Table of Contents

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

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended **December 31, 2019**

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ___to _____

Commission File Number **001-31932**

CATASYS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**88-0464853**
(State or other jurisdiction of incorporation)	*(I.R.S. Employer Identification Number)*

2120 Colorado Ave., Suite 230
Santa Monica, CA 90404
(Address of principal executive offices, including zip code)

(310) 444-4300
(Registrant's telephone number, including area code)

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

Title of Each Class	*Trading Symbol*	*Name of Each Exchange on Which Registered*
Common Stock, par value $0.0001 per share	*CATS*	**The NASDAQ Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:
Not Applicable

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☑

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer", "accelerated filer," "smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☑	Non-accelerated filer ☐	Smaller reporting company ☑
			Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☑

As of June 28, 2019, the last business day of the registrant’s second fiscal quarter, the aggregate market value of the common stock held by non-affiliates of the registrant (without admitting that any person whose shares are not included in such calculation is an affiliate) was $140,851,867 based on the $19.22 closing sales price of the common stock on The NASDAQ Capital Market on that date.

As of March 6, 2020, there were 16,726,964 shares of the registrant’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 2020 definitive Proxy Statement are incorporated by reference into Part III of this Form 10-K.

TABLE OF CONTENTS

In this Annual Report on Form 10-K, except as otherwise stated or the context otherwise requires, the terms “the Company,” “our Company,” “we,” “us” or “our” refer to Catasys, Inc., our variable interest entities, and our wholly-owned subsidiaries. Our common stock, par value $0.0001 per share, is referred to as “common stock.”

Table of Contents

PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed due to factors such as, among others, limited operating history, difficulty in developing, exploiting and protecting proprietary technologies, intense competition and substantial regulation in the healthcare industry. Additional information concerning factors that could cause or contribute to such differences can be found in the following discussion, as well as in Item 1A. "Risk Factors" and Item 7."Management's Discussion and Analysis of Financial Condition and Results of Operations." We encourage you to read those descriptions carefully. We caution you not to place undue reliance on the forward-looking statements contained in this report. These statements, like all statements in this report, speak only as of the date of this report (unless an earlier date is indicated) and we undertake no obligation to update or revise the statements except as required by law. Such forward-looking statements are not guarantees of future performance and actual results will likely differ, perhaps materially, from those suggested by such forward-looking statements.

ITEM 1. BUSINESS

Overview

Catasys, Inc. was incorporated in the State of Delaware on September 29, 2003. Unless the context requires otherwise, the words "Catasys," "we," "Company," "us" and "our" refer to Catasys, Inc.

Catasys was founded with a passion for engaging with and helping improve the health and save lives of anyone impacted by behavioral health conditions. We are a leading Artificial Intelligence ("AI") and technology-enabled healthcare company and harness proprietary big data predictive analytics, artificial intelligence and telehealth, combined with human interaction, to deliver improved member health and cost savings to health plans. We identify, engage and treat health plan members with unaddressed behavioral health conditions that worsen medical comorbidities.

We apply advanced data analytics and predictive modeling to identify members with untreated behavioral health conditions, whether diagnosed or not, and coexisting medical conditions that may be impacted through treatment in the On*Trak* program. We then uniquely engage health plan members who do not typically seek behavioral healthcare by leveraging proprietary enrollment capabilities built on deep insights into the drivers of care avoidance. Our technology enabled On*Trak* solution is an integrated suite of services that includes evidence-based psychosocial and medical interventions delivered either in-person or via telehealth, nurse-led care coaching and local community support. We believe that the program is currently improving member health and, at the same time, demonstrating reduced medical utilization, driving a reduction in total health plan costs for enrolled members.

We have contracted with leading national and regional health plans to make On*Trak* available to eligible members in twenty eight states.

Our Market

The true impact of behavioral health is often under-identified by organizations that provide healthcare benefits. Individuals with unaddressed behavioral health conditions that worsen chronic medical comorbidities cost health plans and employers a disproportionate amount of the total healthcare costs.

