Scientific Learning®

Quarterly Report
June 30, 2016

www.scilearn.com

2016 Q2 Chairman Letter

The second quarter of 2016 was a difficult hurdle, as expected, with two large deals to overcome from 2015. We planned our 2016 growth in the second half of the year, but we were hopeful we could pull a few of our large Q3 targeted transactions into Q2 and add to our string of four consecutive quarters of growth. Unfortunately, we were not successful in pulling any of our large transactions into Q2 as we were in 2014 and 2015. Total sales declined 37% for the quarter, but 21% year to date after a strong first quarter. In Q2, K-12 new business sales and renewals declined as expected, driven by the timing of large transactions. We are anticipating a strong third quarter with a solid pipeline of large transactions. We did have a record sales quarter with our consumer business where parent demand continues to be strong. Our strategic focus remains on Special Education, RTI3, ELL, and students of poverty across all four segments we serve: K-12, Consumer, International, and Clinical.

Our K-12 business sales were down 43% compared to Q2 2015 and down 25% for the first half of 2016 as compared to 2015, driven primarily by timing of large new deals in line with school district budgeting cycle. Renewal sales were down 20% in the quarter, but only 3% in the first half of the year, compared to 2015, primarily from timing of a few large renewal transactions. Although renewal sales were down for the quarter, renewal rates are tracking at expectation after an excellent first quarter. We remain optimistic about reaching our moderate full-year growth goal with a strong second half supported by a 10% increase in marketing leads in the first six months and strong sales pipeline.

Since starting our first ever free trial program in September, we have seen tremendous response in signups from new districts and schools with nearly 1,800 requests. This has been one of our most successfully planned and executed campaigns, as evidenced by our exceeding our cumulative goal of 1,500 new prospects signing-up by end of Q1 to try our solution at no charge for four months. This is allowing new K-12 educators to observe the power of Fast ForWord to quickly impact students' academic performance as well as their behavior to assist them in making a purchasing decision. This trial program is generating qualified leads and growing our 2016 pipeline, and it has already contributed $250,000 in year-to-date sales. We have over 1,200 schools that participated in the free trials and the rate at which we can convert these prospects primarily in Q3 will determine just how successful this program is; however, even a modest conversion rate should have a positive impact on sales in the second half of 2016.

The competitive bid we were awarded from the State of Arizona for an ELL Pilot Project involving up to 7,000 students over the next two years is now scheduled to get underway with the training of teachers and other staff prior to the opening of the new school year. The state has selected the school districts that will participate in this pilot project and the implementation and training plan is in place. We are very pleased to announce that we booked the initial year of licenses and services on July 1st. We will be working with the State of Arizona to demonstrate the power of our neuroscience-based intervention to wire the brain for English and then to provide individualized fluency practice for second language learners. Our personalized, digital tutor (Reading Assistant) models proficient English, provides corrective feedback along with assistance in pronunciation and definitions of specific words.

Our new partnership with Dr. Eric Jensen is increasing awareness and credibility for our neuroscience-based intervention. Dr. Jensen is a very strong voice amongst teachers and educational leaders on the importance of neuroplasticity in improving student performance, and a sought after presenter and renowned writer. We have two in-person and several virtual events planned in coordination with Dr. Jensen in the second half of 2016, with the goal to continue to raise awareness about the power and necessity of neuroplasticity in reaching students who struggle the most, particularly students of poverty.

In general, the U.S. K-12 funding environment continues to be positive for most states, and federal funding is stable and positive; however, a few states are being impacted by low oil prices and we are watching these states closely, including Texas, for any potential budget impact. We are pleased that ESEA was re-authorized and maintains its concentration on subgroups that include our focus areas of Special Education, ELL, and students of poverty. This is a major source of funding for our interventions. This improved environment is evident in our pipelines, which continue to be solid with improving quality as our sales organization matures and our marketing programs continue to be focused in Special Education, RTI 3, ELL, and students of poverty. Additionally, our message of FAST and ENDURING results is gaining traction because of its uniqueness and the exceptional research that allows us to make this claim. This message is appealing for schools and schools district serving students of poverty. There are a tremendous number of neuroscience research studies gaining national attention on the impact of poverty on the brain. We are finding that educational leaders and teachers are very interested in examining our solution in the context of poverty and exploring how cognitive interventions help these students close the achievement gap rapidly by quickly improving foundational skills.

Today, more than 2.6 million learners have used Scientific Learning software products, and since the introduction of MySciLearn platform in late 2011, over 575,000 learners have used our products online. Our Product Development team also continues to deliver innovative enhancements to our MySciLEARN platform, releasing the Manual RPI (Reading Progress Indicator) in May. Our customers are now able to trigger post-assessments with RPI using “Manual RPI”, which enables teachers to administer a manual test to supplement automatic assessments during crucial time periods; for example, at the end of a school year or end of semester. Advances in technology and protocol options, combined with high performance are removing obstacles to using our unique and intense learning interventions.

As previously mentioned, both our strategic and operating plans continue to focus on the students who are not prepared to fully participate in a rigorous academic environment. These are primarily students with specific learning disabilities, students of poverty, and/or English Language Learners. Our solutions produce fast and enduring results among these students who are most in need of help. Additionally, our non-K-12 segments (Consumer, International, and Clinical) are focused on these same students, producing important alignment across each of our target market segments. We are working hard to execute our plan, have built solid pipelines for the second half of the year in line with the traditional seasonality and budget cycles of the K-12 market. Our operating plan continues to be concentrated on entering new districts, aided by our free trial initiative, targeting students with the greatest need, proving the efficacy of our solutions, and then expanding. We believe this focus will keep our K-12 business on a growth path for the 2016 fiscal year and beyond. Q2 was a challenging sales quarter with large transactions to overcome compared to last year and the Arizona ELL Project delayed until July. Q3 is expected to be an exciting quarter with the Arizona Project booked and implementation getting underway, a large expansion and renewal in Texas booked, and other significant transactions in process along with a solid pipeline of other potential Q3 transactions.

