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Research Report – Update

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

Catasys, Inc.

Speculative Buy

John Nobile
December 10, 2018

CATS $11.36 — (NASDAQ)

	2016A	2017A	2018E	2019E
Revenues (millions)	$7.1	$7.7	$14.6	$35.0
Earnings (loss) per share	$(1.95)	$(0.99)	$(0.19)	$(0.49)

52-Week range	$14.29 – $3.30	Fiscal year ends:	December
Common shares out as of 11/13/18	16.1 million	Revenue per share (TTM)	$0.79
Approximate float	4.9 million	Price/Sales (TTM)	14.4X
Market capitalization	$183 million	Price/Sales (FY2019)E	5.2X
Tangible book value/share	$(0.48)	Price/Earnings (TTM)	NMF
Price/tangible book value	NMF	Price/Earnings (FY2019)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 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:

Reiterating Speculative Buy rating and increasing our twelve-month price target to $15.00 per share from $13.00 due primarily to our increased 2019 sales projection.

In 3Q18, enrollment increased 65% from 3Q17. Billings more than tripled to $6.3 million from $2 million in 3Q17. Sequentially, billings increased 21% from $5.2 million in 2Q18.

CATS' outreach pool of eligible members reached approximately 38,000 in 3Q18, 9% higher than at the end of 2Q18. We expect CATS' outreach pool of eligible members should continue to grow due to new program launches and the expansion with existing health plans through our forecast period.

In October 2018, Catasys announced it entered into an agreement with Capital BlueCross, a community-based health insurer serving members in 21 counties in Central Pennsylvania and the Lehigh Valley. Beginning in 1Q19, eligible Capital BlueCross commercial members will be able to take advantage of Catasys' OnTrak solution.

For 2018, we project a loss of $(1.05) per share on revenue growth of nearly 89% to $14.6 million due to growing member enrollment. We previously projected revenue of $14.2 million and a loss of $(1.07) per share. Our forecast primarily reflects 3Q18 results.

For 2019, we project a loss of $(0.49) per share on revenue more than doubling to $35 million. We previously projected revenue of $30 million and a loss of $(0.68) per share. Our increased forecast reflects strong billings growth from a growing pool of eligible members.

CATS reported (November 14, 2018) 3Q18 revenue more than tripled to $4.4 million from $1.2 million. The loss per share was $(0.27) versus $(0.19). We projected revenue of $4 million and a loss of $(0.29) per share.

****Please view our disclosures on pages 13 - 15.***

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Recommendation and Valuation

We are reiterating our Speculative Buy rating on Catasys, Inc. and increasing our twelve-month price target to $15.00 per share from $13.00 due primarily to our increased 2019 sales projection.

Our rating reflects strong revenue growth through our forecast horizon due to increased member enrollment in CATS' OnTrak program. In 3Q18, enrollment increased 65% from 3Q17. Billings more than tripled to $6.3 million in 3Q18 from $2 million in 3Q17.

CATS' outreach pool of eligible members reached approximately 38,000 in 3Q18, 9% higher than at the end of 2Q18. We expect CATS' outreach pool of eligible members should continue to grow due to new program launches and the expansion with existing health plans through our forecast period.

Shares of CATS trade at a multiple of 5.2X (previously 6X) our 2019 sales estimate of $2.17 per share (prior was $1.89). With the strong sales growth we project (averaging over 100% annually into 2019 versus 12% for the industry), we believe CATS' multiple should trade higher than the industry (healthcare services) multiple of 6X (unchanged). Applying a multiple of 7.5X (unchanged) to our FY19 sales per share projection of $2.17, discounted to account for execution risk, we obtain a year-ahead value of approximately $15.00 per share.

Recent Development

<u>*Catasys Signs Agreement with Capital BlueCross*</u> – In October 2018, Catasys announced it entered into an agreement with Capital BlueCross, a community-based health insurer serving members in 21 counties in Central Pennsylvania and the Lehigh Valley. Beginning in 1Q19, eligible Capital BlueCross commercial members will be able to take advantage of Catasys' OnTrak solution.

