fair values of cash, accounts receivable, accounts payable, accrued expenses, and short-term debt (other than the notes payable with Yorkville) are carried at cost, which management believes approximates fair value due to the short-term nature of these instruments. The fair value of the Public Warrants, which trade in active markets, is based on quoted market prices and classified in Level 1 of the fair value hierarchy. The SP Angel Warrants are classified within Level 3 of the fair value hierarchy because their fair values are based on significant inputs that are unobservable in the market.

The following table presents changes in Level 3 warrant liabilities measured at fair value for the three and nine months ended September 30, 2024 and 2023 (in thousands):

Balance – January 1, 2024	$	47
Change in fair value		(20)
Balance – March 31, 2024	$	27
Change in fair value		(11)
Balance – June 30, 2024	$	16
Change in fair value		(12)
Balance – September 30, 2024	$	4
Balance – January 1, 2023	$	129
Change in fair value		(16)
Balance – March 31, 2023	$	113
Change in fair value		81
Balance – June 30, 2023	$	194
Change in fair value		(141)
Balance – September 30, 2023		53

Both observable and unobservable inputs were used to determine the fair value of warrants that the Company has classified within the Level 3 category. Unrealized gains and losses associated with liabilities within the Level 3 category include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

The following table provides quantitative information regarding Level 3 warrant liability fair value measurements inputs at their measurement:

	September 30, 2024	**December 31, 2023**
Strike price (per share)	$ 7.32	$ 7.32
Contractual term (years)	2.7	3.5
Volatility (annual)	69.3%	71.2%
Risk-free rate	3.6%	4.0%
Dividend yield (per share)	0.0%	0.0%

Valuation of short-term notes payable – Yorkville

The Company elected the fair value option to account for the financial instrument with Yorkville signed on March 20, 2024 (see Note 7). The estimate of the fair value as of September 30, 2024 was determined using a binomial lattice model. The fair value measurement of the debt is determined using Level 3 inputs and assumptions unobservable in the market.

Changes in the fair value of debt that is accounted for at fair value, inclusive of related accrued interest expense, are presented as gains or losses as a component of other income (expense) in the accompanying condensed consolidated statements of operations and comprehensive loss under change in fair value of debt, with the exception of changes due to the Company's credit risk, which are presented as a component of accumulated other comprehensive income in the accompanying condensed consolidated balance sheets. The actual settlement of the short-term debt could differ from current estimates based on the timing of when and if Yorkville elects to convert amounts into common shares, potential cash repayment by the Company prior to maturity, and movements in the Company's common stock price.

The following table provides a rollforward of the aggregate fair values of the Company's Yorkville debt for which fair values are determined using Level 3 inputs (in thousands):

Balance as of January 1, 2024	$ -
Addition of short-term notes payable	4,600
Fair value adjustment	(66)
Balance as of March 31, 2024	4,534
Addition of short-term notes payable	4,600
Principal repayments	(2,300)
Fair value adjustment	167
Balance as of June 30, 2024	$ 7,001
Addition of short-term notes payable	2,300
Principal repayments	(4,830)
Fair value adjustment	(94)
Balance as of September 30, 2024	4,377

The following table provides quantitative information regarding Level 3 fair value measurements inputs at their measurement:

	September 30, 2024
Expected term (years)	0.05 – 0.21
Volatility (annual)	80 – 100%
Risk-free rate	4.72 – 4.87%

Valuation of forward options in B. Riley ELOC and Yorkville SEPA

The B. Riley ELOC and Yorkville SEPA are accounted for as derivatives and will be recognized at fair value. Any changes in fair value between the carrying amount of the forward issuance contracts and the settlement amounts will be recognized in other income (expense) in the condensed consolidated statement of operations and comprehensive loss. For the three and nine months ended September 30, 2024, the Company determined there were immaterial changes in derivative liability fair value related to the B. Riley ELOC the Yorkville SEPA. The Company recognized no change in derivative liability fair value for the three and nine months ended September 30, 2024.

5. RESEARCH AND DEVELOPMENT REVENUE

For the three and nine months ended September 30, 2024 and 2023, the Company's revenues disaggregated by the major sources were as follows (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	2023	2024	2023
BARDA	$ 7,567	$ 3,055	$ 20,734	$ 12,018
Other U.S. governmental authorities	606	385	1,243	751
Total revenue	$ 8,173	$ 3,440	$ 21,977	$ 12,769

The following table presents the activity in the Company's contract liabilities during the nine month period ended September 30, 2024 (in thousands):

	December 31, 2023 Balance	Additions	Reductions	September 30, 2024 Balance
Contract liabilities:				
Deferred revenue	$ 2,311	$ 4,238	$ (5,818)	$ 731
Total contract liabilities	$ 2,311	$ 4,238	$ (5,818)	$ 731

6. ACCRUED EXPENSES

Accrued expenses consist of the following as of September 30, 2024 and December 31, 2023 (in thousands):

	September 30, 2024	December 31, 2023
Salary and wages	$ 1,957	$ 1,910
Operating expenses	504	1,563
Benefits	517	720
Taxes	215	107
Borrowing related costs	60	-
Total accrued expenses	$ 3,253	$ 4,300

7. NOTES PAYABLE

The Company entered into the Yorkville Convertible Notes, the Related Party Note, and financing arrangements for a portion of its Directors and Officers insurance premiums, as follows (in thousands):

			Principal Repayments		Outstanding Balance	
			Nine months ended September 30,			
	Amount Financed	Interest Rate	2024	2023	September 30, 2024	December 31, 2023
Yorkville Convertible Notes	$ 11,500	0.0%	$ 7,129	$ -	$ 4,377	$ -
Related Party Note	1,000	8.0%	-	-	1,000	-
2024 Insurance Note	596	8.4%	-	-	597	-
New 2023 Insurance Note	631	8.6%	436	-	-	436
2023 Insurance Note	151	9.7%	-	113	-	-
2022 Insurance Note	376	6.7%	-	175	-	-
			$ 7,565	$ 288	$ 5,974	$ 436

Yorkville Convertible Notes

On March 20, 2024, the Company entered into the SEPA with Yorkville pursuant to which the Company has the right to sell to Yorkville up to $30.0 million of its shares of Company Common Stock, subject to certain limitations and conditions set forth in the SEPA, from time to time during the term of the SEPA (such transaction, the "Yorkville Transaction"). In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of convertible promissory notes (the "Convertible Notes") an aggregate principal amount of up to $12.5 million (the "Pre-Paid Advance"), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $5.0 million with a fixed conversion price of $3.16. The Company received $4.6 million in cash, net of the 8% original issue discount. On May 14, 2024, the shareholders voted to approve the reservation and issuance of shares to Yorkville to exceed the Exchange Cap and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million, which is the $5.0 million second Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $2.03. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million with a fixed conversion price equal to 120% of the average VWAP during the three trading days immediately prior to the issuance of the note. The purchase price for the Pre-Paid Advance is 92.0% of the principal amount of the Pre-Paid Advance. Interest shall accrue on the outstanding balance of any Pre-Paid Advance at an annual rate equal to 0%, subject to an increase to 18% upon an event of default as described in the Convertible Notes.

Beginning on the forty-fifth (45th) day following the issuance date of the Convertible Note issued in connection with the first Pre-Paid Advance, and continuing on the same day of each successive month thereafter, (each, an "Installment Date"), the Company shall repay a portion of the outstanding balance of the Pre-Paid Advance in an amount equal to (i) $1,750,000, provided however, in respect of any Installment Date prior to the closing of the second Pre-Paid Advance, $750,000 (the "Installment Principal Amount"), plus (ii) the a payment premium of 7% of such Installment Principal Amount, and (iii) accrued and unpaid interest hereunder as of each Installment Date. The maturity date of the Convertible Notes issued in connection with each Pre-Paid Advance will be 12 months after the issuance date of such Convertible Notes. In October 2024, the Company and Yorkville agreed to amend the dates and the allocation of installment amounts to be paid pursuant to the Pre-Paid Advances. As of September 30, 2024, Tranche's I and II's had outstanding future obligations of $3.2 million which will be repaid in full by the contractual repayment date in February 2025. Tranche III's outstanding future obligations of $1.9 million will be repaid in full by the contractual repayment date in January 2025. As of September 30, 2024, the Company has made aggregate installment payments on the Pre-Paid Advances in the amount of $8.3 million, of which $7.2 million was settled in cash and $1.1 million was settled in shares. Of the aggregate installment payments, $7.1 million relates to the repayment of the principal, $0.6 million relates to the 8% original issue discount and $0.6 million relates to the 7% payment premium. As of September 30, 2024, the aggregate outstanding principal balance of the Yorkville Convertible Notes is $4.4 million.

As the SEPA is an equity-linked contract that does not qualify for equity classification, any expenses incurred will be recognized in the consolidated statements of operations and comprehensive loss within borrowing related costs. For the three and nine months ended September 30, 2024, the Company recognized $0.2 million and $0.8 million in issuance costs related to the SEPA.

Related Party Note

On March 19, 2024, the Company announced that Spectral IP received a $1.0 million investment from an affiliate of its largest shareholder for the acquisition and development of a health care related artificial intelligence intellectual property portfolio. The investment is structured as a note payable with a one-year maturity, at an interest rate of 8%, and requiring earlier prepayment if the Company spins off Spectral IP to the Company's shareholders or if Spectral IP is sold to a third party. See Note 15 for further information.