Financial Highlights:

- Booked sales for the second quarter of 2016 were $3.3 million compared to $5.2 million in the second quarter of 2015.
    - K-12 booked sales were $2.2 million for the second quarter of 2016, a decrease of 43% as compared to the second quarter of 2015. The overall decrease in sales is mostly attributable to our inability to pull forward a few large deals into Q2, as compared to last Q2 where we pulled in over $1.1 million in large deals, and a similar pattern in 2014. Also, our operating plan expected a Q2 start of our Arizona ELL pilot, which was delayed to July 1st. Although the timing of this year’s growth will be in the second half of the year, we still expect our second consecutive year of modest sales growth.
    - Non-K-12 booked sales decreased 19% for the second quarter of 2016 compared to the second quarter of 2015. This decrease was driven primarily by lower sales in our clinical segment and timing of International sales, offset by an all-time record sales quarter for the Consumer business. We are expecting the Consumer segment to continue double digit growth throughout 2016.

- Revenue decreased for the second quarter by 5% compared to the second quarter of 2015, driven by lower sales in 2016, while 2015 experienced revenue delays with several contracts with delayed start dates. Subscription revenues were up 9% and now account for 52% of total revenue as of June 30, 2016 compared to 47% in the second quarter of 2015.
- Operating loss in the second quarter was $0.2 million compared to a loss of $0.3 million in the second quarter of 2015, driven primarily by expense savings in 2016. Our teams continue to be scrappy, eliminating unnecessary spending and getting more with each dollar spent.
- Net loss in the second quarter of 2016 was $0.2 million compared to a loss of $0.7 million in the second quarter of 2015. The relative improvement is primarily due to the change in valuation of outstanding warrants.
- We finished the quarter with $1.1 million in cash, flat to the cash balance at the end of the second quarter in 2015.

We remain convinced that Scientific Learning has the necessary ingredients for success. We have a suite of unique, patented learning innovations that produce fast and lasting results. These solutions are now delivered on our robust on-demand platform anytime, anywhere, including the iPad®, Chrome Browser, and Chromebook platforms as additional delivery options. We are serving markets with urgent need and growing accountability requirements. There is growing awareness of neuroplasticity and the importance of cognitive skill development to academic success. We have talented, dedicated employees committed to our important work. We have significantly reduced and aligned our cost structures to fit our transformation of the business model. Customer satisfaction is up, and more students each day are accessing our solutions on mobile technology as well as using more flexible protocols. We must continue to improve sales productivity through expansion of our existing customers, improving renewal rates, and adding more new school districts. We remain optimistic about the future.

Attached to this letter are our financial statements for the period ending June 30, 2016, as well as the disclosures according to the OTC Disclosure guidelines.

Your continued interest and support is most appreciated.

Robert C. Bowen
Chairman and Chief Executive Officer

Forward-Looking Statements

This letter contains forward-looking statements. Such statements are subject to substantial risks and uncertainties. Actual events or results may differ materially as a result of many factors, including but not limited to: anticipated future sales and financial results, general economic and financial conditions (including current adverse conditions in government budgets and the general economy); availability of funding to purchase the Company's products and generally available to schools, including the amount and duration of federal and state funding; the acceptance of new products and product changes in existing and new markets; acceptance of subscription and other recurring offerings; seasonality and sales cycles in Scientific Learning's markets; competition; the extent to which the Company's development, marketing, sales and implementation strategies are successful; the results from the Company's free trial program; personnel changes; and the Company's ability to continue to demonstrate the efficacy of its products. The Company disclaims any obligation to update information contained in these forward-looking statements, whether as a result of new information, future events, or otherwise.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

		June 30, 2016		December 31, 2015
Assets				
Current assets:				
Cash and cash equivalents	$	1,051	$	3,513
Accounts receivable, net of allowance for doubtful accounts of $25 and $14, respectively		2,490		1,389
Prepaid expense and other current assets		277		721
Total current assets		3,818		5,623
Property and equipment, net		806		667
Other assets		117		120
Total assets	$	4,741	$	6,410
Liabilities and stockholders' deficit				
Current liabilities:				
Accounts payable	$	214	$	41
Accrued liabilities		1,806		1,348
Deferred revenue		6,027		7,831
Total current liabilities		8,047		9,220
Deferred revenue, net of current		486		224
Subordinated debt		4,841		4,794
Warrant liability		1,438		903
Other liabilities		65		96
Total liabilities		14,877		15,237
Commitments and contingencies (see Note 10 to the consolidated financial statements)				
Stockholders' deficit:				
Common stock $0.001 par value: 40,000,000 authorized, 24,386,210 and 24,344,001 shares issued and outstanding as of June 30, 2016 and December 31, 2015, respectively, and additional paid-in capital		97,356		97,240
Accumulated deficit		(107,487)		(106,062)
Accumulated other comprehensive loss		(5)		(5)
Total stockholders' deficit		(10,136)		(8,827)
Total liabilities and stockholders' deficit	$	4,741	$	6,410

See accompanying notes to consolidated financial statements.