Business

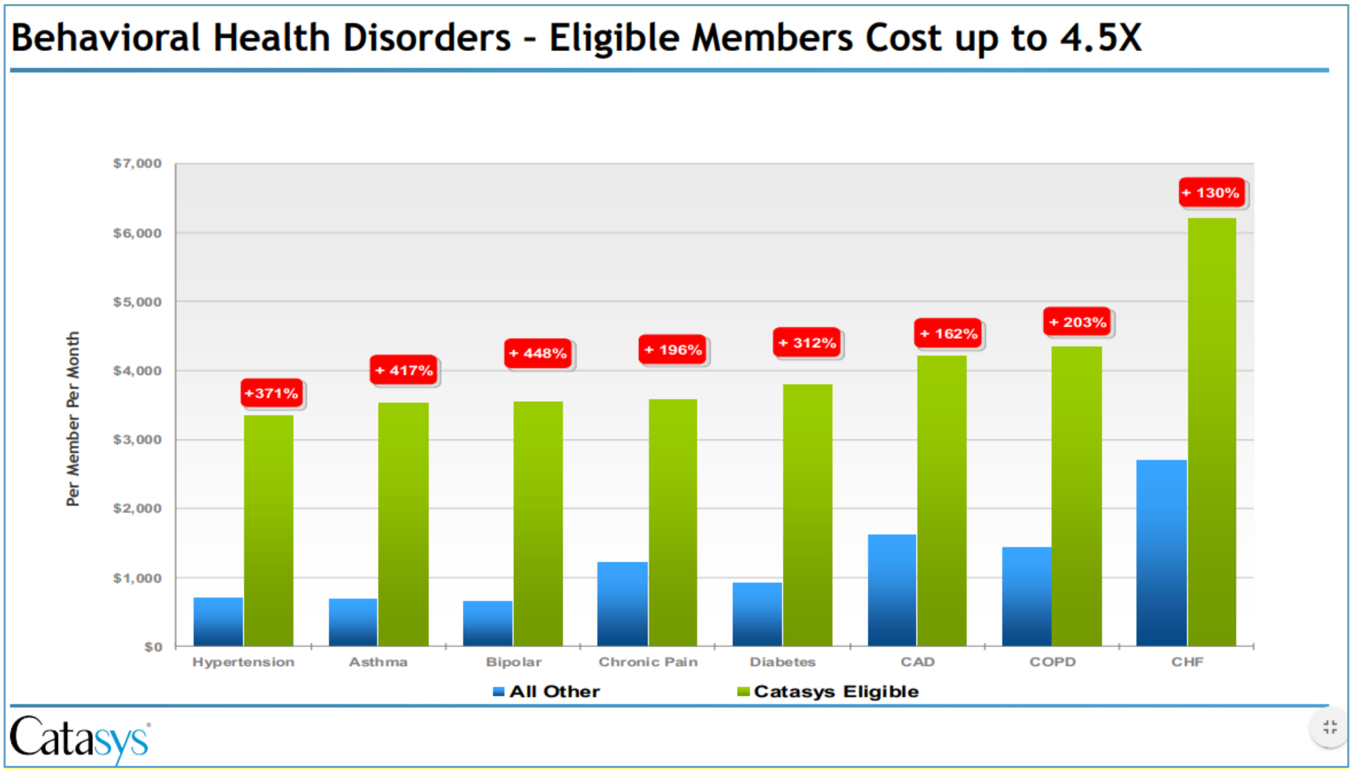
Catasys, headquartered in Los Angeles, California, provides specialized behavioral health management and integrated treatment services to health plans through its proprietary OnTrak solution. OnTrak utilizes proprietary analytics, artificial intelligence and telehealth in integrating medical and psychosocial 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.

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 California, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Massachusetts, Missouri, Nebraska, 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 at right.

