crystal research associates
Facts Without Fiction

Catasys, Inc.

CATS-OTC

EXECUTIVE INFORMATIONAL OVERVIEW® September 9, 2015

Catasys, Inc.
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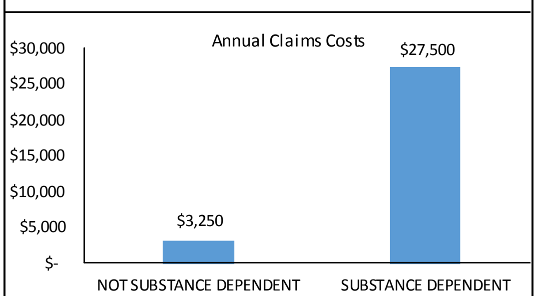
Ticker (Exchange)	CATS (OTC)
Recent Price (09/09/2015)	$0.89
52-week Range	$0.77-$2.45
Shares Outstanding	~46.6 million
Market Capitalization	~$41.5 million
Average 3-month Volume	8,830
Insider Ownership + >5%	~87.3%
Institutional Ownership	~4.3%
EPS (Qtr. ended 06/30/2015)	($0.02)
Employees	50

CATS One-Year Stock Chart

HEALTHCARE PLANS FACE FINANCIAL CHALLENGES ACCOMMODATING HIGH-COST MEMBERS WHO HAVE SUBSTANCE USE DISORDERS



Source: Catasys, Inc.

Company Description

Catasys (or "the Company") provides **big data†**–based analytics and **predictive modeling**–driven health management services for health plans. These services aim to improve member health while simultaneously lowering insurer costs for underserved populations. Catasys' OnTrak™ integrated solutions serve individuals who have **behavioral health** disorders that exacerbate coexisting medical conditions, resulting in higher hospital admissions and emergency room (ER) visits. The Company has developed analytics for identifying which individuals on an insurance plan are "high utilizers" with impactable costs due to having a **substance dependency** or an anxiety disorder. Catasys targets these patients with its proprietary direct outreach capability to enroll them in the OnTrak™ patient-centric treatment program. OnTrak™ integrates evidence-based medical and **psychosocial** interventions in a 52-week outpatient program that has shown a 50%+ reduction in total costs for health insurers' enrolled members—stemming from decreases in hospital days, ambulance usage, and ER visits. The Company has entered into contracts with several insurance providers for OnTrak™, which is now available in 10 states, including through Aetna/Coventry, Humana, Centene, Fallon Health, Health Alliance Medical Plans, and Reliant Medical Group. Collectively, this entails approximately 2.3 million **Commercially Equivalent Lives (CELs)**. Catasys' pipeline includes 10 million additional CELs, with 4 million in advanced discussions. CELs are a metric of growth potential, as increasing CELs may represent increasing future enrollment.

Key Points

- Catasys operates under the premise that substance dependence is a chronic disease, where successful patient outcomes require provider coordination, a whole-person-health treatment philosophy, member skill building, and long-term reinforcement. The Company employs a standardized, evidence-based, integrated treatment program that enables consistent quality of care for members in an outpatient environment, supported by their own **Care Coach**.
- OnTrak™ may help fill the gap that exists as underserved populations with behavioral health conditions do not seek treatment. Moreover, Catasys is able to provide health insurers with data measuring cost reductions and uses this data to help increase adoption of OnTrak™.
- A normal covered life averagely costs a health plan $3,250/year while a high-utilizer, substance-dependent life costs $27,500. If insurers pay Catasys, for example, $8,500 per member who enrolls in OnTrak™, and OnTrak™ generates a 50% cost savings, there is a potential savings to insurers in the first year of ~$5,250 per enrolled member. The cost savings is expected to continue after the first year.
- Catasys' senior management team has over 50 years of experience in substance dependence and 100 years of healthcare experience, specifically in engaging, treating, and empowering members with coexisting medical and behavioral conditions to modify behavior.
- Enrollment in OnTrak™ increased 102% in Q2 2015 versus Q1 2015, and Catasys' Q2 2015 revenue was up 51% year-over-year. As of August 13, 2015, Catasys reported ~$451,000 cash on hand.

†**BOLD** WORDS IN CONTEXT ARE REFERENCED IN THE GLOSSARY ON PAGES 53-54. *See inside for applicable risks and disclosures.*

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Investment Highlights

- ***Over the past several decades, there has been a change in how the U.S. views mental health issues.*** Today, a conversation about a tragic shooting has transitioned from being an "NRA issue" to a "mental health issue," with these topics being picked up by industry, media, and politicians alike. With near-daily news reports of teenage or young adult suicides, attacks on family, military, schools, movie theaters, and so on by undiagnosed and untreated individuals, and a rise in accidental drug overdoses from both illicit and prescription products, conversations have begun to focus on increasing fairness in health insurance for behavioral and mental health conditions while reducing the stigma, costs, and hopelessness of seeking treatment for those who are suffering from a mental or substance disorder.

- ***Substance abuse costs the U.S. over $700 billion annually due to crime, lost work productivity, and healthcare.*** There is a need for more efficient methods of engaging and treating substance-dependent individuals, such as what Catasys is working toward, in order to rectify the treatment gap that currently exists as individuals seek treatment for a physical infirmity but not for an underlying behavioral health condition. As of 2013, approximately 22.7 million U.S. residents (or 8.6% of the population) needed treatment for a problem related to drugs or alcohol, though only 2.5 million people (0.9%) had received treatment at a specialty facility (Source: National Survey on Drug Use and Health).

- ***Catasys offers a new method of integrated substance dependence therapy to health plans and employers for its members through the Company's proprietary OnTrak™ program.*** Employing analytics and proprietary engagement techniques to enroll and engage participants in need of care and patient-centric treatment, the OnTrak™ program has been developed to improve treatment outcomes and lower the utilization of medical health plan services by high-use/high-risk enrollees. Its services integrate medical interventions, a proprietary web-based clinical information platform and database, **manualized** psychosocial programs, and Care Coaching services in a 52-week outpatient program.

    - In any given 30-day period, 10% of the U.S. population is on five or more prescription drugs, many common combinations of which are extremely habit-forming and have a high rate of abuse by patients (Source: CDC). As such, there is a need for substance abuse programs to include physicians trained to fully assess not only the substance dependence but also any other **comorbid** conditions and concerns that may inhibit better health. Catasys has found that many of the high-utilizer individuals identified by its program tend to have chronic and interrelated, comorbid conditions that also need to be managed.

- ***Seeking to transform the entire health management services system, the OnTrak™ program has shown to improve member health while reducing inpatient stays, emergency room utilization, and insurers' total healthcare costs for enrolled members by more than 50%.*** The Company's system is set up with the intent of benefitting healthcare insurers/payers (through cost savings), patients (financially and medically, including encouraging better treatment outcomes as people do not have to avoid treatment or leave the program early due to cost since, for most members, it is 100% covered under their health plan), and Catasys.

- ***Catasys reports that it holds contracts with a number of health insurance plans for the OnTrak™ program, including Aetna/Coventry, Humana, and Centene.*** OnTrak™ is presently available in Florida, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, New Jersey, Oklahoma, West Virginia, and Wisconsin. These contracts cover approximately 2.3 million commercially equivalent lives (CELs). Management has specified that it has a sales pipeline with insurers for an additional 10 million CELs, of which it is in advanced stages of discussion for about four million. Catasys' pipeline reportedly includes existing customers that have acknowledged the value of OnTrak™ and are considering expanding it to additional geographies or lines of business.

- ***Catasys' proprietary data analytics enables it to identify high-cost, substance-dependent members within health insurance plans who have the potential to have reduced costs through effective treatment of their behavioral health conditions.*** The Company then reaches out to these specific members, and has historically been able to persuade an average of 20% of a plan's eligible substance-dependent individuals to enroll in the OnTrak™ treatment program.

- ***High-cost, substance-dependent members cost commercial health plans an estimated eight times more than other members, averaging $27,500 in annual claims versus $3,250 for a "normal" covered life.*** Catasys' data indicates that patients enrolled in the OnTrak™ program exhibit a reduction in claims cost of over 50%. Since health insurers are under constant pressure to reduce costs, they have an incentive to pay Catasys to enroll members in the OnTrak™ program.
    - Catasys' program is helping make substance dependency treatment the same as any medical, pharmacological, or pharmaceutical treatment, where Catasys ***IS*** the treatment. The Company has shown that if payers/insurers pay Catasys $8,500 per commercial life ($9,300 for a Medicare/Medicaid life)—which covers the patient's treatment expenses in the 52-week OnTrak™ outpatient program—the insurer may see a potential savings in the first year of $5,250 (given that it costs a payer/insurer approximately $27,500 in claims costs for these substance-dependent patients, and Catasys has shown a 50% reduction in claims cost). The cost savings is expected to continue after the first year as well as be higher as there is no fee per patient in the second year.
- ***To Catasys' knowledge, OnTrak™ is the only program of its kind entirely devoted to substance dependence.*** Developed by specialists in addiction, OnTrak™ has facilitated the formation of key areas of expertise, differentiating Catasys from others through member engagement, working directly with the member treatment team, providing a consistent, evidence-based treatment across geographies, and a more fully integrated treatment offering.
- ***Catasys can provide its insurance plan customers with outcomes reporting as it relates to clinical and financial metrics to demonstrate and confirm the value of its program***—with data showing an average gross cost reduction of over 50% as measured from the prior 12 months of enrollment. Furthermore, roughly 80% of members who have remained eligible have stayed in the program to date.
- ***The Company's model has been validated in its quarter-over-quarter (and year-over-year) growth.*** For the second quarter 2015 (ended June 30, 2015), revenue was up 51% to $472,000 versus $312,000 reported for the second quarter 2014. Catasys also reported a 102% growth in enrollment in the second quarter 2015 versus the first quarter 2015, which was driven by the expansion of the Company's OnTrak™ program. Catasys recently expanded its Wisconsin program with a national health plan to include its Medicare Advantage members, added a new behavioral health condition (anxiety) in Kansas, and entered into an agreement with a new customer in Illinois that commenced enrollment during the third quarter 2015. For the first six months of 2015, the Company reported revenue of $905,000 versus revenue of $511,000 in the first half of 2014.
- ***There are an estimated 204 million lives covered under managed care in the U.S.*** For every 1 million members in a healthcare plan, approximately $160 million in claims are incurred by commercial plan members diagnosed with substance dependence (equating into what could be a $2 billion market opportunity according to Company calculations). Catasys further has the opportunity to expand into other high-cost, under-managed populations having behavioral health diagnoses, such as anxiety (as it has recently announced) and depressive disorders—which could more than quadruple its current market opportunity.
- ***Catasys is run by senior management that collectively has over 50 years of substance dependence treatment experience and over 100 years of healthcare experience***, having developed an expertise in engaging, treating, and empowering members with coexisting medical and behavioral conditions to modify their behavior.
    - Terren S. Peizer, director, chairman of the board, and chief executive officer (CEO), has personally invested approximately $16 million into Catasys—somewhat uncharacteristic for a microcap company.
- ***Catasys holds certain technology, know-how, and related intangible assets with respect to its OnTrak™ treatment programs.***
- ***As of August 13, 2015, Catasys reported a balance of approximately $451,000 cash on hand.*** The Company had cash and cash equivalents of $152,000 as of June 30, 2015, and subsequently closed on a bridge note financing in July 2015 for approximately $3.3 million in gross proceeds that was used to repay outstanding indebtedness and provide working capital.

Executive Overview

Catasys, Inc. ("Catasys" or "the Company") provides big data–based analytics and predictive modeling–driven health management services for health plans and employers through its novel and proprietary OnTrak™ integrated solutions. Contracted with a growing number of health insurers, Catasys' OnTrak™ has been developed to improve member health while simultaneously lowering insurer costs by greater than 50% for underserved populations who have behavioral health conditions, such as a substance dependency or anxiety disorder, which exacerbate coexisting medical conditions, resulting in higher hospital admissions, ambulance usage, and emergency room (ER) visits. Catasys employs data analytics to identify which individuals on an insurance plan are high utilizers with impactable costs, and is able to engage patients with its proprietary direct outreach capability to enroll individuals in need of care into the OnTrak™ patient-centric treatment program. OnTrak™ entails a standardized, evidence-based, integrated treatment program that enables consistent quality of care for members in an outpatient environment, supported by their own Care Coach.

The Company's current contracts with large health insurance firms include agreements with Aetna/Coventry (Aetna acquired Coventry in May 2013), Humana, and Centene, among others, and cover nearly 2.3 million Commercially Equivalent Lives (CELs) across 10 states—Florida, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, New Jersey, Oklahoma, West Virginia, and Wisconsin. CELs are a key operating metric that Catasys believes reflects the Company's growth potential, since increasing CELs may represent increasing potential future enrollment and revenue streams. As well, Catasys holds a pipeline with insurers that could add 10 million more CELs, for which the Company is in advanced discussions for four million of these. Catasys has initially targeted the high-cost substance abuse populations—incentivizing healthcare plans to spend more on behavioral health—which has shown to lower hospital utilization and costs. As well, Catasys is expanding into other high-cost, under-managed populations within behavioral health such as anxiety (and potentially depression), which based on limited data analysis could quadruple its current market opportunity. To this end, the Company recently extended its OnTrak™ program with a national healthcare provider in Kansas to include members with anxiety (representing the first agreement for this indication).

Substance Dependence

Scientific research has confirmed that substance use and abuse interferes not only with normal brain functioning, but can also have long-lasting effects even after an individual discontinues use. It has been demonstrated that at some point during the course of use, changes may occur in the brain that can turn drug and alcohol abuse into substance dependence—a chronic, relapsing, and potentially fatal condition. Individuals who are dependent may suffer from compulsive drug cravings and may be unable to discontinue use or stay drug abstinent. To break this behavior, professional medical treatment is almost always necessary. Unidentified and untreated, the consequences of substance dependency, anxiety, and depressive disorders can be fatal for the afflicted as well as innocent bystanders.

Market Size

Substance dependence, which affects many individuals with wide-ranging social consequences, remains a global problem with prevalence rates continuing to rise despite efforts by national and local health authorities. As of 2013, approximately 22.7 million U.S. residents (or 8.6% of the population) needed treatment for a problem related to drugs or alcohol, though only 2.5 million people (0.9%) had received treatment at a specialty facility (Source: the National Survey on Drug Use and Health, published by the Substance Abuse and Mental Health Services Administration [SAMHSA], an agency of the U.S. Department of Health and Human Services).

Substance dependence is often under identified by organizations that provide health benefits, though the impact of substance-dependent individuals can be considerable given the following attributes common to this population:

(1) substance-dependent individuals can be prevalent in any organization;

(2) they cost healthcare plans and employers a disproportionate amount of money;

(3) they have higher rates of absenteeism combined with lower rates of productivity; and

(4) when they have co-morbid medical conditions, they incur increased costs for the treatment of these conditions versus a non-substance dependent population.

When assessing substance dependence-related costs, many organizations have traditionally only considered direct treatment costs (typically behavioral claims), when, in reality, substance-dependent individuals by and large have poorer overall health and lower compliance than non-substance dependent individuals, leading to higher costs for related, or even unrelated, co-occurring medical conditions. In these cases, Catasys' analysis has shown that, of the *total* healthcare claims related to substance dependence, the majority are medical claims rather than for behavioral treatment.

There are an estimated 204 million covered lives under various private managed care programs in the U.S., such as Preferred Provider Organizations (PPOs), Health Maintenance Organizations (HMOs), self-insured employers, and managed Medicare/Medicaid programs. It is estimated that approximately 1.9% of these commercial plan members will receive a substance dependence diagnosis every year—a figure which may be greater or lesser for specific payers (depending on the health plan's location and demographics), noting that a higher cost subset of this population drives the majority of the claims costs for the overall substance-dependent population. With that, for every one million members in a healthcare plan, approximately $160 million in claims are incurred by commercial plan members diagnosed with substance dependence (translating into what Catasys believes to be a $2 billion market opportunity). For commercial members with substance dependence and a total annual claims cost of at least $7,500, the average annual per member claims cost is $27,500. This compares to an average of $3,250 for a commercial non-substance dependent member.

The Need for Catasys' OnTrak™ Program

Under current healthcare paradigms, financial responsibility for care is largely divided between health plans covering the costs of treating physical health and managed behavioral healthcare organizations (MBHOs) covering the costs of treating behavioral health. The challenge is that physical and behavioral health are intertwined and impact each other. This can have severe health and cost consequences when an individual has a behavior disorder impacting their physical health but only seeks care when necessary for the physical health condition. For example, a member with substance dependence and diabetes is likely to continue to have ER and inpatient hospital visits related to their diabetes, as long as they continue to abuse alcohol or drugs. In this scenario, the health plan would pay for the high hospital costs for the diabetes, but the member would receive no treatment for the substance dependence. The MBHO is not involved in this case since the member is not seeking substance dependence treatment. Catasys recognized this gap in care and the importance of proactively identifying, engaging, and integrating care for these members who are "falling through the crack" between the health plan and the MBHO.

Catasys' customers provide health insurance to individuals or groups (Contracted Membership), where the Company contracts with its customers to provide the OnTrak™ program typically within specific lines of business (e.g., commercial, Medicare, Medicaid, etc.) and/or in specific states or other geographical areas and for specific indications, including substance use disorders and, more recently, anxiety disorders. The Contracted Membership for which Catasys provides its OnTrak™ program are called "covered lives." Catasys typically receives data as it relates to the Covered Lives on a regular basis from its customers and uses that data to identify members who meet its contractual eligibility requirements (Eligible Members). Catasys then attempts to engage and enroll those members in its OnTrak™ program. Eligible Members can fluctuate significantly month to month due to variations in customers' Contracted Membership and variations in eligibility that stem from changes in claims or eligibility data provided to Catasys by its customers.

Based on analysis of data provided to Catasys by its customers, roughly 0.045% of the adult Contracted Membership in a commercial line of business is believed to be eligible for the OnTrak™ program. As well, the Company's analysis concludes that the Medicare and Medicaid lines of business average approximately 2.5 times the number of Eligible Members for the OnTrak™ program as the same number Covered Lives in a commercial line of business. Furthermore, as Catasys brings the OnTrak™ programs into anxiety (and potentially depression), preliminary data analysis shows that adding these indications into the Company's Covered Lives could considerably increase the pool of Eligible Members. Based on Catasys' analysis of data provided by one client that has contracted with Catasys to provide OnTrak™ for anxiety, the addition of the anxiety indication could increase the number of Eligible Members by roughly four-fold over substance use disorders alone.

The OnTrak™ Approach

The Company's OnTrak™ integrated treatment solutions (which have been developed to improve treatment outcomes and lower the utilization of medical and behavioral healthcare plan services by high-utilizing and high-risk enrollees) include medical and psychosocial interventions; a proprietary web-based clinical information platform; manualized, evidence-based psychosocial programs; and integrated Care Coaching services. "Manualized" indicates that the psychosocial programs have been written into a manual for providers to follow. This practice is believed to be somewhat unusual in behavioral health, specifically for substance disorder treatments, though it is an important aspect of Catasys' services, as having a manual provides for consistency of the treatment delivery and improves adherence to clinical standards. Another key aspect of Catasys' program is its flexibility, where it can be changed in a modular way to enable the Company to partner with payers to accommodate their requirements. A summary of the key features of OnTrak™ is provided in Figure 1, followed by an outline of the program's approach in Figure 2 and described thereafter.

