Initial Research Report

Investors should consider this report as only a single factor in making their investment decision.

Catasys, Inc.

Speculative Buy

John Nobile

October 17, 2017

CATS $3.93 — (NASDAQ)

	2015A	2016A	2017E	2018E
Revenues (millions)	$2.7	$7.1	$9.5	$35.0
Earnings (loss) per share	$(1.07)	$(1.95)	$(0.89)	$(0.18)

52-Week range	$14.00 – $3.56	Fiscal year ends:	December
Common shares out as of 8/11/17	15.9 million	Revenue per share (TTM)	$0.82
Approximate float	9.0 million	Price/Sales (TTM)	4.8X
Market capitalization	$62 million	Price/Sales (FY2018)E	1.9X
Tangible book value/share	$0.40	Price/Earnings (TTM)	NMF
Price/tangible book value	9.8X	Price/Earnings (FY2018)E	NMF

Catasys, headquartered in Los Angeles, California, provides specialized behavioral health management and integrated treatment services to health plans through its proprietary OnTrak program. OnTrak utilizes proprietary analytics in integrating medical and psychosocial treatments with care coaching in a 52-week outpatient program. OnTrak is designed to improve a member's health while lowering costs to the insurer where behavioral health conditions are causing or exacerbating medical conditions.

Key investment considerations:

Initiating coverage of Catasys, Inc. with a Speculative Buy rating and twelve-month price target of $8.00 per share.

The company has contracts with five of the top eight major health plans in the US and expectations are for two more to sign in 2H17. Catasys' pool of eligible members increased approximately four-fold to 24,000 individuals in September 2017 from 6,000 individuals in December 2016. Adding to the eligible member total is the anticipated launch before the end of October 2017 with the largest health plan in the US. This should support strong revenue growth through our forecast period.

In August 2017, the company achieved considerable improvement in eligible members across eight states with a leading national health plan and subsequently expanded the program to include the behavioral issue of anxiety. Catasys also launched an enrollment with the second largest Blue Cross Blue Shield health insurance plan in the US and expanded its OnTrak program to Connecticut with one of the nation's leading health insurance companies.

In May 2017, Catasys began enrolling members from the largest Medicaid plan in Texas.

For 2017, we project 34.1% revenue growth to $9.5 million and a net loss of $12.8 million or $(0.89) per share. Growth should be driven by a growing number of enrolled members.

For 2018, we project the approximate four-fold increase in Catasys' pool of eligible members will result in revenue that should more than triple to $35 million from $9.5 million. We project the net loss should narrow to $3.1 million or $(0.18) per share from $12.8 million or $(0.89) per share in 2017 due to increased sales and operating leverage.

****Please view our disclosures on pages 14 - 16.***

Recommendation and Valuation

We are initiating coverage of Catasys, Inc. with a Speculative Buy rating and twelve-month price target of $8.00 per share.

Supporting our rating are the company's contracts with five of the top eight major health plans in the US and expectations for two more to sign in 2H17. Catasys' pool of eligible members increased approximately four-fold to 24,000 individuals in September 2017 from 6,000 individuals in December 2016. Adding to the eligible member total is the anticipated launch before the end of October 2017 with the largest health plan in the US.

In August 2017, the company achieved considerable improvement in eligible members across eight states with a leading national health plan and subsequently expanded the program to include the behavioral issue of anxiety. Catasys also launched an enrollment with the second largest Blue Cross Blue Shield health insurance plan in the US and expanded its OnTrak program to Connecticut with one of the nation's leading health insurance companies.

In May 2017, Catasys began enrolling members from the largest Medicaid plan in Texas.

Shares of CATS currently trade at a trailing twelve month P/S ratio of 5X while the overall healthcare sector trades at a trailing twelve month P/S ratio of 13X (Reuters). We believe CATS' discount to the industry could be due to the failure of the market to recognize the significant growth potential of CATS over our forecast period.

We applied the current multiple of 5X to our FY18 sales per share projection of $2.06, discounted for execution risk, to obtain a year-ahead value of approximately $8.00 per share.