Source: Catasys Presentation

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, costs the insurance company approximately $3,500 per month. A typical member that suffers from bipolar disorder but does not exhibit a behavioral health disorder, costs an insurance company approximately $600 per month.



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.

The company receives approximately $6,500 per enrolled member. New customer launches take approximately 12 months to ramp up to a 20% yearly enrollment rate of eligible members. One year after launch, Catasys generally enrolls in excess of 20% of its outreach pool.

Catasys' Markets

According to a report 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's belief is 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 insurance company 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 (latest info available), 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 44.7 million or 18.3% of adults in the US each year and primarily includes anxiety, mood and psychotic 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. Sufferers generally feel anxiety toward events in the future and fear current situations.

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 MDE in 2016 and 9% of adolescents (2.2 million adolescents) had an episode with severe impairment. Thus, adolescents who had an episode with severe impairment represented more than two thirds (70.5%) of adolescents in 2016 with 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 AbleTo 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.

3Q18 and Nine-month 2018 Financial Results

3Q18 – Revenue more than tripled to $4.4 million from $1.2 million. The net loss was $4.4 million or $(0.27) per share versus a loss of $3.1 million or $(0.19) per share. We projected 3Q18 revenue of $4 million and a net loss of $4.6 million or $(0.29) per share.

The increase in revenue was primarily due to growth in enrolled members, partly offset by the timing of billings.

Cost of revenue nearly doubled to $3.2 million from $1.7 million, which resulted in a gross margin of 25.9% compared to (39.2%) 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 them.

General and administrative expenses nearly doubled to $5.1 million from $2.6 million reflecting investments in data science, information technology and software development to support growth and drive efficiency.

Interest expense increased to $241,000 from $1,000 in 3Q17 due to increased debt levels.

The company had issued warrants to purchase common stock in April 2015 which 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 3Q18 and 3Q17, Catasys recognized a loss of $65,000 and $2,000, respectively, related to the change in the fair value of its warrant liabilities.

Nine-months 2018 – Revenue more than doubled to $9.6 million. The net loss was $12.8 million or $(0.80) per share versus a loss of $10.9 million or $(0.30) per share. Excluding changes in warrant and derivative liabilities and the loss on conversion of note, the 2017 net loss was $11.5 million or $(0.32) per share.

(in thousands $)	9M18A	9M17A
Revenue	9,553	4,682
Cost of revenue	8,465	4,361
Gross profit	1,088	321
General and administrative	13,298	8,144
Depreciation and amortization	229	131
Operating income (loss)	(12,439)	(7,954)
Other income	40	44
Interest expense	(278)	(3,408)
Loss on conversion of note	-	(1,356)
Loss on issuance of common stock	-	(145)
Change in fair value of warrant liability	(94)	1,767
Change in fair value of derivative liability	-	132
Income before taxes	(12,771)	(10,920)
Income tax	-	4
Net Income / (Loss)	(12,771)	(10,924)
EPS	(0.80)	(0.30)
Shares Outstanding	15,909	36,181
Margin Analysis		
Gross margin	11.4%	6.9%
SG&A	139.2%	173.9%
Operating margin	(130.2)%	(169.9)%
Net margin	(133.7)%	(233.3)%
Tax rate	0.0%	(0.0)%
Year / Year Growth		
Total Revenues	104.0%	
Net Income	NMF	
EPS	NMF	

Source: Company filings

The increase in revenue was primarily due to growth in enrolled members, partly offset by the timing of billings.

Cost of revenue nearly doubled to $8.5 million from $4.4 million, which resulted in a gross margin of 11.4% compared to a gross margin of 6.9% 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 them.

General and administrative expenses increased 63.3% to $13.3 million reflecting investments in data science, information technology and software development to support growth and drive efficiency.

Interest expense decreased to $278,000 from $3.4 million in 2017 due to the conversion to equity of convertible debentures in April 2017.