Figure 1

KEY FEATURES OF ONTRAK™

- Ongoing outreach and engagement
- Evidence-based treatment protocols
- Integrated medical and psychosocial treatment
- Development of select provider networks
- Provider training and ongoing evaluations
- Member electronic health record
- Care coach support
- Predictive modeling and analytics (proactive versus reactive identification and engagement)
- High-intensity, 52-week program

Source: Catasys, Inc.

Figure 2

ONTRAK™ APPROACH

- Identifies members where the program can have an impact
- Engages these members
- Enrolls/refers these members
- Has a provider network
- Provides for outpatient medical treatment
- Provides for outpatient psychosocial treatment
- Provides for care coaching
- Monitors and reports
- Has a web-based clinical information platform called eOnTrak™

Source: Catasys, Inc.

The OnTrak™ Program

Developed by specialists in addiction, Catasys assists health plans in identifying those members who incur significant costs and may be appropriate to enroll in its OnTrak™ program. These members are then engaged and enrolled through direct mailings and telephone outreach, as well as through referral from health plan sources. Following enrollment, the Company's specially trained network of providers employs treatments via integrated medical and psychosocial treatment modalities, such as the **OnTrak™ Relapse Prevention Program**, to assist in developing improved coping skills and a recovery support network.

During the treatment process, Catasys' Care Coaches work directly with members to keep them involved in treatment by proactively providing support to enhance motivation, minimize lapses, and enable lifestyle modifications—which have proven consistent with the recovery objectives. The Company also links providers and Care Coaches to member information through Catasys' eOnTrak™, a web-based clinical information platform, which, in conjunction with other communications, allows each member of the treatment team to be better educated regarding a member's treatment so that they can help provide the most effective care possible. From time to time, Catasys provides outcomes reporting as it relates to clinical and financial metrics to its customers to demonstrate the value of its program—with data showing an average gross cost reduction of over 50% as measured from the 12 months prior to enrollment. Furthermore, roughly 80% of members who have remained eligible have stayed in the program. This figure is obtained by calculating the number of people who have graduated from the program or are currently in treatment over the number of people who have remained eligible. Members are enrolled in OnTrak™ for a maximum of one year though Catasys follows their cost savings to insurers for a maximum of two years (assuming the member has remained with their health plan).

Growth Strategy

Catasys' business model provides for an integrated medical and behavioral program to assist health plans in treating and managing plan members whose behavioral health conditions are aggravating coexisting medical conditions and, consequently, lead to higher medical costs. The Company is initially focused on members with substance use disorders, having a goal of expanding through increased adoption by health plans and other payers. Catasys further seeks to expand into additional populations that experience high treatment costs caused by other behavioral health disorders. Key elements of Catasys' growth strategy include the following:

- Demonstrating and validating the potential for better clinical outcomes and lower costs using the Company's OnTrak™ program with key managed care and other third-party payers;

- Educating third-party payers about the excessively high costs related to their substance-dependent members;

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

- Generating outcomes data from OnTrak™ that demonstrates cost reductions and using this data to increase adoption. The Company believes that OnTrak™ could help fill the gap where there is an absence of programs that proactively engage the right individuals in smaller populations with excessively higher costs driven by behavioral health conditions.

Second Quarter 2015 Financial Highlights

For the second quarter ended June 30, 2015, Catasys reported revenue of $472,000, up 51% from $312,000 for the second quarter 2014. The Company also reported $853,000 in deferred revenue, up 65% versus $515,000 for the first quarter 2015. Depending on the customer, deferred revenue is either recognized over the course of the 52-week program when fees are received in advance, or annually when savings calculations are completed in cases where fees are subject to achieving savings at least equal to program fees. Catasys has been able to record its deferred revenue as actual revenue during the course of the business cycle, except for limited cases where members terminated from the program early. Total revenue increases were driven by an expansion of Catasys' customer base and health plan populations covered under the OnTrak™ program.

The Company announced total operating expenses for the second quarter 2015 of $2.98 million versus $2 million for the year-ago quarter, primarily due to the higher cost of healthcare services based on increasing enrollment and non-cash general and administrative (G&A) expenses. G&A expense was $2.4 million in the second quarter 2015 versus $1.7 million during the same period in 2014. This increase was primarily due to non-cash compensation expense for stock option grants to the members of the Board of Directors.

The Company reported a net loss of $587,000, or a $0.02 loss per basic and diluted share, for the second quarter ended June 30, 2015, versus a net loss of $27.4 million, or a $1.27 loss per basic and diluted share, for the second quarter 2014.

Corporate History and Employees

Catasys was founded to serve health payers/insurers, and provide innovative and integrated substance dependence treatment solutions for their members. The Company previously was called Hythiam, Inc. when it was launched in 2004 and changed its name to Catasys effective March 17, 2011, to better reflect the evolved focus of the Company in providing health insurers and other payers with a comprehensive behavioral health management solution. As of August 20, 2015, Catasys employed 50 employees. The Company was incorporated in the State of Delaware on September 29, 2003. Principal executive offices are located at 11601 Wilshire Blvd., Suite 1100, Los Angeles, California 90025.

Developing the Value Proposition for OnTrak™

In 2007-2008, Catasys was searching for different payers or avenues of payment for treatment programs, understanding that patients largely did not want to pay for treatment themselves given the perception that the treatment did not work. Rather, the Company sought to create a value proposition for health plans that would motivate plan providers to cover 100% of the substance abuse treatment costs. Based on the preliminary data, Catasys knew that these patients were costing health plans a large amount of money in emergency room visits and hospital stays. Thus, if the precise expense could be identified and a program created that would minimize this expense, it could in itself become the value proposition. Catasys concluded that if analytics companies could build predictive models to help profile terrorists for a national security agency, the Company should be able to—through claims data—develop analytics and models that identify individuals with behavioral health conditions (e.g., substance-dependence, anxiety, depression) and high costs that could be reduced through appropriate treatment.

It is estimated, based on claims analysis performed by Catasys and others, that up to 74% of high-cost individuals with substance use disorders in the U.S. have not had a claim related to treatment for their condition in the past year due to a variety of reasons, including the stigma of being labeled. Initially, Catasys worked with predictive modeling experts and an actuarial firm that maintained a large database of health plan claims to develop the cost profiles of health plan members and identify which of the high-cost members could be expected to have reduced costs with effective treatment. A composite of 20 million commercial health plan members was used to develop the utilization patterns and costs associated with high-cost (over $7,500 in claims per year) members. Also, a first predictive model was developed to identify individuals whose costs could be expected to decrease with effective treatment for substance dependence. This was the basis for the analytics that Catasys uses today and continues to improve upon as additional members are added to the program. In order to create a robust and effective treatment program to address the identified individuals, Catasys has integrated medical treatment with a manualized, evidence-based, outpatient, high-touch psychosocial program developed in conjunction with researchers at the University of Washington at Seattle, as well as 52 weeks of Care Coaching by a Catasys-employed nurse.

Key Cost Findings

According to government statistics, in a commercial plan, roughly 10% of individuals are substance dependent, and based on Catasys' analysis, approximately 2% of the adult population in a commercial health plan will likely receive a diagnosis for substance use disorders in a given year. Importantly, with the Company's analytics and algorithms, Catasys believes that it can identify (by analyzing their claims data) the approximate 20% of the diagnosed population who are "high utilizers" and whose claims could potentially be reduced through treatment. "High utilizers" of medical services can cost the plan an average of $27,500 per year. On average, a covered life without substance dependence only costs a health plan $3,250 per year while a substance-dependent individual can cost a health plan an average of $8,000 per year.

There are remaining individuals who are substance dependent but who remain undiagnosed; however, the Company is working to launch programs for anxiety and potentially depression and believes that individuals diagnosed with these disorders may also have undiagnosed substance use disorders, as these are frequently interrelated, comorbid conditions.

Treatment Results

The high-touch outpatient program is generally intensive for the first three to four months, which entails patient treatment, as appropriate, by a physician (e.g., an internist, a psychiatrist, an **addictionologist** who specializes in addictions, or likewise) and a psychologist, as well as coaching and care coordination by Catasys' Care Coaches. Catasys creates a select provider network of physicians and psychologists who are not employees but are in the network. The balance of the 52-week program is primarily focused on practicing and reinforcing the skill building and behavior modification techniques learned during the initial phase and medical and/or psychosocial visits to address coexisting medical or behavioral conditions, with the intensity being driven by member needs.

Throughout the program, there is constant communication with the member to keep him/her engaged in the program. Greater details of the Company's OnTrak™ program are provided on pages 25-29. Catasys reports that it has to date retained 80% to 85% of all patients who have remained eligible in its OnTrak™ program. This retention is believed to be a significant contributing factor in reducing the number of ER visits and inpatient hospital stays, which makes up the bulk of the high costs that the member incurred prior to enrolling in the OnTrak™ program.

The Estimated Savings for Insurers

The Company had 20 million commercial composite lives analyzed by an actuarial firm to illustrate the cost of members with substance use disorders and demonstrate the potential for savings. This analysis demonstrated that there is a potential savings of more than $24,000 based on the difference between average high-utilizing members with substance use disorders versus average members without substance use disorders. If payers/insurers pay Catasys $8,500 per commercial life ($9,300 for a Medicare/Medicaid life)—which generally covers 100% of the patient's treatment expenses in the 52-week OnTrak™ outpatient program for commercial and Medicaid plans (normal cost sharing applies for Medicare members)—the insurer may see a potential savings in the first year of $5,250 (given that the average total cost of such member for a payer/insurer is approximately $27,500 prior to enrollment and there is a 50% savings as Catasys has reported experiencing for its enrolled members). Moreover, Catasys also follows the costs of patients it retains in the 52-week program for the 12 months post-graduation, marking a total of two years, in order to demonstrate that the patients' costs to the plan are lower post treatment as well. Accounting for two years of cost savings minus the $8,500 fee to Catasys, the Company anticipates that the potential total savings to a health plan is likely to be $19,000, or a greater than two-to-one return on investment for the health plan over the first two years plus potentially an additional $13,000 to $14,000 back in a third year post enrollment in OnTrak™—a key paradigm shift for the industry.

Importantly, amid the cost savings is a significant patient benefit of having all or close to all of treatment costs covered so patients are not responsible for any of these costs. As an example, should an individual require a month in the Hazelden Betty Ford Center (a well-known addiction treatment center), a payer/insurer may reimburse a week or five days, and the remainder is paid by the insured. In contrast, Catasys' program has been designed to pay all or substantially all (normal copays apply for some members) of the patient treatment costs, which is a key driver to changing the care system to where the health plan is actually incentivized to pay significantly more for treatment costs. The Company's system is set up with the intent of benefitting the insurers (through cost savings), the patients (financially and medically, including encouraging better treatment outcomes as people do not have to avoid treatment or leave the program early due to cost), and Catasys.

Catasys' program is helping make substance dependency treatment the same as any medical, pharmacological, or pharmaceutical treatment, where Catasys ***IS*** the treatment. The Company has opted to begin with substance dependence and is in the process of rolling out anxiety treatment, and expects to enter treating individuals with depression in the future.

Figure 3
REVENUE MODEL
(ASSUMES 1 MILLION COVERED LIVES)

	Commercial	Medicare
Incidence of substance dependence (SD) (1.9% / 2.6%)	19,000	26,000
Eligible (0.45% / 1.12%)	4,500	11,200
Assumed 20% enrollment in program	900	2,240
Revenue per enrolled member at 80% retention	$ 6,800	$ 7,440
Revenue per million covered members	$ 6,120,000	$ 16,666,000

Note: Each Medicare covered life is equivalent to 2.5 covered commercial lives.

Source: Catasys, Inc.

Growth Strategies and Milestones

To date, Catasys reports that approximately $220 million has been invested into the Company. With research and development (R&D) now complete, the Company is in the process of commercializing its program. Catasys is focused on increasing enrollment as it seeks to expand into additional states as well as behavioral health categories beyond substance use disorders. The Company achieved a 91% increase in enrollment in the first half of 2015 compared to the first half of 2014, which follows an 81% increase in enrollment from 2013 to 2014, and a 105% increase in enrollment from 2012 to 2013. Driving this growth has been an increasing customer base and an expansion of existing customers since launch.

The Company has achieved the recent milestones as listed below over the past several months, and aims to accomplish the following potential milestones in the near term (as outlined on page 13).

Recent Milestones

- In May 2015, enrollment began in an expansion of the OnTrak™ program with a leading national healthcare provider in Kansas. The expansion included members with anxiety, representing the Company's contractual reach into this behavioral health condition, and is anticipated to increase eligible covered lives in Kansas' population by approximately four-fold.

- In April 2015, Humana and the Company jointly announced that the integration of the OnTrak™ program into population-based behavioral care helped improve healthcare outcomes and lowered costs according to a retrospective cohort study co-presented by Humana and Catasys at the American Society of Addiction Medicine's annual conference.

- In April 2015, Catasys also announced, in conjunction with Health Alliance Medical Plans, a multi-year agreement to offer OnTrak™ to Health Alliance members in need in Illinois. Health Alliance is the largest health insurer in downstate Illinois, with additional member-focused health plans in Iowa, Nebraska, and Washington.

- In March 2015, the Company announced that Cenpatico and Managed Health Services (MHS), a Centene health plan in Wisconsin, had expanded OnTrak™ to MHS's eligible Medicare Advantage members in Wisconsin (growing a relationship that began in the first quarter 2014 with Catasys providing OnTrak™ to MHS's eligible Medicaid members in Wisconsin).

- In March 2015, the Company began enrolling **Health Insurance Exchange (HIE)** members for its health plan for customers in Kansas.

- In March 2015, Catasys released results from a recent Matched Pairs test, performed by the Company indicating a 58.2% reduction in paid claims for its OnTrak™ program. The Matched Pairs test is a rigorous methodology that compares each member treated in OnTrak™ with a similar matched member who was not in the program. Both the OnTrak™ member group and the control group started with approximately $24,000 in paid claims over a one-year period. After enrolling in the Catasys program, members saw cost declines of 58.2%, whereas costs for members not in the Catasys program declined by only 19.9%. The gross savings to the health plan for Catasys patients totaled $14,280 per patient per year.

- In February 2015, the Company expanded OnTrak™ into New Jersey via a national health plan. The eligible commercial healthcare plan members will be covered under OnTrak™, which includes medical and psychosocial interventions as well as intensive care coaching over 52 weeks.

Potential Milestones

Going forward, the Company expects to continue to announce new contracts with additional health plans, such as those described on page 12. As well, additional potential milestones could include the following:

- An up-listing to NASDAQ;
- Additional contracts covering millions of CELs;
- Covering for additional disease states beyond substance dependence and anxiety; and
- Expansion of the OnTrak™ program with existing customers.

Leadership

Figure 4 summarizes the Company's executive leadership, including its management and Board of Directors, followed by brief biographies. Catasys' senior management team collectively holds over 50 years of experience treating substance dependence and over 100 years of healthcare experience, having developed an expertise in engaging, treating, and empowering members with coexisting medical and behavioral conditions. Of note, Terren S. Peizer, director, chairman of the Board, and chief executive officer (CEO), has personally invested approximately $16 million into Catasys—rather uncharacteristic for a micro-cap company's executive.

Figure 4

MANAGEMENT AND BOARD OF DIRECTORS

Name	Position
Terren S. Peizer	Director, Chairman of the Board, and Chief Executive Officer
Richard A. Anderson	Director, President, and Chief Operating Officer
Omar Manejwala, M.D.	Senior Vice President and Chief Medical Officer
W. Gregory McLane	Chief Marketing Officer
Susan Etzel	Chief Financial Officer
Barbara "Be" Stark	Senior Vice President, New Business Development
Richard Berman	Director and Chairman of the Audit Committee
David Smith	Director
Marvin Igelman	Director, Chairman of the Corporate Governance Committee, Member of the Compensation Committee, and Member of the Audit Committee
Steve Gorlin	Director

Source: Catasys, Inc.

Terren S. Peizer, Director, Chairman of the Board, and Chief Executive Officer (CEO)

Mr. Peizer is the founder of Catasys and has served as its CEO and chairman of the Board of Directors since the Company's inception in February 2003. Since September 2009, he has served as the chairman of Crede Capital Group, LLC, his personal investment vehicle, and industry leader in investing in micro and small capitalization equities, having invested over $1 billion directly into portfolio companies. Mr. Peizer has been the largest beneficial shareholder, and has held various senior executive positions with several technology, biotech, and healthcare services companies—having invested roughly $16 million of his own money into Catasys. He has assisted companies by assembling management teams, Boards of Directors, and Scientific Advisory Boards, and formulating business, capital formation, and investor relations strategies for the companies. Mr. Peizer has a background in venture capital, investing, mergers and acquisitions, corporate finance, and previously held senior executive positions with the investment banking firms Goldman Sachs, First Boston, and Drexel Burnham Lambert. He received his B.S.E. in finance from the Wharton School of Finance and Commerce.

Richard A. Anderson, President and Chief Operating Officer

Mr. Anderson has served as a director since July 2003 and as a member of the management team since April 2005. He has been president and chief operating officer since July 2008, and in this role, has been primarily responsible for the creation of Catasys' OnTrak™ program. He has more than 20 years of experience in business development, strategic planning, operations, finance and management, with 15 years of that in the healthcare field. Prior to joining the Company, he 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. He received a B.A. in business economics from University of California, Santa Barbara.

Omar Manejwala, M.D., Senior Vice President and Chief Medical Officer

Dr. Manejwala, senior vice president and chief medical officer, is responsible for overseeing Catasys' clinical affairs and leads new product development efforts. A psychiatrist, Dr. Manejwala is a Distinguished Fellow of the American Psychiatric Association and a diplomate of the American Board of Addiction Medicine. He has extensive addiction experience and a passion for integrated treatment approaches. Previously, Dr. Manejwala served as medical director at Hazelden. Prior to Hazelden, he was the associate medical director at the Farley Center and the executive chief resident in psychiatry at Duke University Medical Center. He graduated from the University of Maryland, School of Medicine and earned an MBA from the University of Virginia's Darden School.

W. Gregory McLane, Chief Marketing Officer

Mr. McLane is responsible for the overall marketing efforts of the Company, encompassing marketing strategy, market research, member outreach, member engagement, and account management. Prior to joining Catasys, he led the marketing activities for Magellan Health Services and founded Optimized Benefits, Inc., a health benefits company that replaced the one-size-fits-all HMO, PPO, and CDHP plans with "Life Stage" plans which address the different needs of employees at various stages of their lives. He also led strategy development and product development for CIGNA and ran consumer products businesses for Procter & Gamble, Campbell Soup, and Nabisco. Mr. McLane earned a B.S. from the Wharton School of the University of Pennsylvania with majors in accounting and decision science, and an MBA from Cornell University with concentrations in management and organizational behavior.