SCIENTIFIC LEARNING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Revenues:				
Subscription	$ 1,830	$ 1,760	$ 3,636	$ 3,438
License	182	193	387	536
Service and support	1,510	1,758	3,207	3,589
Total revenues	3,522	3,711	7,230	7,563
Cost of revenues:				
Cost of subscription	218	197	418	423
Cost of license	2	29	8	54
Cost of service and support	609	585	1,287	1,217
Total cost of revenues	829	811	1,713	1,694
Gross profit	2,693	2,900	5,517	5,869
Operating expenses:				
Sales and marketing	1,633	1,828	3,385	3,645
Research and development	578	568	1,184	1,156
General and administrative	738	844	1,484	1,694
Total operating expenses	2,949	3,240	6,053	6,495
Operating income (loss)	(256)	(340)	(536)	(626)
Interest and other income (expense), net	10	(339)	(886)	(574)
Income (loss) before provision for income tax	(246)	(679)	(1,422)	(1,200)
Provision for income taxes	1	2	3	5
Net income (loss)	$ (247)	$ (681)	$ (1,425)	$ (1,205)
Net income (loss) per share:				
Basic	$ (0.01)	$ (0.03)	$ (0.06)	$ (0.05)
Diluted	$ (0.01)	$ (0.03)	$ (0.06)	$ (0.05)
Weighted average shares used in computing net income (loss) per share:				
Basic weighted average shares outstanding	24,358	24,098	24,361	24,077
Diluted weighted average shares outstanding	24,358	24,098	24,361	24,077

See accompanying notes to consolidated financial statements.

SCIENTIFIC LEARNING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Net income (loss)	$ (247)	$ (681)	$ (1,425)	$ (1,205)
Other comprehensive loss:				
Foreign currency translation adjustments, net of tax	-	-	-	-
Comprehensive income (loss)	$ (247)	$ (681)	$ (1,425)	$ (1,205)

See accompanying notes to consolidated financial statements

SCIENTIFIC LEARNING CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Operating Activities:		
Net income (loss)	$ (1,425)	$ (1,205)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	191	182
Stock based compensation expense	117	113
Amortization of debt discount and deferred debt issuance cost	74	151
Increase (decrease) in fair value of warrant	535	147
Changes in operating assets and liabilities:		
Accounts receivable	(1,102)	(1,156)
Prepaid expenses and other current assets	416	441
Accounts payable	173	(60)
Accrued liabilities	459	205
Deferred revenue	(1,542)	(331)
Other liabilities	(21)	(39)
Net cash provided by (used in) operating activities	(2,125)	(1,552)
Investing Activities:		
Purchases of property and equipment and additions to capitalized development	(327)	(165)
Net cash provided by (used in) investing activities	(327)	(165)
Financing Activities:		
Borrowings under bank line of credit	-	232
Repayment of borrowings under bank line of credit	-	(232)
Repayment of borrowings under subordinated debt	-	(4,177)
Payments under capital lease	(10)	(5)
Proceeds from issuance of subordinated debt	-	5,000
Debt issuance cost	-	(47)
Net cash provided by (used in) financing activities	(10)	771
Effect of exchange rate changes on cash and cash equivalents	-	-
Increase (decrease) in cash and cash equivalents	(2,462)	(946)
Cash and cash equivalents at beginning of period	3,513	2,032
Cash and cash equivalents at end of period	$ 1,051	$ 1,086
Supplemental disclosure of cash flow information		
Cash paid for income taxes	$ 16	$ 7
Cash paid for interest	$ 4	$ 177
Non-cash financing activities		
Capital lease	$ 10	$ -

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Description of Business

Scientific Learning Corporation (the "Company") develops, distributes and licenses technology that accelerates learning by improving the processing efficiency of the brain.

The Company's patented products build learning capacity by rigorously and systematically applying neuroscience-based learning principles to improve the fundamental cognitive skills required to read and learn. To facilitate the use of the Company's products, the Company offers a variety of on-site and remote professional and technical services, as well as phone, email and web-based support. The Company sells primarily to K-12 schools in the United States through a direct sales force.

All of the Company's activities are in one operating segment.

The Company was incorporated in 1995 in the State of California and was reincorporated in 1997 in the State of Delaware.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary in Shanghai, China. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States ("U.S. GAAP"), requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent that there are material differences between these estimates and actual results, the Company's consolidated financial statements could be affected.

Interim Financial Information

The interim consolidated financial information as of June 30, 2016 and for the six months ended June 30, 2016 and 2015 is unaudited, and includes all necessary adjustments, which consisted only of normal recurring adjustments, for a fair presentation of the Company's financial position at such dates and the Company's results of operations and cash flows for those periods. The balance sheet as of December 31, 2015 has been derived from audited consolidated financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles ("GAAP") for annual financial statements. In addition, the results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results for the entire year ending December 31, 2016, or for any other period.

These unaudited, condensed consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and notes thereto contained in the Company's Annual Report for the year ended December 31, 2015, filed with the OTC Markets.

Critical Accounting Policies

In the ordinary course of business, we make a number of estimates and assumptions relating to the reporting of the Company's results of operations and financial position in the preparation of our condensed consolidated financial statements in conformity with GAAP. We included in our 2015 Annual Report discussion of our critical accounting policies that are particularly important to the presentation of the Company's financial position and results of operations and that require the use of our management's judgment. We have made no material changes to any of the critical accounting policies discussed in our 2015 Annual Report through June 30, 2016.

Net Income (loss) per Share

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share reflects the potential dilution of securities by adding common stock equivalents (computed using the treasury stock method) to the weighted-average number of common shares outstanding during the period, if dilutive.

For the six months ended June 30, 2016, stock options exercisable for 2.4 million shares of common stock along with common stock warrants exercisable for 5.5 million shares of common stock were excluded from the calculation of diluted net loss per share because their effect is anti-dilutive.