The change in fair value of derivative liabilities was nil versus a gain of $132,000 in 9M17. The change in fair value of its warrant liabilities was a loss of $94,000 compared to a gain of $1.8 million in 9M17.

<u>*Liquidity*</u> - As of September 30, 2018, the company had $4.9 million cash, a current ratio of 0.9, $7.4 million of debt, and a shareholders' deficit of $7.7 million.

In 9M18, cash used in operations was $7.1 million consisting of a $10.1 million cash loss and a $3.1 million decrease in working capital. The decrease in working capital was primarily due to increases in deferred revenue, payables and accrued liabilities, offset in part by an increase in receivables. Cash provided by financing of $7.1 million consisted primarily of increased debt. Cash increased by $76,000 to $4.9 million at September 30, 2018.

In June 2018, CATS entered into a $7.5 million loan agreement with Horizon Technology Finance Corporation and a $2.5 million receivables financing agreement with Heritage Bank of Commerce. The interest rate on the loan is 8.75% plus the amount by which one-month LIBOR exceeds 2.0%. The interest rate on the receivable facility is prime plus 3%.

Economic Outlook

In October 2018, the IMF lowered its global economic growth estimate to 3.7% for both 2018 and 2019, down 0.2% for both periods from its July 2018 estimate. The downward revision was due to rising trade barriers and a reversal of capital flows to emerging economies.

The IMF kept its economic growth estimate for the US at 2.9% for 2018 but lowered its 2019 estimate to 2.5%, down 0.2% from its July 2018 estimate. While the IMF believes that economic momentum is still strong as fiscal stimulus continues to rise, the downward revision for 2019 reflects $200 billion in tariffs on US imports from China.

The 2nd estimate of US GDP growth (released on November 28, 2018) showed the US economy grew at an annual rate of 3.5% in 3Q18, down from 4.2% in 2Q18. The 3Q18 US GDP growth estimate primarily reflects increases in consumer spending, inventory investment, government spending, and business investment.

Projections

<u>*Basis for forecast*</u> – We anticipate strong revenue growth through our forecast horizon due to increased member enrollment in CATS' OnTrak program.

In 3Q18, Catasys' enrollment increased 65% from 3Q17. Billings more than tripled to $6.3 million in 3Q18 from $2 million in 3Q17. Compared to 2Q18, billings increased 21% from $5.2 million.

In 3Q18, CATS' outreach pool of eligible members reached approximately 38,000, 9% higher than at the end of 2Q18. We expect CATS' outreach pool of eligible members should continue to grow due to new program launches and the expansion with existing health plans through our forecast period.

_FY18_ – We project a net loss of $16.8 million or $(1.05) per share on revenue growth of nearly 89% to $14.6 million due to growing member enrollment. We previously projected revenue of $14.2 million and a net loss of $17 million or $(1.07) per share). Our forecast primarily reflects 3Q18 results.

We project gross profit increasing to $2.5 million from $1.3 million with gross margins increasing to 17.3% from 17.2%, as the company begins to benefit from its past investments in staffing in support of future contracts.

We project G&A expenses increasing by $6.6 million to $18.4 million reflecting investments in technology to support growth and drive efficiency. G&A expense margins should decrease to 126.8% from 153.1%.

We project $519,000 in interest expense and the company paying minimal to no taxes due to its large amount of net operating loss carry-forwards ($235 million as of December 31, 2017).

We project CATS' will use $9.4 million cash from operations primarily from its cash loss of $12.6 million offset in part by a $3.2 million decrease in working capital. The decrease in working capital should be primarily due to increases in deferred revenue offset in part by an increase in receivables. The company's cash used in operations should necessitate a $7.5 million raise from the issuance of debt, decreasing cash by $2.2 million to $2.5 million at December 31, 2018.

_FY19_ – We project a net loss of $7.9 million or $(0.49) per share on revenue more than doubling to $35 million. We previously projected revenue of $30 million and a net loss of $10.8 million or $(0.68) per share. Our increased forecast reflects strong billings growth from a growing pool of eligible members.