According to the U.S. Census Bureau in 2017, there were over 295 million lives in the U.S. covered by various private managed care programs, including Preferred Provider Organizations, Health Maintenance Organizations, self-insured employers and managed Medicare/Medicaid programs. Each year, based on our analysis, approximately 1.9% of commercial plan members will have a substance dependence diagnosis, and that figure may be lesser or greater for specific payors depending on the health plan demographics and location. A smaller, high-cost subset of this population drives the majority of the claims costs for the overall substance dependent population. One in five adults in the United States of America are impacted by one of the following behavioral health issues:

- Substance abuse. Scientific research indicates that not only can drugs interfere with normal brain functioning, but they can also have long-lasting effects that persist even after the drug is no longer being used. Data indicates that at some point, changes may occur in the brain that can turn drug and alcohol abuse into substance dependence—a chronic, relapsing, and sometimes fatal disease. Those dependent on drugs may suffer from compulsive drug craving and usage and be unable to stop drug use or remain drug abstinent without effective treatment. Professional medical treatment may be necessary to end this physiologically-based compulsive behavior.

- Anxiety Disorders. According to the National Institute of Mental Health, anxiety disorders are the most common mental illness in the U.S., affecting an estimated 19.1% of adults aged 18 years or older.

- Depression. In 2016, an estimated 10.3 million U.S. adults aged 18 or older, or approximately 4.3% of all U.S. adults, had at least one major depressive episode in the past year, according to the National Institute of Mental Health. Patients with substance dependence and mood disorders were ranked four out of the top 10 reasons leading to readmission rates for Medicaid patients.

When considering behavioral health-related costs, many organizations have historically only looked at direct treatment costs–usually behavioral claims. For the members we seek to engage our solution, costs associated with behavioral health treatment represent a small portion of their overall healthcare claims, while the medical costs are significant.

Our Solution

Our On*Trak* solution includes the identification, engagement and treatment of health plan members with unaddressed behavioral health conditions that worsen medical comorbidities. We specifically focus on members with anxiety, depression and/or substance use disorder(s). We apply claims-based analytics and predictive modeling to first identify health plan members with medical costs that may be impacted through behavioral health treatment with the On*Trak* program. These members may or may not be diagnosed with a behavioral condition. We then conduct multichannel outreach to eligible members. Enrolled members receive nurse-led care coaching, the opportunity to participate in telehealth or face-to-face evidence-based psychosocial and pharmacological treatment and in some cases, in-market Community Care Coordinator support. We believe the benefits of On*Trak* include improved clinical outcomes and decreased costs for the payor, as well as improved quality of life for the member. We provide outcomes reporting to payors on a periodic basis to demonstrate the value of the program.

Our business strategy is to deliver proven, repeatable clinical and financial outcomes to health plans for their members with unaddressed behavioral conditions that worsen medical comorbidities. We do this by identifying, engaging and treating these members through our On*Trak* solution. Our On*Trak* solution to date has focused on substance use disorder, anxiety and depression.

Our On*Trak* solution combines care coaching, innovative psychosocial and medical treatment delivered through a proprietary provider network and in-market support from Community Care Coordinators. The solution is designed to help payors treat and manage populations struggling with substance use disorder, depression, and anxiety to improve their health and thereby decrease their overall health care costs.

We are currently marketing our On*Trak* solution to payors on a case rate, monthly fee, or fee for service basis, which involves educating them on the disproportionately high cost of their population with unaddressed behavioral health conditions that exacerbate medical comorbidities, and demonstrating the potential for On*Trak* to reduce these costs.

Employees

As of December 31, 2019, we employed 395 full-time employees. We are not a party to any labor agreements and none of our employees are represented by a labor union.

Corporate Information

We were incorporated in the State of Delaware on September 29, 2003. Our principal executive offices are located at 2120 Colorado Ave., Suite 230, Santa Monica, CA 90404, and our telephone number is (310) 444-4300.

Our corporate website address is *www.catasys.com*, the contents of which are not incorporated herein. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). The Securities and Exchange Commission maintains an internet site that contains our public filings with the Securities and Exchange Commission and other information regarding our company, at *www.sec.gov.* The contents of these websites are not incorporated into this Annual Report. Further, our references to the URLs for these websites are intended to be inactive textual reference only.

ITEM 1A. RISK FACTORS

In evaluating us and our common stock, we urge you to carefully consider the risks and other information in this Annual Report on Form 10-K. Any of the risks discussed in this Annual Report on Form 10-K, as well as additional risks and uncertainties not currently known to us or that we currently deem immaterial, could materially and adversely affect our results of operations or financial condition. If any of these risks occur, our business, results of operations and financial condition could be harmed, the price of our common stock could decline, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements contained in this Annual Report on Form 10-K.