New Accounting Pronouncements Adopted

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"), which simplifies the presentation of debt issuance costs by requiring debt issuance costs to be presented as a deduction from the corresponding debt liability rather than an asset that is amortized. The recognition and measurement guidance for debt issuance costs is not affected by the standards. The Company adopted the standards in the six months ended June 30, 2016. Upon adoption, the unamortized debt issuance costs previously reported in Other assets, net, with a carrying amount of approximately $36,000, were reclassified and presented as a deduction of the corresponding subordinated debt liabilities.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606*). This new standard will replace most existing U.S. GAAP guidance on this topic. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective for the Company beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact of adopting this new accounting standard on its consolidated financial statements and has not selected a transition method.

In November 2015, the FASB issued an ASU No. 2015-17, *Income Taxes (Topic 740).* ASU 2015-17 amends the accounting for income taxes and requiring all deferred tax assets and liabilities to be classified as non-current on the consolidated balance sheet. The ASU is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The ASU may be adopted either prospectively or retrospectively. The Company is currently evaluating the method of adoption.

In February 2016, the FASB issued ASU No. 2016-02, "*Leases (Topic 842)*," which requires lessees to recognize a right-of-use asset and lease liability for all leases with terms of more than 12 months. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. ASU 2016-02 is effective for the Company on December 15, 2018. The Company is currently assessing the impact of the adoption of this new accounting standard on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09 "Compensation – Stock Compensation," which amends the accounting for stock-based compensation and requires excess tax benefits and deficiencies to be recognized as a component of income tax expense rather than equity. This guidance also requires excess tax benefits to be presented as an operating activity on the statement of cash flows and allows an entity to make an accounting policy election to either estimate expected forfeitures or to account for them as they occur. The ASU is effective for reporting periods beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact of the ASU on the consolidated financial statements.

2. Warrant Liability

In connection with the Company's private common stock offering that closed on March 28, 2012, the Company issued warrants ("PIPE warrants") to purchase an aggregate of 2,505,852 shares of common stock. The warrants have an exercise price of $1.82 per share and expire five years from the date of issuance. In addition, the warrants contain a cash settlement provision that may be triggered upon request by the warrant holders if the Company is acquired or in the case of a merger event, as defined by the warrant agreement.

Additionally, in connection with the Company's subordinated debt financing completed on April 5, 2013, the Company issued warrants ("2013 Sub-debt warrants") to purchase an aggregate of 1,846,940 shares of common stock. The warrants have an exercise price of $1.03 per share and expire three years from the date of issuance. The warrants contain a cash settlement provision that may be triggered upon request by the warrant holders if the Company is acquired or in the event of a merger, as defined by the warrant agreement. As of June 30, 2016 these warrants had no value and have expired.

On April 6, 2015, in connection with the Company's re-financing of its subordinated debt, the Company issued warrants ("2015 Sub-debt warrants") to purchase an aggregate of 3,000,000 shares of the Company's common stock at an initial exercise price of $0.14 per share. The 2015 Sub-debt warrants expire five years from the date of issuance. The warrants contain a cash settlement provision that may be triggered upon request by the warrant holders if the Company is acquired or in the event of a merger, as defined by the warrant agreement.

Under the FASB Accounting Standards Codification ("ASC") Topic 815, *Derivatives and Hedging*, an equity contract that can be settled in cash at the request of the holder must be classified as an asset or a liability. The accounting guidance also requires that the warrants be re-measured at fair value at each reporting date, with the change in fair value recorded in the Company's consolidated statement of operations. See Note 3 to the consolidated financial statements. The fair value was estimated using the Black-Scholes-Merton option pricing model, which requires input of highly subjective assumptions as determined by management. To the extent these assumptions change in future periods, the fair value of the common stock warrants may increase or decrease and the change in fair value will be recorded in our results of operations. As of June 30, 2016, all non-expired common stock warrants were outstanding.

3. Fair Value Measurements of Financial Instruments

The Company generally invests its excess cash in money market funds. Cash and cash equivalents represents highly liquid instruments with insignificant interest rate risk and original maturities of three months or less.

The Company has established a three-tier fair value hierarchy, categorizing the inputs used to measure fair value. The hierarchy can be described as follows: Level 1- observable inputs such as quoted prices in active markets; Level 2- inputs other than the quoted prices in active markets that are observable either directly or indirectly; and Level 3- unobservable inputs for which there is little or no market data, which require the reporting entity to develop its own assumptions.

Cash equivalents consist of money market funds that have original maturities of 90 days or less. These instruments are valued using quoted prices in active markets and are classified in Level 1 of the fair value hierarchy. At June 30, 2016, the fair value of the money market instruments was $0.3 million, accounted for at fair value on a recurring basis by level in accordance with the fair value hierarchy described above.

At June 30, 2016, the Company had no borrowings outstanding under its credit line with Bridge Bank. The line of credit is measured at the carrying value at each reporting period and is classified as a current liability, as loan payable. The line of credit is classified as a Level 1 in the Company's fair value hierarchy. The fair value of the line of credit approximates the carrying value.

The Company has no Level 2 financial assets or liabilities as of June 30, 2016 and 2015.

At June 30, 2016 the Company had outstanding warrants to purchase shares of its common stock, which were issued on March 28, 2012 and April 6, 2015. The warrants are measured at fair value each reporting period and are classified as liabilities with a combined fair value of $1.4 million at June 30, 2016. The warrants are valued using the Black-Scholes-Merton option pricing model using valuation assumptions determined by management and are classified as Level 3 in the Company's fair value hierarchy. To the extent these assumptions change in future periods, the fair value of the common stock warrants may increase or decrease and the change in fair value will be recorded in our results of operations.