We project gross profit increasing to $15.2 million from $2.5 million with gross margins increasing to 43.3% from 17.3%. The increase in gross margins reflects prior years investments in support staff.

We project G&A expenses increasing by $3.6 million to $22 million reflecting continued investments in technology to support growth and drive efficiency. G&A expense margins should decrease to 62.9% from 126.8%.

We project $964,000 in interest expense from a full year of interest payments from the 2018 issuance of debt. The company should pay minimal to no taxes due to its large amount of net operating loss carry-forwards.

We project CATS' will use $2 million cash from operations primarily from its cash loss of $2.5 million. Cash should decrease by $2.1 million to $473,000 at December 31, 2019.

Risks

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

Going concern – Catasys has been unprofitable and has experienced negative cash flow from operations since its inception in 2003. 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 – Approximately 61% 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 4.9 million shares in the float and the average daily volume is approximately 86,000 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	2017A	9/18A	2018E	2019E
Cash and cash equivalents	916	851	4,779	4,855	2,534	473
Receivables	590	1,052	511	2,391	2,426	3,208
Prepaid and other	575	420	366	628	628	628
Total current assets	2,081	2,323	5,656	7,874	5,587	4,310
Net property, plant and equipment	412	410	612	314	307	164
Deposits	387	371	336	291	291	291
Total assets	**2,880**	**3,104**	**6,604**	**8,479**	**6,185**	**4,765**
Accounts payable	753	870	980	441	502	826
Accrued compensation and benefits	1,703	2,089	1,177	1,205	1,455	2,450
Deferred revenue	1,683	1,525	2,914	5,031	5,031	5,031
Other accrued liabilities	682	575	578	1,973	1,973	1,973
Short-term debt	-	9,796	-	-	-	-
Short-term derivative liability	-	8,122	-	-	-	-
Total current liabilities	4,821	22,977	5,649	8,650	8,961	10,280
Deferred rent and other	198	117	25	-	-	-
Long-term debt	3,662	-	-	7,415	7,415	7,415
Capital leases	66	31	2	-	-	-
Long-term derivative liability	2,348	-	-	-	-	-
Warrant liabilities	509	5,307	30	124	124	124
Total liabilities	**11,604**	**28,432**	**5,706**	**16,189**	**16,500**	**17,819**
Total stockholders' equity*	**(8,724)**	**(25,328)**	**898**	**(7,710)**	**(10,315)**	**(13,055)**
Total liabilities & stockholders' equity	**2,880**	**3,104**	**6,604**	**8,479**	**6,185**	**4,765**

*2018 includes $1.9 million gain from the adoption of accounting standard
Source: Company filings and Taglich Brothers' estimates

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

	2015A	2016A	2017A	2018E	2019E
Revenue	2,705	7,075	7,717	14,553	35,000
Cost of revenue	2,433	4,670	6,391	12,040	19,833
Gross profit	272	2,405	1,326	2,513	15,168
General and administrative	9,049	8,838	11,811	18,448	22,000
Depreciation and amortization	122	141	246	305	143
Operating income (loss)	(8,899)	(6,574)	(10,731)	(16,240)	(6,976)
Other income	64	106	132	40	-
Interest expense	(2,590)	(5,354)	(3,409)	(519)	(964)
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	1,778	(94)	-
Change in fair value of derivative liability	(2,761)	(5,774)	132	-	-
Income before taxes	(7,214)	(17,927)	(13,599)	(16,813)	(7,940)
Income tax	9	9	6	-	-
Net Income / (Loss)	(7,223)	(17,936)	(13,605)	(16,813)	(7,940)
EPS	(1.07)	(1.95)	(0.99)	(1.05)	(0.49)
Shares Outstanding	6,729	9,179	13,751	15,966	16,135
Margin Analysis					
Gross margin	10.1%	34.0%	17.2%	17.3%	43.3%
SG&A	334.5%	124.9%	153.1%	126.8%	62.9%
Operating margin	(329.0)%	(92.9)%	(139.1)%	(111.6)%	(19.9)%
Net margin	(267.0)%	NMF	(176.3)%	(115.5)%	(22.7)%
Tax rate	(0.1)%	(0.1)%	0.0%	0.0%	0.0%
Year / Year Growth					
Total Revenues		161.6%	9.1%	88.6%	140.5%