Susan Etzel, CPA, Chief Financial Officer

Ms. Etzel has served as the Company's chief financial officer since July 2011, and prior to that, was the Company's corporate controller since February 2011. Prior to joining the Company, she acted as the controller of Clearant, Inc., a developer of a universal pathogen inactivation technology, from July 2005 until February 2011. Prior to joining Clearant, she held a senior-level auditor position at Arthur Anderson LLP. She received a Bachelor's in business economics with an emphasis in accounting from the University of California, Santa Barbara. She is also a certified public accountant (CPA).

Barbara "Be" Stark, Senior Vice President, New Business Development

Ms. Stark is responsible for new customer acquisition and oversees Catasys' sales organization. She brings over 30 years of healthcare sales and sales leadership experience to Catasys, along with an extensive network of senior-level relationships with national and regional managed care organizations. Ms. Stark has led managed care and healthcare services sales teams in the integrated home health, pharmaceutical, specialty pharmacy, and medical device industries, including as senior vice president of sales at Univita Health and sales leadership positions with Coram Specialty Infusion Services, Novartis Pharmaceuticals, Gentiva Specialty Pharmacy Services, Alere, and Apria Healthcare. She received a B.A. in education from the University of Iowa.

Richard Berman, Director, and Chairman of the Audit Committee

Mr. Berman is currently the president and chief executive officer of LICAS, a K-12, College and University, Health Care consulting firm. In addition, he currently serves as chairman of the board of directors of Emblem Health's quality of care committee and a member of its audit committee. Mr. Berman is also an entrepreneur in residence at GaTech's ATDC and visiting professor at USF MUMA College of Business. He is an elected member of the Institute of Medicine of the National Academy of Sciences. Previously, he was a management consultant for McKinsey & Company, executive vice president of NYU Medical Center, and professor of health care management at the NYU School of Medicine. He has also held various roles at Korn Ferry International, Howe-Lewis International, the New York Office of Health Systems Management, U.S. Department of Health Education, and Welfare, and as the President of Manhattanville College. In 1995, Mr. Berman was selected by Manhattanville College to serve as its 10th president. He is credited with the turnaround of the College, where he served until 2009. In 2006, he was awarded a Fulbright Commission grant to travel to Uganda and provide strategic planning and leadership training to Kabale University. Mr. Berman has a Bachelor's of business administration, an MBA, and a Master's in Public Health.

David Smith, Director

Mr. David Smith is the president, CEO, and chief investment officer of the Trading Advisor. He was the founder and CEO of Coast Asset Management. Mr. Smith has worked in various capacities in the securities industry, including as vice president of Security Pacific Bank, and Oppenheimer and Company as a bond arbitrageur, and he is also a successful investor in small cap growth companies. Mr. Smith has an MBA from the University of California at Berkeley.

Marvin Igelman, Director, and Chairman of the Corporate Governance Committee, Member of the Compensation Committee, and Member of the Audit Committee

Mr. Marvin Igelman is the CEO of Sprylogics International Inc., a leader in the semantic search technology sector and currently on the Board of Directors of Jamba Juice. Previously, he was CEO of Unomobi, Inc., a mobile advertising and messaging platform that was acquired in February 2010 by Poynt Corporation. Mr. Igelman was also founder, president, and CEO of Brandera Inc., which operated Portfolios.com, a leading online business-to-business site for the Graphic Arts and creative community, and has served as a business development consultant for numerous technology companies, and established a number of other successful ventures. Mr. Igelman has a Bachelor of Laws from Osgoode Hall Law School.

Steve Gorlin, Director

Mr. Steve Gorlin is an entrepreneur who has founded numerous successful biotechnology and pharmaceutical companies over the last 40 years, including Medivation and Entremed. He currently serves as executive chairman to Conkwest, Inc. and served as chairman of the Board of MiMedx, Inc., a wound care company, from November 2006 to June 2013. Mr. Gorlin served many years on the Business Advisory Council to the Johns Hopkins School of Medicine as well as on the advisory board of the Johns Hopkins BioMedical Engineering Advisory Board.

Core Story

BACKGROUND OF BEHAVIORAL HEALTHCARE IN THE U.S.

Over the years, U.S. health plans have separated behavioral health from medical health, and have outsourced it to entities such as Magellon Health, Inc. (www.magellanhealth.com), which is the largest managed care behavioral organization, and ValueOptions, Inc. (www.valueoptions.com), now called Beacon Health Options, a provider of behavioral health solutions for regional and specialty health plans, employers, labor organizations, and federal, state, and local governments. Health plans that have opted not to outsource behavioral healthcare have instead created their own captive subsidiary, such as United Behavioral Health. By separating out behavioral health, health plans sought to have behavioral health managed by those with a better understanding of behavioral health, eliminate a part of the business (a specific member population) that they either did not want to service or did not believe could be effectively treated. Historically, physical health has faced less stigma and has been given higher priority than behavioral health by society. Consequently, over time, significantly less money has been invested on treatment per behavioral health patient in the U.S. than on physical health, and mental health funding has been repeatedly reduced. Thus, outcomes are becoming progressively worse.

Utilization management is the evaluation of the medical necessity, appropriateness, and efficiency of the use of healthcare services, procedures, and facilities, as defined by health plans. While utilization management is used in both physical and behavioral health, Catasys believes that it has had a disproportionate impact on behavioral health. This appears to be primarily due to historically less evidence-based treatment, significant variation in treatment between providers, a lack of understanding of the pathology of behavioral health diseases, and an inherent bias that behavioral health treatments do not work. This has often led to a restriction or denial of care, and these trends are believed to have led to worse outcomes for patients in need of behavioral health therapies and treatments and have not been helping influence untreated individuals to seek help for their afflictions.

Catasys was founded in 2003 with the aim of reversing trends in behavioral healthcare in order to help create a nationwide behavioral health system that works for both the insurers and the patients, as well as create a proactive approach to bringing care to those in need.

The Disparity between Behavioral/Mental Health and Medical Health

Over the past several decades, there has been a change in how the U.S. views mental health issues. Today, a conversation about a tragic shooting has transitioned from being an “NRA issue” to a “mental health issue,” with these topics being introduced by industry, media, and politicians alike. Whereas employers and insurers have long fought against increasing coverage for mental health and addiction treatment in the insurance market (to achieve **parity**) due to concerns over cost, in the past decade conversations have begun to focus on increasing fairness in health insurance and reducing the stigma and hopelessness felt by many who suffer from a mental or substance disorder (Source: *Milbank Quarterly*, September 2010; 88(3): 404–433).

The Mental Health Parity and Addiction Equity Act of 2008

In 2007, U.S. Senators Pete Domenici (R-N.M.), Edward Kennedy (D-Mass.), and Mike Enzi (R-Wyo.) introduced into the Senate new mental health legislation to ensure greater health insurance parity for persons with mental illness, stating that if insurers are covering behavioral health diseases, they must treat them as they would medical health diseases. The Senate bill, the Mental Health Parity Act of 2007, was the result of more than a year’s worth of negotiations with lawmakers, mental health, insurance, and business organizations to craft legislation that builds upon the 1996 Mental Health Parity Act (a law authored by Senator Domenici and the late Minnesota Senator Paul Wellstone) that began the process of ending health insurance discrimination against people with mental illness.

A similar bill was introduced and passed in the U.S. House of Representatives. The compromise legislation, the Mental Health Parity and Addiction Equity Act of 2008, was passed in late 2008 and became fully effective on January 1, 2010. While not mandating that group plans provide mental health coverage, this act does require health insurance plans that offer mental health coverage to provide that coverage on par with financial and treatment coverage offered for other physical illnesses. This entails that financial requirements (e.g., co-pays, deductibles) and treatment limitations (e.g., frequency of treatment, number of visits, days of coverage, other similar limits on the scope or duration of treatment, out-of-network benefits) applicable to mental health or substance use disorder benefits are no more restrictive than those applied to substantially all medical/surgical benefits (Source: U.S. Department of Labor's Employee Benefits Security Administration). However, the act does not require that a plan provide behavioral health benefits and does not apply to health insurance policies for employers with 50 or fewer employees or policies for individuals.

Affordable Care Act (ACA) on Behavioral Health

Signed into law in 2010 by President Barack Obama, the Affordable Care Act (ACA) states that in order to be a qualified health plan, substance dependence and behavioral health disease must also be covered. The ACA specifically includes prevention, early intervention, and treatment of mental and/or substance use disorders as an "essential health benefit." Accordingly, these essential health benefits must be covered by health plans offered through the new **Health Insurance Marketplace** (Source: the Substance Abuse and Mental Health Services Administration [SAMHSA]), which includes health plans for small groups and individuals that were not mandated to provide behavioral healthcare in the 2008 Mental Health Parity Act.

It is estimated that the ACA and 2008 Mental Health Parity Act have been able to collectively extend behavioral health benefits to approximately 62 million U.S. residents (Source: U.S. Department of Health and Human Services' Office of the Assistant Secretary for Planning and Evaluations' [ASPE] Issue Brief, February 20, 2013). While there are loopholes to each of these pieces of legislation, the message is clear: there has been a disparity in treatment in the U.S. between behavioral health and medical health that needs to be rectified.

COMPANY OVERVIEW

Catasys provides big data–based analytics and predictive modeling–driven health management services for health plans. These services aim to improve member health while simultaneously lowering insurer costs for underserved populations. Catasys' OnTrak™ integrated solutions serve individuals who have behavioral health disorders that exacerbate coexisting medical conditions, resulting in higher hospital admissions and emergency room (ER) visits. The Company has developed analytics for identifying which individuals on an insurance plan are "high utilizers" with impactable costs due to having a substance dependency or an anxiety disorder. Catasys targets these patients with its proprietary direct outreach capability to enroll them in the OnTrak™ patient-centric treatment program. OnTrak™ entails a standardized, evidence-based, integrated treatment program that enables consistent quality of care for members in an outpatient environment, supported by their own Care Coach. Catasys currently operates OnTrak™ in Florida, Kansas, Kentucky, Louisiana, Massachusetts, New Jersey, Oklahoma, West Virginia, and Wisconsin and has recently expanded into Illinois.

The Company provides the demonstrated financial incentives to enroll members in its OnTrak™ program—with data indicating that enrolled patients exhibit a reduction in claims costs of over 50%—stemming from decreases in hospital days, ambulance usage, and ER visits. Catasys currently has contracts with large health insurance plans, including Aetna/Coventry, Humana, and Centene, among others. These contracts currently cover approximately 2.3 million Commercially Equivalent Lives (CELs)—noting that CELs are a key operating metric that Catasys believes reflects the Company's growth potential as increasing CELs represent increasing potential future enrollment and revenue streams. Management has stated that it has a sales pipeline with insurers for approximately 10 million additional CELs, for which the Company is in advanced stages of discussion for approximately four million of these CELs.

The need for Catasys' services are greater than ever given the increasing cost pressures that health plans/payers are under to lower expenditures—with premiums up 100% in the past decade alone. PricewaterhouseCoopers' Health Research Institute has projected medical costs to increase by 6.8% in 2015 versus 6.5% in 2014. Members with substance dependence disorders (alcoholics, cocaine, methamphetamine, opiate dependence, and so on) cost healthcare plans over $21 billion in annual incremental medical outlays. Thus, for every 1 million members in a healthcare plan, almost $160 million in claims stem from members with substance dependence issues. Catasys believes that this could translate into a market opportunity of roughly $2 billion.

Catasys' model has been validated via quarter-over-quarter as well as year-over-year growth. In the first quarter 2015 (ended March 31, 2015), revenue was up 118% to $433,000 versus $199,000 in the first three months of 2014. Growth drivers included a 67% increase in enrollment, expansion of the Company's OnTrak™ program with a national healthcare plan, and the addition of a new behavioral health condition (anxiety). For the full year 2014, the Company reported a 169% increase in recognized revenue to $2 million versus $0.75 million for the full year 2013.

Of note is that while Catasys believes that its business and operations are in compliance with applicable laws and regulations, the healthcare industry is highly regulated, and criteria can be vague and subject to change and interpretation by various federal and state legislatures, courts, enforcement, and regulatory authorities. As well, a treating physician must make a determination as to whether the OnTrak™ program is appropriate for a specific patient. A description of some of the risks that Catasys may be face is provided on pages 39-52.

Substance Dependence

Substance dependence affects millions of people and has broad consequences, with these individuals generally having poor overall health, which leads to more costly treatment for related, and many times seemingly unrelated, co-occurring medical conditions. This translates into substance dependence members' total healthcare claim costs that are considerably higher than those costs of an average member. According to Catasys' estimates, high-utilizer, substance-dependent members (which are estimated at approximately 0.45% of the members in a plan) incur an average of $27,500 in claims per year (for which the majority are not behavioral treatment costs) versus average claims of $3,250 per year by members without a substance dependence diagnosis. In support of the Company's findings, roughly 50% of drug-related emergency room (ER) visits are due to non-abuse events, such as side effects to pharmaceuticals taken as prescribed or accidental ingestion. However, the other 50% (or approximately 2.5 million ER visits as of 2011 and increasing) are due to substance abuse or dependency (Source: 2009 and 2011 DAWN data).

Substance abuse is costly to the patient, the insurer, and society as a whole. The U.S.'s National Institute on Drug Abuse estimates that substance dependency (the abuse of tobacco, alcohol, and illicit drugs) costs the U.S. over $700 billion annually due to crime, lost work productivity, and healthcare. Figure 5 summarizes this cost breakdown.

Figure 5

COSTS OF SUBSTANCE ABUSE

	Healthcare	Overall
Tobacco	$130 billion	$295 billion
Alcohol	$25 billion	$224 billion
Illicit Drugs	$11 billion	$193 billion

Source: the National Institute on Drug Abuse, January 2015.

With OnTrak™, Catasys believes that it is able to provide the following benefits, which translate into a cost savings for medical, behavioral, and pharmaceutical treatment:

- improved patient health;
- increased worker productivity by reducing workplace absenteeism, compensation claims, and job related injuries; and
- decreased emergency room and inpatient utilization and hence decreased readmission rates.

Patient Identification/Engagement

The current healthcare system has no measures in place to directly recognize or address high-cost, substance-dependent members who do not otherwise seek care. This is important as 74% of substance-dependent members have had no behavioral claims and, when left untreated, these individuals create high hospital expenses due to medical events. Catasys provides a unique data tool for analytics and screening as well as an outreach program that has proven successful at encouraging high-cost members to sign on.

Need for New Methods of Recognizing and Treating Substance Dependence

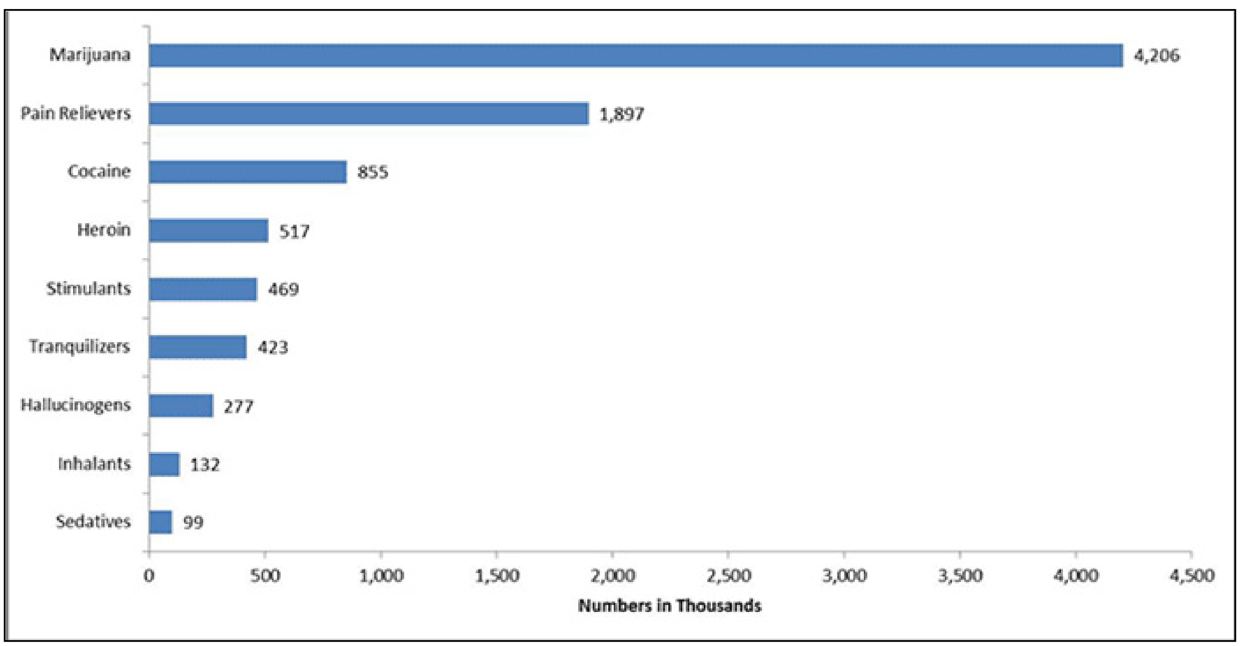
The latest version of the National Survey on Drug Use and Health from SAMHSA (data is from 2013) states that there continues to be a large treatment gap in the U.S. as it relates to substance abuse. SAMHSA's data found that as of 2013, approximately 22.7 million U.S. residents (or 8.6% of the population) needed treatment for a problem related to drugs or alcohol, though only 2.5 million people (0.9%) had received treatment at a specialty facility. This problem is exemplified in the young adult population, though occurs at all ages. Emergency rooms' DAWN data (Drug Abuse Warning Network) has documented that the number of people aged 18 to 25 who visited an emergency room (ER) as a result of substance abuse has increased from 2005 through 2011, though the percentage of young adults receiving substance abuse treatment is relatively unchanged (Source: SAMHSA's *CBHSQ Report*, June 10, 2014). Across all age ranges, there were nearly 2.5 million ER visits in 2011 attributed to substance abuse, up from 2.1 million in 2009 (Source: 2009 and 2011 DAWN data).

Figure 6 shows the number of people in the U.S. who met clinical criteria for dependence or abuse of illicit drugs during 2013, noting that this chart does not include people dependent on alcohol. Alcohol is the leading cause of substance dependency, dwarfing the next most common substance, marijuana. As of 2013, 17.3 million U.S. residents (6.6% of the population) had problems related to alcohol (abuse/**binge drinking/heavy drinking**), as compared to 4.2 million people who were dependent on marijuana.