Insurance Notes

The Company determined that the carrying amounts of all of the insurance notes approximate fair value due to the short-term nature of borrowings and current market rates of interest.

8. COMMITMENTS AND CONTINGENCIES

Legal Matters

The Company is not a party to any material legal proceedings or pending claims. The Company is aware of a material threatened claim that it believes is without merit. From time to time, the Company may be subject to various legal proceedings and claims that arise in the ordinary course of its business activities, none of which we believe are material or would be expected to have, individually or in the aggregate, a material adverse effect on our business, financial condition, cash flows or results of operations.

9. LEASES

The Company leases office space for its principal office in Dallas, Texas, which was amended in April 2024 to extend the lease term to expire in February 2028. The lease amendment also included a landlord-provided tenant improvement allowance of up to $0.3 million to be applied to the costs of the construction of leasehold improvements. The Company determined that it owns the leasehold improvements under the lease and, as such, reflected the $0.3 million lease incentive as a reduction in lease liabilities and right-of-use assets. As of September 30, 2024, the Company has not yet incurred any leasehold improvement costs that were paid for by the lessor.

During 2023, the Company entered into a lease for office space in the United Kingdom for annual payments of $0.1 million under a lease that expired in March 2024. The lease was renewed in March 2024, however the Company has excluded this lease from the tables below as the term is twelve months.

The following table summarizes quantitative information about the Company's operating leases for the three and nine months ended September 30, 2024 and 2023 (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	2023	2024	2023
Operating cash flows from operating leases	$ 232	$ 208	$ 662	$ 536
Right-of-use assets exchanged for operating lease liabilities	$ -	$ -	$ 1,771	$ 483
Weighted average remaining lease term (in years)	3.4	1.3	3.4	1.3
Weighted average discount rate	8.5%	8.5%	8.5%	8.5%

The following table provides the components of the Company's lease cost included in general and administrative expense in the condensed consolidated statement of operations (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	2023	2024	2023
Operating leases				
Operating lease cost	$ 182	$ 205	$ 569	$ 597
Variable lease cost	119	92	288	256
Operating lease expense	301	297	857	853
Short-term lease rent expense	38	41	116	69
Total rent expense	$ 339	$ 338	$ 973	$ 922

Variable lease cost is primarily attributable to amounts paid to lessors for utility charges, parking, and property taxes under an office space lease.

As of September 30, 2024, future minimum payments under the non-cancelable operating leases were as follows (in thousands):

Remaining period ended December 31, 2024	$ 232
Year Ended December 31, 2025	691
Year Ended December 31, 2026	850
Year Ended December 31, 2027	871
Year Ended December 31, 2028	149
Total	2,793
Less: imputed interest	(384)
Less: tenant improvement allowance	(327)
Operating lease liabilities	$ 2,082

10. STOCKHOLDERS' EQUITY

In conjunction with the Closing, the Company's certificate of incorporation was amended and restated to authorize the issuance of 80,000,000 shares of Company Common Stock, $0.0001 par value and 1,000,000 shares of preferred stock, $0.0001 par value (the "Company Preferred Stock").

On December 26, 2023, the Company entered into a Common Stock Purchase Agreement (the “Purchase Agreement”) and related Registration Rights Agreement with B. Riley Principal Capital II, LLC (“B. Riley”). Upon the terms and subject to the satisfaction of the conditions set forth in the Purchase Agreement, the Company has the right, in our sole discretion, to sell to B. Riley up to $10.0 million in aggregate gross proceeds of newly issued shares of the Company’s Common Stock (the “ELOC”). During the nine months ended September 30, 2024 the Company issued 1,187,398 shares to B. Riley under the ELOC for $2.7 million in aggregate gross proceeds. During the nine months ended September 30, 2024, the Company recognized $0.4 million of related stock issuance costs and $0.1 million of service fee costs which are included in transaction costs within the condensed consolidated statements of operations and comprehensive loss. The Company did not issue any shares under the ELOC during the three months ended September 30, 2024.

On March 20, 2024, the Company also entered into a Standby Equity Purchase Agreement (“SEPA”) with YA II PN, LTD, a Cayman Islands exempt limited partnership (“Yorkville”) pursuant to which the Company has the right to sell to Yorkville up to $30.0 million in shares of Company Common Stock, subject to certain limitations and conditions set forth in the SEPA (such transaction, the “Yorkville Transaction”). In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of convertible promissory notes an aggregate principal amount of up to $12.5 million (the “Pre-Paid Advance”), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $4.6 million, which is the $5.0 million Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $3.16. On May 14, 2024, the shareholders voted to approve the reservation and issuance of shares to Yorkville to exceed the Exchange Cap and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million, which is the $5.0 million second Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $2.03. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million. In connection with the execution and delivery of the SEPA, the Company is authorized to drawdown an additional $3.0 million from the ELOC prior to utilizing the SEPA. The Company issued 94,937 shares of Company Common Stock in April 2024 as a commitment fee under the SEPA. The Company also issued 906,706 shares as repayment of principal under the SEPA during the three and nine months ended September 30, 2024.

11. STOCK-BASED COMPENSATION

Each option and warrant to purchase common stock of Legacy Spectral was converted into an option and warrant, respectively, to purchase Spectral AI’s common stock based on the Exchange Ratio, with corresponding adjustments to the exercise price. Accordingly, the options and warrants to purchase 46,592,862 and 762,712, respectively, shares of the common stock of Legacy Spectral were converted into options and warrants to purchase 4,519,191 and 73,978, respectively, shares of Spectral AI’s common stock. Legacy Spectral’s 600,000 RSUs were converted into 58,197 Spectral AI RSUs, based on the Exchange Ratio.

2018 Long Term Incentive Plan

On July 24, 2018, Legacy Spectral’s Board of Directors adopted the 2018 Long Term Incentive Plan (the “2018 Plan”) which permitted granting of incentive stock options (which must meet all statutory requirements), non-qualified stock options, stock appreciation rights, restricted stock, stock units, performance shares, performance units, incentive bonus awards, and other cash-based or stock-based awards. In May 2024, all awards outstanding under the 2018 Plan were replaced with corresponding awards to be issued pursuant to the 2023 Plan, as discussed below, and no new grants will be made under the 2018 Plan.

2022 Long Term Incentive Plan

On September 27, 2022, Legacy Spectral’s stockholders approved the adoption of the 2022 Long Term Incentive Plan (the “2022 Plan”) which permitted granting of incentive stock options (they must meet all statutory requirements), non-qualified stock options, stock appreciation rights, restricted stock, stock units, performance shares, performance units, incentive bonus awards, and other cash-based or stock-based awards. In May 2024, all awards outstanding under the 2022 Plan were replaced with corresponding awards to be issued pursuant to the 2023 Plan, as discussed below, and no new grants will be made under the 2022 Plan.

2023 Long Term Incentive Plan

On May 14, 2024, the Company's shareholders approved the adoption of the 2023 Long Term Incentive Plan (the "2023 Plan") which permits granting of incentive stock options (they must meet all statutory requirements), non-qualified stock options, stock appreciation rights, restricted stock, stock units, performance shares, performance units, incentive bonus awards, and other cash-based or stock-based awards. The options, restricted stock units and other securities issued pursuant to the 2018 Plan and 2022 Plan will be replaced with a corresponding award to be issued pursuant to the 2023 Plan. No new grants will be made under the 2022 Plan and the 2018 Plan and all outstanding grants under the 2018 Plan and 2022 Plan will be assumed by the 2023 Plan. The maximum aggregate number of shares that may be issued under the Plan shall not exceed 8,000,000, plus the number of shares that are automatically added on January 1st of each year for a period of up to ten years, commencing on January 1, 2024 and ending on (and including) January 1, 2033, in an amount equal to the lesser of (i) five percent (5%) of the total number of shares of stock outstanding on December 31st of the preceding calendar year, and (ii) an amount determined by the Board of Directors. Pursuant to the 2023 Plan, stock options must expire within 10 years and must be granted with exercise prices of no less than the fair value of the common stock on the grant date, as determined by the Board of Directors. As of September 30, 2024, under the 2023 Plan, 3,786,191 shares of common stock were issuable upon exercise of outstanding options and 469,400 restricted stock units ("RSUs") were issuable. Under the 2023 Plan, 3,744,410 shares remain available for issuance through grants of future options. RSUs awarded under the 2023 Plan for the purchase of common stock will vest based on continued service which is generally three years or based on the achievement of market terms as set forth in the individual awards. The grant date fair value of the award will be recognized as compensation expense over the requisite service period. The fair value of the RSUs is estimated on the date of grant based on the fair value of the Company's common stock. The 2023 Plan provides that the Compensation Committee shall determine the vesting conditions of awards granted under the 2023 Plan, and the Compensation Committee has from time-to-time approved vesting schedules for certain awards that deviate from the vesting conditions described in the previous sentence.