Source: Company filings and Taglich Brothers' estimates

Quarterly Income Statements 2017A - 2019E
(in thousands $)

	3/17A	6/17A	9/17A	12/17A	2017A	3/18A	6/18A	9/18A	12/18E	2018E	3/19E	6/19E	9/19E	12/19E	2019E
Revenue	1,822	1,665	1,195	3,035	7,717	1,911	3,273	4,369	5,000	14,553	7,000	8,150	9,350	10,500	35,000
Cost of revenue	1,365	1,332	1,664	2,030	6,391	2,287	2,941	3,237	3,575	12,040	4,550	4,890	5,143	5,250	19,833
Gross profit	457	333	(469)	1,005	1,326	(376)	332	1,132	1,425	2,513	2,450	3,260	4,208	5,250	15,168
General and administrative	2,629	2,940	2,575	3,667	11,811	3,786	4,392	5,120	5,150	18,448	5,200	5,400	5,600	5,800	22,000
Depreciation and amortization	39	45	47	115	246	85	85	59	76	305	36	36	36	35	143
Operating income (loss)	(2,211)	(2,652)	(3,091)	(2,777)	(10,731)	(4,247)	(4,145)	(4,047)	(3,801)	(16,240)	(2,786)	(2,176)	(1,429)	(585)	(6,976)
Other income	14	14	16	88	132	40	-	-	-	40	-	-	-	-	-
Interest expense	(2,867)	(539)	(1)	(1)	(3,409)	(1)	(36)	(241)	(241)	(519)	(241)	(241)	(241)	(241)	(964)
Loss on debt extinguishment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loss on conversion of note	(926)	(430)	-	-	(1,356)	-	-	-	-	-	-	-	-	-	-
Loss on issuance of common stock	-	(145)	-	-	(145)	-	-	-	-	-	-	-	-	-	-
Change in fair value of warrant liability	(5,181)	6,950	(2)	11	1,778	(10)	(19)	(65)	-	(94)	-	-	-	-	-
Change in fair value of derivative liability	(10,596)	10,728	-	-	132	-	-	-	-	-	-	-	-	-	-
Income before taxes	(21,767)	13,926	(3,078)	(2,679)	(13,599)	(4,218)	(4,200)	(4,353)	(4,042)	(16,813)	(3,027)	(2,417)	(1,670)	(826)	(7,940)
Income tax	1	1	2	2	6	-	-	-	-	-	-	-	-	-	-
Net Income / (Loss)	(21,768)	13,925	(3,080)	(2,681)	(13,605)	(4,218)	(4,200)	(4,353)	(4,042)	(16,813)	(3,027)	(2,417)	(1,670)	(826)	(7,940)
EPS	(2.35)	0.97	(0.19)	(0.17)	(0.99)	(0.27)	(0.26)	(0.27)	(0.25)	(1.05)	(0.19)	(0.15)	(0.10)	(0.05)	(0.49)
Shares Outstanding	9,246	14,299	15,889	15,889	13,751	15,898	15,913	15,917	16,135	15,966	16,135	16,135	16,135	16,135	16,135
Margin Analysis															
Gross margin	25.1%	20.0%	(39.2)%	33.1%	17.2%	(19.7)%	10.1%	25.9%	28.5%	17.3%	35.0%	40.0%	45.0%	50.0%	43.3%
SG&A	144.3%	176.6%	215.5%	120.8%	153.1%	198.1%	134.2%	117.2%	103.0%	126.8%	74.3%	66.3%	59.9%	55.2%	62.9%
Operating margin	(121.4)%	(159.3)%	NMF	(91.5)%	(139.1)%	(222.2)%	(126.6)%	(92.6)%	(76.0)%	(111.6)%	(39.8)%	(26.7)%	(15.3)%	(5.6)%	(19.9)%
Net margin	NMF	836.3%	NMF	(88.3)%	(176.3)%	(220.7)%	(128.3)%	(99.6)%	(80.8)%	(115.5)%	(43.2)%	(29.7)%	(17.9)%	(7.9)%	(22.7)%
Tax rate	0.0%	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%	0.0%
Year / Year Growth															
Total Revenues	150.3%	36.1%	(10.6)%	(19.9)%	9.1%	4.9%	96.6%	265.6%	64.7%	88.6%	266.3%	149.0%	114.0%	110.0%	140.5%