Figure 6

SPECIFIC ILLICIT DRUG DEPENDENCE OR ABUSE IN THE U.S. IN 2013 (DOES NOT INCLUDE ALCOHOL)

NUMBERS IN THOUSANDS



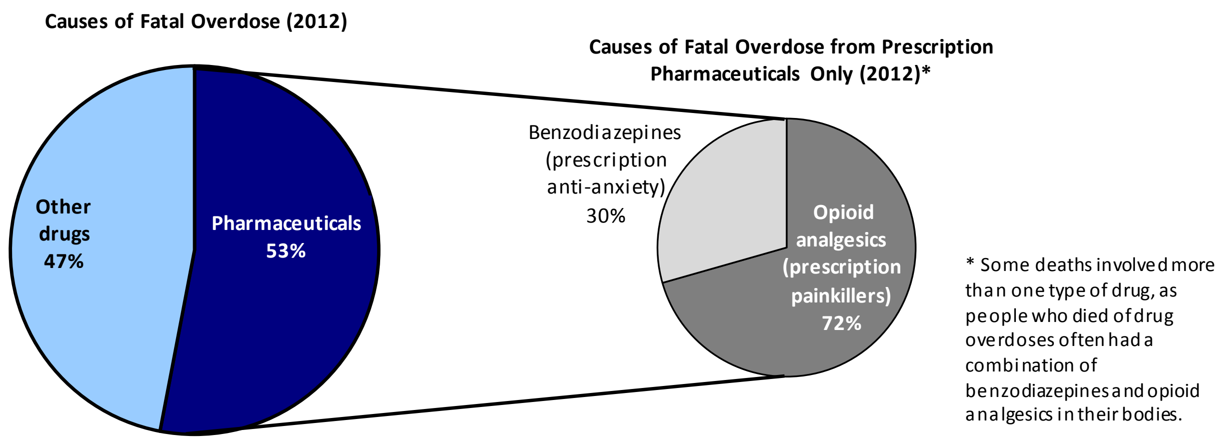
Source: the National Institute on Drug Abuse, The Science of Drug Abuse and Addiction's "DrugFacts: Nationwide Trends," June 2015.

Unidentified and untreated, the consequences of substance dependency can be fatal. As an illustration, Figure 7 summarizes CDC data pertaining to drug overdoses in the U.S. It is important to recognize that substance abuse can stem from illicit drugs (the 47% of fatal overdoses in 2012), legal drugs (alcohol, tobacco [not shown in Figure 7]), and prescription pharmaceuticals, which are rapidly overtaking illicit drugs as the most common cause of lethal drug overdose—the vast majority of which are unintentional. This is problematic on several fronts, including that individuals who are substance dependent often have coexisting conditions necessitating medical or behavioral healthcare, such as anxiety or depression, and the combination of products can be harmful. Catasys is also targeting anxiety and potentially depression, thus this market is introduced following Figure 7.

Figure 7

LETHAL DRUG OVERDOSE IN THE U.S. IS MOSTLY FROM PRESCRIPTION PHARMACEUTICALS

As of 2012: 41,502 drug overdose deaths Nearly 80% of which were unintentional	259 million: Number of prescriptions for painkillers written by healthcare providers in 2012



Sources: U.S. Centers for Disease Control and Prevention's "Prescription Drug Overdose in the United States: Fact Sheet," updated October 17, 2014 (data) and Crystal Research Associates, LLC (graphic).

In a given 30-day period, close to 50% of the U.S. population is taking at least one prescription pharmaceutical (Source: CDC/National Center for Health Statistics, "Therapeutic Drug Use" updated June 12, 2014). More than 20% of people are on three or more medicines in any given 30-day period, and 10% of the population is on five or more prescription drugs. Combinations of **opioid analgesics** (narcotic pain relievers such as morphine, fentanyl, oxycodone, etc.) and anti-anxiety benzodiazepines (e.g., Xanax®, Valium®) are extremely habit-forming and have a high rate of abuse by patients. Nevertheless, in 2012, there were 259 million prescriptions for opioid painkillers written in the U.S.—which is enough medicine for every American adult to have a bottle of pain pills (Source: CDC).

Anxiety and Depression

Driven by high stress levels stemming from a variety of factors (economic, social, etc.), substance use is on the rise, particularly among the baby boomer population on Medicare and Medicaid. In parallel, rates of anxiety and depression are growing, with anxiety disorders now the most common mental health disorder in the U.S. Anxiety is estimated to affect 18% of the adult population, or over 40 million people in the U.S. (Source: Anxiety and Depression Association of America [ADAA]). Anxiety disorders include obsessive compulsive disorder (OCD), post-traumatic stress disorder (PTSD), generalized anxiety disorder (GAD), panic attacks, and other social phobias. Benzodiazepines such as Valium®, Xanax®, and Ativan® are widely prescribed to patients suffering from anxiety. At present, the FDA has approved approximately 15 of these products, though anxiety may also be treated with antidepressants or with **beta-blockers** that help reduce trembling and sweating (Source: WebMD's Substance Abuse and Addiction Health Center).

There appears to be an unhealthy trend in anxiety treatment, where either patients are largely untreated (ADAA estimates place this figure at two-thirds of anxiety sufferers who do not receive treatment) or they are overprescribed strong pharmaceuticals as a first-line approach (Source: Patricia Pearson's *A Brief History of Anxiety (Yours and Mine)*). Benzodiazepines are often used because they have a quicker onset of action versus antidepressants, which patients begin taking in small amounts at first and increase to larger doses. With benzodiazepines, the most common side effects are drowsiness and dizziness but also include upset stomach, blurred vision, headaches, confusion, and nightmares. However, the biggest risk comes as patients build a tolerance to the therapy and become dependent on the anti-anxiety medication. Benzodiazepines are likewise associated with withdrawal symptoms when patients discontinue treatment, and can have damaging effects when combined with other products, including narcotic painkillers or alcohol.

From 2004 to 2011, the rate of ER visits due to misuse or abuse of pharmaceuticals increased by 114%, driven by abuse of anti-anxiety and insomnia medications, which topped even narcotic pain relievers (Source: *The DAWN Report*, February 22, 2013). Anti-anxiety medication Xanax® was found to be the most common cause, followed by Klonopin®, Ativan®, and Ambien®. The rate of ER visits for anti-anxiety and insomnia products has increased by 124% in recent years. In many cases antidepressants are often taken in combination with anti-anxiety medications, as roughly 50% of people diagnosed with depression are also diagnosed with an anxiety disorder (Source: ADAA).

Costs to Healthcare System

With over 40 million people in the U.S. afflicted with anxiety, there is a substantial cost to the healthcare system. In line with Catasys' findings regarding certain high-utilizer patients, the ADAA has found that people with an anxiety disorder are three to five times more likely to go to the physician and six times more likely to be hospitalized for psychiatric disorders than those who do not suffer from anxiety disorders. Many of these repeated visits are for the relief of symptoms that mimic physical illnesses, accounting for roughly half of the economic burden of anxiety disorders in the U.S.

CATASYS' BUSINESS MODEL

Catasys' business model involves contracting with health plans, where the Company enrolls members both directly and with the healthcare plan. The Company receives monthly fees for the enrolled members, and in some cases, on a fee-for-service basis, or charges an upfront case rate, as well as shares in the savings from its program. A network of medical and psychosocial providers are then paid for the services that they provide. A selection of some of the Company's larger customers—which in total amount to approximately 2.3 million Commercially Equivalent Lives (CELs) across 10 states—is provided in Figure 8, with Catasys continuing to work toward adding additional insurers.

Figure 8
CURRENT CLIENTS

Humana. | aetna | COVENTRY Health Care
CENTENE Corporation | fallon community health plan | Advantra® from Coventry Health Care
Reliant Medical Group Atrius Health | Health Alliance

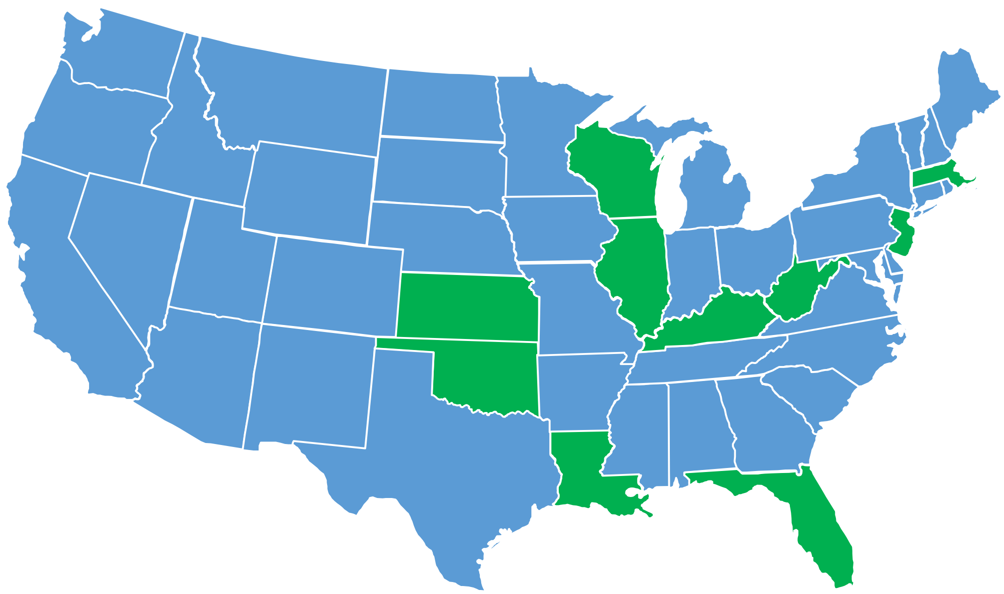
Source: Catasys, Inc.

Current Contracts

The Company's current contracts with health plans include Aetna/Coventry, Humana, Centene, Fallon Health, Health Alliance Medical Plans, and Reliant Medical Group and cover nearly 2.3 million CELs across 10 states—Florida, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, New Jersey, Oklahoma, West Virginia, and Wisconsin (as shown in Figure 9). Management has announced that it has a sales pipeline with insurers for approximately 10 million additional CELs and is currently in advanced stages of discussion for approximately four million of those CELs.

Figure 9

STATE-BY-STATE EXPANSION OF ONTRAK™



States where the OnTrak™ program is available

Source: Catasys, Inc.

Due to the success of the Company's initial experience with limited populations, Coventry (owned by Aetna) and Humana have selected to expand the number of their plans under contract with Catasys, where the contracts with Coventry now include Kansas, Louisiana, and Oklahoma. Catasys' contracts with Humana now include Kentucky, West Virginia, and the addition of a large commercial population in Florida (launched late in the fourth quarter 2014). In April 2015, the Company announced a multi-year agreement with Health Alliance Medical Plans to offer the OnTrak™ program to Health Alliance members in need in Illinois. The 52-week program commenced enrolling Health Alliance members in Illinois who qualify in the third quarter 2015. Health Alliance is the largest health insurer in downstate Illinois, with additional member-focused health plans in Iowa, Nebraska, and Washington.

Sales Cycle and Enrollment Process

The sales cycle starts with educating payers about the excessively high cost of their substance-dependent members. A key asset for Catasys is its proprietary data analytics where, by using claims data in a novel way, the Company is able to identify high-cost, substance-dependent members within health insurance plans who have the potential for reduced costs if effectively treated. Once recognized, the Company initiates an outreach approach to convince these members to enroll in the OnTrak™ program.

How a Patient is Made Aware of the OnTrak™ Program

Initially a contract is signed with a health plan and terms are agreed upon. From that point, it can take approximately 45 to 90 days to launch. The customer begins sending Catasys claims data (proprietary information). Catasys believes that its ability to contract with national plans such as Humana, Aetna, Centene, and so on, to provide their claims data is a testament to the potential of the Company's OnTrak™ program. Subsequently, upon receiving this data, Catasys runs the data through its analytics to identify the members who may benefit from its OnTrak™ program, or the "eligible members." Generally, eligible members represent 0.45% of a commercial plan's adult population. From there, Catasys is able to contact and subsequently enroll one out of every five members.

The eligible population is those members that the analytics pinpoint, which are the individuals who Catasys is then pursuing. During the launch phase, Catasys sends the program introduction materials to the eligible members. These materials essentially inform the target individuals that they are eligible for a new program or benefit being offered by their health plan. That letter is followed by monthly themed letters. Each letter is followed up by phone calls from Catasys' outreach specialists or Care Coaches who are trained on how to engage members, describe the benefits of the program (specifically that up to 100% of the cost of the program can be covered), and encourage members to enroll in the program. It becomes an iterative process, where not everyone signs up day one, though perhaps following a few more trips to the emergency room, hospital stays, or other events, members may be encouraged to enroll in the program. Thus over time, enrollment increases.

<u>Matched Pairs Test</u>

Catasys has amassed a set of outcomes data from its OnTrak™ program, which has demonstrated that it is attaining the desired results—improved patient health along with achieving cost reductions. The Company recently released results from a specific data analysis utilizing a Matched Pairs Test, which showed that patients enrolled in its OnTrak™ program achieved a reduction in paid claims of over 50%. The Matched Pairs Test is a rigorous methodology comparing each member (125 were part of this analysis) treated in the program with a similar matched member who was not in the program. Members were further matched on criteria such as age, sex, disease burden, geography, and initial paid claims, and were sampled from multiple health plans, geographies, and lines of business. Each group's members had approximately $24,000 in paid claims in the prior one-year period. In the year after enrolling in the OnTrak™ program, members' costs declined 58.2%, whereas costs for members not in Catasys' program declined by only 19.9%. This represents a gross savings to the health plan for a Catasys patient of $14,280 per patient per year based on an anticipated treatment total of $7,000 (and a net savings advantage over non-enrolled patients of about $2,500).

Payment Terms

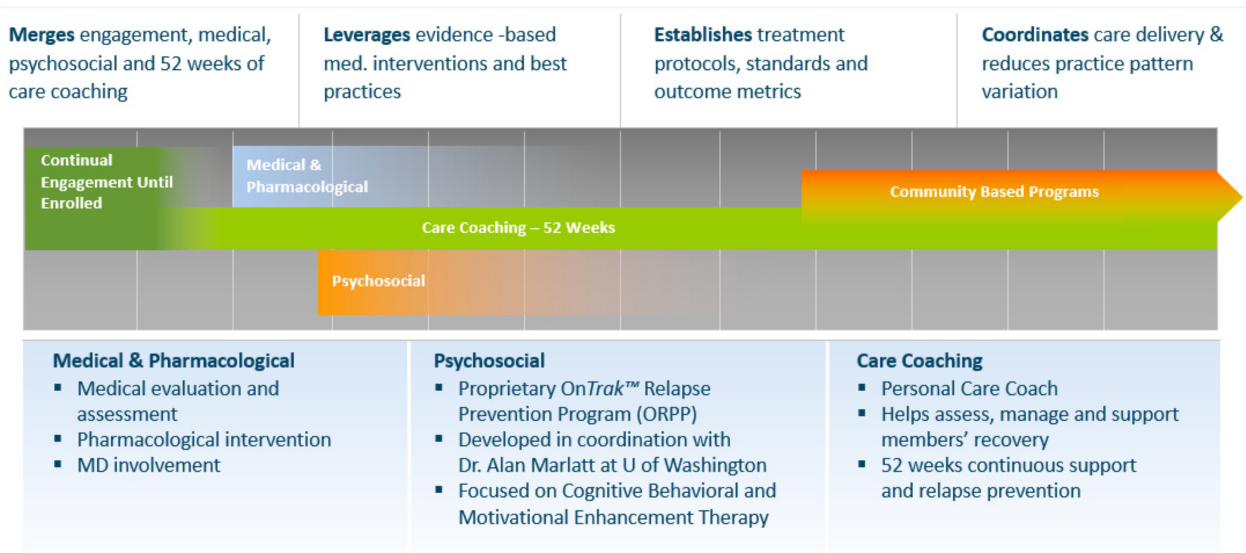
Of note is that with a list price of $8,500 per enrollee to participate in its 52-week program, Catasys receives payment on different terms from its insurance providers. For example, the insurance provider pays Catasys via monthly fees. As well, other fee arrangements calls for the Company to receive a payment per member visit to network providers of the physician services, or a lower case rate upon enrollment. Furthermore, other contracts include a minimum performance guarantee with respect to cost reduction. Other contracts involve the Company refunding a portion of the fees to the extent that members do not remain enrolled in the program for the full 52 weeks.

ONTRAK™ INTEGRATED TREATMENT APPROACH

Based on proprietary data analytics, OnTrak™ identifies high-utilizing, substance-dependent or anxiety members believed to benefit the most from intervention. The Company conducts a direct outreach and enrollment process. The program includes evidence-based, manualized, member-specific medical and behavioral treatment modalities, Care Coaching support for 52 weeks in an outpatient setting by health professionals, and online tools to support the member on their course of treatment. The OnTrak™ program is designed to addresses a member's physical, psychological, and social needs, coordinates care among service providers, and addresses the gap that exists due to an absence of programs focused on smaller, underserved populations of behavioral health conditions—seeking to address the medical consequences stemming from substance dependence (higher inpatient admissions, ER visits, and total costs).

A summary of the key features of the OnTrak™ integrated treatment approach are provided in Figure 10.

Figure 10
ONTRAK™ INTEGRATED TREATMENT APPROACH



Source: Catasys, Inc.

Identification

Catasys employs advanced data mining techniques and analytics to identify members with a substance dependence diagnosis who are high utilizers of healthcare services and who are believed to have costs that can be reduced through effective behavioral health treatment. Company analysis has shown that 74% of high-cost members diagnosed with substance dependence do not have any claims for a behavioral health treatment within the past year and are therefore most often are not getting the necessary care. The goal is preempting high-cost utilization and thus saving time, resources, and expenditures in treating these members.

Outreach and Enrollment

The process of reaching these members is critical—necessitating training, skill, sensitivity, and care as these individuals are challenging to engage. Most (roughly 74%) are not seeking treatment or are not following up on referrals and are continuing to experience consequences of chronic substance dependence and continuing to incur medical costs in treating those consequences. "Readiness to change" is a key element in looking for substance dependence treatment. OnTrak™ repeatedly reaches out to engage members (which is helpful when the member is ready to change).

Catasys increases member engagement through the following methods:

- Using multiple modalities, including phone, mail, and email outreach;
- Providing motivating communication that is patient research-driven;
- Having direct knowledge of trigger points;
- Having conducted extensive market research with substance-dependent individuals in order to understand behaviors, motivators, and fears; and
- Having created trust with the member via the outreach specialist or Care Coach (described below), who is the point of contact during the outreach campaign, which can help ease the enrollment process.

The OnTrak™ team of Care Coaches have strong clinical backgrounds and credentials (e.g., registered nurses) with many years of experience in the behavioral health field. Responsible for conducting outreach, the Care Coaches have direct experience in interventions and treatment, specifically in dealing with difficult cases (particularly those individuals who have many past treatment failures).

Medical Treatments

OnTrak™ employs proven medical interventions that have been created to reduce cravings, anxiety, and other symptoms frequently present after individuals cease using substances or as replacement or taper therapy (primarily for individuals suffering from alcohol, stimulant, or opiate dependence). Interventions are administered in an outpatient setting. The trained physicians fully assess not only the substance dependence but also any other comorbid conditions and concerns that may inhibit better health. OnTrak™ medical components include medical/behavioral history; physical examination; a review of current medications; care plan development; the making of necessary referrals; a review of available medications to lower substance cravings, which can improve near-term sobriety and reduce potential for relapse; and the administration and prescribing of medications.

Psychosocial Treatments

As part of recovery and to help address a member's need for psychosocial treatment, OnTrak™ includes a network of psychosocial providers who are specially trained to deliver the OnTrak™ Relapse Prevention Program (ORPP). ORPP is an evidence-based program leveraging clinically tested practices that provide a sequence of **Motivational Enhancement Therapy (MET)** and relapse prevention **Cognitive-Behavioral Therapy (CBT)** modules to maintain abstinence from alcohol and drugs. The ORPP treatment platform is built upon data from SAMHSA, the National Institute on Drug Abuse, and the National Institute on Alcohol Abuse and Alcoholism. As such, ORPP is believed to have empirical support for its efficacy in the treatment of substance use disorders.