Restricted Stock Units

On January 3, 2024, pursuant to the 2022 Plan, the Company granted its then-CFO a market condition RSU of up to 150,000 shares of the Company's common stock. The award had a grant date fair value of approximately $0.4 million using a Monte Carlo simulation model. The RSUs under this market-based award will vest partially based on achievement of stock price targets of the Company's common stock. 50,000 RSUs vest when the 180-day VWAP meets or exceeds $8.00 per share, 50,000 RSUs vest when the 180-day VWAP meets or exceeds $12.00 per share, and 50,000 RSUs are not market-based and will vest over the continued service period of three years. These market-based conditions must be met in order for portions of the RSU award to vest, and it is therefore possible that certain awards ultimately would not vest. The grant date fair value of each RSU grant is expensed over the requisite service period. Compensation expense relating to share-based awards with market-based conditions is not reversed if these awards are forfeited based solely on failing to meet such market-based conditions.

On February 29, 2024, pursuant to the 2022 Plan, the Company granted both its CFO and CEO awards of RSUs up to 150,000 shares of the Company's common stock. The awards had a grant date fair value of approximately $0.6 million using a Monte Carlo simulation model. The portion of RSUs that are market-based awards will vest partially based on achievement of stock price targets of the Company's common stock. 37,500 RSUs vest when the 180-day VWAP meets or exceeds $8.00 per share, 37,500 RSUs vest when the 180-day VWAP meets or exceeds $10.00 per share. The market-based conditions must be met in order for the market-based portion of the RSU awards to vest, and it is therefore possible that certain awards ultimately would not vest. 75,000 RSUs are not market-based and will vest over the continued service period of three years. The grant date fair value of each RSU grant is expensed over the requisite service period. Compensation expense relating to share-based awards with market-based conditions is not reversed if these awards are forfeited based solely on failing to meet such market-based conditions.

On February 29, 2024, the Company amended the terms of the January 3, 2024 RSU grant to its then-CFO to provide for identical vesting terms to those provided in the February 29, 2024 RSU grant. The Company determined the amended RSU grant represents a modification of the original award, however, the incremental compensation cost of the amendment was not material.

A summary of RSU activities for the nine months ended September 30, 2024 are presented below:

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Nonvested as of January 1, 2024	58,197	$ 4.65
Granted	450,000	$ 2.16
Vested	(29,097)	$ 0.45
Forfeited	(9,700)	$ 0.45
Nonvested as of September 30, 2024	469,400	$ 1.97

During the nine months ended September 30, 2024 and 2023, the Company granted 450,000 and 58,197 restricted stock units, respectively, with a weighted-average grant date fair value of $2.16 per share and $4.65 per share, respectively. As of September 30, 2024, total unrecognized compensation expense related to restricted stock units was $0.8 million, which is expected to be recognized over a weighted-average period of 1.8 years.

Stock Options

The fair value of each employee and non-employee stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Legacy Spectral's stock became publicly traded on July 22, 2021 on the AIM Market of the London Stock Exchange, and lacks company-specific historical and implied volatility information. On September 11, 2023 the Company completed the Business Combination and was listed on NASDAQ under the symbol MDAI. Legacy Spectral estimated its expected stock volatility based on the historical volatility of a publicly traded set of peer companies. Spectral AI continues to estimate its expected stock volatility based on the historical volatility of a publicly traded set of peer companies. Due to the lack of historical exercise history, the expected term of Legacy Spectral's and Spectral AI's stock options for employees has been determined utilizing the simplified method by taking an average of the vesting periods and the original contractual terms for each award. The expected term of stock options granted to non-employees is equal to the contractual term of the option award. The risk-free interest rate is determined by reference to the US. Treasury yield curve in effect at the time of grant of the award for time periods approximately equal to the expected term of the award. Expected dividend yield is zero based on the fact that Legacy Spectral and Spectral AI have never paid cash dividends and Spectral AI does not expect to pay any cash dividends in the foreseeable future.

The Company's stock options generally vest ratably annually over 3 years and have a contractual term of 10 years. In applying the Black Scholes option pricing model, the Company used the following assumptions for stock options granted during the nine months ended September 30, 2024 and 2023:

	Nine months ended September 30, 2024	Nine months ended September 30, 2023
Exercise price (per share)	$ 1.76	$ 0.44
Expected term (years)	5.6	6.0
Volatility (annual)	66%	72%
Risk-free rate	4.3%	3.5%
Dividend yield (per share)	0%	0%

A summary of stock options activity for the nine months ended September 30, 2024 is presented below:

	Stock Options		*Weighted Average Exercise Price*	*Weighted Average Remaining Contractual Life (in years)*		*Aggregate Intrinsic Value (in thousands)*
Outstanding at January 1, 2024	3,598,944	$	2.20	6.5	$	8,087
Options granted	443,437	$	1.76			
Options forfeited	(133,441)	$	4.07			
Options cancelled	(122,749)	$	4.54			
Options exercised	-	$	-			
Outstanding as of September 30, 2024	3,786,191	$	1.99	6.1	$	18
Options vested and exercisable as of September 30, 2024	3,186,977	$	1.79	5.6	$	18

The aggregate intrinsic value of options is calculated as the difference between the exercise price of the stock options and the fair value of the Company's common stock for those stock options that had exercise prices lower than the fair value of the common stock as of the respective date.

As of September 30, 2024, there was approximately $0.8 million of unrecognized stock-based compensation related to stock option grants that will be amortized over a weighted average period of 0.9 years.

The Company recorded stock-based compensation expense for stock options, RSUs, and restricted stock awards of $0.2 million and $0.9 million for the three and nine months ended September 30, 2024, respectively, and $0.3 million and $1.0 million for the three and nine months ended September 30, 2023, respectively, in general and administrative expenses in the condensed consolidated statements of operations.

During the year ended December 31, 2018, the Company granted 973,803 stock options to investors (the "Investor Options") that were approved by the Board of Directors outside of the 2018 Plan. During the year ended December 31, 2023, 34,779 of the Investor Options were exercised and the remaining 904,245 Investor Options expired in November 2023. The Investor Options had an exercise price of $2.06 per share. As of September 30, 2024, there is no unrecognized stock-based compensation expense related to the Investor Options.

12. INCOME TAXES

The Company recorded an income tax provision of approximately $37,338 and $128,406 for the three and nine months ended September 30, 2024, respectively and an income tax benefit of approximately $54,000 for the three months ended September 30, 2023 and an income tax provision of approximately $32,000 for the nine months ended September 30, 2023. The effective tax rate was 2.5% and 1.7% for the three and nine months ended September 30, 2024, respectively and (0.5%) and 0.2% for the three and nine months ended September 30, 2023, respectively.

The tax provision for interim periods is determined using an estimate of the Company's annual effective tax rate, adjusted for discrete items arising in that quarter. The Company's effective tax rate differs from the U.S. statutory tax rate in the three and nine months ended September 30, 2024 primarily due to changes in valuation allowances on deferred tax assets as it is more likely than not that the Company's deferred tax assets will not be realized.

The Company evaluates its tax positions on a quarterly basis and revises its estimate accordingly.

13. NET LOSS PER COMMON SHARE

Basic and diluted net loss per common share attributable to common stockholders are the same for the three and nine months ended September 30, 2024 and 2023, since the inclusion of all potential shares of common stock outstanding would have been anti-dilutive due to the Company's net loss.

The table below summarizes potentially dilutive securities that were excluded from the computation of net loss per common share as of the periods presented because including them would be anti-dilutive.

	September 30,	
	2024	2023
Common stock options	3,786,191	4,519,195
Common stock warrants	8,507,311	8,507,311
Unvested restricted stock units	469,400	58,197
Potentially dilutive securities	12,762,902	13,084,703

14. RELATED PARTY TRANSACTIONS

On March 7, 2024, the Company formed a new wholly-owned subsidiary, Spectral IP, to be utilized to advance artificial intelligent intellectual property with a specific emphasis on healthcare. On March 19, 2024, the Company announced that Spectral IP received a $1.0 million investment from an affiliate of its largest shareholder for the development of its artificial intelligence intellectual property portfolio. The investment is structured as a note payable with a one-year maturity, an interest rate of 8%, and requiring earlier prepayment if the Company spins off Spectral IP to the Company's shareholders or if Spectral IP is sold to a third party (the "Note"). See Note 15 for further information.

For the year ended December 31, 2023, the Company did not have any transactions with related parties.

15. SUBSEQUENT EVENTS

On October 1, 2024, the Related Party Note was amended to (i) reduce the annual interest rate from 8% to 4%, (ii) extend the term of the Note through the second anniversary of the issuance date, March 18, 2026, (iii) include a conversion feature at the option of either IP Protocol or Spectral IP to convert the then outstanding principal and accrued but unpaid interest into shares of the Company at any time (into such number of shares calculated by taking a five percent (5.00%) discount to the closing price of the Parent's common stock on the day prior to the date of notice to the Company of the exercise of the conversion right) and at maturity, respectively, and (iv) provide for registration rights of any shares of the Company issued in satisfaction of the outstanding obligations.

On October 1, 2024, the Company and Yorkville agreed to amend the dates and the allocation of installment amounts to be paid pursuant to the Pre-Paid Advances under the SEPA, such that the payment period of the remaining outstanding balance of the Pre-Paid Advances was extended through February 2025.

On October 16, 2024, the Company filed a shelf registration statement on Form S-3, containing a base prospectus covering the offering, issuance, and sale by the Company of up to $50,000,000 of the Company's Common Stock from time to time after the effective date of the registration statement. The registration statement was declared effective by the SEC on October 31, 2024.