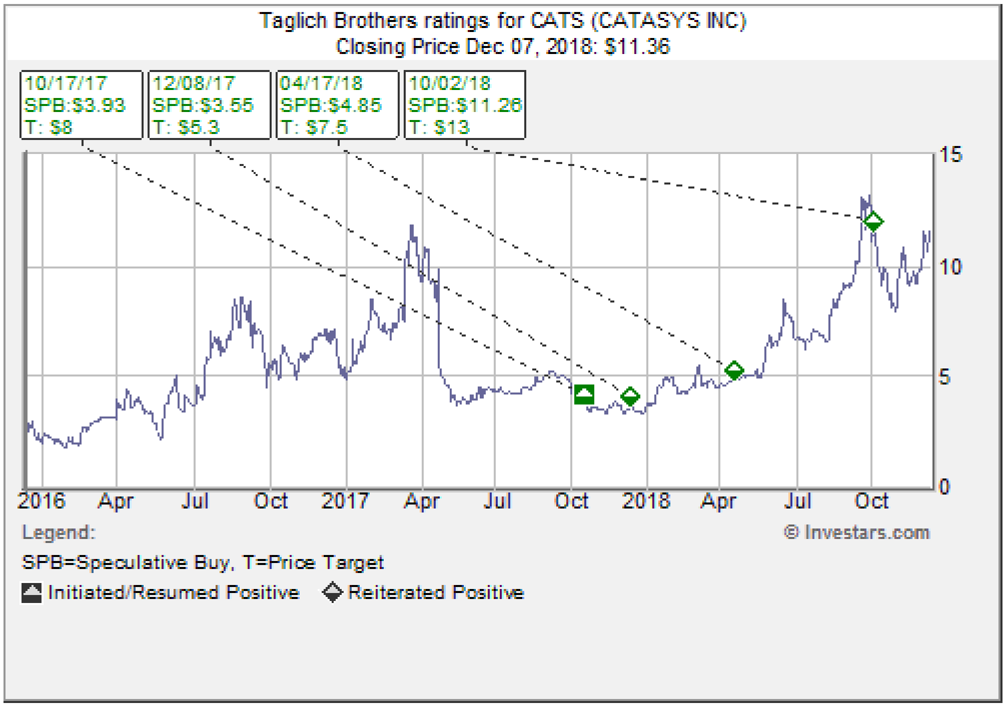
Source: Company filings and Taglich Brothers' estimates