Business

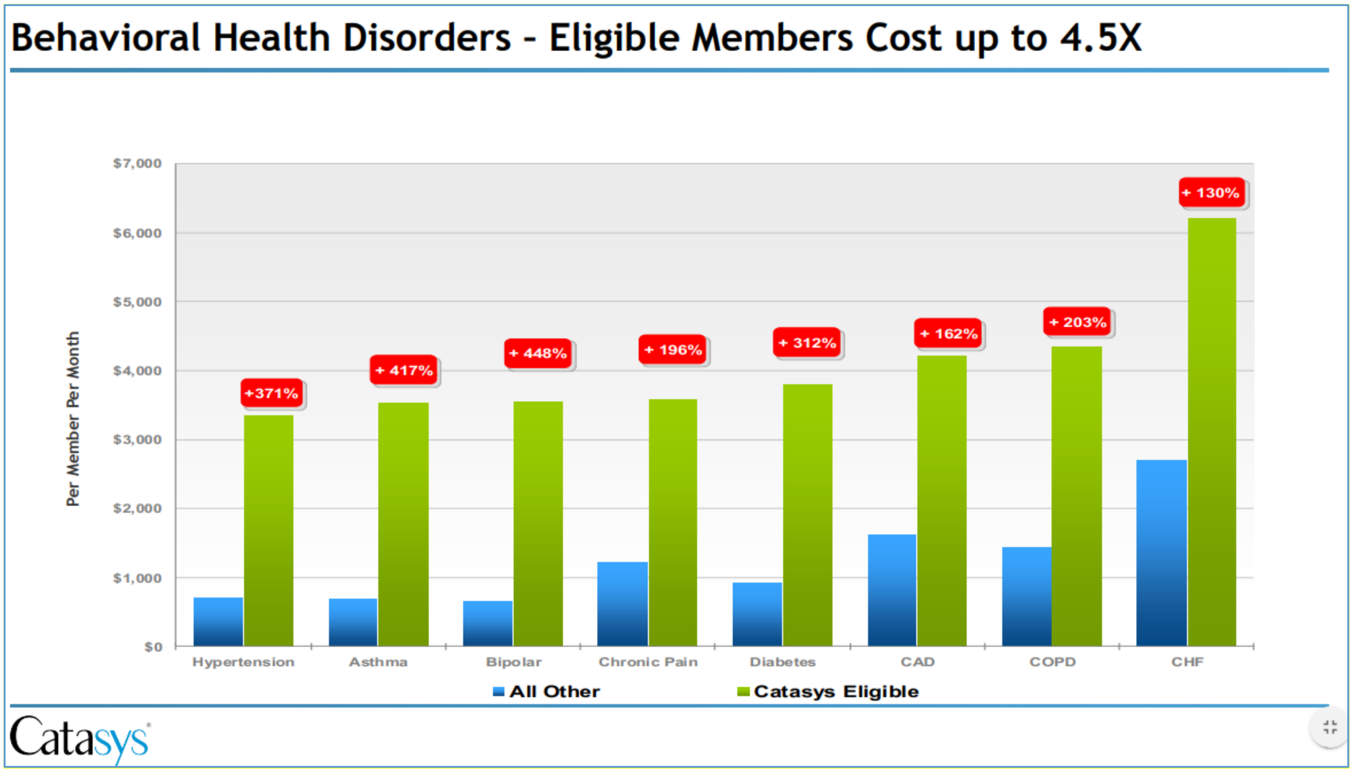
Catasys, headquartered in Los Angeles, California, provides specialized behavioral health management and integrated treatment services to health plans through its proprietary OnTrak™ solution. OnTrak utilizes proprietary analytics in integrating medical and psychosocial treatments with care coaching in a 52-week outpatient program. OnTrak is designed to improve a member's health while lowering costs to the insurer where behavioral health conditions are causing or exacerbating medical conditions.

Source: Catasys Presentation

After initially focusing on members with substance use disorders (substance use disorders occur when the recurrent use of alcohol and/or drugs causes clinically and functionally significant impairment, such as health problems, disability, and failure to meet major responsibilities at work, school, or home), the company expanded OnTrak to assist members with anxiety and depression disorders. Catasys currently operates in Florida, Georgia, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, Missouri, New Jersey, North Carolina, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, West Virginia and Wisconsin. The company's services are provided to commercial (employer funded), managed Medicare Advantage, and managed Medicaid and duel eligible (Medicare and Medicaid) populations. The Tier-1 health insurance companies that the company has signed contracts with can be seen in the chart above.

OnTrak

Catasys' OnTrak program consists of identifying, engaging, enrolling and treating passive, care avoidant, high cost members. The chart below shows how eligible members' costs can be up to 4.5X higher when compared to members without behavioral health disorders. The chart below indicates that a person suffering from bipolar disorder and is eligible for OnTrak, cost the insurance company approximately $3,500 per month versus approximately $600 per month for members that have the bipolar disorder but do not meet the criteria for the OnTrak program.



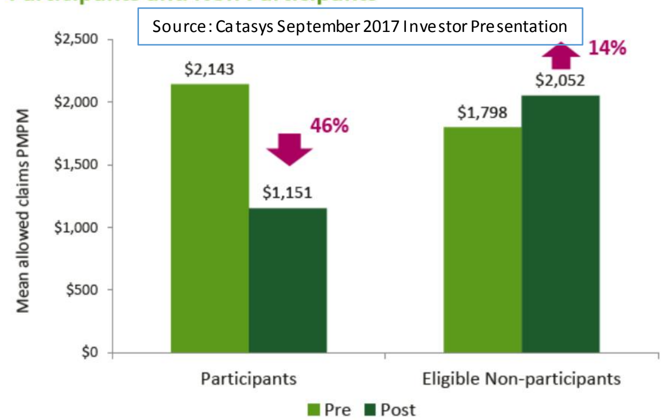
Catasys assists health plans in identifying members who may be appropriate for enrollment into OnTrak. The company then engages and enrolls targeted members into its program through direct mailings and by telephone, and referral through health plan sources. After enrollment, Catasys' contracted network of providers provide treatments utilizing integrated medical and psychosocial treatments, including the company's proprietary OnTrak therapy modules for anxiety, depression, and substance use disorders to help members develop improved coping skills and find a recovery support network. Throughout the treatment process, care coaches work directly with members to keep them engaged in treatment by enhancing motivation, minimizing lapses, and enabling lifestyle modifications consistent with the recovery goals. The company periodically reports clinical and financial outcome metrics to its customers (insurance companies) to demonstrate the extent of the program's value.

Clinical and financial outcomes from the OnTrak program have been promising. OnTrak enrolled members have achieved an average gross cost reduction of more than 50% for the year after enrollment compared to the twelve months prior to enrollment. Also, approximately 80% of members who remain eligible have been retained in the program.