On November 6, 2024, the Company announced its intent to spin off its Spectral IP Inc. subsidiary through a transaction with Sauvegarder Investment Management. The transaction will be in the form of a distribution to its shareholders of stock of Spectral IP, which will become a new, independent publicly-traded company. The Company expects the transaction will be completed within 90 days from the announcement, subject to final approval by the Company's Board of Directors, a Form 10 registration statement being declared effective by the U.S. Securities and Exchange Commission, regulatory approvals, and the satisfaction of any remaining closing conditions.

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

You should read the following discussion and analysis of our financial condition and results of operations together with the unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K for the year ended December 31, 2023 (the "2023 Annual Report"). Some of the information contained in this discussion and analysis or set forth elsewhere in this Quarterly Report, including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. As a result of many factors, including those factors set forth in the section titled "Risk Factors," in our 2023 Annual Report and in other reports we have filed or may file with the SEC, our actual results could differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

Overview

We are an artificial intelligence ("AI") company focused on predictive medical diagnostics. We operate in one segment. Currently, we are devoting substantially all of our efforts towards research and development of our DeepView® System, an internally developed multi-spectral imaging device that has previously received FDA breakthrough device designation status for an earlier version. Given our recent receipt of the UKCA mark for burn indication on our DeepView® System, we expect to begin commercialization activities in the United Kingdom in the second half of 2024. Our DeepView® System uses proprietary algorithms to distinguish between damaged and healthy human tissue invisible to the naked eye, providing "Day One" healing assessments. DeepView's output is specifically engineered to allow the physician to make a more accurate, timely and informed decision regarding the treatment of the patient's wound. Our focus from 2013 through 2021 was on the burn indication, which we expanded to also include the diabetic foot ulcer ("DFU") indication in 2022.

For burn wounds, a non-healing assessment could aid the clinician in making an immediate and objective determination for appropriate candidates for surgery, as well as determining what specific areas of the burn wound will require excision and skin grafting. We have conducted three large clinical studies with multiple sites across the United States, enrolling 413 burn patients, including 329 adult and 84 pediatric patients. Through these studies, we were able to quantify the burn assessment accuracy in patients undergoing both surgical and non-surgical treatment. In December 2023 we initiated a pivotal clinical study seeking enrollment of 240 patients, including 180 adult and 60 pediatric patients through multiple sites across the United States in both burn center and emergency departments. By the end of the third quarter of 2024, the Company had completed the enrollment of 169 patients at burn centers, finishing that portion of the overall study.

In the case of DFUs, our DeepView® System provides an assessment in seconds as to the non-healing portions of a DFU. The non-healing assessment could provide the physician with an objective assessment to use an advanced wound care therapy on "Day One" as opposed to the current approach that involves waiting up to 30 days to see how the wound develops before making such clinical assessment.

We have not generated any product revenue to date. We have received substantial support from the U.S. government for our DeepView® System 's application for burn wounds, particularly from the Biomedical Advanced Research and Development Authority ("BARDA"), which is part of the HHS Office of the Assistant Secretary for Preparedness and Response in the United States, established to aid in securing the United States from chemical, biological, radiological, and nuclear threats, as well as from pandemic influenza and emerging infectious diseases. We have also received funding from the National Science Foundation (the "NSF"), the National Institute of Health (the "NIH") and the Defense Health Agency (the "DHA"). Since 2013, we have received approximately $281.0 million in funding awards from government contracts, primarily from BARDA, which accounts for $272.9 million. This has allowed us to develop our technology and further our clinical trials.

In September 2023, we executed our third contract with BARDA for a multi-year Project BioShield ("PBS") agreement, valued at up to approximately $150.0 million (the "PBS BARDA Contract"). This multi-year contract includes an initial award of nearly $54.9 million to support the clinical validation and FDA clearance of DeepView® for commercial marketing and distribution purposes, which we expect to continue through the first quarter of 2026. This contract funding is non-dilutive to our shareholders, and we believe it validates the important nature of our mission and technology.

In addition to our PBS BARDA Contract, we received a $4.0 million grant award from the Medical Technology Enterprise Consortium ("MTEC") in April 2023, which, building on prior awards from DHA, is to be used to support military battlefield burn evaluation via a handheld version of the DeepView® System (the "MTEC Agreement"). In August 2024, the MTEC award was increased to $4.9 million and is currently intended to run through December 2025 with funding dependent on various milestones. In September 2024, we received an additional $0.9 million from MTEC for further development of the handheld device. In March 2024, we received an additional $0.5 million award from the Defense Health Agency to further this development.

Once commercialized, we anticipate that the DeepView® System will have two revenue streams, a SaMD (software as a medical device) model, and an imaging device component. The SaMD model applies a SaaS (software as a service) treatment for the DeepView® System which will feature a software licensing fee that includes maintenance, image hosting, and access to algorithm updates. The proprietary imaging device accesses artificial intelligence algorithms and is a universal platform to house multiple clinical applications. Pricing for these components will be evaluated and strategically set per country and site-of-service for heightened customer adoption.

Business Combination

On September 11, 2023, we consummated a business combination, pursuant to the business combination agreement dated April 11, 2023 by and among the Company (previously, Rosecliff Acquisition Corp I (“Rosecliff”)), Ghost Merger Sub I (a wholly owned subsidiary of Rosecliff), Ghost Merger Sub II (a wholly owned subsidiary of Rosecliff) and Spectral MD Holdings, Ltd. (“Legacy Spectral”). Upon the closing of the Business Combination (the “Closing”), in sequential order: (a) Ghost Merger Sub I merged with and into Legacy Spectral, with Legacy Spectral continuing as the surviving company as our wholly owned subsidiary (the “Spectral Merger”) and then, (b) Legacy Spectral merged with and into Ghost Merger Sub II (the “SPAC Merger”, together with the Spectral Merger (the “Business Combination”)), with Ghost Merger Sub II (renamed Spectral MD Holdings LLC) surviving the SPAC Merger as our direct wholly-owned subsidiary. Upon the Closing, we changed our name from Rosecliff Acquisition Corp I to Spectral AI, Inc. In addition to our Common Stock, we currently have 8,433,333 redeemable warrants (the “Public Warrants”) and 73,978 warrants (“SP Angel Warrants”) to SP Angel Corporate Finance LLP remaining outstanding.

On September 12, 2023, the Company began trading its shares of the Company Common Stock and the Public Warrants on the Nasdaq Global Market (the “Nasdaq”) under the symbols “MDAI” and “MDAIW”, respectively.

The Business Combination was accounted for as a reverse recapitalization in accordance with GAAP. Under the guidance in Accounting Standards Codification (“ASC”) 805, Business Combinations, Rosecliff, which is the legal acquirer, has been treated as the “acquired” company for financial reporting purposes and the Company has been treated as the accounting acquirer. This determination was primarily based on the following:

(i) Legacy Spectral’s former shareholders maintained a majority of the voting power of the Company;

(ii) Legacy Spectral’s senior management comprises all of the senior management of the Company;

(iii) Legacy Spectral selected five of the six of the directors for the Board of Directors of the Company;

(iv) Legacy Spectral’s relative size of assets and operations compared to Rosecliff; and

(v) Legacy Spectral’s operations comprised the ongoing operations of the Company.

Accordingly, for accounting purposes, the Business Combination was treated as the equivalent of a capital transaction in which Legacy Spectral issued stock for the net assets of Rosecliff prior to the Closing. Upon the Closing, the net assets of Rosecliff are stated at fair value, with no goodwill or other intangible assets recorded. All historical financial information presented in the consolidated financial statements represents the accounts of Legacy Spectral at their historical cost as if Legacy Spectral is the predecessor to the Company. Upon consummation of the Business Combination, Spectral AI has continued as an SEC-registered and Nasdaq-listed company. The consolidated financial statements following the Closing reflect the results of the Combined Company’s operations.

Key Operating and Financial Metrics

We regularly review a number of metrics, including the following key operating and financial metrics, to evaluate our business, measure our performance, identify trends in our business, prepare financial projections and make strategic decisions. We believe the operating and financial metrics presented are useful in evaluating our operating performance, as they are similar to measures by our public competitors and are regularly used by security analysts, institutional investors, and other interested parties in analyzing operating performance and prospects. Adjusted EBITDA is a non-GAAP measure, as it is not a financial measure calculated in accordance with GAAP and should not be considered as a substitute for net (loss) income, calculated in accordance with GAAP. See “Non-GAAP Financial Measures” for additional information on adopted non-GAAP financial measures and a reconciliation of these non-GAAP measures to the most comparable GAAP measures.

Comparison of Three and Nine months ended September 30, 2024 and 2023

The following table summarizes these metrics for the three and nine months ended September 30, 2024 and 2023 (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	**2023**	**2024**	**2023**
	(In thousands)			
Research and development revenue	$ 8,173	$ 3,440	21,977	$ 12,769
Gross Profit	3,667	1,472	9,926	5,444
Gross margin	44.9%	42.8%	45.2%	42.6%
Operating loss	(886)	(4,166)	(5,471)	(10,055)
Net loss	(1,504)	(10,629)	(7,573)	(17,308)
Adjusted EBITDA	(711)	(3,885)	(4,606)	(9,073)

See “Non-GAAP Financial Measures” below for a reconciliation of net loss to Adjusted EBITDA.