ORPP includes MET, which entails working with a member to identify his/her needs and goals and building the motivation to change. CBT is intended to develop the member's relapse prevention skills and give them the knowledge, skills, and confidence to achieve treatment goals.

Care Coaching

A key part of Catasys' program is the Care Coaching. These individuals have proficiency in the clinical treatment of substance-dependent individuals and are in charge of working directly with members to keep them engaged in treatment. Care Coaches work with the rest of the care team (physicians and psychologists) to coach patients on commencing and maintaining their recovery. The relationship between the member and their Care Coach minimizes lapses and affords the lifestyle modifications that are consistent with the recovery goals developed with their healthcare provider. Catasys' integrated information technology platform guides each member's Care Coach in the process of assessment, care planning, and coaching. Key features of the Care Coaches include help removing barriers to treatment (e.g., transportation), coordinating care with OnTrak™ providers and other medical providers as needed, developing individualized Care Plans with members that address recovery goals as well as behavioral, medical, and lifestyle needs by coordinating among other treatment program providers and other interested parties. As well, Care Coaches support and augment the psychosocial treatment delivered by face-to-face therapy providers through coaching. Furthermore, Care Coaches continue to provide telephone support to members according to the Care Plan and member needs throughout the 52-week program.

Monitoring and Reporting

Catasys further focuses on achieving a culture of results and outcomes, where the Company accepts responsibility for outcomes and is willing to structure payment terms to reflect favorable outcomes.

Key Elements of OnTrak™ Program

Central to Catasys' business model is the need to keep the program outpatient. The Company began its program focused on substance dependence, given that this area is believed to have among the most ineffective behavioral health issues as it relates to treatment and reimbursement. However, it can be challenging career-wise for employees to check into an inpatient rehabilitation center. It is important to Catasys to not exacerbate the stigma for the substance-dependent individual but rather to make treatment more appealing, where patients are not separated from their support systems of family and friends. Furthermore, keeping the treatment outpatient has the added benefit of keeping costs lower and teaching people to practice their new skills in the environment in which they live.

Effectively integrating the medical and the physiological is a feat Catasys believes to be very challenging with current healthcare paradigms. Until recently, there has been little true understanding of the neurological function and the role it has in behavioral health disease. Behavioral disorder condition names were created in the early 1900s that, for example, if an individual was obsessive and compulsive, he/she would be described as having "obsessive compulsive disorder." If one was depressed, he/she would be diagnosed with depression. Thus, the behavior was described and given a name, versus actually understanding that these were physiological neurological pathologies that occurred in the brain—whether they be neurochemical abundances or neurochemical deficiencies.

As health plans evolved, they focused on physical health due in large part to the background of their clinical leadership. Behavioral health was largely ignored. Over time, health plans became increasingly proficient at managing physical health conditions and benefits and began recognizing that they had little expertise or understanding of behavioral health conditions, which were undermanaged and costly. As a result, health plans began outsourcing the behavioral health portion to other entities, which eventually became known as managed behavioral healthcare organizations (MBHOs). That outsourcing generally involved the MBHOs taking on financial risk for the members' behavioral health treatment. This system resulted in each entity focusing on its financial responsibility: health plans on the cost of treating physical health and MBHOs on the cost of treating behavioral health. The challenge is that physical and behavioral health are intertwined and impact each other. This can have severe health and cost consequences when an individual has a behavior disorder that is impacting their physical health but only seeks care when necessary for the physical health condition. For example, a member with substance dependence and diabetes is likely to continue to have ER and inpatient hospital visits related to their diabetes, as long as they continue to abuse alcohol or drugs. The health plan would pay for the high hospital costs for the diabetes, but the member would receive no treatment for the substance dependence. The MBHO is not involved in this case since the member is not seeking substance dependence treatment. Catasys recognized this gap in care and the importance of proactively identifying and engaging these members who are "falling through the crack" between the health plan and the MBHO and then integrating care for these members.

Further, Catasys has recognized the need to integrate medical and psychological treatment in the treatment of behavioral health disorders—addressing the physiological aspects and pathology, and companioning it with the psych, social, and behavioral. With that aim in mind, the Company began to develop an outpatient program, combining the physiological and the medical with the psychosocial, acknowledging that to have a nationwide program, there would need to be a payer. Thus, Catasys is working to incentivize and motivate health plans to pay 100% of the costs on the medical side (which then would be able to change the system).

Capturing Early Adopters is Key

In order to accept the value proposition (detailed on pages 10-11), health plans must see proof that Catasys' program works given the difficult nature of capturing early adopters in managed care. The payers/insurers must see data that convinces them to act, since, theoretically, they could pay Catasys $8,500 per member (increasing their expenses), without knowing the true practical payoff of this investment.

Catasys has been able to capture early adopters to the tune of approximately 500,000 covered lives. The Company needed approximately 1.5 million covered lives (CELs) to engage Medicare/Medicaid populations, which have 2.5 times the incidence rate of an eligible commercial plan population. Thus, the Medicare/Medicaid plan is worth 2.5 times more than the commercial medical plan, yet in order to equate everything back to a commercial plan, it is called "Commercial Equivalent Lives"—which are effectively the lowest common denominator. This means that it was anticipated there needed to be approximately 1.5 million covered lives to achieve breakeven, as listed in Figure 11.

Catasys has been able to capture early adopters from Coventry Health (a super-regional plan acquired by Aetna in 2013) for Kansas, Missouri, Oklahoma, and Louisiana. As well, the Company was able to sign Fallon Health and Reliant Medical Group in Massachusetts—totaling approximately 500,000 covered lives. While short of the 1.5 million lives needed to achieve profitability, these early adopters provided Catasys the opportunity to prove its theoretical numbers in terms of enrollment and savings, which it not only did, but did so by, on average, reducing enrolled members' total costs for the year after enrollment by more than 50% compared to the year prior to enrollment. Using 500,000 covered lives, Catasys was able to generate outcomes data and convince the health plans (Humana, Aetna, and Centene) to adopt its program—each beginning with a state or two. Catasys has seen expansion in its initial health plans, both geographically and into additional lines of business (Medicare, Medicaid, health exchanges), and has also begun to seek out ways to expand across other product lines (anxiety, depression)—noting that the Company recently announced its anxiety product in Kansas with one of its national health plans, as described on page 29.

Figure 11
GROWTH POTENTIAL

Commercial Equivalent Members Covered[1]	~2,300,000
Approx. Breakeven Coverage[2]	1,500,000
Sales Pipeline[3]	10,400,000
Contract Discussion/Data Analysis[4]	4,000,000
Potential Market Commercial Equivalent	196,000,000

1 Medicare Advantage lives calculated as commercial equivalent lives based on number of HUSD members.

2 Represents the approximate number of lives covered by contracts that Catasys will need in order to break even on a cash flow basis. Assumes standard pricing of $8,500 in annual fees per enrollee and some accelerated payment terms at point of assumed full enrollment of 20%. Actual number may vary significantly based on actual eligible lives within the covered lives, customer and payment mix, and enrollment rates.

3 Represents the approximate number of covered lives for enrollment with Catasys as potential clients with whom Catasys has at least made initial contact as of March 2015, and where the clients have expressed interest and Catasys is involved in follow-up discussions.

4 Represents the approximate number of covered lives for enrollment with Catasys at potential clients with whom Catasys has moved forward from the initial contact phase and into the contract discussion/data analysis phase as of March 2015. There is no assurance that Catasys will enter into such contract or the timing of such contract if it should occur.

Source: Catasys, Inc.

- *Humana.* As the largest Medicare Advantage program, Humana began with West Virginia and Kentucky, and subsequently expanded OnTrak™ to its commercial population into Florida. It is possible that this expansion could continue across the country (into roughly 12 million CELs), and, as well, into the commercial population nationally.

- *Centene.* Beginning with Medicaid, which is 80% of Centene's plan (including 20% of the plan that is Medicare), Centene initially rolled out OnTrak™ in Wisconsin. Reportedly satisfied with the results from this initial rollout, the company expanded from Medicaid Wisconsin into Medicare Wisconsin. It is possible that this expansion could continue further into approximately four million of Centene's Medicaid lives (which may be as many as 11 million CELs).

Anxiety Rollout

Catasys has announced an anxiety product rollout with one of its national health plans in Kansas. Having never worked with anxiety, the incidence rate and the eligible population for which the Company can enroll is estimated at over 20%, which is estimated at four times that of the substance dependent population—adding approximately 500,000 CELs.

Staying Ahead of its Competition

Catasys does not believe that it is likely to compete with MBHOs, which would be the most likely place of competition. This is because these organizations have not had the ability to integrate the physiological, medical, and the psychosocial, nor do they have the analytics to do so. Catasys believes that while it is possible that the managed care plans could develop such programs over time, they would be challenged to do so on many levels—largely being the enrollment process. Catasys started with 15% enrollment, and is now above 20%. This increase is important as the Company has been able to identify, enroll, and engage members in its 52-week outpatient program, all while being able to guide behavior modification for people in need.

Furthermore, should a MBHO plan attempt to try and identify these individuals, the expenses associated with this process would be identified as administrative rather than medical expenses, and consequently be included in the medical loss ratio. Therefore, it actually becomes more cost effective to subcontract these services out to Catasys rather than attempt to deliver them internally, given the inclusion in the respective medical loss ratio (noting that the plans would prefer not to address difficult patient populations). Another factor that is likely to limit competition is there is not a health plan anywhere that will adopt a significant change without significant data supporting such a change. That said, a summary of companies that could be placed into the same category as Catasys is provided under Competition on pages 30-33.

Potential Competition

Catasys provides a substance dependence solution encompassing an array of activities, from novel methods for identifying and engaging members to the use of new medical and psychosocial treatments. The comprehensive and integrated nature of the Company's solution may present a competitive advantage for Catasys as customers have a range of substance dependence treatment methods, facilities, and service providers to choose from. To this end, the Company may encounter competition from a number of entities, including healthcare management service organizations, disease management companies, managed behavioral health organizations (MBHOs), and other specialty healthcare and managed care companies—collectively representing approximately 13,500 facilities providing substance abuse treatment per the Substance Abuse and Mental Health Services Administration (SAMHSA) on an inpatient or outpatient basis. Currently substance dependence treatment is managed by behavioral health organizations under fixed fee contracts—thus for the type of service being offered by Catasys, the Company does not believe that it faces direct competition. The reason being is that most high cost substance dependent users are never identified and the focus is on behavioral health utilization rather than total patient cost. Furthermore, substance dependent users are most often under-diagnosed and under-treated, thus it is a fractionated market with inconsistent treatment.

Catasys' OnTrak™ program focuses primarily on substance dependence and is thus marketed to healthcare plans in addition to other insurance payers. The Company competes with other healthcare management service organizations and disease management companies, including MBHOs that manage behavioral health benefits, perform utilization reviews, provide case management and patient coaching, and pay their network of providers for behavioral healthcare services delivered. The majority of Catasys' competitors are significantly larger and have greater financial, marketing, and other resources available to them.

Managed care companies may seek to provide similar specialty healthcare services directly to their members rather than by contracting with Catasys for its services. Behavioral health conditions, like substance dependence, are usually managed for insurance companies by internal divisions or third parties (MBHOs) under capitated arrangements, where MBHOs are paid a fixed monthly fee and then pay providers for its provided services. This incentivizes entities to decrease members' cost and utilization of services. Catasys seeks to differentiate its program for high-utilizing, substance-dependent members by increasing treatment as well as the impact of overall healthcare costs for members—from the population utilization management programs that MBHOs offer to manage a health benefit.

Upon contracting with a third-party payer, Catasys implements its program and commences outreach to eligible members for enrollment in the OnTrak™ program. As part of the enrollment process, Catasys competes with numerous other providers of substance dependence treatment programs and facilities for those members that have chosen to receive substance dependence treatment. If a member selects a different provider that is part of a healthcare plan network of providers, such treatment costs may be paid in whole or in part by Catasys' healthcare plan customer. The businesses summarized on pages 31-33 are not intended to be an exhaustive collection of Catasys' potential competition but rather are believed to be indicative of the type of competitors the Company may face as it seeks to increase its market penetration.

Acadia Healthcare Company Inc. (ACHC-NASDAQ)
www.acadiahealthcare.com

Tennessee-based Acadia Healthcare provides inpatient behavioral healthcare services focused on helping children, adolescents, adults, and seniors suffering from mental health disorders and/or alcohol and drug addiction. Acadia operates a network of 225 behavioral healthcare facilities with approximately 9,190 beds in 37 U.S. states, the United Kingdom, and Puerto Rico. Its programs include psychiatric and chemical dependency services, inpatient psychiatric hospitals, residential treatment centers, outpatient clinics, and therapeutic school-based programs. In 2014, Acadia made its fifth acquisition in a 12-month period by acquiring CRC Health Group Inc. for $1.18 billion. CRC was a substance-abuse treatment provider with 120 facilities seeing roughly 40,000 patients daily. Included in the transaction was Acadia's acquisition of CRC's Sierra Tucson facility. Founded in Arizona in 1983, Sierra Tucson is licensed as both a special hospital and a behavioral health residential treatment center known for its treatment of addictions, behavioral disorders, chronic pain, depression, trauma, and eating disorders. Sierra Tucson employs a multidisciplinary approach to teach patients how to manage symptoms, overcome challenges, and develop the skills needed to manage their disease and return to a productive lifestyle. The facility has developed the Sierra Tucson Model of evidence-based practices, integrative services, a family program, continuing care, and physician involvement, though the model has recently come into question by news reports of a series of patient deaths (three in a 13-month period) while under the care of Sierra Tucson (Source: *Arizona Daily Star*, February 7, 2015).

Beacon Health Options
www.beaconhealthoptions.com

Following the merger of Beacon Health Strategies and ValueOptions, Beacon Health Options (headquartered in Boston, Massachusetts) now provides managed behavioral healthcare services to 45 million people across the U.S. and United Kingdom. The company targets its offerings, which are exclusively related to behavioral health (mental illness, autism, and addiction), to regional and specialty health plans; employers and labor organizations; and federal, state, and local governments. Collectively, Beacon Health Options reports that it has as clients and partners 225 employers, 100 health plans, public sector populations in 25 states including D.C. and federal employees, and the military. This MBHO's services entail each of the following: mental health/substance use disorder, employee assistance program, work/life services, health and wellness services, care for persons with SMI/SED, autism spectrum disorder support, persons with dual Medicare/Medicaid eligibility, integrated care at the practice level (which Beacon states is a manner of integrating physical health, behavioral health, and psychosocial care management into a single product, using behavior change principles and evidence-based practice guidelines), psychotropic drug intervention, recovery, education and access to community health, and risk identification and revenue optimization. In terms of risk identification, Beacon Health Options states that it uses a proprietary predictive modeling and stratification approach to identify individuals with undiagnosed behavioral health conditions, a process that is aided through analyzing claims data. The company then seeks to engage or re-engage those identified individuals in order to both improve health outcomes and help achieve physical and behavioral health cost savings.

Castlight Health, Inc. (CSLT-NYSE)
www.castlighthealth.com

San Francisco-based Castlight Health uses big data analytics to provide cost savings to health plans. The company's Enterprise Healthcare Cloud technology is designed for employers seeking to understand and manage healthcare investments and to give employees the information they need to make better healthcare decisions for themselves and their families. Castlight's Enterprise Healthcare Cloud services include analytics to help employers understand their healthcare spend; a program called Castlight Elevate™ that is targeted to behavioral healthcare; pharmacy and dental benefits; a rewards program to increase engagement among employees; an educational or "Academy" component to guide employees through a healthcare curriculum tailor-made for their company; a method for employers to introduce reference-based pricing gradually, minimizing disruption and educating employees about the benefit of smart healthcare shopping; and integration with other third-party healthcare programs. Castlight Elevate™ seeks to lower medical costs and increase use of behavioral health resources by identifying members who may have behavioral health needs and offering confidential, targeted recommendations for care through a personalized portal. The system allows members to search for and choose providers and care options as well as take self-assessments, find pricing and quality ratings information for inpatient and outpatient services, access services from home, integrate with telemedicine vendors, and more.

Health Integrated, Inc.
www.healthintegrated.com

Florida-based Health Integrated seeks healthcare reform by changing the behavior of its participants to protect vulnerable members. The provider's care management strategies emphasize the relationship between behavioral, social, and medical needs of individuals, and Health Integrated works with Medicare, Medicaid, dual-eligible, and commercial plan members nationwide to drive better health outcomes, higher member satisfaction, and lower healthcare costs. Among the company's products, it recently partnered with the Eastern Oregon Coordinated Care Organization (EOCCO), which serves 47,000 Oregon Health Plan beneficiaries, for the provision of Synergy Targeted Population Management®, a targeted chronic condition management program designed to improve patient health and reduce healthcare costs. Synergy is designed to identify and engage high-risk patients with multiple chronic conditions combined with diagnosed, undiagnosed, or untreated psychological and social barriers, such as lack of family support or adequate housing. These patients have been shown to make repeated emergency room visits and have higher rates of hospitalizations. Health Integrated's Synergy program has been shown to reduce this kind of usage by 10% to 20% with similar populations while assisting them in accessing the right care at the right time. In the wake of significant growth, Health Integrated has recently hired an additional 140 people for a total of more than 400 employees, which includes clinicians, informatics professionals, and data analysts.

Magellan Health, Inc. (MGLN-NASDAQ)
www.magellanhealth.com

Scottsdale, Arizona-based Magellan Health is a healthcare management company focused on managed behavioral healthcare, diagnostic imaging, specialty pharmaceutical services, and pharmacy benefits administration. Magellan takes a "complete-person perspective" toward full-service healthcare, including behavioral health, pharmacy benefits management, and specialty healthcare solutions. In terms of behavioral health specifically, the company has provided care and employee assistance programs for over 40 years. Magellan's behavioral health services include "population health," which entails an array of programs designed to impact the health of individuals before they need traditional behavioral healthcare. Such initiatives include an integrated care model focused on proactive prevention and wellness campaigns; care for specific populations through programs focused on autism, caregiving, prescription drug abuse, and suicide prevention; and virtual care solutions providing clinical programs tailored for members, using interactive, proven self-management tools and over-the-phone coaching capabilities. As well, using advanced analytics, Magellan seeks to identify, stratify, and provide integrated care coordination for members needing behavioral health care in inpatient/outpatient settings, helping individuals transition to lower levels of care as appropriate. Its services for employer plans include integrated employee assistance programs (EAPs) and behavioral health plans for accessing mental health and substance dependency benefits in line with the company's philosophy for treating the complete person at every stage of care. Beyond employers, Magellan's healthcare, imaging, pharmaceutical, and pharmacy offerings are used by health plans, federal and state employees, other public sector, Medicaid/Medicare, and military.