The company receives $8,500 per patient enrolled and at a typical 78% retention rate, this equates to revenue of $6,630 per enrolled member, or approximately $6.6 million per 1,000 enrolled members.

Humana and Catasys Joint Evaluation - In 2015, Humana and Catasys reported results of an evaluation of the effectiveness of the OnTrak program in a poster at the American Society of Addiction Medicine. The objective was to compare changes in emergency room (ER) visits and inpatient hospitalizations for participants in the substance abuse treatment group, and to compare changes in the total cost of care among participants in the substance abuse treatment group versus eligible individuals who did not participate (the control group). The results showed there were 16% fewer ER visits, 67% fewer inpatient hospitalizations, and a 46% reduction in healthcare costs per member per month (PMPM) for the participants compared to a 14% increase in costs for the control group (see chart at right).

Figure 2. PMPM Costs Pre and Post Treatment for Program Participants and Non Participants



PMPM costs were reduced by nearly half among participants

Catasys' Markets

According to a July 2017 behavioral health industry update by the advisory firm Stout, substance use disorders are a significant contributor to high healthcare costs. Stout cited the Substance Abuse and Mental Health Services Administration as saying that excessive substance use and substance use disorders are costly to the nation due to lost productivity, healthcare, and crime. Addressing the impact of substance use alone is estimated to cost Americans more than $600 billion each year. Stout said that behavioral companies can help reduce these costs by preventing hospital readmissions via mental health and substance use disorder treatment programs. This is why insurance companies are engaging Catasys' OnTrak program.

Catasys is focused on members with behavioral health conditions such as substance use disorders, anxiety and depression. Members with these behavioral health disorders average higher medical costs for covering health insurance providers and many of these high costs members do not seek treatment.

Substance Use Disorders – Substance use disorders caused by the recurrent used of alcohol or other drugs (or both) can significantly impair a person and result in health problems, disability, and failure to meet major responsibilities at work, school, or home.

According to the Substance Abuse and Mental Health Services Administration's National Survey on Drug Use and Health (NSDUH), approximately 20.1 million people in the US aged 12 or older had a substance use disorder in 2016, including 15.1 million people who had an alcohol use disorder and 7.4 million people who had an illicit drug use disorder. Among the 7.4 million people aged 12 or older who had an illicit drug use disorder, the most common disorders were for marijuana (4 million people) and prescription pain relievers (1.8 million people). In 2016, smaller numbers of people had disorders related to their use of cocaine, methamphetamines, and heroin or prescription stimulants.

Approximately one out of 10 people with a substance use disorder seeks treatment.

Anxiety – IBISWorld reports that mental illness affects an estimated 43.8 million adults in the US each year and primarily includes anxiety, impulse-control, and mood disorders.

Anxiety includes panic disorder, agoraphobia (an abnormal fear of being in crowds, public places, or open areas), social phobia, generalized anxiety, post-traumatic stress, obsessive-compulsive stress, and adult separation anxiety. Those suffering from anxiety generally feel anxiety toward events in the future and fear current events.

Approximately one out of three people with an anxiety disorder seeks treatment.

Depression – Major depressive episodes (MDE) are generally characterized by changes in mood, thought, or behavior and are generally defined as being in a depressed mood for two weeks or more, and a loss of interest or pleasure in everyday activities, accompanied by other symptoms such as feelings of emptiness, hopelessness, anxiety, worthlessness, guilt and/or irritability, as well as changes in appetite, problems concentrating, remembering details or making decisions, and thoughts of or attempts at suicide.

According to the Substance Abuse and Mental Health Services Administration, 12.8% of adolescents aged 12 to 17 (3.1 million adolescents) had an MDE in 2016 and 9% of adolescents (2.2 million adolescents) had an MDE with severe impairment. Thus, adolescents who had an MDE with severe impairment represented more than two thirds (70.5%) of adolescents in 2016 with and MDE.

In 2016, 6.7% of adults aged 18 or older (16.2 million adults) had at least one MDE and 4.3% of adults (10.3 million adults) had an MDE with severe impairment. Adults who had an MDE with severe impairment represented nearly two thirds (64%) of adults who had an MDE in 2016.

Approximately two out of 10 people who suffer from depression seek treatment.

Competition

Catasys operates in highly competitive markets. The company competes with other healthcare management service organizations, care management and disease management companies. Those competing organizations include managed behavioral health organizations (MBHOs) that manage behavioral health benefits, perform utilization reviews, provide case management and patient coaching, and pay their network of providers for behavioral health services delivered. Most of Catasys' competitors are significantly larger and have greater financial, marketing and other resources than the company.

Competitors include companies such as Hummingbird, One Health Solutions, and Health Integrated that offer coaching, social media, and in the case of Health Integrated, more comprehensive products to address the costs of members with substance dependence and other behavioral health conditions. The company believes that its ability to offer customers an outcomes based comprehensive and integrated solution, including the utilization of innovative medical and psychosocial treatments and engagement methodologies, along with its network of treatment providers, will enable Catasys to compete effectively. However, there can be no assurance that the company will not encounter more effective competition in the future.

Strategy

Catasys' business strategy is to provide a quality integrated medical and behavioral program to help health plans and other organizations treat and manage health plan members whose behavioral health conditions are exacerbating co-existing medical conditions resulting in increased in-patient medical costs.