Research and Development Revenue

We define research and development revenue as revenue generated from the research, testing and development of our DeepView® System as utilized in connection with our burn indication. This research and development revenue reflects applied research and experimental development costs relating to our burn application as developed in connection with our BARDA, MTEC, and DHA contracts.

Gross Profit and Gross Margin

We define gross profit as research and development revenue, less cost of revenue, and define gross margin, expressed as a percentage, as the ratio of gross profit to revenue. Gross profit and gross margin can be used to understand our financial performance and efficiency and as we begin commercialization, it will allow investors to evaluate our pricing strategy and compare against our competitors. Our management uses these metrics to make strategic decisions, pricing decisions, identify areas for improvement, set targets for future performance and make informed decisions about how to allocate resources going forward.

Adjusted EBITDA

We define adjusted earnings before interest, tax, depreciation and amortization (“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. See “Non-GAAP Financial Measures” for a reconciliation of GAAP net loss to Adjusted EBITDA.

Key Factors that May Influence Future Results of Operations

Our financial results of operations may not be comparable from period to period due to several factors. Key factors affecting our results of operations are summarized below.

Revenue Sources. As a pre-commercialization company, we currently generate revenue almost exclusively from two U.S. governmental agencies. We are highly dependent upon the continuation of the existing U.S. governmental contract awards, as well as future governmental procurement or other awards. Our operating results may not be comparable between periods as the timing and amount of awards or procurements from the U.S. government may be inconsistent with the timing of prior awards and the phasing of the development study schedules may be different. Our revenues may continue to be almost exclusively dependent upon the terms of those awards.

Gross Margin. When we begin commercial sales of the DeepView® System , we may need to determine lower pricing and incentives to accelerate adoption and implementation of the DeepView® System , which may negatively impact future revenue and gross margin percentages.

Managing our Supply Chain. We are reliant on contract manufacturers and suppliers to produce our components. While we have not been subject to any disruptions in our current limited production, we may be subject to component shortages, which may cause delays in critical components and inventory, longer lead times, increased costs and delays in product shipments. Our ability to grow depends, in part, on the ability of our contract manufacturers and suppliers to provide high quality services and deliver components and finished products on time and at reasonable costs. While we do not maintain sole-source suppliers, there is a concentration of suppliers which could lead to supply shortages, long lead times for components and supply changes. In the event we are unable to mitigate the impact of delays and/or price increases in raw materials, electronic components and freight, it could delay the manufacturing and installation of our products, which would adversely impact our cash flows and results of operations, including revenue and gross margin.

Components of Consolidated Statements of Operations

Research and Development Revenue

Our primary source of revenue is research and development revenue. Currently, we are highly dependent upon the reimbursements from BARDA for the burn diagnostic testing of our DeepView® System. Our research and development revenue is affected by the amount of research and development that is expended each month with respect to our PBS BARDA Contract and other U.S. governmental contract awards. During 2023, we received a grant under the MTEC Agreement, which we earn based on the achievement of milestones. Our revenue growth is dependent on a number of factors including expanding the research and development expense under the PBS BARDA Contract, research and development reimbursed expenses relating to other contract awards from U.S. governmental agencies and the intended future commercial sales of our DeepView® System.

Cost of Revenue

Our cost of revenue consists primarily of direct and indirect costs associated with the research and development expenses relating to the PBS BARDA Contract and MTEC Agreement. Our cost of revenue is affected by the extent of research and development expenses as well as expansion of work on other U.S. governmental projects and the expanded applications for our DeepView® System.

Gross Profit

Gross profit may vary from period-to-period and is primarily affected by the current reimbursement rates under the PBS BARDA Contract and other U.S. governmental contract awards, as well as the percentage of revenue related to the PBS BARDA Contract as compared to the MTEC project. These reimbursement rates are fixed under each contact award. Our gross profit represents this reimbursement rate plus a variable component relating to non-reimbursed expenses incurred in connection with the work completed on these contracts.

Operating Costs and Expenses

Operating costs and expenses consist of general and administrative expense. These expenses primarily relate to salaries and related costs of our organization's support and operations staff, consulting fees, rent, insurance and office expenses, and our non-revenue generating research and development expenses, primarily related to salaries and related costs and consulting fees.

Other income (expense)

In 2024, other income (expense) consists of fees incurred in connection with the Yorkville transaction and B. Riley purchase agreement, net interest income, borrowing related costs related to the Yorkville convertible notes, change in fair value of notes payable, change in fair value of warrant liabilities, changes in fair value of derivatives, and foreign exchange transaction gains/losses. In 2023, other income (expense) consists of transaction costs related to the Business Combination, net interest income, change in fair value of warrant liabilities and foreign exchange transaction gain/losses. Historic foreign exchange transaction loss primarily relates to changes in the exchange rate between the U.S. dollar and the British pound sterling 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.

Results of Operations

The following table summarizes of our results of operations for the three and nine months ended September 30, 2024 and 2023 (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	2023	2024	2023
	(In thousands)			
Research and development revenue	8,173	$ 3,440	21,977	$ 12,769
Cost of revenue	(4,506)	(1,968)	(12,051)	(7,325)
Gross profit	3,667	1,472	9,926	5,444
Operating costs and expenses:				
General and administrative	4,553	5,638	15,397	15,499
Total operating costs and expenses	4,553	5,638	15,397	15,499
Operating loss	(886)	(4,166)	(5,471)	(10,055)
Other income (expense):				
Net interest (expense) income	(8)	42	-	128
Borrowing related costs	(1,059)	-	(2,034)	-
Change in fair value of warrant liability	350	1,069	718	1,004
Change in fair value of notes payable	94	-	(7)	-
Foreign exchange transaction (loss) gain, net	(9)	(24)	(34)	(11)
Other income (expenses), including transaction costs	51	(7,604)	(617)	(8,342)
Total other expense, net	(581)	(6,517)	(1,974)	(7,221)
Loss before income taxes	(1,467)	(10,683)	(7,445)	(17,276)
Income tax provision	37	54	(128)	(32)
Net loss	(1,504)	$ (10,629)	(7,573)	$ (17,308)

Research and Development Revenue

	Three Months Ended September 30,		Change in		Nine months ended September 30,		Change in	
	2024	2023	$	%	2024	2023	$	%
	(In thousands, except percentages)							
Research and development revenue	$ 8,173	$ 3,440	$ 4,733	137.6%	$ 21,977	$ 12,769	$ 9,208	72.1%

Research and development revenue was $8.2 million and $22.0 million for the three and nine months ended September 30, 2024, respectively, an increase of 137.6% and 72.1%, respectively, compared to the comparable periods in 2023, reflecting more activity as we completed work under the PBS BARDA Contract and in the awards and work performed under the Company's other U.S. governmental contracts.

For the three and nine months ended September 30, 2024 and 2023, the Company's revenues disaggregated by the major sources was as follows:

	Three Months Ended September 30,		Change in		Nine months ended September 30,		Change in	
	2024	2023	$	%	2024	2023	$	%
	(In thousands, except percentages)							
BARDA	$ 7,567	$ 3,055	$ 4,512	147.7%	$ 20,734	$ 12,018	$ 8,716	72.5%
Other U.S. governmental authorities	606	385	221	57.4%	1,243	751	492	65.5%
Total research and development revenue	$ 8,173	$ 3,440	$ 4,733	137.6%	$ 21,977	$ 12,769	$ 9,208	72.1%

Cost of Revenues and Gross Profit

	Three Months Ended September 30,		Change in		Nine months ended September 30,		Change in	
	2024	2023	$	%	2024	2023	$	%
	(In thousands, except percentages)							
Cost of revenue	$ 4,506	$ 1,968	$ 2,538	129.0%	$ 12,051	$ 7,325	$ 4,726	64.5%
Gross profit	3,667	1,472	2,195	149.1%	9,926	5,444	4,482	83.3%
Gross margin	44.9%	42.8%			45.2%	42.6%		

Cost of revenue for the three and nine months ended September 30, 2024 was $4.5 million and $12.1 million, respectively, an increase of 129.0% and 64.5%, respectively, compared to the comparable periods in 2023, due to increased development activity to fulfill our U.S. governmental contracts, consistent with increased research and development revenue.

Gross margin for the three and nine months ended September 30, 2024 was 46.3% and 45.7%, respectively, representing an increase of 3.5% and 3.1%, respectively, as compared to the comparable periods in 2023, due to a higher reimbursement rate under the PBS BARDA Contract, executed in September 2023, than the rate in the BARDA Burn II contact.

General and Administrative Expense

	Three Months Ended September 30,		Change in		Nine Months Ended September 30,		Change in	
	2024	2023	$	%	2024	2023	$	%
	(In thousands, except percentages)							
General and administrative expense	$ 4,553	$ 5,638	$ (1,085)	(19.2)%	$ 15,397	$ 15,499	$ (102)	(0.7)%

General and administrative expense was $4.6 million and $15.4 million for the three and nine months ended September 30, 2024, respectively, representing a decrease of 19.2% and 0.7%, respectively as compared to the comparable periods in 2023. Non-revenue generating research and development activities have decreased by approximately $1.0 million and $1.1 million for the three and nine months ended September 30, 2024 compared to the comparable periods in 2023 offset by an increase of approximately $1.1 million related to other administrative expenses for the nine months ended September 30, 2024, compared to the nine months ended September 30, 2023. Other administrative expenses for the three months ended September 30, 2024 decreased by less than $0.1 million, compared to the three months ended September 30, 2023.