The Company used the following assumptions when determining the fair value of the PIPE warrants:

	June 30, 2016	December 31, 2015
Expected life (in years)	0.75	1.30
Risk-free interest rate	0.59 %	0.53 %
Dividend yield	0 %	0 %
Expected volatility	154 %	172 %

The Company used the following assumptions when determining the fair value of the 2013 Sub-debt warrants. These warrants expired on April 5, 2016:

	June 30, 2016	December 31, 2015
Expected life (in years)	0.00	0.30
Risk-free interest rate	0.00 %	0.2 %
Dividend yield	0 %	0 %
Expected volatility	0 %	127 %

The Company used the following assumptions when determining the fair value of the 2015 Sub-debt warrants:

	June 30, 2016	December 31, 2015
Expected life (in years)	3.77	4.30
Risk-free interest rate	0.82 %	1.59 %
Dividend yield	0 %	0 %
Expected volatility	100 %	100 %

The following table summarizes the Company's financial liabilities as of June 30, 2016, that are accounted for at fair value on a recurring basis by level in accordance with the fair value hierarchy described above, and the changes in fair value for the outstanding common stock warrants (*in thousands*):

	Six Months Ended June 30, 2016	
Balance at December 31, 2015	$	903
Total change in fair value		535
Balance at June 30, 2016	$	1,438

4. Warranties and Indemnification

The Company generally provides a warranty that the Company's software products substantially operate as described in the manuals and guides that accompany the software for a period of 90 days. The warranty does not apply in the event of misuse, accident, and certain other circumstances. To date, the Company has not incurred any material costs associated with these warranties and has no accrual for such items as of June 30, 2016.

From time to time, the Company enters into contracts that require the Company, upon the occurrence of certain contingencies, to indemnify parties against third party claims. These contingent obligations primarily relate to (i) claims against the Company's customers for violation of third party intellectual property rights caused by the Company's products; (ii) claims resulting from personal injury or property damage resulting from the Company's activities or products; (iii) claims by the Company's office Lessor arising out of the use of the premises; and (iv) agreements with the Company's officers and directors under which the Company may be required to indemnify such persons for liabilities arising out of their activities on behalf of the Company. No liabilities have been recorded for these obligations as of June 30, 2016.

5. Subordinated debt

On April 6, 2015, the Company re-financed its subordinated debt and issued $5.0 million of subordinated debt securities ("2015 sub-debt") and warrants to purchase an aggregate of 3,000,000 shares of the Company's common stock at an initial exercise price of $0.14 per share to a group of its current investors and one new investor. The new subordinated debt proceeds were used for the repayment of outstanding subordinated debt, working capital and general corporate purposes. The notes issued pursuant to the subordinated note and warrant purchase agreement bear simple interest at a rate of 12% per annum. The full principal is due on maturity on April 6, 2018 with the option of two one-year extensions. The Company will pay accrued interest in arrears on August 31 and November 30 and the final payment date. The Note and Warrant Purchase Agreement ("2015 Agreement") contains customary affirmative and negative covenants, including notification and information covenants and covenants restricting the Company's ability to merge or liquidate, incur debt, dispose of assets, incur liens, declare dividends or enter into transactions with affiliates. As of June 30, 2016, the Company was in material compliance with all covenants related to the subordinated debt. The 2015 Agreement also requires the Company to repay the notes upon the occurrence of a change of control (as defined in the 2015 Agreement) at 101% of the principal amount thereof plus accrued and unpaid interest.

The total value allocated to the 2015 sub-debt warrants was approximately $261,000 and was recorded as a debt discount against the proceeds of the notes and is being amortized to interest expense over term of the notes. See Note 3 to the consolidated financial statements. The aggregate debt issuance costs associated with the 2015 subordinated debt financing were $47,000 which were comprised of outside legal costs. These costs have been capitalized as debt issuance costs, and are being amortized as interest expense over the life of the notes. As of June 30, 2016, the Company recorded interest expense related to the debt issuance costs of $7,000.

On April 5, 2013, the Company issued $4.6 million of subordinated debt securities ("2013 sub-debt") and warrants to purchase an aggregate of 1,846,940 shares of the Company's common stock, to a group of its current investors. The notes issued pursuant to the subordinated note and warrant purchase agreement bore simple interest at a rate of 12% per annum. From the issuance date through April 5, 2014, the Company accrued unpaid interest quarterly in arrears by increasing the principal amount of each note ("PIK Interest") and thereafter paid accrued interest in cash in arrears on July 31, 2014 and November 30, 2014. The notes matured on April 5, 2015. On April 6, 2015 the Company paid the outstanding balance of the 2013 sub-debt and the accrued interest in cash as part of the subordinated debt re-financing disclosed above.

At June 30, 2016 the Company's sub-debt notes payable is made up of the following (*in thousands*):

	June 30, 2016		December 31, 2015	
Subordinated notes payable	$	5,000	$	5,000
Deferred debt discount		(130)		(170)
Debt issurance costs		(29)		(36)
Total subordinated debt	$	4,841	$	4,794

To comply with the recent FASB accounting guidance, the Company changed the presentation of unamortized debt issuance costs on the balance sheets from being presented in other long term assets to a direct deduction from the subordinated debt liability. The Company also retrospectively changed its December 31, 2015 balance sheet for this presentation.

6. Loan payable

On June 23, 2014, the Company executed a Business Financing Agreement ("line of credit") with Bridge Bank. This agreement provides the Company a line of credit of $2 million secured by the Company's personal property and related assets. Advances on the line of credit are permitted up to 80% of eligible accounts receivable. The line of credit requires the Company to have a lock-box arrangement whereby customers are required to submit all payments on invoices to the lock-box. Bridge Bank controls the lock-box and all collections of financed receivables are used to pay off advances on the line of credit. The line of credit bears an interest rate of prime plus 3% per annum. The line of credit is a senior credit facility to the Subordinated Debt. Borrowings under the line of credit are subject to reporting covenants requiring the remittance of financial statements and supporting working capital reports to Bridge Bank.