Key elements of the company's business strategy include:

1. Demonstrating the potential for improved clinical outcomes and reduced costs associated with using OnTrak with key managed care and other third-party payors;

2. Educating third-party payors on the disproportionately high cost of their substance dependent population;

3. Providing OnTrak to third-party payors for reimbursement on a case rate, fee for service, or monthly fee basis; and

4. Generating outcome data from OnTrak to demonstrate its cost reduction effectiveness and to facilitate broader adoption.

2Q and 1H 2017 Financial Results

2Q17 – Revenue increased 36% to $1.7 million. Net income was $13.9 million or $0.97 per share versus a net loss of $4.7 million or $(0.51) per share. Excluding changes in warrant and derivative liabilities, the 2Q17 net loss was $3.8 million or $(0.26) per share versus a net loss of $2.7 million or $(0.29) per share in 2Q16.

The increase in revenue was primarily due to more members enrolled in the company's programs.

Cost of revenue increased 14.6% to $1.3 million resulting in gross margins of 20% compared to 5% in the year ago period. The increase in cost of revenue was primarily due to more members being treated and the addition of staff to manage the increase in enrolled members.

General and administrative expenses increased 37.6% to $2.9 million primarily due to increased legal and investor relations services.

Interest expense decreased to $539,000 from $591,000 due to the payoff of debt.

1H17 – Revenue increased 79% to $3.5 million. The net loss was $7.8 million or $(0.68) per share versus a net loss of $9 million or $(0.98) per share. Excluding changes in warrant and derivative liabilities, the 1H17 net loss was $9.7 million or $(0.84) per share versus a net loss of $5.4 million or $(0.59) per share.

The increase in revenue was primarily due more members enrolled in the company's programs.

Cost of revenue increased 26.7% to $2.7 million resulting in gross margins of 22.7% compared to (9.1%) in the year ago period. The increase in cost of revenue was primarily due to the addition of staff to manage the increased number of enrolled members.

General and administrative expenses increased 28.8% to $5.6 million primarily due to increased legal and investor relations services.

Interest expense increased to $3.4 million from $924,000 due the cost of issuing warrants and interest related to the issuance of convertible debentures.

Liquidity - As of June 30, 2017, the company had $9.2 million cash, a current ratio of 2.2X, no debt, and 57% of assets financed by equity.

Cash used in operations in the first six months of 2017 was $3.2 million consisting of a $4.3 million cash burn and a $1.1 million decrease in working capital. The decrease in working capital was primarily due to an increase in deferred revenue.

(in thousands $)	6m 2017A	6m 2016A
Revenue	3,487	1,951
Cost of revenue	2,697	2,128
Gross profit	790	(177)
General and administrative	5,569	4,323
Depreciation and amortization	84	64
Operating income (loss)	(4,863)	(4,564)
Other income	28	75
Interest expense	(3,406)	(924)
Loss on conversion of note	(1,356)	-
Loss on issuance of common stock	(145)	-
Change in fair value of warrant liability	1,769	(750)
Change in fair value of derivative liability	132	(2,844)
Income before taxes	(7,841)	(9,007)
Income tax	2	5
Net Income / (Loss)	(7,843)	(9,012)
EPS	(0.68)	(0.98)
Shares Outstanding	11,578	9,168
Margin Analysis		
Gross margin	22.7%	(9.1)%
SG&A	159.7%	221.6%
Operating margin	(139.5)%	(233.9)%
Net margin	(224.9)%	(461.9)%
Tax rate	(0.0)%	(0.1)%
Year / Year Growth		
Total Revenues	78.7%	
Net Income	NMF	
EPS	NMF	

Source: Company filings

Cash used in investing consisted solely of $127,000 of capital expenditures. Cash provided by financing of $11.7 million consisted primarily of proceeds from the issuance of common stock offset in part by the payment of debt. Cash increased by $8.4 million to $9.2 million at June 30, 2017.

In March 2017, Catasys entered into amendments with the holders of certain outstanding warrants to eliminate certain anti-dilution provisions in such warrants, which resulted in a warrant liability of $5.3 million on the balance sheet as of December 31, 2016. The elimination of the anti-dilution provision resulted in the write-off of $6.2 million of the warrant liability as of June 30, 2017.

In January 2017, Catasys entered into a subscription agreement with Acuitas, pursuant to which the company received gross proceeds of $1.3 million in consideration of the issuance of an 8% Series B convertible debenture due March 31, 2017 and five-year warrants to purchase shares of the company's common stock at an exercise price of $5.10 per share. In April 2017, Catasys used the net proceeds from a public offering of common stock ($15 million gross proceeds) to repay the loan including interest of $1.3 million.

The company has issued warrants to purchase common stock from February 2012 to June 2017. Some of the warrants are being accounted for as liabilities in accordance with FASB accounting rules due to anti-dilution provisions in some warrants that protect the holders from declines in the stock price. For the three and six months ended June 30, 2017, Catasys recognized a gain of $7.0 million and $1.8 million, respectively, compared with a loss of $522,000 and $750,000 for the same periods in 2016, respectively, related to the revaluation of its warrant liabilities.

In April 2017, convertible debentures that were originally issued in July 2015 were converted into 2,385,111 shares of common stock and the derivative liability was written off. For the three and six months ended June 30, 2017, the company recognized a gain of $10.7 million and $132,000, respectively, compared with a loss of $1.5 million and $2.8 million for the same periods in 2016, related to the revaluation of derivative liabilities.