Other income (expense)

	Three Months Ended September 30,		Change in	Nine months ended September 30,		Change in
	2024	2023	$	2024	2023	$
			(In thousands)			
Net interest (expense) income	$ (8)	$ 42	$ (50)	$ -	$ 128	$ (128)
Borrowing related costs	(1,059)	-	(1,059)	(2,034)	-	(2,034)
Change in fair value of warrant liability	350	1,069	(719)	718	1,004	(286)
Change in fair value of notes payable	94	-	94	(7)	-	(7)
Foreign exchange transaction loss, net	(9)	(24)	15	(34)	(11)	(23)
Other income (expenses), including transaction costs	51	(7,604)	7,655	(617)	(8,342)	7,725
Total other income (expense), net	$ (581)	$ (6,517)	$ 5,936	$ (1,974)	$ (7,221)	$ 5,247

Net interest (expense) income for the three and nine months ended September 30, 2024 primarily relates to cash interest received or (paid) by us from our deposit accounts.

Borrowing related costs increased $1.1 million and $2.1 million for the three and nine months ended September 30, 2024, respectively, compared to the comparable periods in 2023 due to debt issuance costs and payments of the discount and premium related to the Yorkville Convertible Notes that were expensed during the period.

Change in fair value of warrant liability decreased by $0.7 million and $0.3 million for the three and nine months ended September 30, 2024, respectively, as compared to the comparable periods in 2023. The decrease reflects changes in the fair value of the Public Warrants, which were issued in September 2023.

Change in fair value of notes payable increased by approximately $0.1 million and decreased less than $0.1 million for the three and nine months ended September 30, 2024, respectively, which reflects the total change in the fair value of the Yorkville notes issued 2024.

Other income (expenses), including transaction costs for the three and nine months ended September 30, 2024 primarily relate to legal, professional, and service fees incurred in connection with the Yorkville transaction and B. Riley purchase agreement. Other income (expenses), including 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, 2024 and 2023 (in thousands):

	Three Months Ended September 30,		Nine months ended September 30,	
	2024	2023	2024	2023
	(In thousands)			
Net loss	$ (1,504)	$ (10,629)	$ (7,573)	$ (17,308)
Adjust:				
Depreciation expense	2	2	7	7
Provision for income taxes	37	(54)	128	32
Net interest (income) expense	8	(42)	-	(128)
EBITDA	**(1,457)**	**(10,723)**	**(7,438)**	**(17,397)**
Additional adjustments:				
Stock-based compensation	173	279	858	975
Borrowing related costs	1,059	-	2,034	-
Change in fair value of warrant liability	(350)	(1,069)	(718)	(1,004)
Change in fair value of notes payable	(94)	-	7	-
Foreign exchange transaction (gain) loss	9	24	34	11
Other (income) expenses, including transaction costs	(51)	7,604	617	8,342
Adjusted EBITDA	**$ (711)**	**$ (3,885)**	**$ (4,606)**	**$ (9,073)**

Liquidity and Capital Resources

Sources of Liquidity

As of September 30, 2024, we had approximately $3.7 million in cash, short-term notes payable of $5.0 million, and $1.0 million of long-term debt. We had an accumulated deficit of approximately $40.3 million. Included in our cash balance is $0.9 million in cash in the Company's newly-formed wholly-owned subsidiary Spectral IP, Inc., a Delaware corporation ("Spectral IP") which was formed on March 7, 2024. See Notes 7 and 15 for further information.

On December 26, 2023, we entered into a Common Stock Purchase Agreement and related Registration Rights Agreement with B. Riley Principal Capital II, LLC ("B. Riley"). Upon the terms and subject to the satisfaction of the conditions set forth in the Common Stock Purchase Agreement, the Company has the right, in our sole discretion, to sell to B. Riley up to $10.0 million in aggregate gross purchase price of newly issued shares of the Company's Common Stock (the "ELOC").

On March 20, 2024, the Company also entered into a Standby Equity Purchase Agreement ("SEPA") with YA II PN, LTD, a Cayman Islands exempt limited partnership ("Yorkville") pursuant to which the Company has the right to sell to Yorkville up to $30.0 million of its shares of Common Stock, subject to certain limitations and conditions set forth in the SEPA. In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of convertible promissory notes an aggregate principal amount of up to $12.5 million (the "Pre-Paid Advance"), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $5.0 million with a fixed conversion price of $3.16. The Company received $4.6 million in cash, net of the 8% original issue discount. On May 14, 2024, the shareholders voted to approve the reservation and issuance of shares to Yorkville to exceed the Exchange Cap and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million, which is the $5.0 million second Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $2.03. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million. In connection with the execution and delivery of the SEPA, the Company may also drawdown $3.0 million from the ELOC prior to utilizing the SEPA.

We have historically funded our operations through the issuance of notes and the sale of preferred stock and common stock, along with payments under governmental contracts for research and development activity.

In September 2023, the Company executed its third contract with BARDA for a multi-year PBS BARDA Contract, valued at up to approximately \$150.0 million. This multi-year contract includes an initial award of nearly \$54.9 million to support the clinical validation and FDA clearance of DeepView® for commercial development and distribution purposes. The Company completed the second contract with BARDA, referred to as BARDA Burn II, which was signed in July 2019 and completed in November 2023. Under this contract, the Company furthered the DeepView® System design, developed the AI algorithm, and took steps to obtain FDA approval.

In April 2023, the Company received a \$4.0 million grant under the MTEC Agreement, which was increased to \$4.9 million in August 2024 and is currently intended to run through December 2025. The MTEC Agreement is for the development of a handheld version of the DeepView® System which is to be used to support military battlefield burn evaluation. The project has three phases, beginning with planning, design and testing; followed by development, design modification and buildout of the handheld device; and then the manufacturing of the handheld device.

Based on our current operating plan, we believe that our cash and cash equivalents, together with the PBS BARDA Contract, the MTEC Agreement, the B. Riley ELOC, and the Yorkville Transaction, will be sufficient to fund operations for at least one year beyond the release date of these condensed consolidated financial statements. We have based this determination on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect. The Company could utilize cost-savings measures to limit the expenditures of our DFU indication to conserve our working capital and to focus our efforts primarily on the burn indication. Changing circumstances could also cause us to consume capital significantly faster than we currently anticipate, and we may need to raise capital sooner or in greater amounts than currently expected because of circumstances beyond our control. Changes in the current equity markets may also limit our ability to utilize the B. Riley ELOC and Yorkville Transaction as currently structured. To the extent additional capital is necessary, there are no assurances that we will be able to raise additional capital on favorable terms or at all, and therefore we may not be able to execute our business plans and the continued work on indications beyond expanding our burn indication.’

Our future capital requirements will depend on many factors, including the revenue growth rate, the success of future product development and capital investment required, and the timing and extent of spending to support further sales and marketing and research and development efforts. In addition, we expect to incur additional costs as a result of operating as a U.S. public company. If we are unable to raise additional capital when desired, our business, operating results, and financial condition could be adversely affected.

Cash Flows

The following table summarizes our cash flows for the nine months ended September 30, 2024 and 2023 (in thousands):

	Nine months ended September 30,	
	2024	**2023**
Net cash used in operating activities	\$ (9,668)	\$ (10,865)
Net cash provided by financing activities	8,567	4,039

Cash Flows Used in Operating Activities

Net cash used in operating activities increased by approximately \$1.2 million for the nine months ended September 30, 2024, as compared to the nine months ended September 30, 2023 primarily driven by changes in operating liabilities including accrued expenses and deferred revenue, partially offset by a decrease in net loss. The lower net loss is a result of higher research and development revenue due to increased BARDA activity and lower non-operating transaction costs in the nine months ended September 30, 2024 compared to the same period in 2023.

Cash Flows Provided by Financing Activities

Net cash provided by financing activities increased approximately $4.5 million for the nine months ended September 30, 2024 compared to the nine months ended September 30, 2023. This was primarily attributable to the proceeds of $2.7 million from the ELOC, proceeds of $12.5 received from notes payable principally from the Pre-Paid Advances under the SEPA, partially offset by $6.6 million of repayments of notes payable as compared to proceeds of $3.4 million from the issuance of Common Stock and operating cash received upon closing of the Business Combination of $0.7 million during the nine months ended September 30, 2023.

Current Indebtedness

On March 20, 2024, the Company entered into the SEPA with Yorkville pursuant to which the Company has the right to sell to Yorkville up to $30.0 million of its shares of Company Common Stock, subject to certain limitations and conditions set forth in the SEPA, from time to time during the term of the SEPA (such transaction, the "Yorkville Transaction"). In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of convertible promissory notes (the "Convertible Notes") an aggregate principal amount of up to $12.5 million (the "Pre-Paid Advance"), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $5.0 million with a fixed conversion price of $3.16. The Company received $4.6 million in cash, net of the 8% original issue discount. On May 14, 2024, the shareholders voted to approve the reservation and issuance of shares to Yorkville to exceed the Exchange Cap and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million, which is the $5.0 million second Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $2.03. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million with a fixed conversion price equal to 120% of the average VWAP during the three trading days immediately prior to the issuance of the note. The purchase price for the Pre-Paid Advance is 92.0% of the principal amount of the Pre-Paid Advance. Interest shall accrue on the outstanding balance of any Pre-Paid Advance at an annual rate equal to 0%, subject to an increase to 18% upon an event of default as described in the Convertible Notes.