Risks related to our business

We have a limited operating history, expect to continue to incur substantial operating losses and may be unable to obtain additional financing.

We have been unprofitable since our inception in 2003 and expect to incur substantial additional operating losses and negative cash flow from operations for at least the next twelve months. At December 31, 2019, cash and cash equivalents was $13.6 million and accumulated deficit was $331 million. During the year ended December 31, 2019, our cash and cash equivalents used by operating activities was ($16.9) million. Additionally, we had working capital of $6.3 million. We expect our current cash resources to cover expenses through at least the next twelve months, however, delays in cash collections, revenue, or unforeseen expenditures could impact this estimate.

Historically, we have seen and continue to see net losses, net loss from operations, negative cash flow from operating activities, and historical working capital deficits as we continue through a period of rapid growth. The accompanying financial statements do not reflect any adjustments that might result if we were unable to continue as a going concern. We have alleviated substantial doubt by both entering into contracts for additional revenue-generating health plan customers and expanding our On*Trak* program within existing health plan customers. To support this increased demand for services, we invested and will continue to invest in additional headcount needed to support the anticipated growth. Additional management plans include increasing the outreach pool as well as improving our current enrollment rate. We will continue to explore ways to increase margins on both existing and new members.

We have a growing customer base and believe we are able to fully scale our operations to service the contracts and future enrollment providing leverage in these investments that will generate positive cash flow in the near future. We believe we will have enough capital to cover expenses through the foreseeable future and we will continue to monitor liquidity. If we add more health plans than budgeted, increase the size of the outreach pool by more than we anticipate, decide to invest in new products or seek out additional growth opportunities, we would consider financing these options with either a debt or equity financing.

We may need additional funding, and we cannot guarantee that we will find adequate sources of capital in the future.

We have incurred negative cash flows from operations since inception and have expended, and expect to continue to expend, substantial funds to grow our business. We may require additional funds before we achieve positive cash flows and we may never become cash flow positive.

If we raise additional funds by issuing equity securities, such financing will result in further dilution to our stockholders. Any equity securities issued also may provide for rights, preferences or privileges senior to those of holders of our common stock. If we raise funds by issuing debt securities, these debt securities would have rights, preferences and privileges senior to those of holders of our common stock, and the terms of the debt securities issued could impose significant restrictions on our operations in addition to those referenced above.

We do 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, we may need to continue to downsize, curtail program development efforts or halt our operations altogether.

We may fail to successfully manage and grow our business, which could adversely affect our results of operations, financial condition and business.

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

We may be unable to successfully execute on our growth initiatives, business strategies or operating plans.

We are continually executing a number of growth initiatives, strategies and operating plans designed to enhance our business. The anticipated benefits from these efforts are based on several assumptions that may prove to be inaccurate. Moreover, we may not be able to successfully complete these growth initiatives, strategies and operating plans and realize all of the benefits, including growth targets and cost savings, that we expect to achieve or it may be more costly to do so than we anticipate. A variety of risks could cause us not to realize some or all of the expected benefits. These risks include, among others, delays in the anticipated timing of activities related to such growth initiatives, strategies and operating plans, increased difficulty and cost in implementing these efforts, including difficulties in complying with new regulatory requirements and the incurrence of other unexpected costs associated with operating the business. Moreover, our continued implementation of these programs may disrupt our operations and performance. As a result, we cannot assure you that we will realize these benefits. If, for any reason, the benefits we realize are less than our estimates or the implementation of these growth initiatives, strategies and operating plans adversely affect our operations or cost more or take longer to effectuate than we expect, or if our assumptions prove inaccurate, our business, financial condition and results of operations may be materially adversely affected.

Our programs may not be as effective as we believe them to be, which could limit our potential revenue growth.

Our belief in the efficacy of our On*Trak* 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 our programs. If the initially indicated results cannot be successfully replicated or maintained over time, utilization of our programs could decline substantially. There are no standardized methods for measuring efficacy of programs such as ours. Even if we believe our solutions are effective, our customers could determine they are not utilizing different outcomes measures. In addition, even if our customers determine our solutions are effective they may discontinue them because they determine that the aggregate cost savings are not sufficient or that our programs do not have a high enough return on investment. Our success is dependent on our ability to enroll third-party payor members in our On*Trak* solutions. Large scale outreach and enrollment efforts have not been conducted and only for limited time periods and we may not be able to achieve the anticipated enrollment rates.