On April 6, 2015, the Company extended the line of credit with Bridge Bank in conjunction with the refinance efforts as disclosed in Note 5 of the consolidated financial statements.

As of June 30, 2016 the Company had a zero balance in borrowings under its line of credit and was in compliance with all financial reporting covenants.

7. Provision for Income Taxes

In the three months and six months ended June 30, 2016, the Company recorded income tax of $1,000 and $3,000, respectively. The tax expense for the three and six months ended June 30, 2016 consists of current state tax expense. In the three months and six months ended June 30, 2015, the Company recorded income tax expense of $2,000 and $5,000, respectively. The tax expense for the three months and six months ended June 30, 2015 consists of current state tax expense.

The Company has established and continues to maintain a full valuation allowance against its deferred tax assets as the Company does not believe that realization of those assets is more likely than not.

At June 30, 2016, the Company has unrecognized tax benefits of approximately $2.2 million. The Company does not have unrecognized tax benefits that, if recognized, would affect the effective tax rate. The Company does not believe there will be any material changes in the unrecognized tax positions over the next twelve months. Interest and penalty costs related to unrecognized tax benefits are insignificant and classified as a component of "Provision for Income Taxes" in the accompanying statement of operations.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. Tax returns remain open to examination by the appropriate governmental agencies for tax years 2010 to 2015. The federal and state taxing authorities may choose to audit tax returns for tax years beyond the statute of limitation period due to significant tax attribute carryforwards from prior years, making adjustments only to carryforward attributes. The Company is not currently under audit in any major tax jurisdictions.

8. Stock-Based Compensation

The Company did not grant any options to purchase shares of common stock or restricted stock units during the three months ended June 30, 2016. The Company did not grant any options to purchase shares of common stock or restricted stock units during the three months ended June 30, 2015. The Company granted 508,750 stock options and 9,375 restricted stock units during the six months ended June 30, 2016. The Company granted 303,750 stock options and 9,375 restricted stock units during the six months ended June 30, 2015.

The fair value of each option award is estimated on the date of grant using a Black-Scholes Merton option pricing model with subjective assumptions, including expected stock price volatility, the expected life of each award and estimated pre-vesting forfeitures noted in the table below:

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	2016	2015	2016	2015
Expected life (in years)	n/a	n/a	2.5	3.4
Risk-free interest rate	n/a	n/a	0.90%	1.10%
Dividend yield	n/a	n/a	0%	0%
Expected volatility	n/a	n/a	198%	171%
Estimated forfeiture rate	n/a	n/a	10.87%	16.43%

9. Commitments and Contingencies

On September 1, 2015, the Company entered into an agreement to lease approximately 7,226 square feet in Oakland, California for its new corporate headquarters. The term of the lease agreement is for 63 months from the lease commencement, which began in December 2015 and expires in March 2021. The Company also has a lease agreement for its Tucson, Arizona office, which was extended in June 2012 through August 2017. In addition, the Company leases certain equipment under capital lease arrangements that extend through 2019.

At June 30, 2016 the Company's future minimum lease payments are as follows (*in thousands*):

	Remaining 2016	2017	2018	2019	2020 and thereafter	Total
Lease obligations	$ 268	$ 429	$ 282	$ 280	$ 315	$ 1,574
Total	$ 268	$ 429	$ 282	$ 280	$ 315	$ 1,574

10. Subsequent Events

Management has evaluated subsequent events through August 9, 2016, the date the consolidated financial statements were available for issuance. No events have occurred that would have a material impact on the consolidated financial statements.

<u>OTC Disclosures</u>

Section 1: Name of Issuer

Scientific Learning Corporation

Section 2: Address of the issuer's principal executive offices

Company Headquarters
1956 Webster Street, Suite 200
Oakland, CA 94612-2943

888-665-9707
www.scilearn.com

<u>IR Contact</u>
No investor relations firm is currently engaged

Section 3: Security Information

Trading Symbol: **SCIL**
Exact title and class of securities outstanding: **Common Stock**
CUSIP: **808760102**

Par or Stated Value: **$<u>0.001</u>**

Total shares authorized:	**<u>40,000,000</u>**	as of: **<u>6/30/2016</u>**
Total shares outstanding:	**<u>24,386,210</u>**	as of: **<u>6/30/2016</u>**

<u>Transfer Agent</u>
Continental Stock Transfer & Trust Company
17 Battery Place
New York, NY 10004
212-509-4000

Is the Transfer Agent registered under the Exchange Act?* Yes: ☒ No: ☐

List any restrictions on the transfer of security:

None

Describe any trading suspension orders issued by the SEC in the past 12 months.

None

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months:

None

Section 4: Issuance History

List below any events, in chronological order, that resulted in changes in total shares outstanding by the issuer in the past two fiscal years and any interim period. The list shall include all offerings of securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services, describing (1) the securities, (2) the persons or entities to whom such securities were issued and (3) the services provided by such persons or entities. The list shall indicate:

A. The nature of each offering (e.g., Securities Act Rule 504, intrastate, etc.)

B. Any jurisdictions where the offering was registered or qualified;

C. The number of shares offered;

D. The number of shares sold;

E. The price at which the shares were offered, and the amount actually paid to the issuer;

F. The trading status of the shares; and

G. Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act.