Economic Outlook

In October 2017, the IMF raised its economic growth estimate for the US to 2.2% in 2017 and 2.3% in 2018, up from its earlier (July 2017) growth forecast of 2.1% for both years. The upward revision reflects strong, broad based US economic activity in 1H17.

The third estimate of US GDP growth (released on September 28, 2017) showed the US economy grew at an annual rate of 3.1% in 2Q17, up from 1.2% growth in 1Q17. The 2Q17 US GDP growth estimate primarily reflects increases in consumer spending, business investment, exports, and federal government spending. Partly offsetting these contributions to GDP growth were declines in housing investment and state and local government spending.

Projections

Basis for forecast – We anticipate strong revenue growth through our forecast horizon due to greater member enrollment in CATS' OnTrak program.

The company has contracts with five of the top eight major health plans in the US and expectations are for two more to sign in 2H17. Catasys' pool of eligible members increased approximately four-fold to 24,000 individuals in September 2017 from 6,000 individuals in December 2016. Adding to the eligible member total is the anticipated launch before the end of October 2017 with the largest health plan in the US.

In May 2017, Catasys began enrolling members from the largest Medicaid plan in Texas. In August 2017, the company achieved considerable improvement in eligible members across eight states with a leading national health plan and subsequently expanded the program to include anxiety disorders. Catasys also launched an enrollment with the second largest Blue Cross Blue Shield health insurance plan and expanded its OnTrak program to Connecticut with one of the nation's leading health insurance companies.

FY17 - We project 34.1% revenue growth to $9.5 million and a net loss of $12.8 million or $(0.89) per share. Excluding the change in warrant and derivative liabilities in 1H17, we project a net loss of $14.7 million or $(1.02) per share. Growth should be driven by a growing number of enrolled members.

We project a 7.7% increase in gross profit to $2.6 million with gross margins decreasing to 27.3% from 34% as the company incurs costs to hire and train additional staff in anticipation of a significant ramp-up in business.

G&A expenses are projected to increase by $3.4 million to $12.3 million from $8.8 million due to increased legal and investor relations costs. G&A margins should increase to 129.3% from 124.9%.

We project interest expense decreasing to $3.4 million from $5.45 million due to the conversion and payoff of debt. In 2Q17, all but $38,000 of CATS' warrant liabilities were written off due to the elimination of anti-dilution provisions associated with the company's up-listing to the NASDAQ in April 2017. All of CATS' derivative liabilities were also written off in 2Q17 due to the conversion of convertible debt into common stock. The company should pay minimal to no taxes due to its large amount of net operating loss carry forwards ($222 million as of December 31, 2016).

We project CATS will use $7.8 million cash from operations from an $8.8 million cash burn offset in part by a $1.1 million decrease in working capital. The change in working capital should come primarily from an increase in deferred revenue. The $16.5 million received from the issuance of common stock in 1H17 will cover cash burn from operations, capital expenditures and debt repayments, increasing cash by $3.7 million to $4.5 million at December 31, 2017.

FY18 – We project revenue more than tripling to $35 million from $9.5 million due to the approximate four-fold increase in Catasys' pool of eligible members in 2017. We project a net loss of $3.1 million or $(0.18) per share.

We project gross profit increasing to $14 million from $2.6 million with gross margins increasing to 40% from 27.3% as the rate of staffing growth slows relative to revenue growth.

We project G&A expenses increasing by $4.7 million to $17 million from $12.3 million in order to support the rapid growth in members on OnTrak. G&A margins should decrease to 48.63% from 129.3%.

We project no interest expense due to the conversion and payoff of debt that occurred in 2017. The company should pay minimal to no taxes due to its large amount of net operating loss carry forwards.

We project CATS will use $1.5 million cash from operations from a $2 million cash burn offset in part by a $525,000 decrease in working capital. The change in working capital reflects an increase in accounts payable. Cash used in operations, capital expenditures and capital lease obligations should decrease cash by $1.8 million to $2.8 million at December 31, 2018.

Management

Terren S. Peizer, Director, Chairman of the Board and Chief Executive Officer - Peizer, founder of Catasys, served as its CEO and Chairman of the Board since the company's inception in 2004. Peizer is also the founder, Chairman and CEO of NeurMedix, Inc., and Chairman of Acuitas Group Holdings, LLC. Peizer has been the largest beneficial shareholder of, and has held various senior executive positions with, several other publicly-traded growth companies, including having served as Chairman of Cray, Inc. Previously held senior executive positions with the investment banking firms Goldman Sachs, First Boston, and Drexel Burnham Lambert. BSE in Finance from The Wharton School of Finance and Commerce.

Richard A. Anderson, Director, President and Chief Operating Officer – Anderson served as a director since July 2003 and as a member of Catasys' management team since April 2005. President and COO of Catasys since July 2008 where he has been primarily responsible for the creation and leadership of OnTrak. Anderson has more than 25 years of experience in business development, strategic planning, operations, finance and management, with more than 15 years of that in the healthcare field. Prior to Catasys, held senior level financial and operational positions in healthcare and financial companies, and served as a director in PriceWaterhouseCoopers LLP's business assurance and transaction support practices. BA in Business Economics from University of California, Santa Barbara.

Christopher L. Shirley, Chief Financial Officer – Shirley was appointed CFO in May 2017. He has approximately 20 years of finance experience, including senior financial leadership roles at healthcare technology and big data companies. Prior to joining Catasys, he was CFO of GE Intelligent Platforms. Prior, held multiple senior finance leadership roles at GE Healthcare IT's Enterprise Imaging and Workforce Management software businesses. BS in Finance from DePaul University in Chicago, IL.