Our On*Trak* solution may not become widely accepted, which could limit our growth.

Our ability to achieve further marketplace acceptance for our On*Trak* solution is dependent on our ability to demonstrate financial and clinical outcomes from our agreements. If we are unable to secure sufficient contracts to achieve recognition or acceptance of our On*Trak* solution or if our program does not demonstrate the expected level of clinical improvement and cost savings, it is unlikely that we will be able to achieve widespread market acceptance.

Disappointing results for our solutions or failure to attain our publicly disclosed milestones could adversely affect market acceptance and have a material adverse effect on our stock price.

Disappointing results, later-than-expected press release announcements or termination of evaluations, pilot programs or commercial On*Trak* solutions could have a material adverse effect on the commercial acceptance of our solutions, our stock price and on our results of operations. In addition, announcements regarding results, or anticipation of results, may increase volatility in our stock price. In addition to numerous upcoming milestones, from time to time we provide financial guidance and other forecasts to the market. While we believe that the assumptions underlying projections and forecasts we make 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 our results of operations and the price of our common stock.

We face business disruption and related risks resulting from the recent outbreak of the novel coronavirus 2019 (COVID-19), which could have a material adverse effect on our business and results of operations.

Our business could be disrupted and materially adversely affected by the recent outbreak of COVID-19. As a result of measures imposed by the governments in affected regions, businesses and schools have been suspended due to quarantines intended to contain this outbreak and many people have been forced to work from home in those areas. The spread of COVID-19 from China to other countries has resulted in the Director General of the World Health Organization declaring the outbreak of COVID-19 as a Public Health Emergency of International Concern (PHEIC), based on the advice of the Emergency Committee under the International Health Regulations (2005), and the Centers for Disease Control and Prevention in the U.S. issued a warning on February 25, 2020 regarding the likely spread of COVID-19 to the U.S. While the COVID-19 outbreak is still in very early stages, international stock markets have begun to reflect the uncertainty associated with the slow-down in the Chinese economy and the reduced levels of international travel experienced since the beginning of January and the significant decline in the Dow Industrial Average at the end of February 2020 was largely attributed to the effects of COVID-19. We are still assessing our business operations and system supports and the impact COVID-19 may have on our results and financial condition, but there can be no assurance that this analysis will enable us to avoid part or all of any impact from the spread of COVID-019 or its consequences, including downturns in business sentiment generally or in our sector in particular.

Our industry is highly competitive, and we may not be able to compete successfully.

The healthcare business in general, and the behavioral health treatment business in particular, are highly competitive. While we believe our products and services are unique, we operate in highly competitive markets. We compete with other healthcare management service organizations, care management and disease management companies, including Managed Behavioral Healthcare Organizations (MBHOs), other specialty healthcare and managed care companies, and healthcare technology companies that are offering treatment and support of behavioral health on-line and on mobile devices. Most of our competitors are significantly larger and have greater financial, marketing and other resources than us. We believe that our ability to offer customers a comprehensive and integrated behavioral health solution, including the utilization of our analytical models and innovative member engagement methodologies, will enable us to compete effectively. However, there can be no assurance that we will not encounter more effective competition in the future, that we will have financial resources to continue to improve our offerings or that we will be successful improving them, which would limit our ability to maintain or increase our business.

Our competitors may develop and introduce new processes and products that are equal or superior to our programs in treating behavioral health conditions. Accordingly, we may be adversely affected by any new processes and products developed by our competitors.

A substantial percentage of our revenues are attributable to four large customers, any or all of which may terminate our services at any time.

Four customers account for an aggregate of 85% and 76% of our revenue for the years ended December 31, 2019 and 2018, respectively, and four customers represented an aggregate of 89% and 88% of our accounts receivable as of December 31, 2019 and 2018, respectively. We expect that revenues from a limited number of customers will continue for the foreseeable future. Sales to these customers are made pursuant to agreements with flexible termination provisions, generally entitling the customer to terminate with or without cause on limited notice to us. We may not be able to keep our key customers, or these customers may decrease their enrollment levels. Any substantial decrease or delay in revenues relating to one or more of our key customers would harm our financial results. If revenues relating to current key customers cease or are reduced, we may not obtain sufficient enrollments from other customers necessary to offset any such losses or reductions**.**

We depend on key personnel, the loss of which could impact the ability to manage our business.