Beginning on the forty-fifth (45th) day following the issuance date of the Convertible Note issued in connection with the first Pre-Paid Advance, and continuing on the same day of each successive month thereafter, (each, an "Installment Date"), the Company shall repay a portion of the outstanding balance of the Pre-Paid Advance in an amount equal to (i) $1,750,000, plus (ii) the a payment premium of 7% of such Installment Principal Amount, and (iii) accrued and unpaid interest hereunder as of each Installment Date. The maturity date of the Convertible Notes issue in connection with each Pre-Paid Advance will be 12 months after the issuance date of such Convertible Notes. In October 2024, the Company and Yorkville agreed to amend the dates and the allocation of installment amounts to be paid pursuant to the Pre-Paid Advances, such that the outstanding balance of the Pre-Paid Advances is to be paid by February 2025. As of September 30, 2024, the Company has made aggregate installment payments on the Pre-Paid Advances in the amount of $8.3 million, of which $7.2 million was settled in cash and $2.1 million was settled in shares. Of the aggregate installment payments, $7.1 million relates to the repayment of the principal, $0.6 million relates to the 8% original issue discount and $0.6 million relates to the 7% payment premium.

Related Party Transactions

On March 7, 2024, the Company formed a new wholly-owned subsidiary, Spectral IP, to be utilized to acquire artificial intelligent intellectual property with a specific emphasis on healthcare. On March 19, 2024, the Company announced that Spectral IP received a $1.0 million investment from an affiliate of its largest shareholder for the development of its artificial intelligence intellectual property portfolio. The investment is structured as a note payable with a one-year maturity, an interest rate of 8%, and requiring earlier prepayment if the Company spins off Spectral IP to the Company's shareholders or if Spectral IP is sold to a third party. See Note 15 for further information.

Off-Balance Sheet Arrangements

During the periods presented, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Critical Accounting Policies

Our management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of these condensed consolidated financial statements and related disclosures requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, costs and expenses and the disclosure of contingent assets and liabilities in our financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates which include, but are not limited to, accrued expenses, stock-based compensation expense, and income taxes. We base our estimates on historical experience, known trends and events and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions.

Our critical accounting policies are described under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies" in our Annual Report on Form 10-K for the year ended December 31, 2023, which was filed with the SEC on March 29, 2024.

Recent Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, of the notes to our condensed consolidated financial statements included elsewhere in this Form 10-Q for recently adopted accounting standards and recently issued accounting standards as of the dates of the statement of financial position included in this Form 10-Q.

Emerging Growth Company

We are an emerging growth company, as defined in the JOBS Act. 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. This provision allows an emerging growth company to delay the adoption of some accounting standards until those standards would otherwise apply to private companies. We have elected to use the extended transition period under the JOBS Act for the adoption of certain accounting standards until the earlier of the date we (i) are no longer an emerging growth company or (ii) affirmatively and irrevocably opt out of the extended transition period provided in the JOBS Act. As a result, our financial statements may not be comparable to companies that comply more promptly with new or revised accounting pronouncements as of public company effective dates.

In addition, as an emerging growth company, we may take advantage of specified reduced disclosure and other requirements that are otherwise applicable generally to public companies. These provisions include:

- being permitted to present only two years of audited consolidated financial statements in addition to any required unaudited interim consolidated financial statements, with correspondingly reduced disclosure in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations";

- an exception from compliance with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, as amended;

- reduced disclosure about our executive compensation arrangements in our periodic reports, proxy statements and registration statements;

- exemptions from the requirements of holding non-binding advisory votes on executive compensation or golden parachute arrangements; and

We may take advantage of these provisions until the last day of the fiscal year ending after the fifth anniversary of the Company's initial public offering or such earlier time that we no longer qualify as an emerging growth company. We will cease to qualify as an emerging growth company on the date that is the earliest of: (i) December 31, 2026; (ii) the last day of the fiscal year in which we have more than $1.235 billion in total annual gross revenues; (iii) the date on which we are deemed to be a "large accelerated filer" under the rules of the SEC, which means the market value of our common stock that is held by non-affiliates exceeds $700.0 million as of the prior September 30th and we have been a public company for at least 12 months and have filed one annual report on Form 10-K; or (iv) the date on which we have issued more than $1.0 billion of non-convertible debt over the prior three-year period. We may choose to take advantage of some but not all of these reduced reporting burdens. Accordingly, the information contained herein may be different than you might obtain from other public companies in which you hold equity interests.

We are also a “smaller reporting company.” If we are a smaller reporting company at the time we cease to be an emerging growth company, we may continue to rely on exemptions from certain disclosure requirements that are available to smaller reporting companies. Specifically, as a smaller reporting company, we may choose to present only the two most recent fiscal years of audited consolidated financial statements in our Annual Report and, similar to emerging growth companies, smaller reporting companies have reduced disclosure obligations regarding executive compensation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate, foreign exchange, credit and inflation risks.

Interest Rate Sensitivity

We maintain a large amount of our assets in cash. Our cash is held primarily in cash deposits. The fair value of our cash would not be significantly affected by either an increase or decrease in interest rates due mainly to the short-term nature of these instruments. Additionally, changes to interest rates will impact on the cost of any future borrowings. With respect to our current borrowings, the interest rates on the notes are fixed. Changes in prevailing interest rates could have a material impact on our results of operations.

Foreign Currency Risk

Our revenue is denominated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States and UK, with an insignificant portion of expenses incurred in our wholly owned subsidiaries in the UK and denominated in British pound sterling.

Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of cash and accounts receivable. The vast majority of our cash is held in U.S. financial institutions which, at times, exceed federally insured limits. We have not recognized any losses from credit risks on such accounts. We believe we are not exposed to significant credit risk on cash.

Additional credit risk is related to our concentration of receivables and revenues. One customer (which is a U.S. government agency) represents the majority of our research and development revenue and accounts receivable.

Inflation Risk

The recent increase in inflation partially contributed to the increase in the cost of our research and development as well as operating costs. If the cost of our products, employee costs, or other costs continue to be subject to significant inflationary pressures, such inflationary pressure may have an adverse effect on our ability to maintain current levels of gross margin and selling, general and administrative expense. As a result, our inability to quickly respond to inflation could harm our cash flows and results of operations in the future.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, including our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on management's evaluation as of the quarter ended September 30, 2024, our Chief Financial Officer have concluded that, as a result of the material weaknesses in our internal control over financial reporting as described below and in Part II, Item 1A. Risk Factors, our disclosure controls and procedures were not effective as of September 30, 2024. In connection with the preparation of our consolidated financial statements for the year ended December 31, 2023, we identified material weaknesses in: (i) lack of communication within management and internal departments regarding complex and unusual arrangements. This resulted in communication failures of relevant facts necessary for the accounting group to properly conclude and apply the required accounting treatment of certain stock transactions; (ii) the Company did not maintain adequately designed controls to ensure the proper recording of operating expenses, related accruals and unbilled revenue in the correct period. As a result, certain control activities in the accrual and unbilled revenue processes were not designed and implemented effectively; and (iii) our financial statement close process controls which relate to all financial statement accounts, did not consistently operate effectively or lacked appropriate evidence, to ensure account reconciliations, transactions, and journal entries were performed or reviewed at the appropriate level of precision and on a timely basis. These control deficiencies could result in a material misstatement of our accounts or disclosures that would not be prevented or detected on a timely basis, and accordingly, we determined that these control deficiencies in aggregate constitute a material weakness.

Notwithstanding the identified material weaknesses, our management believes that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows as of and for the periods presented in accordance with U.S. GAAP.

Remediation Plan for Material Weaknesses

Remediation generally requires making changes to how controls are designed and implemented and then adhering to those changes for a sufficient period of time such that the effectiveness of those changes is demonstrated with an appropriate amount of consistency. In response to the material weaknesses, we implemented, and are continuing to implement, measures designed to improve our internal control over financial reporting. These efforts include:

- engaging a professional accounting services firm to help us assess and document our internal controls for complying with the Sarbanes-Oxley Act of 2002;

- strengthening, formalizing, documenting and testing accounting processes and internal controls, specifically regarding accrued expenses and contract reviews and improving the information flow throughout the organization to allow for timely communication of new agreements and transactions;

- enhancing functionality of our enterprise resource planning system to support certain key financial processes and controls and enforce certain segregation of duties through automation and approval workflows.

The measures we are implementing are subject to continued management review supported by confirmation and testing, as well as audit committee oversight. Management and the Audit Committee remain committed to the implementation of remediation efforts to address the material weaknesses. We will continue to implement measures to remedy our internal control deficiencies, though there can be no assurance that our efforts will be successful or avoid potential future material weaknesses. In addition, until remediation steps have been completed and are operated for a sufficient period of time, and subsequent evaluation of their effectiveness is completed, the material weaknesses previously disclosed, and as described above, will continue to exist.