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

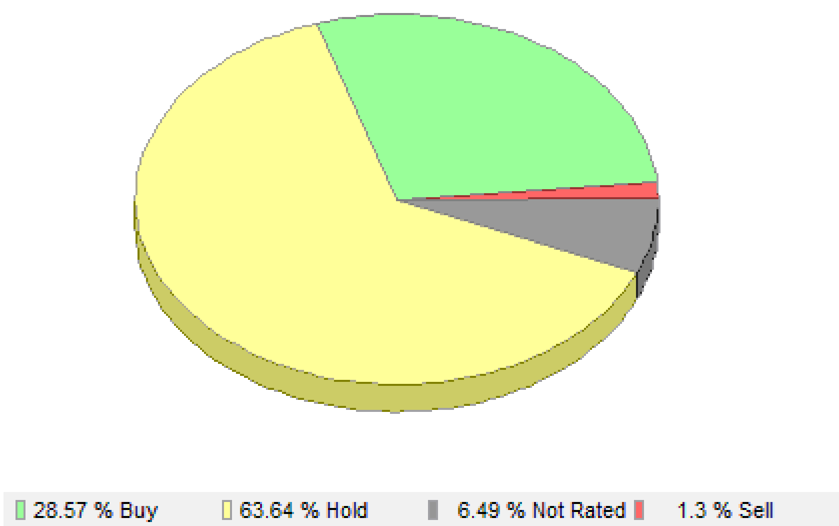
	2015A	2016A	2017A	9M18A	2018E	2019E
Net income (loss)	(7,223)	(17,936)	(13,605)	(12,771)	(16,813)	(7,940)
Depreciation & amortization	122	141	246	229	305	143
Amortization of debt discount and issuance costs	2,324	4,651	3,082	95	127	127
Loss on disposal of intangible assets	88	-	-	69	69	-
Loss on debt extinguishment	195	2,424	-	-	-	-
Warrants issued for services	168	-	252	86	500	850
Provision for doubtful accounts	10	47	590	-	-	-
Deferred rent	(44)	(70)	(81)	(67)	(67)	-
Share-based compensation	1,397	697	465	2,024	2,700	3,500
Common stock issued for services	172	235	181	112	500	850
Loss on conversion of convertible debentures	-	-	1,356	-	-	-
Loss on issuance of common stock	-	-	145	-	-	-
Loss on exchange of warrants	4,410	-	-	-	-	-
Fair value adjustment on warrant liability	(11,665)	(2,093)	(1,778)	94	94	-
Fair value adjustment on derivative liability	2,761	5,774	(132)	-	-	-
Cash earnings (loss)	(7,285)	(6,130)	(9,279)	(10,129)	(12,585)	(2,470)
Changes in assets and liabilities						
Receivables	(111)	(509)	(49)	(1,880)	(1,915)	(783)
Prepaid and other current assets	17	155	54	3	(262)	-
Deferred revenue	1,329	(158)	1,389	3,994	4,360	992
Accounts payable and other	882	916	517	949	1,025	233
(Increase) decrease in working capital	2,117	404	1,911	3,066	3,209	442
Net cash provided by (used in) operations	**(5,168)**	**(5,726)**	**(7,368)**	**(7,063)**	**(9,377)**	**(2,027)**
Purchases of property and equipment	(107)	(106)	(448)	-	-	-
Deposits and other assets	-	16	35	-	-	-
Net cash used in investing	**(107)**	**(90)**	**(413)**	**-**	**-**	**-**
Proceeds from the issuance of common stock and warrants	2,463	-	16,458	-	-	-
Proceeds from bridge loan	-	-	1,300	-	-	-
Proceeds from the issuance of convertible debt	5,910	300	-	-	-	-
Payments on convertible debt	(2,681)	-	(4,363)	-	-	-
Proceeds from the issuance of notes	-	5,505	-	7,500	7,500	-
Transaction costs	(185)	-	(1,667)	(336)	(336)	-
Capital lease obligations	(24)	(54)	(19)	(25)	(33)	(33)
Net cash provided by (used in) financing	**5,483**	**5,751**	**11,709**	**7,139**	**7,131**	**(33)**
Net change in cash	**208**	**(65)**	**3,928**	**76**	**(2,246)**	**(2,060)**
Cash - beginning of period	**708**	**916**	**851**	**4,779**	**4,779**	**2,534**
Cash - end of period	**916**	**851**	**4,779**	**4,855**	**2,534**	**473**

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	**3**	**11**
Hold		
Sell		
Not Rated	**1**	**50**

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)
Centene (NYSE: CNC)
Cray (NASDAQ: CRAY)
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.