We are highly dependent on our senior management and key operating and technical personnel. The loss of the services of any member of our senior management and key operating and technical personnel could have a material adverse effect on our

business, operating results and financial condition. We also rely on consultants and advisors to assist us in formulating our strategy.

We will need to hire additional employees in order to achieve our objectives. There is currently intense competition for skilled executives and employees with relevant expertise, and this competition is likely to continue. The inability to attract and retain sufficient personnel could adversely affect our business, operating results and financial condition.

Our success depends largely upon the continued services of our key executive officers. These executive officers are at-will employees and therefore they may terminate employment with us at any time with no advance notice. We also rely on our leadership team in the areas of research and development, marketing, services and general and administrative functions. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. The replacement of one or more of our executive officers or other key employees would likely involve significant time and costs and may significantly delay or prevent the achievement of our business objectives.

To continue to execute our growth strategy, we also must attract and retain highly skilled personnel. Competition is intense for qualified professionals. We may not be successful in continuing to attract and retain qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled personnel with appropriate qualifications. The pool of qualified personnel with experience working in the healthcare market is limited overall. In addition, many of the companies with which we compete for experienced personnel have greater resources than we have.

In addition, in making employment decisions, particularly in high-technology industries, job candidates often consider the value of the stock options or other equity instruments they are to receive in connection with their employment. Volatility in the price of our stock may, therefore, adversely affect our ability to attract or retain highly skilled personnel. Further, the requirement to expense stock options and other equity instruments may discourage us from granting the size or type of stock option or equity awards that job candidates require to join our company. Failure to attract new personnel or failure to retain and motivate our current personnel, could have a material adverse effect on our business, financial condition and results of operations.

We are dependent on our ability to recruit, retain and develop a very large and diverse workforce. We must transform our culture in order to successfully grow our business.

Our products and services and our operations require a large number of employees. A significant number of employees have joined us in recent years as we continue to grow and expand our business. Our success is dependent on our ability to transform our culture, align our talent with our business needs, engage our employees and inspire our employees to be open to change, to innovate and to maintain member- and client-focus when delivering our services. Our business would be adversely affected if we fail to adequately plan for succession of our executives and senior management; or if we fail to effectively recruit, integrate, retain and develop key talent and/or align our talent with our business needs, in light of the current rapidly changing environment. While we have succession plans in place and we have employment arrangements with a limited number of key executives, these do not guarantee that the services of these or suitable successor executives will continue to be available to us.

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

All significant medical treatments and procedures, including treatment utilizing our programs, involve the risk of serious injury or death. While we have not been the subject of any such claims, our business entails an inherent risk of claims for personal injuries and substantial damage awards. We cannot control whether individual physicians and therapists will apply the appropriate standard of care in determining how to treat their patients. While our agreements typically require physicians to indemnify us for their negligence, there can be no assurance they will be willing and financially able to do so if claims are made. In addition, our license agreements require us to indemnify physicians, hospitals or their affiliates for losses resulting from our negligence.

We currently have insurance coverage for personal injury claims, directors’ and officers’ liability insurance coverage, and errors and omissions insurance. We may not be able to maintain adequate liability insurance at acceptable costs or on favorable terms. We expect that liability insurance will be more difficult to obtain and that premiums will increase over time and as the volume of patients treated with our programs increases. In the event of litigation, we may sustain significant damages or settlement expense (regardless of a claim's merit), litigation expense and significant harm to our reputation.

If third-party payors fail to provide coverage and adequate payment rates for our solutions, our revenue and prospects for profitability will be harmed.

Our future revenue growth will depend in part upon our ability to contract with health plans and other insurance payors for our On*Trak* solutions. In addition, insurance payors are increasingly attempting to contain healthcare costs, and may not cover or provide adequate payment for our programs. Adequate insurance reimbursement might not be available to enable us 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 our operations and could adversely affect our revenues and earnings.

We may not be able to achieve promised savings for our On*Trak* contracts, which could result in pricing levels insufficient to cover our costs or ensure profitability.