Risks

In our view, these are the principal risks underlying the stock.

Going concern issues – Catasys has been unprofitable since its inception in 2003 and expectations are for continued operating losses and negative cash from operations for the remainder of 2017. These conditions raise substantial doubt as to the company's ability to continue as a going concern.

No assurance of growing acceptance of OnTrak – The company's ability to achieve further acceptance for its OnTrak program is dependent on its ability to contract with a sufficient number of third party payors and to demonstrate financial and clinical benefits from those agreements. If Catasys is unable to secure sufficient contracts for its OnTrak program or if the program does not demonstrate the expected level of clinical improvement and cost savings, it is unlikely that OnTrak will be able to achieve widespread market acceptance.

Competition - The healthcare business in general, and the behavioral health treatment business in particular, are highly competitive. Catasys competes with other healthcare management service organizations, care management and disease management companies, other specialty healthcare and managed care companies, and healthcare technology companies that offer treatment and support of behavioral health on-line and on mobile devices. Most of the company's competitors are significantly larger and have greater financial, marketing and other resources than Catasys. There can be no assurance that the company will be able to effectively compete.

Regulations - Healthcare companies are subject to extensive and complex federal, state and local laws and regulations. Catasys' failure to comply with applicable healthcare laws and regulations could adversely impact its business operations.

Insider ownership – Over 50% of CATS' outstanding common stock is beneficially owned Acuitas Group Holdings, LLC, whose sole managing member is CATS' Chairman and CEO, Terren Peizer. As a result, Peizer is expected to significantly influence the election of CATS' Board of Directors and the outcome of matters submitted by stockholders. Peizer's interest may not always be in the best interest of other stockholders

Liquidity risk - Shares of Catasys have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in stock price. There are 9 million shares in the float and the average daily volume is approximately 47,000 shares.

Miscellaneous risk - The company's financial results and equity values are subject to other risks and uncertainties including competition, operations, financial markets, regulatory risk, and/or other events. These risks may cause actual results to differ from expected results.

Consolidated Balance Sheets
(in thousands $)

	2015A	2016A	6/17A	2017E	2018E
Cash and cash equivalents	916	851	9,222	4,546	2,797
Receivables	590	1,052	987	1,411	5,204
Prepaid and other	575	420	178	178	178
Total current assets	2,081	2,323	10,387	6,135	8,179
Net property, plant and equipment	412	410	454	420	451
Deposits	387	371	371	371	371
Total assets	**2,880**	**3,104**	**11,212**	**6,926**	**9,001**
Accounts payable	753	870	656	766	2,333
Accrued compensation and benefits	1,703	2,089	1,171	1,423	4,375
Deferred revenue	1,683	1,525	2,368	2,368	2,368
Other accrued liabilities	682	575	540	540	540
Short-term debt	-	9,796	-	-	-
Short-term derivative liability	-	8,122	-	-	-
Total current liabilities	4,821	22,977	4,735	5,097	9,616
Deferred rent and other	198	117	72	72	72
Long-term debt	3,662	-	-	-	-
Capital leases	66	31	14	14	14
Long-term derivative liability	2,348	-	-	-	-
Warrant liabilities	509	5,307	38	38	38
Total liabilities	**11,604**	**28,432**	**4,859**	**5,221**	**9,740**
Total stockholders' equity*	**(8,724)**	**(25,328)**	**6,353**	**1,705**	**(739)**
Total liabilities & stockholders' equity	**2,880**	**3,104**	**11,212**	**6,926**	**9,001**

*2017 Includes $22.7 million of additional paid-in-capital
Source: Company filings and Taglich Brothers' estimates

Income Statements for the Fiscal Years Ended
(in thousands $)

	2015A	2016A	2017E	2018E
Revenue	2,705	7,075	9,487	35,000
Cost of revenue	2,433	4,670	6,897	21,000
Gross profit	272	2,405	2,590	14,000
General and administrative	9,049	8,838	12,269	17,000
Depreciation and amortization	122	141	174	180
Operating income (loss)	(8,899)	(6,574)	(9,853)	(3,180)
Other income	64	106	56	56
Interest expense	(2,590)	(5,354)	(3,406)	-
Loss on impairment of intangible assets	(88)	-	-	-
Loss on exchange of warrants	(4,410)	-	-	-
Loss on debt extinguishment	(195)	(2,424)	-	-
Loss on conversion of note	-	-	(1,356)	-
Loss on issuance of common stock	-	-	(145)	-
Change in fair value of warrant liability	11,665	2,093	1,769	-
Change in fair value of derivative liability	(2,761)	(5,774)	132	-
Income before taxes	(7,214)	(17,927)	(12,803)	(3,124)
Income tax	9	9	2	-
Net Income / (Loss)	(7,223)	(17,936)	(12,805)	(3,124)
EPS	(1.07)	(1.95)	(0.89)	(0.18)
Shares Outstanding	6,729	9,179	14,386	17,000
Margin Analysis				
Gross margin	10.1%	34.0%	27.3%	40.0%
SG&A	334.5%	124.9%	129.3%	48.6%
Operating margin	(329.0)%	(92.9)%	(103.9)%	(9.1)%
Net margin	(267.0)%	(253.5)%	(135.0)%	(8.9)%
Tax rate	(0.1)%	-0.1%	0.0%	0.0%
Year / Year Growth				
Total Revenues		161.6%	34.1%	268.9%
Net Income		NMF	NMF	NMF
EPS		NMF	NMF	NMF