Changes in Internal Control over Financial Reporting

Except for the remediation efforts in connection with the material weaknesses described above, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2024 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In September 2024, we received a letter with a draft Particulars of a Complaint from Stifel in which Stifel contends that the Company owes Stifel approximately $2,550,000 pursuant to a previous engagement letter entered into with Stifel on November 15, 2021 (the “Engagement Letter”). Stifel alleges that the Engagement Letter entitles them to a percentage of the value of the Company’s Business Combination with Rosecliff. The Company further believes that we have substantial factual, legal and contractual defenses to the claims presented and will vigorously contest the claims, if ultimately brought. The Company also believes it has meritorious claims it is entitled to assert against Stifel and one or more of its representatives. However, the results of litigation are inherently unpredictable and the possibility exists that the ultimate resolution of this matter could result in a material effect on our financial position, results of operations or liquidity.

Item 1A. Risk Factors

Factors that could cause our actual results to differ materially from those in this Quarterly Report include the risk factors described in our Annual Report on Form 10-K filed with the SEC on March 29, 2024 and in the Registration Statement on Form S-1 filed with the SEC on January 5, 2024, as amended. Any of those factors could result in a significant or material adverse effect on our results of operations or financial condition. Additional risk factors not presently known to us or that we currently deem immaterial may also impair our business or results of operations. As of the date of this Quarterly Report, there have been no material changes to the risk factors disclosed in our Annual Report on Form 10-K filed with the SEC on March 31, 2024, in the Registration Statement on Form S-4 filed with the SEC on January 5, 2024, as amended, and in the Registration Statement on Form S-3 filed with the SEC on October 16, 2024, except as listed below. We may disclose changes to such factors or disclose additional factors from time to time in our future filings with the SEC.

The Company is not currently in compliance with the continued listing requirements for The Nasdaq Stock Market. If the Company does not regain compliance and continue to meet the continued listing requirements, the Common Stock may be delisted, which could affect the market price and liquidity for the Company’s Common Stock and reduce the Company’s ability to raise additional capital. On June 3, 2024, the Company received a letter from the Listing Qualifications Staff of the Nasdaq Stock Market, LLC (“Nasdaq”) that the Company was not in compliance with the requirement of Rule 5550(b)(2) relating to the maintenance of a minimum market value of its listed securities of $35.0 million for the last 31 consecutive business days. Pursuant to Nasdaq Listing Rule 5810(c)(3)(C), the Company has 180 calendar days from receipt of a notice from Nasdaq (the “Compliance Period”), to regain compliance with the market value of listed securities requirement. If at any time before December 2, 2024, the closing market capitalization of the Company’s Common Stock closes at or above $35.0 million for a minimum of 10 consecutive business days, subject to Nasdaq’s discretion to extend this period pursuant to Nasdaq Listing Rule 5810(c)(3)(G) to 20 consecutive business days, Nasdaq will provide written notification that the Company has achieved compliance with the minimum market capitalization requirement, and the matter would be resolved. If the Company does not regain compliance during the review period ending December 2, 2024, then Nasdaq may grant the Company a second 180 calendar day period to regain compliance, provided the Company meets the continued listing requirement for all other initial listing standards for the Nasdaq, other than the minimum market value of listed securities requirement, and notifies Nasdaq of its intent to cure the deficiency.

Although alternative public and private transaction structures may be available, these may require additional time and cost, may impose operational restrictions on the Company, and may not be available on attractive terms. The Company’s inability to continue to raise capital with its Common Stock as listed on Nasdaq will harm its business, financial condition and results of operations, and will likely cause the Company’s stock value to further decline.

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

Yorkville Standby Equity Purchase Agreement

On March 20, 2024, the Company entered into the Yorkville Transaction pursuant to which the Company has the right to sell to Yorkville up to $30.0 million of its shares of Company Common Stock, subject to certain limitations and conditions set forth in the SEPA, from time to time during the term of the SEPA. In connection with the SEPA, and subject to the conditions set forth therein, Yorkville has agreed to advance to the Company in the form of the Convertible Notes an aggregate principal amount of up to $12.5 million (the “Pre-Paid Advance”), which will be paid in three tranches. The first Pre-Paid Advance was disbursed on March 20, 2024 in the amount of $5.0 million with a fixed conversion price of $3.16. The Company received $4.6 million in cash, net of the 8% original issue discount. On May 14, 2024, the shareholders voted to approve the reservation and issuance of shares to Yorkville to exceed the Exchange Cap and the second Pre-Paid Advance was disbursed on May 16, 2024 in the amount of $4.6 million, which is the $5.0 million second Pre-Paid Advance net of $0.4 million of the 8% original issue discount, with a fixed conversion price of $2.03. The third Pre-Paid Advance was disbursed on July 17, 2024 in the principal amount of $2.5 million with a fixed conversion price equal to 120% of the average VWAP during the three trading days immediately prior to the issuance of the note. The purchase price for the Pre-Paid Advance is 92.0% of the principal amount of the Pre-Paid Advance. Interest shall accrue on the outstanding balance of any Pre-Paid Advance at an annual rate equal to 0%, subject to an increase to 18% upon an event of default as described in the Convertible Notes.

Beginning on the forty-fifth (45th) day following the issuance date of the Convertible Note issued in connection with the first Pre-Paid Advance, and continuing on the same day of each successive month thereafter, (each, an “Installment Date”), the Company shall repay a portion of the outstanding balance of the Pre-Paid Advance in an amount equal to (i) $1,750,000, plus (ii) the a payment premium of 7% of such Installment Principal Amount, and (iii) accrued and unpaid interest hereunder as of each Installment Date. The maturity date of the Convertible Notes issue in connection with each Pre-Paid Advance will be 12 months after the issuance date of such Convertible Notes. In October 2024, the Company and Yorkville agreed to amend the dates and the allocation of installment amounts to be paid pursuant to the Pre-Paid Advances, such that the outstanding balance of the Pre-Paid Advances is to be paid by February 2025. As of September 30, 2024, the Company has made aggregate installment payments on the Pre-Paid Advances in the amount of $8.3 million, of which $7.2 million was settled in cash and $2.1 million was settled in shares. Of the aggregate installment payments, $7.1 million relates to the repayment of the principal, $0.6 million relates to the 8% original issue discount and $0.6 million relates to the 7% payment premium.

B. Riley Committed Equity Facility

On December 26, 2023, the Company entered into a Purchase Agreement with B. Riley, pursuant to which, upon the terms and subject to the satisfaction of the conditions contained in the Purchase Agreement, we have the right, in our sole discretion, to sell to B. Riley up to $10,000,000 of shares of the common stock (subject to certain limitations contained in the Purchase Agreement), from time to time during the term of the Purchase Agreement through a Market Open Purchase or an Intraday Purchase on any Purchase Date (each term as defined in the Purchase Agreement). Sales of Common Stock pursuant to the Purchase Agreement, and the timing of any sales, are solely at our option, and we are under no obligation to sell any securities to B. Riley under the Purchase Agreement.

Use of Proceeds

There has been no material change in the planned use of the proceeds from the Business Combination, as is described in the Company’s final prospectus (Registration No. 333-275218), as filed with the SEC on January 2, 2024. Additionally, there has been no material change in the planned use of proceeds from the ELOC or the Yorkville Transaction (Registration No. 333-278610), as is described in the Company’s final prospectus (Registration No. 333-276406), as filed with the SEC on February 1, 2024.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed as part of, or incorporated by reference into, this Quarterly Report on Form 10-Q:

No.	Description of Exhibit
2.1	Business Combination Agreement, dated as of April 11, 2023, by and among Rosecliff Acquisition Corp I, Ghost Merger Sub I Inc., Ghost Merger Sub II and Spectral MD Holdings Ltd. (incorporated by reference to the Company's Form 8-K, filed with the SEC on April 17, 2023).
31.1*	Certification of Principal Executive Officer
31.2*	Certification of Chief Financial Officer (Principal Financial and Accounting Officer)
32**	18 U.S.C. Section 1350 Certification
101.INS*	Inline XBRL Instance Document.
101.SCH*	Inline XBRL Taxonomy Extension Schema Document.
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Filed herewith.

** Furnished herewith.

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.

	SPECTRAL AI, INC.
Date: November 6, 2024	By: /s/ J. Michael DiMaio
	Name: J. Michael DiMaio
	Title: Chairman of the Office of the Chairman (Principal Executive Officer)
Date: November 6, 2024	By: /s/ Vincent S. Capone
	Name: Vincent S. Capone
	Title: Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION PURSUANT TO RULES 13A-14(A) AND 15D-14(A)

UNDER THE SECURITIES EXCHANGE ACT OF 1934,

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Michael DiMaio, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Spectral AI, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2024

/s/ J. Michael DiMaio

J. Michael DiMaio
Chairman of the Board
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION PURSUANT TO RULES 13A-14(A) AND 15D-14(A)

UNDER THE SECURITIES EXCHANGE ACT OF 1934,

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Vincent S. Capone, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Spectral AI, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and

    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2024

/s/ Vincent S. Capone

Vincent S. Capone
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Spectral AI, Inc. (the "Company"), does hereby certify, to such officer's knowledge, that:

The Quarterly Report on Form 10-Q for the period ended September 30, 2024 of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 6, 2024	/s/ J. Michael DiMaio
	Name: J. Michael DiMaio
	Title: Chairman of the Board (Principal Executive Officer)
Dated: November 6, 2024	/s/ Vincent S. Capone
	Name: Vincent S. Capone
	Title: Chief Financial Officer (Principal Financial and Accounting Officer)

These certifications are furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by such Act, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such certifications will not be deemed to be incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates them by reference.