Viverae
http://viverae.com

Texas-based wellness and health management company Viverae provides its partners with a wellness and health management platform to support their businesses and employees with the tools and resources needed to create a healthy lifestyle. Viverae combines health assessments, employee incentives, coaching and engagement strategies, and proprietary software to manage client programs from beginning to end in accordance with the Affordable Care Act and other applicable law. Through MyViverae™, a web-based health engagement tool, members establish and update their health profile and follow a care plan. Members make personal choices, have accountability to keep them engaged, and earn an incentive. The company is stated to have over 350 customers across the U.S., comprising 650,000 members. In 2014, Viverae acquired OneHealth Solutions, a behavioral change technology and social networking site for people in recovery that had conducted pilot studies with a national health plan showing a reduction in inpatient readmissions for substance dependence treatment and with a managed behavioral health organization that exceeded expectations on duration and frequency of participant engagement. OneHealth holds a patent-pending Social Solutioning® platform that integrates physical and mental health management into a mobile and web experience for health plan members, employees, and patients. OneHealth's technology platform is centered on private online social communities that allows members to anonymously give and receive support for emotional and physical health.

Historical Financial Results

Figures 12, 13, and 14 summarize Catasys' key historical financial statements: its Condensed Consolidated Statements of Operations, Balance Sheets, and Statements of Cash Flows, as presented in the Company's Form 10-Q filed with the U.S. Securities and Exchange Commission (SEC) on August 14, 2015.

Figure 12
Catasys, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

(In thousands, except per share amounts)	**Three Months Ended June 30, 2015**	**Three Months Ended June 30, 2014**	**Six Months Ended June 30, 2015**	**Six Months Ended June 30, 2014**
Revenues				
Healthcare services revenues	$ 472	$ 312	$ 905	$ 511
Operating expenses				
Cost of healthcare services	529	267	935	532
General and administrative	2,422	1,709	5,156	3,046
Depreciation and amortization	30	28	64	52
Total operating expenses	2,981	2,004	6,155	3,630
Loss from operations	(2,509)	(1,692)	(5,250)	(3,119)
Other Income	10	1,194	21	1,194
Interest expense	(1,110)	(1,462)	(1,112)	(2,774)
Loss on exchange of warrants	(4,410)	-	(4,410)	—
Change in fair value of warrant liability	7,434	(25,493)	9,908	(20,392)
Loss from continuing operations before provision for income taxes	(585)	(27,453)	(843)	(25,091)
Provision for income taxes	2	2	4	4
Loss from continuing operations	$ (587)	$ (27,455)	$ (847)	$ (25,095)
Income/(Loss) from discontinued operations, net of income taxes	$ —	$ 8	$ —	$ (213)
Net Loss	$ (587)	$ (27,447)	$ (847)	$ (25,308)
Basic and diluted net loss from continuing operations per share:	$ (0.02)	$ (1.27)	$ (0.03)	$ (1.22)
Weighted number of shares outstanding	35,375	21,702	30,358	20,581
Basic and diluted net loss from discontinued operations per share:	$ 0.00	$ 0.00	$ 0.00	$ (0.01)
Weighted number of shares outstanding	35,375	21,702	30,358	20,581

Source: Catasys, Inc.

Figure 13
Catasys, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except for number of shares)	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$ 152	$ 708
Receivables, net of allowance for doubtful accounts of $1 and $0, respectively	249	189
Receivables from related party	—	300
Prepaids and other current assets	586	313
Total current assets	987	1,510
Long-term assets		
Property and equipment, net of accumulated depreciation of $2,057 and $2,002, respectively	314	354
Intangible assets, net of accumulated amortization of $427 and $418, respectively	92	101
Deposits and other assets	521	387
Total Assets	$ 1,914	$ 2,352
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable	$ 610	$ 341
Accrued compensation and benefits	1,509	1,392
Deferred revenue	853	354
Other accrued liabilities	652	614
Short term debt	2,336	—
Warrant liabilities	7	259
Total current liabilities	5,967	2,960
Long-term liabilities		
Deferred rent and other long-term liabilities	233	267
Capital leases	13	23
Warrant liabilities	965	40,326
Total Liabilities	7,178	43,576
Stockholders' deficit		
Preferred stock, $0.0001 par value; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value; 500,000,000 shares authorized; 46,597,760 and 25,244,485 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	5	3
Additional paid-in-capital	250,073	213,333
Accumulated deficit	(255,342)	(254,560)
Total Stockholders' Deficit	(5,264)	(41,224)
Total Liabilities and Stockholders' Deficit	$ 1,914	$ 2,352

Source: Catasys, Inc.

Figure 14
Catasys, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands) (unaudited)	**Six Months Ended June 30,**	
	2015	**2014**
Operating activities:		
Net loss	$ (847)	$ (25,308)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss from discontinued operations	$ —	$ 213
Amortization of debt discount and issuance costs included in interest expense	1,056	2,771
Provision for doubtful accounts	75	—
Depreciation and amortization	63	52
Write-off of accrued liabilities	—	(1,194)
Deferred rent	(34)	137
Share-based compensation expense	1,037	26
Common stock issued for consulting services	172	—
Warrants issued for services	56	—
Loss on exchange of warrants	4,410	—
Fair value adjustment on warrant liability	(9,908)	20,392
Changes in current assets and liabilities:		
Receivables	230	(29)
Prepaids and other current assets	118	150
Deferred revenue	499	295
Accounts payable and other accrued liabilities	478	(112)
Net cash used in operating activities of continuing operations	$ (2,595)	$ (2,607)
Net cash used in operating activities of discontinued operations	—	(208)
Net cash used in operating activities	$ (2,595)	$ (2,815)
Investing activities:		
Purchases of property and equipment	$ (16)	$ (36)
Deposits and other assets	—	53
Net cash provided by/(used in) investing activities	$ (16)	$ 17
Financing activities:		
Proceeds from the issuance of common stock and warrants	$ —	$ 2,500
Proceeds from the exercise of warrants	—	77
Proceeds from the issuance of convertible debenture	2,000	—
Proceeds from bridge loan	250	—
Transaction Costs	(185)	240
Capital lease obligations	(10)	(14)
Net cash provided by financing activities	$ 2,055	$ 2,803
Net increase (decrease) in cash and cash equivalents	$ (556)	$ 5
Cash and cash equivalents at beginning of period	708	1,136
Cash and cash equivalents at end of period	$ 152	$ 1,141
Supplemental disclosure of cash paid		
Interest	$ —	$ 11
Income taxes	$ 34	$ —
Supplemental disclosure of non-cash activity		
Property and equipment acquired through capital leases and other financing	$ —	$ 8

Source: Catasys, Inc.

Recent Events

08/17/2015—Catasys reported second quarter financial results for the period ended June 30, 2015. The Company reported revenue of $472,000 for Q2 2015, an increase of 51% over the $312,000 reported for Q2 2014. Sequential second quarter revenue of $472,000 increased by 9% over the $433,000 achieved during the first quarter ended March 31, 2015. Deferred revenue was $853,000 as of June 30, 2015, a sequential quarterly increase of $338,000 or 65% compared to $515,000 as of March 31, 2015. A net loss of ($587,000), or ($0.02) per diluted share, was reported for Q2 2015 versus a net loss of ($27,447,000), or ($1.27) per diluted share, for the same period in 2014.

05/20/2015—Announced that it entered into agreements to exchange existing warrants to purchase up to 21,277,220 shares of its common stock, with an exercise price of $0.58 per share for 21,277,220 unregistered shares of common stock, thereby extinguishing an associated liability of approximately $38 million reflected on its balance sheet as of March 31, 2015. This represents an important step in moving the Company toward its goal of meeting the stockholders' equity test for a listing on a national exchange. The Company reported that 95% of the warrants exchanged (representing approximately 20,000,000 shares) were held by insiders. In connection with the warrant exchange, the warrant holders entered into lock-up agreements related to the shares received in the exchange until the earlier of six months after the Company files a registration statement on Form S-1 or Form S-3, and January 4, 2016. The transaction has enabled Catasys to improve its balance sheet and stockholders' equity.

05/18/2015—Reported first quarter 2015 financial results for the period ended March 31, 2015. The Company reported a 67% increase in enrollment for the first three months ended March 31, 2015, compared with the first three months ended March 31, 2014; a 118% increase in recognized revenue to $433,000 for the first quarter 2015 compared to $199,000 for the first quarter 2014; deferred revenue of $515,000 at March 31, 2015, compared with $354,000 at March 31, 2014; and cash and cash equivalents in the total of $84,000 at March 31, 2015.

05/12/2015—Announced that it began enrolling members with anxiety disorder in its OnTrak™ program with a national healthcare provider in Kansas, substantially increasing the number of eligible lives in Kansas' population. This announcement follows a previous announcement that Catasys implemented a multi-year agreement with Health Alliance Medical Plans to offer OnTrak™ to eligible Health Alliance members in Illinois, thus adding approximately 100,000 Commercially Equivalent Lives (CELs) covered under OnTrak™. As of May 2015, Catasys had increased its CELs under contract by 28% to approximately 2.3 million covered CELs (noting that CELs are a key operating metric that the Company believes reflect its growth potential, as increasing CELs represent increasing potential future enrollment and revenue streams).

04/30/2015—Announced that the integration of a substance abuse treatment program into population-based behavioral care helped improve healthcare outcomes and lower costs according to a peer-reviewed, retrospective cohort study released by Humana and Catasys at the American Society of Addiction Medicine annual conference. According to the National Survey on Drug Use and Health, approximately 23 million U.S. residents need treatment for a substance abuse disorder. However, less than 11% receive treatment. This approach creates a passive system, wherein over 20 million people who may benefit from substance abuse treatment are overlooked.

04/22/2015—Announced with Health Alliance a multi-year agreement to offer OnTrak™ to Health Alliance members in Illinois. Health Alliance is the largest health insurer in downstate Illinois, with member-focused health plans in Iowa, Nebraska, and Washington. Health Alliance Medical Plans in Illinois and Health Alliance Midwest in Iowa are acknowledged as top-ranked for HMO/POS/PPO products according to the National Committee of Quality Assurance (NCQA) Private Health Insurance rankings, 2014-2015.

04/01/2015—Announced 2014 financial results. The Company reported an 81% increase in enrollment for the 12 months ended December 31, 2014, versus the full year 2013. Recognized revenue increased by 169% to $2.0 million for the full year 2014 versus $0.75 million for the full year 2013. Deferred revenue increased to $2.4 million (up 216%) at December 31, 2014, versus December 31, 2013. A national health insurance provider expanded the availability of OnTrak™ to Florida during the fourth quarter 2014. The Company also commenced enrollment for another customer in New Jersey during the fourth quarter 2014.

03/26/2015—Announced that it has expanded its OnTrak™ program with a national healthcare provider in Kansas to include members with anxiety. Now members that are considered high cost and have been diagnosed with either substance use disorders or anxiety disorders are to be eligible for the program in Kansas. This move represents the Company's contractual expansion into this behavioral health condition and is anticipated to increase eligible covered lives in Kansas' population by approximately four-fold.

03/18/2015—Announced that Cenpatico and Managed Health Services (MHS), a Centene health plan in Wisconsin, have expanded Catasys' OnTrak™ program to MHS' eligible Medicare Advantage members in Wisconsin. This expands a relationship that began in the first quarter 2014 with Catasys providing OnTrak™ services to MHS' eligible Medicaid members in Wisconsin. MHS' eligible Medicaid members affected by substance use disorders are covered under Catasys' OnTrak™ program, which includes medical and psychosocial interventions, as well as a care coaching component over 52 weeks. Catasys receives monthly fees for members enrolled in the OnTrak™ program.

03/12/2015—Announced that it has begun enrolling Health Insurance Exchange (HIE) members for its healthcare plan for customers in Kansas. This represents the continued expansion of Catasys' covered membership with one of the national health insurance providers from its current eligible Medicare and Commercial members in Kansas.

03/05/2015—Announced that it has been increasing the number of managed Medicare and Medicaid members covered under the OnTrak™ program. In addition to increases in commercial members covered under its OnTrak™ program, which includes the recent expansion into new commercial populations (such as New Jersey and Florida), Catasys believes it will continue to add Medicare and Medicaid covered lives in 2015 and beyond, with enrollment growing as an overall portion of the business mix.

03/03/2015—Announced results from a recent Matched Pairs test, performed by the Company indicating a 58.2% reduction in paid claims for its OnTrak™ program. As a result of OnTrak's outcomes, Catasys continues to drive significant customer expansion. The Matched Pairs test is a rigorous methodology that compares each member treated in the OnTrak™ program with a similar matched member who was not in the program. Members were matched on standard criteria including: age, sex, disease burden, geography, and initial paid claims. The test included members from multiple health plans, geographies and lines of business. Both the OnTrak™ member group and the control group started with approximately $24,000 in paid claims over a one-year period. After enrolling in the Catasys program, members saw cost declines of 58.2%, whereas costs for members not in Catasys program declined by only 19.9%. The gross savings to the health plan for Catasys patients totaled $14,280 per patient per year. Members eligible for OnTrak™ tend to have one or more chronic comorbid conditions.

02/26/2015—Announced that it expanded its Catasys' OnTrak™ program into New Jersey with one of the nation's national health plans. The plan's eligible commercial healthcare plan members will be covered under the OnTrak™ program, which includes medical and psychosocial interventions, as well as intensive care coaching over 52 weeks.

11/17/2014—Announced its financial results for the third quarter ended September 30, 2014. The Company reported a 63% increase in third quarter enrollment compared with the same quarter last year. As well, Catasys reported a 239% increase in recognized revenue to $370,000 in the third quarter, compared with the same quarter last year. Furthermore, there was a $454,000 increase in deferred revenue to $988,000, or 85% increase, at September 30, 2014, compared with December 31, 2013.

08/15/2014—Announced its financial results for the second quarter ended June 30, 2014. The Company reported an 80% increase in second quarter enrollment compared with the same quarter last year. As well, Catasys reported a 192% increase in recognized revenue from the healthcare services to $312,000 in the second quarter, compared with the same quarter last year. Furthermore, there was a $295,000 increase in deferred revenue from healthcare services to $829,000 at June 30, 2014, compared with December 31, 2013.

Risks and Disclosures

This Executive Informational Overview® (EIO) has been prepared by Catasys, Inc. (“Catasys” or “the Company”) with the assistance of Crystal Research Associates, LLC (“CRA”) based upon information provided by the Company. CRA has not independently verified such information. Some of the information in this EIO relates to future events or future business and financial performance. Such statements constitute forward-looking information within the meaning of the Private Securities Litigation Act of 1995. Such statements can only be predictions and the actual events or results may differ from those discussed due to the risks described in Catasys’ statements on Forms S-1, 10-K, 10-Q, and 8-K, as well as other forms filed from time to time.

The content of this report with respect to Catasys has been compiled primarily from information available to the public released by the Company through news releases, Annual Reports, and U.S. Securities and Exchange Commission (SEC) filings. Catasys is solely responsible for the accuracy of this information. Information as to other companies has been prepared from publicly available information and has not been independently verified by Catasys or CRA. Certain summaries of activities and outcomes have been condensed to aid the reader in gaining a general understanding. CRA assumes no responsibility to update the information contained in this report. In addition, CRA’s compensation is a cash amount of forty thousand U.S. dollars and three hundred thousand warrants for its services in creating this report and for updates. For more complete information about the risks involved in an investment in the Company, please see Catasys’ most recently filed Annual Report on Form 10-K for the year ended December 31, 2014. Investors should carefully consider risks and information about Catasys’ business. Investors should not interpret the order in which considerations are presented in this or other filings as an indication of their relative importance. Additional risks and uncertainties not presently known to Catasys or that it currently believes to be immaterial may also adversely affect its business. If any of such risks and uncertainties develops into an actual event, Catasys’ business, financial condition, and results of operations could be materially adversely affected, and the trading price of the Company’s shares could decline.

This report is published solely for information purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any state. Past performance does not guarantee future performance. Additional information about Catasys and its public filings, as well as copies of this report, can be obtained by calling (310) 444-4300.

RISKS RELATED TO THE BUSINESS

Catasys has a limited operating history, expects to continue to incur substantial operating losses, and may be unable to obtain additional financing, causing its independent registered public accounting firm to express substantial doubt about the Company’s ability to continue as a going concern.

As reported in Catasys’ Form 10-Q filed with the SEC on August 14, 2015, as of August 13, 2015, the Company had a balance of approximately $451,000 cash on hand. Catasys had working capital deficit of approximately $5.0 million at June 30, 2015. The Company has incurred significant operating losses and negative operating cash flows since inception. Catasys could continue to incur negative cash flows and operating losses for the next 12 months. Its current cash burn rate is approximately $450,000 per month, excluding non-current accrued liability payments. The Company expects its current cash resources to cover expenses into the fourth quarter 2015; however, delays in cash collections, revenue, or unforeseen expenditures could impact this estimate. Catasys is in need of additional capital, however, there is no assurance that additional capital can be timely raised in an amount which is sufficient for the Company or on terms favorable to the Company and its stockholders, if at all. If Catasys does not obtain additional capital, there is a significant doubt as to whether it can continue to operate as a going concern and it will need to curtail or cease operations or seek bankruptcy relief. If the Company discontinues operations, it may not have sufficient funds to pay any amounts to its stockholders.

The Company may fail to successfully manage and grow its business, which could adversely affect its results of operations, financial condition, and business.

Continued expansion could put significant strain on Catasys' management, operational, and financial resources. The need to comply with the rules and regulations of the SEC will continue to place significant demands on the Company's financial and accounting staff, financial, accounting and information systems, and its internal controls and procedures, any of which may not be adequate to support the Company's anticipated growth. The need to comply with the state and federal healthcare, security, and privacy regulation will continue to place significant demands on Catasys' staff and its policies and procedures, any of which may not be adequate to support its anticipated growth. The Company may not be able to effectively hire, train, retain, motivate, and manage required personnel. Failure to manage growth effectively could limit Catasys' ability to satisfy its reporting obligations, or achieve its marketing, commercialization, and financial goals.

Catasys will need additional funding, and the Company cannot guarantee that it will find adequate sources of capital in the future.

The Company has incurred negative cash flows from operations since inception and has expended, and expects to continue to expend, substantial funds to grow its business. If Catasys raises additional funds by issuing equity securities, such financing could result in further dilution to the Company's stockholders. Any equity securities issued also may provide for rights, preferences, or privileges senior to those of holders of the Company's common stock. If Catasys raises funds by issuing debt securities, these debt securities would have rights, preferences, and privileges senior to those of holders of the Company's common stock, and the terms of the debt securities issued could impose significant restrictions on Catasys' operations. The Company does not know whether additional financing will be available on commercially acceptable terms, or at all. If adequate funds are not available or are not available on commercially acceptable terms, Catasys may need to continue to downsize, curtail program development efforts, or halt operations altogether.

The Company's programs may not be as effective as it believes them to be, which could limit potential revenue growth.

Catasys' belief in the efficacy of its OnTrak™ solution is based on a limited experience with a relatively small number of patients. Such results may not be statistically significant, have not been subjected to close scientific scrutiny, and may not be indicative of the long-term future performance of treatment with the Company's programs. If the initially indicated results cannot be successfully replicated or maintained over time, utilization of Catasys' programs could decline substantially.

There are no standardized methods for measuring efficacy of programs such as Catasys'. Even if the Company believes its solutions are effective, its customers could determine that they are not utilizing different outcomes measures. In addition, even if Catasys' customers determine its programs are effective, they may discontinue them because they determine that the aggregate cost savings are not sufficient or that its programs do not have a high enough return on investment.

The Company's success is dependent on its ability to enroll third-party payer members in its OnTrak™ programs. Large scale outreach and enrollment efforts have not been conducted and only for limited time periods and Catasys may not be able to achieve the anticipated enrollment rates.