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2016A - 2018E
(in thousands $)

	3/16A	6/16A	9/16A	12/16A	2016A	3/17A	6/17A	9/17E	12/17E	2017E	3/18E	6/18E	9/18E	12/18E	2018E
Revenue	728	1,223	1,336	3,788	7,075	1,822	1,665	2,000	4,000	9,487	7,500	8,125	9,375	10,000	35,000
Cost of revenue	966	1,162	1,253	1,289	4,670	1,365	1,332	1,500	2,700	6,897	4,500	4,875	5,625	6,000	21,000
Gross profit	(238)	61	83	2,499	2,405	457	333	500	1,300	2,590	3,000	3,250	3,750	4,000	14,000
General and administrative	2,187	2,136	2,195	2,320	8,838	2,629	2,940	3,200	3,500	12,269	3,800	4,100	4,400	4,700	17,000
Depreciation and amortization	32	32	38	39	141	39	45	45	45	174	45	45	45	45	180
Operating income (loss)	(2,457)	(2,107)	(2,150)	140	(6,574)	(2,211)	(2,652)	(2,745)	(2,245)	(9,853)	(845)	(895)	(695)	(745)	(3,180)
Other income	65	10	15	16	106	14	14	14	14	56	14	14	14	14	56
Interest expense	(333)	(591)	(3,215)	(1,215)	(5,354)	(2,867)	(539)	-	-	(3,406)	-	-	-	-	-
Loss on debt extinguishment	-	-	-	(2,424)	(2,424)	-	-	-	-	-	-	-	-	-	-
Loss on conversion of note	-	-	-	-	-	(926)	(430)	-	-	(1,356)	-	-	-	-	-
Loss on issuance of common stock	-	-	-	-	-	-	(145)	-	-	(145)	-	-	-	-	-
Change in fair value of warrant liability	(228)	(522)	(3,484)	6,327	2,093	(5,181)	6,950	-	-	1,769	-	-	-	-	-
Change in fair value of derivative liability	(1,337)	(1,507)	1,423	(4,353)	(5,774)	(10,596)	10,728	-	-	132	-	-	-	-	-
Income before taxes	(4,290)	(4,717)	(7,411)	(1,509)	(17,927)	(21,767)	13,926	(2,731)	(2,231)	(12,803)	(831)	(881)	(681)	(731)	(3,124)
Income tax	2	3	2	2	9	1	1	-	-	2	-	-	-	-	-
Net Income / (Loss)	(4,292)	(4,720)	(7,413)	(1,511)	(17,936)	(21,768)	13,925	(2,731)	(2,231)	(12,805)	(831)	(881)	(681)	(731)	(3,124)
EPS	(0.47)	(0.51)	(0.81)	(0.16)	(1.95)	(2.35)	0.97	(0.16)	(0.13)	(0.89)	(0.05)	(0.05)	(0.04)	(0.04)	(0.18)
Shares Outstanding	9,168	9,168	9,174	9,179	9,179	9,246	14,299	17,000	17,000	14,386	17,000	17,000	17,000	17,000	17,000
Margin Analysis															
Gross margin	(32.7)%	5.0%	6.2%	66.0%	34.0%	25.1%	20.0%	25.0%	32.5%	27.3%	40.0%	40.0%	40.0%	40.0%	40.0%
SG&A	300.4%	174.7%	164.3%	61.2%	124.9%	144.3%	176.6%	160.0%	87.5%	129.3%	50.7%	50.5%	46.9%	47.0%	48.6%
Operating margin	(337.5)%	(172.3)%	(160.9)%	3.7%	(92.9)%	(121.4)%	(159.3)%	(137.3)%	(56.1)%	(103.9)%	(11.3)%	(11.0)%	(7.4)%	(7.5)%	(9.1)%
Net margin	(589.6)%	(385.9)%	(554.9)%	(39.9)%	(253.5)%	(1194.7)%	836.3%	(136.6)%	(55.8)%	(135.0)%	(11.1)%	(10.8)%	(7.3)%	(7.3)%	(8.9)%
Tax rate	0.0%	(0.1)%	0.0%	(0.1)%	(0.1)%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Year / Year Growth															
Total Revenues					161.6%	150.3%	36.1%	49.7%	5.6%	34.1%	311.6%	388.0%	368.8%	150.0%	268.9%
Net Income					NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF
EPS					NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF	NMF

Source: Company filings and Taglich Brothers' estimates

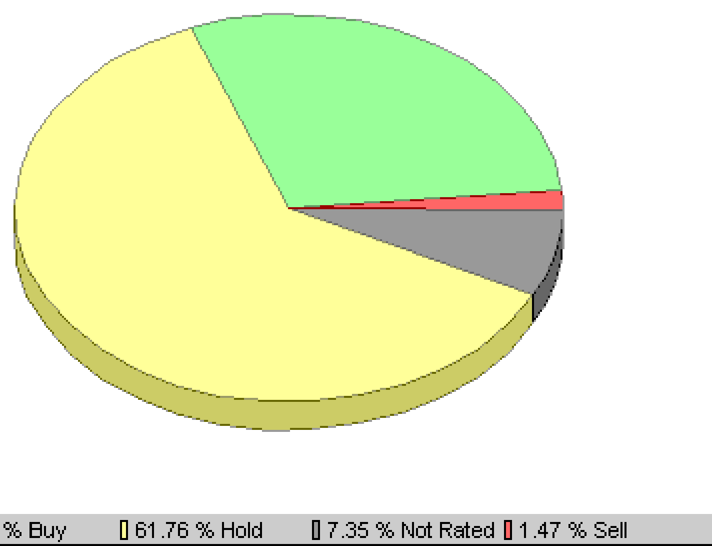
Statement of Cash Flows for the Periods Ended
(in thousands $)