Many of our On*Trak* contracts are based upon anticipated or guaranteed levels of savings for our customers and achieving other operational metrics resulting in incentive fees based on savings. If we are unable to meet or exceed promised savings, achieve agreed upon operational metrics, or favorably resolve contract billing and interpretation issues with our customers, we may be required to refund from the amount of fees paid to us any difference between savings that were guaranteed and the savings, if any, which were actually achieved; or we may fail to earn incentive fees based on savings. Accordingly, during or at the end of the contract terms, we may be required to refund some or all of the fees paid for our services. This exposes us 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 our solution. Therefore, failure to anticipate or control costs could have a materially adverse effect on our business.

Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations.

Our net operating loss carryforwards ("NOLs") will begin to expire in 2023. These NOLs may be used to offset future taxable income, to the extent we generate any taxable income, and thereby reduce or eliminate our 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 our NOLs would be subject to an annual limitation under Section 382 determined by multiplying the value of our 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. We 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 our NOLs, or a portion thereof, against our future taxable income may be subject to an annual limitation under Section 382, which may result in expiration of a portion of our NOLs before utilization.

In order to protect the Company’s significant NOLs, we filed an Amended and Restated Certificate of Incorporation of the Company containing an amendment (the “Protective Amendment”) with the Delaware Secretary of State on October 28, 2019. The Protective Amendment was approved by the Company’s stockholders by written consent dated September 24, 2019.

The Protective Amendment is designed to assist in protecting the long-term value of our accumulated NOLs by limiting certain transfers of our common stock. The Protective Amendment’s transfer restrictions generally restrict any direct or indirect transfers of common stock if the effect would be to increase the direct or indirect ownership of the common stock by any person from less than 4.99% to 4.99% or more of the common stock, or increase the percentage of the common stock owned directly or indirectly by a person owning or deemed to own 4.99% or more of the common stock. Any direct or indirect transfer attempted in violation of the Protective Amendment will be void as of the date of the prohibited transfer as to the purported transferee.

The Protective Amendment also requires any person attempting to become a holder of 4.99% or more of our common stock to seek the approval of our Board. This may have an unintended “anti-takeover” effect because our Board may be able to prevent any future takeover. Similarly, any limits on the amount of stock that a shareholder may own could have the effect of making it more difficult for shareholders to replace current management. Additionally, because the Protective Amendment may have the effect of restricting a shareholder’s ability to dispose of or acquire our common stock, the liquidity and market value of our common stock might suffer.

The Protective Amendment is not binding with respect to shares of common stock issued prior to its adoption unless the holder of such shares has voted in favor of the Protective Amendment and the resulting transfer restriction is noted conspicuously on the certificate representing such shares, or, in the case of uncertificated shares, the registered owners are notified of the Protective Amendment, or such registered owner has actual knowledge of the Protective Amendment. Therefore, even after the effectiveness of the Protective Amendment, we cannot assure you that we will not experience an ownership change as defined in Section 382, including as a result of a waiver or modification by our Board as permitted by the Protective Amendment.

Risks related to our 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 our proprietary technology and processes, we rely in part on confidentiality provisions in our 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 our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

We may be subject to claims that we infringe the intellectual property rights of others, and unfavorable outcomes could harm our business.

Our future operations may be subject to claims, and potential litigation, arising from our 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. We may experience claims or litigation initiated by existing, better-funded competitors and by other third parties. Court-ordered injunctions may prevent us 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 our ability to meet our expenses and continue operations.

Risks related to our healthcare industry

Recent changes in insurance and health care laws have created uncertainty in the health care industry.

The Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act, each enacted in March 2010, generally known as the Health Care Reform Law, significantly expanded health insurance coverage to uninsured Americans and changed the way health care is financed by both governmental and private payers. Following the 2016 federal elections, which resulted in the election of the Republican presidential nominee and Republican majorities in both houses of Congress, there were renewed legislative efforts to significantly modify or repeal the Health Care Reform Law and certain executive policy changes designed to modify its impact, including the enactment of the Tax Cuts and Jobs Act in December 2017 which repealed the penalties under the Health Care Reform Law for uninsured persons. We cannot predict what further reform proposals, if any, will be adopted, when they may be adopted, or what impact they may have on our business. There may also be other risks and uncertainties associated with the Health Care Reform Law. If we fail to comply or are unable to effectively manage such risks and uncertainties, our financial condition and results of operations could be adversely affected.