Catasys' OnTrak™ Program may not become widely accepted, which could limit its growth.

The Company's ability to achieve further marketplace acceptance for its OnTrak™ Program may be dependent on its ability to contract with a sufficient number of third party payers and to demonstrate financial and clinical outcomes from those agreements. If unable to secure sufficient contracts to achieve recognition or acceptance of Catasys' OnTrak™ program or if its program does not demonstrate the expected level of clinical improvement and cost savings, it is unlikely the Company will be able to achieve widespread market acceptance.

Disappointing results for the Catasys Program or failure to attain the Company's publicly disclosed milestones, could adversely affect market acceptance and have a material adverse effect on Catasys' stock price.

Disappointing results, later-than-expected press release announcements, or termination of evaluations, pilot programs, or commercial OnTrak™ programs could have a material adverse effect on the commercial acceptance of its programs, stock price, and on the Company's results of operations. In addition, announcements regarding results, or anticipation of results, may increase volatility in the Company's stock price. In addition to numerous upcoming milestones, from time to time, Catasys provides financial guidance and other forecasts to the market.

While the Company believes that the assumptions underlying projections and forecasts it makes publicly available are reasonable, projections and forecasts are inherently subject to numerous risks and uncertainties. Any failure to achieve milestones, or to do so in a timely manner, or to achieve publicly announced guidance and forecasts, could have a material adverse effect on the Company's results of operations and the price of its common stock.

Catasys' industry is highly competitive, and the Company may not be able to compete successfully.

The healthcare business, in general, and the substance dependence treatment business in particular, is highly competitive. While the Company believes its products and services are unique, the Company operates in highly competitive markets. Catasys competes with other healthcare management service organizations and disease management companies, including MBHOs and other specialty healthcare and managed care companies. Most of the Company's competitors are significantly larger and have greater financial, marketing, and other resources than Catasys.

The Company believes that its ability to offer customers a comprehensive and integrated substance dependence solution, including the utilization of innovative medical and psychosocial treatments, and its unique technology platform could enable the Company to compete effectively. However, there can be no assurance that the Company will not encounter more effective competition in the future, which would limit its ability to maintain or increase its business

Catasys competes with many types of substance dependence treatment methods, treatment facilities, and other service providers, many of whom are more established and better funded than the Company. There are approximately 13,500 facilities reporting to the SAMHSA that provide substance abuse treatment on an inpatient or outpatient basis.

Well-known examples of residential treatment programs include the Betty Ford Center®, Caron Foundation®, Hazelden®, and Sierra Tucson®. In addition, individual physicians may provide substance dependence treatment in the course of their practices. Many of these other treatment methods and facilities are well established in the same markets the Company targets, have substantial sales volume, and are provided and marketed by companies with much greater financial resources, facilities, organization, reputation, and experience than Catasys. The Company's competitors may develop and introduce new processes and products that are equal or superior to its programs in treating alcohol and substance dependencies. Accordingly, Catasys may be adversely affected by any new processes and technology developed by its competitors.

Catasys depends on key personnel, the loss of which could impact the ability to manage its business.

The Company's future success depends on the performance of its senior management and operating personnel. The loss of the services of any key member of management and operating personnel could have a material adverse effect on the Company' ability to manage its business.

Catasys may be subject to future litigation, which could result in substantial liabilities that may exceed its insurance coverage.

All significant medical treatments and procedures, including treatment utilizing its programs, involve the risk of serious injury or death. Even under proper medical supervision, withdrawal from alcohol may cause severe physical reactions. While the Company has not been the subject of any such claims, its business entails an inherent risk of claims for personal injuries and substantial damage awards. The Company cannot control whether individual physicians will apply the appropriate standard of care in determining how to treat their patients.

While the Company's agreements typically require physicians to indemnify it for their negligence, there can be no assurance they will be willing and financially able to do so if claims are made. In addition, Catasys' license agreements require it to indemnify physicians, hospitals, or their affiliates for losses resulting from its negligence. The Company currently has insurance coverage for personal injury claims, directors' and officers' liability insurance coverage, and errors and omissions insurance. It may not be able to maintain adequate liability insurance at acceptable costs or on favorable terms. Catasys expects that liability insurance will be more difficult to obtain and that premiums will increase over time and as the volume of patients treated with its programs increases. In the event of litigation, the Company may sustain significant damages or settlement expense (regardless of a claim's merit), litigation expense, and significant harm to its reputation.

If third-party payers fail to provide coverage and adequate payment rates for its programs, the Company's revenue and prospects for profitability will be harmed.

Future revenue growth will depend, in part, upon the Company's ability to contract with health plans and other third-party payers for its OnTrak™ program. To date, Catasys has not received a significant amount of revenue from its OnTrak™ substance dependence programs from health plans and other third-party payers, and acceptance of the OnTrak™ substance dependence programs is critical to the future prospects of its business.

In addition, third-party payers are increasingly attempting to contain healthcare costs, and may not cover or provide adequate payment for Catasys' programs. Adequate third-party reimbursement might not be available to enable the Company to realize an appropriate return on investment in research and product development, and the lack of such reimbursement could have a material adverse effect on the Company's operations and could adversely affect its revenues and earnings.

Catasys may not be able to achieve promised savings for its OnTrak™ contracts, which could result in pricing levels insufficient to cover the Company's costs or ensure profitability.

The Company anticipates that many of its OnTrak™ contracts will be based upon anticipated or guaranteed levels of savings for its customers and achieving other operational metrics resulting in incentive fees based on savings. If Catasys is unable to meet or exceed promised savings or achieve agreed upon operational metrics, or favorably resolve contract billing and interpretation issues with its customers, the Company may be required to refund from the amount of fees paid to it any difference between savings that were guaranteed and the savings, if any, which were actually achieved, or Catasys may fail to earn incentive fees based on savings.

Accordingly, during or at the end of the contract terms, the Company may be required to refund some or all of the fees paid for its services. This exposes Catasys to significant risk that contracts negotiated and entered into may ultimately be unprofitable. In addition, managed care operations are at risk for costs incurred to provide agreed upon services under the Company's program. Therefore, failure to anticipate or control costs could have materially adverse effects on its business.

The Company's ability to utilize net operating loss carryforwards may be limited.

As of December 31, 2014, Catasys had net operating loss carryforwards (NOLs) of approximately $191 million for federal income tax purposes that will begin to expire in 2024. These NOLs may be used to offset future taxable income, to the extent the Company generates any taxable income, and thereby reduce or eliminate the future federal income taxes otherwise payable. Section 382 of the Internal Revenue Code imposes limitations on a corporation's ability to utilize NOLs if it experiences an ownership change, as defined in Section 382. In general terms, an ownership change may result from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50% over a three-year period.

In the event that an ownership change has occurred, or were to occur, utilization of the Company's NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of Catasys' stock at the time of the ownership change by the applicable long-term tax exempt rate, as defined in the Internal Revenue Code. Any unused annual limitation may be carried over to later years.

Catasys may be found to have experienced an ownership change under Section 382 as a result of events in the past or the issuance of shares of common stock, or a combination thereof. If so, the use of the Company's NOLs, or a portion thereof, against the Company's future taxable income may be subject to an annual limitation under Section 382, which may result in expiration of a portion of Catasys' NOLs before utilization.

RISKS RELATED TO THE COMPANY'S INTELLECTUAL PROPERTY

Confidentiality agreements with employees, treating physicians, and others may not adequately prevent disclosure of trade secrets and other proprietary information.

In order to protect the Company's proprietary technology and processes, Catasys relies, in part, on confidentiality provisions in its agreements with employees, treating physicians, and others. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover trade secrets and proprietary information. Costly and time-consuming litigation could be necessary to enforce and determine the scope of the Company's proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect Catasys' competitive business position.

Catasys may be subject to claims that it infringes the intellectual property rights of others, and unfavorable outcomes could harm its business.

Future operations may be subject to claims, and potential litigation, arising from Catasys' alleged infringement of patents, trade secrets, trademarks, or copyrights owned by other third parties. Within the healthcare, drug, and bio-technology industry, many companies actively pursue infringement claims and litigation, which makes the entry of competitive products more difficult. The Company may experience claims or litigation initiated by existing, better-funded competitors, and by other third parties.

Court-ordered injunctions may prevent Catasys from continuing to market existing products or from bringing new products to market and the outcome of litigation and any resulting loss of revenues and expenses of litigation may substantially affect the Company's ability to meet its expenses and continue operations.

RISKS RELATED TO THE COMPANY'S INDUSTRY

The recently enacted healthcare reforms pose risks and uncertainties that may have a material adverse effect on Catasys' business.

There may be risks and uncertainties arising from the recently enacted healthcare reform and the implementing regulations that will be issued in the future. If the Company fails to comply with these laws or is unable to deal with these risks and uncertainties in an effective manner, Catasys' financial condition and results of operations could be adversely affected.

The Company's policies and procedures may not fully comply with complex and increasing regulation by state and federal authorities, which could negatively impact its business operations.

The healthcare industry is highly regulated and continues to undergo significant changes as third-party payers, such as Medicare and Medicaid, traditional indemnity insurers, managed care organizations, and other private payers, increase efforts to control cost, utilization, and delivery of healthcare services. Healthcare companies are subject to extensive and complex federal, state, and local laws, regulations, and judicial decisions. Catasys' failure, or the failure of its treating physicians, to comply with applicable healthcare laws and regulations may result in the imposition of civil or criminal sanctions that the Company cannot afford, or require redesign or withdrawal of its programs from the market.

The Company or its healthcare professionals may be subject to regulatory, enforcement, and investigative proceedings, which could adversely affect its financial condition or operations.

Catasys or one or more of its healthcare professionals could become the subject of regulatory, enforcement, or other investigations or proceedings, and its relationships, business structure, and interpretations of applicable laws and regulations may be challenged. The defense of any such challenge could result in substantial cost and a diversion of management's time and attention. In addition, any such challenge could require significant changes to how the Company conducts its business and could have a material adverse effect on its business, regardless of whether the challenge ultimately is successful. If determination is made that Catasys or one or more of its healthcare professionals has failed to comply with any applicable laws or regulations, its business, financial condition, and results of operations could be adversely affected.

Catasys' business practices may be found to constitute illegal fee-splitting or corporate practice of medicine, which may lead to penalties and adversely affect its business.

Many states, including California, where the Company's principal executive offices and its managed professional medical corporation are located, have laws that prohibit business corporations, such as Catasys, from practicing medicine, exercising control over medical judgments or decisions of physicians or other healthcare professionals (such as nurses or nurse practitioners), or engaging in certain business arrangements with physicians or other healthcare professionals, such as employment of physicians and other healthcare professionals or fee-splitting.

The state laws and regulations and administrative and judicial decisions that enumerate the specific corporate practice and fee-splitting rules vary considerably from state to state and are enforced by both the courts and government agencies, each with broad discretion. Courts, government agencies, or other parties, including physicians, may assert that Catasys is engaged in the unlawful corporate practice of medicine, fee splitting, or payment for referrals by providing administrative and other services in connection with the Company's treatment programs.

As a result of such allegations, the Company could be subject to civil and criminal penalties, its contracts could be found invalid and unenforceable, in whole or in part, or Catasys could be required to restructure its contractual arrangements. If so, the Company may be unable to restructure its contractual arrangements on favorable terms, which would adversely affect its business and operations.

The Company's business practices may be found to violate anti-kickback, physician self-referral, or false claims laws, which may lead to penalties and adversely affect Catasys' business.

The healthcare industry is subject to extensive federal and state regulation with respect to kickbacks, physician self-referral arrangements, false claims, and other fraud and abuse issues. The federal anti-kickback law prohibits, among other things, knowingly and willfully offering, paying, soliciting, receiving, or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing, arranging for, or recommending of an item or service that is reimbursable, in whole or in part, by a federal healthcare program. "Remuneration" is broadly defined to include anything of value, such as, for example, cash payments, gifts, or gift certificates, discounts, or the furnishing of services, supplies, or equipment.

The Anti-Kickback Law is broad, and prohibits many arrangements and practices that are lawful in businesses outside of the healthcare industry. Recognizing the breadth of the Anti-Kickback Law and the fact that it may technically prohibit many innocuous or beneficial arrangements within the healthcare industry, the Office of Inspector General has issued a series of regulations, known as the safe harbors. Compliance with all requirements of a safe harbor immunizes the parties to the business arrangement from prosecution under the Anti-Kickback Law. The failure of a business arrangement to fit within a safe harbor does not necessarily mean that the arrangement is illegal or that the OIG will pursue prosecution. Still, in the absence of an applicable safe harbor, a violation of the Anti-Kickback Law may occur even if only one purpose of an arrangement is to induce referrals.

The penalties for violating the Anti-Kickback Law can be severe. These sanctions include criminal and civil penalties, imprisonment, and possible exclusion from the federal healthcare programs. Many states have adopted laws similar to the Anti-Kickback Law, and some apply to items and services reimbursable by any payer, including private insurers.

In addition, the federal ban on physician self-referrals, commonly known as the Stark Law, prohibits, subject to certain exceptions, physician referrals of Medicare patients to an entity providing certain "designated health services" if the physician or an immediate family member of the physician has any financial relationship with the entity. A "financial relationship" is created by an investment interest or a compensation arrangement. Penalties for violating the Stark Law include the return of funds received for all prohibited referrals, fines, civil monetary penalties, and possible exclusion from the federal healthcare programs.

In addition to the Stark Law, many states have their own self-referral bans, which may extend to all self-referrals, regardless of the payer. The federal False Claims Act imposes liability on any person or entity that, among other things, knowingly presents, or causes to be presented, a false or fraudulent claim for payment to the federal government. Under the False Claims Act, a person acts knowingly if he has actual knowledge of the information or acts in deliberate ignorance or in reckless disregard of the truth or falsity of the information. Specific intent to defraud is not required.

Violations of other laws, such as the Anti-Kickback Law or the FDA prohibitions against promotion of off-label uses of drugs, can lead to liability under the federal False Claims Act. The qui tam provisions of the False Claims Act allow a private individual to bring an action on behalf of the federal government and to share in any amounts paid by the defendant to the government in connection with the action. The number of filings of qui tam actions has increased significantly in recent years. When an entity is determined to have violated the False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties of between $5,500 and $11,000 for each false claim. Conduct that violates the False Claims Act may also lead to exclusion from the federal health care programs.

Given the number of claims likely to be at issue, potential damages under the False Claims Act for even a single inappropriate billing arrangement could be significant. In addition, various states have enacted similar laws modeled after the False Claims Act that apply to items and services reimbursed under Medicaid and other state healthcare programs, and, in several states, such laws apply to claims submitted to all payers.

On May 20, 2009, the Federal Enforcement and Recovery Act of 2009, or FERA, became law, and it significantly amended the federal False Claims Act. Among other things, FERA eliminated the requirement that a claim must be presented to the federal government. As a result, False Claims Act liability extends to any false or fraudulent claim for government money, regardless of whether the claim is submitted to the government directly, or whether the government has physical custody of the money. FERA also specifically imposed False Claims Act liability if an entity "knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government."

As a result, the knowing and improper failure to return an overpayment can serve as the basis for a False Claims Act action. In March 2010, Congress passed the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010, collectively the ACA, which also made sweeping changes to the federal False Claims Act. The ACA also established that Medicare and Medicaid overpayments must be reported and returned within 60 days of identification or when any corresponding cost report is due.

Finally, the Health Insurance Portability and Accountability Act of 1996 and its implementing regulations created the crimes of healthcare fraud and false statements relating to healthcare matters. The healthcare fraud statute prohibits knowingly and willfully executing a scheme to defraud any healthcare benefit program, including a private insurer. The false statements statute prohibits knowingly and willfully falsifying, concealing, or covering up a material fact or making any materially false, fictitious, or fraudulent statement in connection with the delivery of or payment for healthcare benefits, items, or services. A violation of this statute is a felony and may result in fines, imprisonment, or exclusion from the federal healthcare programs.

Federal or state authorities may claim that the Company's fee arrangements, its agreements and relationships with contractors, hospitals and physicians, or other activities violate fraud and abuse laws and regulations. If Catasys' business practices are found to violate any of these laws or regulations, the Company may be unable to continue with its relationships or implement its business plans, which would have an adverse effect on its business and results of operations. Further, defending the business practices could be time consuming and costly, and an adverse finding could result in substantial penalties or require the Company to restructure its operations, which it may not be able to do successfully.

Catasys' business practices may be subject to state regulatory and licensure requirements.

The Company's business practices may be regulated by state regulatory agencies that generally have discretion to issue regulations and interpret and enforce laws and rules. These regulations can vary significantly from jurisdiction to jurisdiction, and the interpretation of existing laws and rules also may change periodically. Some of the Company's business and related activities may be subject to state healthcare-related regulations and requirements, including managed healthcare, utilization review (UR) or third party administrator-related regulations and licensure requirements. These regulations differ from state to state, and may contain network, contracting, and financial and reporting requirements, as well as specific standards for delivery of services, payment of claims, and adequacy of healthcare professional networks. If a determination is made that Catasys has failed to comply with any applicable state laws or regulations, its business, financial condition, and results of operations could be adversely affected.

Catasys may be subject to healthcare anti-fraud initiatives, which may lead to penalties and adversely affect its business.

State and federal government agencies are devoting increased attention and resources to anti-fraud initiatives against healthcare providers and the entities and individuals with whom they do business, and such agencies may define fraud expansively to include the Company's business practices, including the receipt of fees in connection with a healthcare business that is found to violate any of the complex regulations described above. While to Catasys' knowledge, it has not been the subject of any antifraud investigations, if such a claim were made, defending its business practices could be time consuming and costly, and an adverse finding could result in substantial penalties or require the Company to restructure its operations, which Catasys may not be able to do successfully.

The Company's use and disclosure of patient information is subject to privacy and security regulations, which may result in increased costs.

In conducting research or providing administrative services to healthcare providers in connection with the use of the Company's treatment programs, Catasys may collect, use, disclose, maintain, and transmit patient information in ways that will be subject to many of the numerous state, federal, and international laws and regulations governing the collection, use, disclosure, storage, privacy, and security of patient-identifiable health information, including the administrative simplification requirements of the Health Insurance Portability and Accountability Act of 1996 and its implementing regulations (HIPAA) and the Health Information Technology for Economic and Clinical Health Act of 2009 (HITECH).

The HIPAA Privacy Rule restricts the use and disclosure of patient information and requires safeguarding that information. The HIPAA Security Rule and HITECH establish elaborate requirements for safeguarding PHI transmitted or stored electronically. HIPAA applies to covered entities, which may include healthcare facilities and also includes health plans that will contract for the use of the Company's programs and its services. HIPAA and HITECH require covered entities to bind contractors that use or disclose protected health information to compliance with certain aspects of the HIPAA Privacy Rule and all of the HIPAA Security Rule. In addition to contractual liability, Business Associates are also directly subject to regulation by the federal government. Direct liability means that Catasys is subject to audit, investigation, and enforcement by federal authorities.

HITECH imposes new breach notification obligations requiring the Company to report breaches of "Unsecured Protected Health Information" or PHI that has not been encrypted or destroyed in accordance with federal standards. Business Associates must report such breaches so that their covered entity customers may in turn notify all affected patients, the federal government, and in some cases, local or national media outlets.