The following table represents the Issuance History for the six months ended June 30, 2016:

Date	Entity	A Nature of Offering	B Juris.	C Shares Offered	D Shares Sold	E Price Offered	E Price Sold	Warrants	F Trading Status	G Legend
		Balance at December 31, 2013		**23,873,705**	**23,873,705**			**4,352,792**		
3/10/2014	Edward Vermont Blanchard, Jr	Directors RSU's Vested	DE	939	939				Restricted	Rule 144
3/10/2014	Robert C. Bowen	Directors RSU's Vested	DE	626	626				Restricted	Rule 144
3/10/2014	Rodman W. Moorhead III	Directors RSU's Vested	DE	813	813				Restricted	Rule 144
3/10/2014	Michaeal A. Moses	Directors RSU's Vested	DE	939	939				Restricted	Rule 144
3/10/2014	Paula A. Tallal	Directors RSU's Vested	DE	939	939				Restricted	Rule 144
3/10/2014	Jeffrey D. Thomas	Directors RSU's Vested	DE	939	939				Restricted	Rule 144
5/20/2014	Robert C. Bowen	Director's RSU Vested	DE	18,750	18,750				Restricted	Rule 144
5/20/2014	Employees	Employee's RSU Vested	DE	28,110	28,110				Restricted	Rule 144
6/3/2014	Employees	ESPP	DE	88,758	88,758				Restricted	Rule 144
9/10/2014	Blanchard, Jr., Edward Vermont	Director's RSU Vested	DE	936	936				Restricted	Rule 144
9/10/2014	Bowen, Robert C.	Director's RSU Vested	DE	312	312				Restricted	Rule 144
9/10/2014	Freeman, Jane A.	Director's RSU Vested	DE	25,000	25,000				Restricted	Rule 144
9/10/2014	Moorhead III, Rodman W.	Director's RSU Vested	DE	1,124	1,124				Restricted	Rule 144
9/10/2014	Moses, Michael A.	Director's RSU Vested	DE	936	936				Restricted	Rule 144
9/10/2014	Tallal, Paula A.	Director's RSU Vested	DE	936	936				Restricted	Rule 144
9/10/2014	Thomas, Jeffrey D.	Director's RSU Vested	DE	936	936				Restricted	Rule 144
11/20/2014	Employees	Employee's RSU Vested	DE	5,422	5,422				Restricted	Rule 144
11/20/2014	Robert C. Bowen	Director's RSU Vested	DE	18,750	18,750				Restricted	Rule 144
		Balance at December 31, 2014		**24,068,870**	**24,068,870**			**4,352,792**		
3/10/2015	Edward Vermont Blanchard, Jr	Director's RSU Vested	DE	939	939				Restricted	Rule 144
3/10/2015	Robert C. Bowen	Director's RSU Vested	DE	313	313				Restricted	Rule 144
3/10/2015	Rodman W. Moorhead III	Director's RSU Vested	DE	1,126	1,126				Restricted	Rule 144
3/10/2015	Michaeal A. Moses	Director's RSU Vested	DE	939	939				Restricted	Rule 144
3/10/2015	Paula A. Tallal	Director's RSU Vested	DE	939	939				Restricted	Rule 144
3/10/2015	Jeffrey D. Thomas	Director's RSU Vested	DE	939	939				Restricted	Rule 144
3/10/2015	Employees/Consultants	Employee's/Consultants RSU Vested	DE	12,500	12,500				Restricted	Rule 144
4/6/2015	Subordinated Debt Holders	Warrants issued with Subordinated Debt Offering	DE	-	-			3,000,000	Restricted	Rule 144
5/20/2015	Robert C. Bowen	Director's RSU Vested	DE	18,750	18,750				Restricted	Rule 144
5/20/2015	Employees/Consultants	Employee's/Consultants RSU Vested	DE	4,429	4,429				Restricted	Rule 144
7/1/2015	Edward Vermont Blanchard, Jr	Director's RSA Vested	DE	200,000	200,000				Restricted	Rule 144
9/10/2015	Edward Vermont Blanchard, Jr	Director's RSU Vested	DE	624	624				Restricted	Rule 144
9/10/2015	Employees/Consultants	Employee's/Consultants RSU Vested	DE	7,028	7,028				Restricted	Rule 144
9/10/2015	Rodman W. Moorhead III	Employee's/Consultants RSU Vested	DE	1,124	1,124				Restricted	Rule 144
9/10/2015	Michaeal A. Moses	Director's RSU Vested	DE	624	624				Restricted	Rule 144
9/10/2015	Paula A. Tallal	Director's RSU Vested	DE	624	624				Restricted	Rule 144
9/10/2015	Jeffrey D. Thomas	Director's RSU Vested	DE	624	624				Restricted	Rule 144
11/20/2015	Employees/Consultants	Director's RSU Vested	DE	4,859	4,859				Restricted	Rule 144
11/20/2015	Robert C. Bowen	Director's RSU Vested	DE	18,750	18,750				Restricted	Rule 144
		Balance at December 31, 2015		**24,344,001**	**24,344,001**			**7,352,792**		
3/10/2016	Edward Vermont Blanchard, Jr	Director's RSU Vested	DE	1,251	1,251				Restricted	Rule 144
3/10/2016	Rodman W. Moorhead III	Director's RSU Vested	DE	1,251	1,251				Restricted	Rule 144
3/10/2016	Michaeal A. Moses	Director's RSU Vested	DE	1,251	1,251				Restricted	Rule 144
3/10/2016	Paula A. Tallal	Director's RSU Vested	DE	1,251	1,251				Restricted	Rule 144
3/10/2016	Jeffrey D. Thomas	Director's RSU Vested	DE	1,251	1,251				Restricted	Rule 144
3/10/2016	Employees/Consultants	Employee's/Consultants RSU Vested	DE	12,500	12,500				Restricted	Rule 144
4/6/2016	Subordinated Debt Holders	Warrants expired with 2013 Subordidnated Debt Offering	DE	-	-			(1,846,940)	Restricted	Rule 144
5/20/2016	Robert C. Bowen	Director's RSU Vested	DE	18,750	18,750				Restricted	Rule 144
5/20/2016	Employees/Consultants	Employee's/Consultants RSU Vested	DE	4,704	4,704				Restricted	Rule 144
		Balance at June 30, 2016		**24,386,210**	**24,386,210**			**5,505,852**		

Section 5: Financial Statements

See above

Section 6: Issuer's Business, Products and Services

A. Description of the issuer's business operations;

We are an education company that accelerates learning by applying proven research on how the brain learns in online and on premise software solutions. Our results show that learners who use our products can realize achievement gains of up to 2 years in as little as 3 months and maintain an accelerated rate of learning even after product use ends. We provide our learning solutions primarily to U.S. K-12 schools in traditional brick-and-mortar, virtual or blended learning settings and also to parents and learning centers, in over fifty-five countries around the world.