Our policies and procedures may not fully comply with complex and increasing regulation by state and federal authorities, which could negatively impact our business operations.

The healthcare industry is highly regulated and continues to undergo significant changes as third-party payors, such as Medicare and Medicaid, traditional indemnity insurers, managed care organizations and other private payors, 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. Our failure or the failure of our treating physicians, to comply with applicable healthcare laws and regulations may result in the imposition of civil or criminal sanctions that we cannot afford, or require redesign or withdrawal of our programs from the market.

We may become subject to medical liability claims, which could cause us to incur significant expenses and may require us to pay significant damages if not covered by insurance.

Our business entails the risk of medical liability claims against both our providers and us. Although we carry insurance covering medical malpractice claims in amounts that we believe are appropriate in light of the risks attendant to our business, successful medical liability claims could result in substantial damage awards that exceed the limits of our insurance coverage. We carry professional liability insurance for ourselves, and we separately carry a general insurance policy, which covers medical malpractice claims. In addition, professional liability insurance is expensive and insurance premiums may increase significantly in the future, particularly as we expand our services. As a result, adequate professional liability insurance may not be available to us in the future at acceptable costs or at all.

Any claims made against us that are not fully covered by insurance could be costly to defend against, result in substantial damage awards against us and divert the attention of our management and our providers from our operations, which could have a material adverse effect on our business, financial condition and results of operations. In addition, any claims may adversely affect our business or reputation.

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

Many states, including California where our principal executive offices are located, have laws that prohibit business corporations, such as us, from practicing medicine, exercising control over medical judgments or decisions of physicians or other health care professionals (such as nurses or nurse practitioners), or engaging in certain business arrangements with physicians or other health care professionals, such as employment of physicians and other health care 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 we are engaged in the unlawful corporate practice of medicine, fee-splitting, or payment for referrals by providing administrative and other services in connection with our treatment programs. As a result of such allegations, we could be subject to civil and criminal penalties, our contracts could be found invalid and unenforceable, in whole or in part, or we could be required to restructure our contractual arrangements. If so, we may be unable to restructure our contractual arrangements on favorable terms, which would adversely affect our business and operations.

Our business practices may be found to violate anti-kickback, physician self-referral or false claims laws, which may lead to penalties and adversely affect our 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 (the “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 health care 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 it prohibits many arrangements and practices that are lawful in businesses outside of the health care industry.

Recognizing the breadth of the Anti-Kickback Law and the fact that it may technically prohibit many innocuous or beneficial arrangements within the health care industry, the Office of Inspector General (“OIG”) 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 health care programs. Many states have adopted laws similar to the Anti-Kickback Law, and some apply to items and services reimbursable by any payor, 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 health care 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 payor.

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 health care programs, and, in several states, such laws apply to claims submitted to all payors.

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 health care fraud and false statements relating to health care matters. The health care fraud statute prohibits knowingly and willfully executing a scheme to defraud any health care 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 health care benefits, items, or services. A violation of this statute is a felony and may result in fines, imprisonment, or exclusion from the federal health care programs.

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

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

Our 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 our business and related activities may be subject to state health care-related regulations and requirements, including managed health care, 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 health care professional networks. If a determination is made that we have failed to comply with any applicable state laws or regulations, our business, financial condition and results of operations could be adversely affected.

If our providers or experts are characterized as employees, we would be subject to employment and withholding liabilities.

We structure our relationships with our providers and experts in a manner that we believe results in an independent contractor relationship, not an employee relationship. An independent contractor is generally distinguished from an employee by his or her degree of autonomy and independence in providing services. A high degree of autonomy and independence is generally indicative of a contractor relationship, while a high degree of control is generally indicative of an employment relationship. Although we believe that our providers and experts are properly characterized as independent contractors, tax or other regulatory authorities may in the future challenge our characterization of these relationships. If such regulatory authorities or state, federal or foreign courts were to determine that our providers or experts are employees, and not independent contractors, we would be required to withhold income taxes, to withhold and pay social security, Medicare and similar taxes and to pay unemployment and other related payroll taxes. We would also be liable for unpaid past taxes and subject to penalties. As a result, any determination that our providers or experts are our employees could have a material adverse effect on our business, financial condition and results of operations.