The Company may be required to indemnify its covered entity customers for costs associated with breach notification and the mitigation of harm resulting from breaches that it causes. If Catasys is providing management services that include electronic billing on behalf of a physician practice or facility that is a covered entity, the Company may be required to conduct those electronic transactions in accordance with the HIPAA regulations governing the form and format of those transactions. Services provided under the Catasys program not only require it to comply with HIPAA and HITECH, but also Title 42 Part 2 of the Code of Federal Regulations. Part 2 is a federal, criminal law that severely restricts the Company's ability to use and disclose drug and alcohol treatment information obtained from federally-supported treatment facilities.

The Company's operations must be carefully structured to avoid liability under this law. The Company's Catasys program qualifies as a federally funded treatment facility, which requires it to disclose information on members only in compliance with Title 42. In addition to the federal privacy regulations, there are a number of state laws governing the privacy and security of health and personal information. The penalties for violation of these laws vary widely and the area is rapidly evolving.

Catasys believes that it has taken the steps required of it to comply with health information privacy and security laws and regulations in all jurisdictions, both state and federal. However, the Company may not be able to maintain compliance in all jurisdictions where it does business. Failure to maintain compliance, or changes in state or federal privacy and security laws could result in civil and/or criminal penalties and could have a material adverse effect on Catasys' business, including significant reputational damage associated with a breach.

If regulations change or it is determined that the Company is not in compliance with privacy regulations, it may be required to modify aspects of its program, which may adversely affect program results and its business or profitability. Under HITECH, Catasys is subject to prosecution or administrative enforcement and increased civil and criminal penalties for non-compliance, including a new, four-tiered system of monetary penalties. The Company is also subject to enforcement by state attorneys general, who were given authority to enforce HIPAA.

Certain of the Company's professional healthcare employees, such as nurses, must comply with individual licensing requirements.

All of Catasys' healthcare professionals who are subject to licensing requirements, such as Care Coaches, are licensed in the state in which they provide professional services in person. While the Company believes its nurses provide coaching and not professional services, one or more states may require Catasys' healthcare professionals to obtain licensure if providing services telephonically across state lines to the state's residents. Healthcare professionals who fail to comply with these licensure requirements could face fines or other penalties for practicing without a license, and the Company could be required to pay those fines on behalf of its healthcare professionals. If required to obtain licenses for Catasys' nurses in states where they provide telephonic coaching, it would significantly increase the cost of providing the Company's product. In addition, new and evolving agency interpretations, federal or state legislation or regulations, or judicial decisions could lead to the implementation of out-of-state licensure requirements in additional states, and such changes would increase the cost of services and could have a material effect on the Company's business.

Security breaches, loss of data, and other disruptions could compromise sensitive information related to Catasys' business, prevent it from accessing critical information or expose the Company to liability, which could adversely affect its business and its reputation.

In the ordinary course of its business, Catasys collects and stores sensitive data, including legally protected patient health information, personally identifiable information about its employees, intellectual property, and proprietary business information. The Company manages and maintains its applications and data utilizing an off-site co-location facility. These applications and data encompass a wide variety of business critical information, including research and development information, commercial information and business and financial information. The secure processing, storage, maintenance, and transmission of this critical information is vital to the Company's operations and business strategy, and Catasys devotes significant resources to protecting such information.

Although the Company takes measures to protect sensitive information from unauthorized access or disclosure, its information technology and infrastructure may be vulnerable to attaches by hackers; viruses, breaches, or interruptions due to employee error or malfeasance, terrorist attacks, earthquakes, fire, flood, other natural disasters, power loss, computer systems failure, data network failure, Internet failure, or lapses in compliance with privacy and security mandates. Any such virus, breach, or interruption could compromise the Company's networks and the information stored there could be accessed by unauthorized parties, publicly disclosed, lost, or stolen.

Catasys has measures in place that are designed to detect and respond to such security incidents and breaches of privacy and security mandates. Any such access, disclosure, or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, such as HIPAA, government enforcement actions and regulatory penalties. The Company may also be required to indemnify its customers for costs associated with having their data on its system breached. Unauthorized access, loss, or dissemination could also interrupt the Company's operations, including Catasys' ability to bill its customers, provide customer support services, conduct research and development activities, process, and prepare company financial information, manage various general and administrative aspects of its business and damage its reputation, or the Company may lose one or more of its customers, especially if they felt their data may be breached—any of which could adversely affect its business.

RISKS RELATED TO THE COMPANY'S COMMON STOCK

Catasys' common stock has limited trading volume and is therefore susceptible to high price volatility.

The Company's common stock is traded on the OTCQB under the symbol "CATS" and has limited trading volume. As such, its common stock is more susceptible to significant and sudden price changes than stocks that are widely followed by the investment community and actively traded on an exchange. The liquidity of the Company's common stock depends upon the presence in the marketplace of willing buyers and sellers. Catasys cannot assure an investor that he/she will be able to find a buyer for the Company's shares.

In the future, if the Company successfully lists the common stock on a securities exchange or obtains trading authorization, Catasys will not be able to assure investors that an organized public market for its securities will develop or that there will be any private demand for the common stock. The Company could also subsequently fail to satisfy the standards for continued national securities exchange trading, such as standards having to do with a minimum share price, the minimum number of public shareholders, or the aggregate market value of publicly held shares. Any holder of the Company's securities should regard them as a long-term investment and should be prepared to bear the economic risk of an investment in Catasys' securities for an indefinite period.

The Company's common stock is considered a "penny stock" and may be difficult to sell.

Catasys' common stock is subject to certain rules and regulations relating to "penny stocks." Penny stocks are generally equity securities with a price of less than $5.00 (other than securities registered on certain national securities exchanges, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the risks in the penny stock market.

The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer's account. In addition, the penny stock rules generally require that prior to a transaction in a penny stock, the broker-dealer make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules. Since the Company's securities are subject to the penny stock rules, investors in the Company may find it more difficult to sell their securities.

Failure to maintain effective internal controls could adversely affect the Company's operating results and the market for its common stock.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that Catasys maintain internal control over financial reporting that meets applicable standards. As with many smaller companies with small staff, material weaknesses in the Company's financial controls and procedures may be discovered. If unable, or perceived to be unable, to produce reliable financial reports due to internal control deficiencies, investors could lose confidence in the Company's reported financial information and operating results, which could result in a negative market reaction and adversely affect Catasys' ability to raise capital.

Approximately 77% of Catasys' outstanding common stock is beneficially owned by its chairman and chief executive officer (CEO), who has the ability to substantially influence the election of directors and other matters submitted to stockholders.

Respectively, 32,750, 31,315,373, and 56,792 shares are beneficially held of record by Reserva Capital, LLC, Crede CG III, Ltd., and Bonmore, LLC, whose sole managing member is the Company's chairman and CEO, which represents beneficial ownership of approximately 77% of Catasys' outstanding shares of common stock. As a result, he has and is expected to continue to have the ability to significantly influence the election of the Board of Directors and the outcome of all other issues submitted to the Company's stockholders. His interest may not always coincide with the Company's interests or the interests of other stockholders, and they may act in a manner that advances their best interests and not necessarily those of other stockholders. One consequence to this substantial influence or control is that it may be difficult for investors to remove management of the Company. It could also deter unsolicited takeovers, including transactions in which stockholders might otherwise receive a premium for their shares over then current market prices.

The Company's stock price may be subject to substantial volatility, and the value of its stockholders' investment may decline.

The price at which Catasys' common stock will trade may fluctuate as a result of a number of factors, including the number of shares available for sale in the market, quarterly variations in operating results, and actual or anticipated announcements of the Company's OnTrak™ Program, announcements regarding new or discontinued OnTrak™ Program contracts, new products or services by the Company or competitors, regulatory investigations or determinations, acquisitions or strategic alliances by Catasys or its competitors, recruitment or departures of key personnel, the gain or loss of significant customers, changes in the estimates of the Company's operating performance, actual or threatened litigation, market conditions in the Company's industry and the economy as a whole.

Numerous factors, including many over which Catasys has no control, may have a significant impact on the market price of the Company's common stock, including those listed on page 50:

- announcements of new products or services by the Company or its competitors;
- current events affecting the political, economic, and social situations in the U.S. and other countries where the Company operates;
- trends in the Company's industry and the markets in which it operates;
- changes in financial estimates and recommendations by securities analysts;
- acquisitions and financings by the Company or its competitors;
- the gain or loss of a significant customer;
- quarterly variations in operating results;
- the operating and stock price performance of other companies that investors may consider to be comparable;
- purchases or sales of blocks of the Company's securities; and
- issuances of stock.

Furthermore, stockholders may initiate securities class action lawsuits if the market price of Catasys' stock drops significantly, which may cause the Company to incur substantial costs and could divert the time and attention of management.

Future sales of common stock by existing stockholders, or the perception that such sales may occur, could depress the Company's stock price.

The market price of Catasys' common stock could decline as a result of sales by, or the perceived possibility of sales by, existing stockholders. The Company has completed a number of private placements of its common stock and other securities over the last several years, and has effective resale registration statements pursuant to which the purchasers can freely resell their shares into the market. In addition, most of the Company's outstanding shares are eligible for public resale pursuant to Rule 144 under the Securities Act of 1933, as amended.

As of March 30, 2015, approximately 20.5 million shares of the Company's common stock was held by Company affiliates and may be sold pursuant to an effective registration statement or in accordance with the volume and other limitations of Rule 144 or pursuant to other exempt transactions. Future sales of common stock by significant stockholders, including those who acquired their shares in private placements or who are affiliates, or the perception that such sales may occur, could depress the price of the Company's common stock.

Future issuances of common stock and hedging activities may depress the trading price of the Company's common stock.

Any future issuance of equity securities, including the issuance of shares upon direct registration, upon satisfaction of the Company's obligations, compensation of vendors, exercise of outstanding warrants, or effectuation of a reverse stock split, could dilute the interests of existing stockholders, and could substantially decrease the trading price of the Company's common stock. As of March 30, 2015, Catasys has outstanding options to purchase approximately 1,648,124 shares of its common stock and warrants to purchase approximately 21,461,570 shares of its common stock at prices ranging from $0.58 to $3,200.00 per share. The Company may issue equity securities in the future for a number of reasons, including to finance operations and business strategy, in connection with acquisitions, to adjust the ratio of debt to equity, to satisfy Company obligations upon the exercise of outstanding warrants or options, or for other reasons.

There may be future sales or other dilution of the Company's equity, which may adversely affect the market price of its common stock.

In the future, Catasys may need to raise additional funds through public or private financing, which might include sales of equity securities. The issuance of any additional shares of common stock or securities convertible into, exchangeable for, or that represent the right to receive common stock or the exercise of such securities could be substantially dilutive to holders of the Company's common stock. Holders of shares of Catasys' common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series.

Provisions in the Company's certificate of incorporation and Delaware law could discourage a change in control, or an acquisition of Catasys by a third party, even if the acquisition would be favorable to an investor.

The Company's certificate of incorporation and the Delaware General Corporation Law contain provisions that may have the effect of making more difficult or delaying attempts by others to obtain control of the Company, even when these attempts may be in the best interests of stockholders. For example, Catasys' certificate of incorporation also authorizes the Company's Board of Directors, without stockholder approval, to issue one or more series of preferred stock, which could have voting and conversion rights that adversely affect or dilute the voting power of the holders of common stock.

Delaware law also imposes conditions on certain business combination transactions with "interested stockholders." These provisions, and others that could be adopted in the future, could deter unsolicited takeovers or delay or prevent changes in Company control or management, including transactions in which stockholders might otherwise receive a premium for their shares over then current market prices. These provisions may also limit the ability of stockholders to approve transactions that they may deem to be in their best interests.

Catasys does not expect to pay dividends in the foreseeable future.

The Company has paid no cash dividends on its common stock to date, and intends to retain its future earnings, if any, to fund the continued development and growth of its business. As a result, the Company does not expect to pay any cash dividends in the foreseeable future. Further, any payment of cash dividends will also depend on the Company's financial condition, results of operations, capital requirements and other factors, including contractual restrictions to which the Company may be subject, and will be at the discretion of Catasys' Board of Directors.

A number of the Company's outstanding warrants contain anti-dilution provisions that, if triggered, could cause substantial dilution to Catasys' then-existing stockholders and adversely affect its stock price.

A number of the Company's outstanding warrants contain anti-dilution provisions. As a result, if Catasys, in the future, issues or grants any rights to purchase any of its common stock or other securities convertible into its common stock, for a per share price less than the exercise price of its warrants, the exercise price, or in the case of some of the Company's warrants the exercise price and number of shares of common stock, will be reduced. If Catasys' available funds and cash generated from operations are insufficient to satisfy its liquidity requirements in the future, then the Company may need to raise substantial additional funds in the future to support its working capital requirements and for other purposes. If shares of the Company's common stock or securities exercisable for its common stock are issued in consideration of such funds at an effective per share price lower than the Company's existing warrants, then the anti-dilution provisions would be triggered, thus possibly causing substantial dilution to the then-existing shareholders if such warrants are exercised. Such anti-dilution provisions may also make it more difficult to obtain financing.

The exercise of Catasys' outstanding warrants may result in a dilution of the Company's current stockholders' voting power, and an increase in the number of shares eligible for future resale in the public market, which may negatively impact the market price of the Company's stock.

The exercise of some or all of the Company's outstanding warrants could significantly dilute the ownership interests of its existing stockholders. As of March 30, 2015, Catasys had outstanding warrants to purchase an aggregate of 21,461,570 shares of common stock at exercise prices ranging from $0.58 to $80.00 per share. To the extent warrants are exercised, additional shares of common stock will be issued, and such issuance may dilute existing stockholders and increase the number of shares eligible for resale in the public market. In addition to the dilutive effects described above, the exercise of those warrants would lead to a potential increase in the number of shares eligible for resale in the public market. Sales of substantial numbers of such shares in the public market could adversely affect the market price of the Company's shares.

Certain investors are parties to securities purchase agreements with the Company that would permit them to receive additional shares of its common stock upon a reverse stock split, which could cause substantial dilution to the Company's then-existing stockholders.

Catasys has entered into securities purchase agreements with several investors, which provide that in the event that the Company effectuates a reverse stock split of its common stock within 24 months of the closing date of the securities purchase agreement and the volume weighted average price of the common stock during the 20 trading days following the effective date of the Reverse Split declines from the closing price on the trading date immediately prior to the effective date of the Reverse Split, that the Company issue additional shares of common stock. In the event that the Company issues such Adjustment Shares, this could cause substantial dilution to the Company's then-existing shareholders. This provision could also make it more difficult to obtain financing.

Glossary

Addictionologist—A specialist in the diagnosis, study, and treatment of psychological dependence.

Behavioral Health—The scientific study of the emotions, behaviors, and biology relating to a person's mental well-being, their ability to function in everyday life, and their concept of self.

Beta-Blockers—Any of a class of drugs that prevent the stimulation of the adrenergic receptors responsible for increased cardiac action. Beta blockers are used to control heart rhythm, treat angina, and reduce high blood pressure.

Big Data—Extremely large data sets that may be analyzed computationally to reveal patterns, trends, and associations, especially relating to human behavior and interactions.

Binge Drinking/Heavy Drinking—Binge drinking is five or more drinks on the same occasion. Heavy drinking is binge drinking on at least five separate days in the past month.

Care Coach—The OnTrak™ team of Care Coaches have strong clinical backgrounds and credentials (e.g., registered nurses, licensed therapists, etc.) with many years of experience in the substance dependence treatment field. Responsible for coordinating, managing, and conducting outreach, the Care Coaches have direct experience in interventions and treatment, specifically in dealing with difficult cases (particularly those individuals who have many past treatment failures).

Cognitive-Behavioral Therapy (CBT)—A type of psychotherapy in which negative patterns of thought about the self and the world are challenged in order to alter unwanted behavior patterns or treat mood disorders such as depression.

Commercially Equivalent Lives (CELs)—Medicare/Medicaid populations have 2.5 times the incidence rate of substance dependency versus an eligible commercial plan population. Thus, the Medicare/Medicaid plan is worth 2.5 times more than the commercial medical plan, yet in order to equate everything back to a commercial plan, it is called "Commercial Equivalent Lives"—which are effectively the lowest common denominator.

Comorbid—Two or more disorders or illnesses occurring in the same person. They can occur at the same time or one after the other. Comorbidity also implies interactions between the illnesses that can worsen the course of both.

Health Insurance Exchange (HIE)—In the U.S., health insurance marketplaces, also called health exchanges, are organizations set up to facilitate the purchase of health insurance in each state in accordance with the Patient Protection and Affordable Care Act (ACA).

Health Insurance Marketplace—In the U.S., health insurance marketplaces, also called health exchanges, are organizations set up to facilitate the purchase of health insurance in each state in accordance with the Patient Protection and Affordable Care Act (ACA).

Manualized—In the context of Catasys' OnTrak™ program, "manualized" indicates that the program's psychosocial components have been written into a manual for providers to follow. This practice is believed to be somewhat unusual in behavioral health, specifically for substance disorder treatments, though it is an important aspect of Catasys' services, as having a manual provides for consistency of the treatment delivery and improves adherence to clinical standards.

Motivational Enhancement Therapy (MET)—A counseling approach that helps individuals resolve their ambivalence about engaging in treatment and stopping their drug use. This approach aims to evoke rapid and internally motivated change, rather than guide the patient stepwise through the recovery process.

OnTrak™ Relapse Prevention Program—As part of recovery and to help address a member's need for psychosocial treatment, OnTrak™ includes a network of psychosocial providers who are specially trained to deliver the OnTrak™ Relapse Prevention Program (ORPP). ORPP is an evidence-based program leveraging clinically tested practices that provide a sequence of motivational enhancement therapy and relapse prevention cognitive-behavioral therapy modules to maintain abstinence from alcohol and drugs. The ORPP treatment platform is built upon data from SAMHSA, the National Institute on Drug Abuse, and the National Institute on Alcohol Abuse and Alcoholism. As such, ORPP is believed to have empirical support for its efficacy in the treatment of substance use disorders.

Opioid Analgesics—Known as narcotic analgesics, opioids are pain relievers that act on the central nervous system. Like all narcotics, they may become habit-forming if used over long periods. Other side effects include drowsiness, dizziness, breathing problems, and physical or mental dependence. Drugs in this category include codeine; propoxyphene (Darvon); propoxyphene and acetaminophen (Darvocet N); meperidine (Demerol); hydromorphone (Dilaudid); morphine; oxycodone; oxycodone and acetaminophen (Percocet, Roxicet); and hydrocodone and acetaminophen (Lortab, Anexsia).

Parity—The state or condition of being equal, especially regarding status or pay.

Predictive Modeling—A process used in predictive analytics to create a statistical model of future behavior. Predictive analytics is the area of data mining concerned with forecasting probabilities and trends.

Psychosocial—For a concept to be psychosocial means it relates to one's psychological development in, and interaction with, a social environment. The individual needs not be fully aware of this relationship with his or her environment.

Substance Dependency—Also known as drug dependence, this is an adaptive state that develops from repeated drug administration, and which results in withdrawal upon cessation of drug use.

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