We are highly differentiated because of our focus on the "science of learning" - combining advances in the field of brain research with standards-based learning objectives to achieve dramatic student gains. Proof that our products produce substantial academic gains was demonstrated in 280 efficacy studies, including randomized controlled trials and longitudinal studies, representing results from approximately 120,000 aggregate participants. These studies show gains for students at all K-12 grade levels, for at-risk, special education, English language, Title I (low income, under achieving), and a variety of other students. Gains have been demonstrated throughout the United States and in ten other countries. The studies show that these gains endure over time.

In 2011, we began implementing a software as a service (SaaS) model. Our easy-to-use and easy-to-access web-based platforms are able to effectively deliver individualized learning opportunities to a large number of students simultaneously. Our Fast ForWord and Reading Assistant educational software products are now available on our browser-based SciLEARN Enterprise software platform, which can be hosted on the customer's servers, and our on-demand platform MySciLEARN On Demand, which we host. The SciLEARN Enterprise and MySciLEARN platforms meet the needs of institution and district-wide installations by providing scalability, remote access, centralized reporting, asynchronous online professional development, and ease of administration for multiple campuses.

B. Date and State (or Jurisdiction) of Incorporation:

The Company was incorporated in 1995 in the State of California and was reincorporated in 1997 in the State of Delaware.

C. Issuer's primary and secondary SIC Codes:

Primary SIC Code: 73729903 Educational Computer Software
Secondary SIC Code: 8299, Schools and Educational Services

D. Issuer's fiscal year end date;

December 31, Calendar year

E. Principal products or services, and their markets;

Our principal products include: Fast ForWord, Fast ForWord Language and Literacy, Fast ForWord Reading, Reading Assistant, Results Now!, and Fast Forward Home.

We sell to our principal market, K-12 schools and districts throughout the US and Canada, using a diversified direct sales channel, including both inside and field sales personnel. In addition to selling to K-12 schools, we also sell to and through private practice professionals and learning centers, international value-added resellers (VARs) and directly to consumers.

Section 7: Describe the Issuer's Facilities

We currently have the following leased properties:

1. **A lease for approximately 7,226 square feet of office space in Oakland, California for our new headquarters, which expires in March 2021.**

2. **A lease for approximately 10,800 square feet of office space in Tucson, Arizona for our sales and support center that expires in August 2017.**

Section 8: Officers, Directors, and Control Persons

Robert C. Bowen – Chairman and Chief Executive Officer
Edward V. Blanchard Jr. – Director
Christopher Brookhart - General Counsel, Secretary and Sr. Vice President
Rodman W. Moorhead III - Director
Michael A. Moses – Director
Steve Nathan - Vice President of Finance, Corporate Controller, and Treasurer
Paula A. Tallal - Director
Jeffrey D. Thomas - Director

B. Legal/Disciplinary History. Please identify whether any of the foregoing persons have, in the last five years, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

   None

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

   None

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

   None

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.

   None

C. Beneficial Shareholders. Provide a list of the name, address and shareholdings or the percentage of shares owned by all persons beneficially owning more than ten percent (10%) of any class of the issuer's equity securities. If any of the beneficial shareholders are corporate shareholders, provide the name and address of the person(s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders.

Below is a list of Beneficial Owners as of December 31, 2015. This is most recent information that is available.

As of 12/31/2015	**Shares Beneficially Owned (1)**	
Beneficial Owner	**Number**	**Percent**
Nantahala Capital Management, LLC Daniel Mack 100 First Stamford Place, 2nd floor Stamford, CT 06902	7,393,857	30%

(1) This table is based upon information supplied by the shareholders. Applicable percentages are based on 24,344,001 shares outstanding on December 31, 2015.

Section 9: Third Party Providers

Below is the name, address, and telephone number of each of the following outside providers that advise the issuer on matters relating to operations, business development and disclosure

External Legal Counsel:
Wilson, Sonsini Goodrich & Rosati
650 Page Mill Road
Palo Alto, CA 94304
650.493.9300

Auditor:
Armanino LLP
12657 Alcosta Blvd.
Suite 500
San Ramon, CA 94583
925-790-2755

Investor Relations Consultant
No investor relations firm is currently engaged

Section 10: Issuer Certification

I, Robert C. Bowen certify that:

1. I have reviewed this annual disclosure statement of Scientific Learning Corporation for the three months ended June 30, 2016 and June 30, 2015;

2. Based on my knowledge, this disclosure statement 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 disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

_____ August 9, 2016

_____ /s/Robert C. Bowen

_____ Chairman and Chief Executive Officer

I, Steve Nathan certify that:

1. I have reviewed this annual disclosure statement of Scientific Learning Corporation for the three months ended June 30, 2016 and June 30, 2015;

2. Based on my knowledge, this disclosure statement 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 disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

_____ August 9, 2016

_____ /s/Steve Nathan

_____ Vice President of Finance, Corporate Controller and Treasurer