	2015A	2016A	6M17A	2017E	2018E
Net income (loss)	(7,223)	(17,936)	(7,843)	(12,805)	(3,124)
Depreciation & amortization	122	141	84	157	169
Amortization of debt discount and issuance costs	2,324	4,651	3,335	3,335	-
Loss on disposal of intangible assets	88	-	-	-	-
Loss on debt extinguishment	195	2,424	-	-	-
Warrants issued for services	168	-	-	-	-
Provision for doubtful accounts	10	47	234	234	234
Deferred rent	(44)	(70)	(39)	(45)	-
Share-based compensation	1,397	697	159	320	320
Common stock issued for services	172	235	181	360	360
Loss on conversion of convertible debentures	-	-	1,356	1,356	-
Loss on issuance of common stock	-	-	145	145	-
Loss on exchange of warrants	4,410	-	-	-	-
Fair value adjustment on warrant liability	(11,665)	(2,093)	(1,769)	(1,769)	-
Fair value adjustment on derivative liability	2,761	5,774	(132)	(132)	-
Cash earnings (loss)	(7,285)	(6,130)	(4,289)	(8,844)	(2,041)
Changes in assets and liabilities					
Receivables	(111)	(509)	(169)	(359)	(3,794)
Prepaid and other current assets	17	155	242	242	-
Deferred revenue	1,329	(158)	843	843	-
Accounts payable and other	882	916	164	331	4,319
(Increase) decrease in working capital	2,117	404	1,080	1,057	525
Net cash provided by (used in) operations	**(5,168)**	**(5,726)**	**(3,209)**	**(7,787)**	**(1,516)**
Purchases of properrty and equipment	(107)	(106)	(127)	(200)	(200)
Deposits and other assets	-	16	-	-	-
Net cash used in investing	**(107)**	**(90)**	**(127)**	**(200)**	**(200)**
Proceeds from the issuance of common stock and warrants	2,463	-	16,458	16,458	-
Proceeds from bridge loan	-	-	1,300	1,300	-
Proceeds from the issuance of convertible debt	5,910	300	-	-	-
Payments on convertible debt	(2,681)	-	(4,363)	(4,363)	-
Proceeds from the issuance of notes	-	5,505	-	-	-
Transaction costs	(185)	-	(1,667)	(1,667)	-
Capital lease obligations	(24)	(54)	(21)	(46)	(34)
Net cash provided by (used in) financing	**5,483**	**5,751**	**11,707**	**11,682**	**(34)**
Net change in cash	**208**	**(65)**	**8,371**	**3,695**	**(1,750)**
Cash - beginning of period	**708**	**916**	**851**	**851**	**4,546**
Cash - end of period	**916**	**851**	**9,222**	**4,546**	**2,797**

Source: Company filings and Taglich Brothers' estimates

Price Chart

Taglich Brothers' Current Ratings Distribution



Investment Banking Services for Companies Covered in the Past 12 Months		
Rating	#	%
Buy	**2**	**10**
Hold		
Sell		
Not Rated	**1**	**33**

Important Disclosures

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I, John Nobile, the research analyst of this report, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers; and that no part of my compensation was, is, or will be, directly, or indirectly, related to the specific recommendations or views contained in this report.

Public companies mentioned in this report:

Aetna (NYSE: AET)
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General Electric (NYSE: GE)
Goldman Sachs (NYSE: GS)
Humana (NYSE: HUM)

Meaning of Ratings

Buy – The growth prospects, degree of investment risk, and valuation make the stock attractive relative to the general market or comparable stocks.

Speculative Buy – Long term prospects of the company are promising but investment risk is significantly higher than it is in our BUY-rated stocks. Risk-reward considerations justify purchase mainly by high risk-tolerant accounts. In the short run, the stock may be subject to high volatility and could continue to trade at a discount to its market.

Neutral – Based on our outlook the stock is adequately valued. If investment risks are within acceptable parameters, this equity could remain a holding if already owned.

Sell – Based on our outlook the stock is significantly overvalued. A weak company or sector outlook and a high degree of investment risk make it likely that the stock will underperform relative to the general market.

Dropping Coverage – Research coverage discontinued due to the acquisition of the company, termination of research services, non-payment for such services, diminished investor interest, or departure of the analyst.

Some notable Risks within the Microcap Market

Stocks in the Microcap segment of the market have many risks that are not as prevalent in Large-cap, Blue Chips or even Small-cap stocks. Often it is these risks that cause Microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume which can lead to large spreads and high volatility in stock price. In addition, Microcaps tend to have significant company specific risks that contribute to lower valuations. Investors need to be aware of the higher probability of financial default and higher degree of financial distress inherent in the microcap segment of the market.

From time to time our analysts may choose to withhold or suspend a rating on a company. We continue to publish informational reports on such companies; however, they have no ratings or price targets. In general, we will not rate any company that has too much business or financial uncertainty for our analysts to form an investment conclusion, or that is currently in the process of being acquired.