We may be subject to healthcare anti-fraud initiatives, which may lead to penalties and adversely affect our 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 our 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 our knowledge we have not been the subject of any anti-fraud investigations, if such a claim were made, defending our business practices could be time consuming and expensive and an adverse finding could result in substantial penalties or require us to restructure our operations, which we may not be able to do successfully.

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

In providing administrative services to healthcare providers and operating our treatment programs, we 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 ("Protected Health Information" or "PHI"), 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 our programs and our services. HIPAA and HITECH require covered entities to bind contractors that use or disclose protected health information (or "Business Associates") 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 we are subject to audit, investigation and enforcement by federal authorities. HITECH imposes new breach notification obligations requiring us 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. We may be required to indemnify our covered entity customers for costs associated with breach notification and the mitigation of harm resulting from breaches that we cause. If we are providing management services that include electronic billing on behalf of a physician practice or facility that is a covered entity, we 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 our On*Trak* solution not only require us to comply with HIPAA and HITECH but also Title 42 Part 2 of the Code of Federal Regulations ("Part 2"). Part 2 is a federal, criminal law that severely restricts our ability to use and disclose drug and alcohol treatment information obtained from federally-supported treatment facilities. Our operations must be carefully structured to avoid liability under this law. Our On*Trak* solution qualifies as a federally funded treatment facility which requires us 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.

In 2018, California passed a privacy law (the "CCPA"), which gives consumers significant rights over the use of their personal information, including the right to object to the "sale" of their personal information. While certain information covered by HIPAA is exempt from the applicability of the CCPA, the rights of consumers under the CCPA may restrict our ability to use personal information in connection with our business operations. The CCPA also provides a private right of action for security breaches.

In 2019, New York passed a law known as the SHIELD Act, which will, as of March 21, 2020, require companies to have robust data security programs in place. Other states, including Washington, have introduced significant privacy bills, and Congress is debating federal privacy legislation, which if passed, may restrict our business operations and require us to incur additional costs for compliance.

In addition, several foreign countries and governmental bodies, including the E.U., Brazil and Canada, have laws and regulations concerning the collection and use of personally identifiable information obtained from their residents, including identifiable health information, which are often more restrictive than those in the U.S. Laws and regulations in these jurisdictions apply broadly to the collection, use, storage, disclosure and security of personally identifiable information, including health information, identifying, or which may be used to identify, an individual, such as names, email addresses and, in some jurisdictions, Internet Protocol (IP) addresses, device identifiers and other data. Although we currently conduct business only in the United States of America, these laws and regulations could become applicable to us in the event we expand our operations into other countries. These and other obligations may be modified and interpreted in different ways by courts, and new laws and regulations may be enacted in the future.

Within the EEA, the General Data Protection Regulation ("GDPR") took full effect on May 25, 2018, superseding the 1995 European Union Data Protection Directive and becoming directly applicable across E.U. member states. The GDPR includes more stringent operational requirements for processors and controllers of personal data, for companies established in the EEA and those outside the EEA that collect and use personal data, including health information, imposes significant penalties for non-compliance and has broader extra-territorial effect. As the GDPR is a regulation rather than a directive, it applies throughout the EEA, but permits member states to enact supplemental requirements if they so choose. Noncompliance with the GDPR can trigger fines of up to the greater of €20 million or 4% of global annual revenues. Further, a Data Protection Act substantially implementing the GDPR was enacted in the U.K., effective in May 2018. It remains unclear, however, if the U.K.'s withdrawal from the E.U. will ultimately transpire and, if it does, how U.K. data protection laws or regulations will develop in the medium to longer term and how data transfers to and from the U.K. will be regulated. In addition, some countries are considering or have enacted legislation requiring local storage and processing of data that could increase the cost and complexity of delivering our services.

We believe that we have taken the steps required of us to comply with laws governing the privacy and security of personal information, including health information privacy and security laws and regulations, in all applicable jurisdictions, both state and federal. However, we may not be able to maintain compliance in all jurisdictions where we do 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 our business, including significant reputational damage associated with a breach. Under HITECH, we are subject to prosecution or administrative enforcement and increased civil and criminal penalties for non-compliance, including a four-tiered system of monetary penalties. We are also subject to enforcement by state attorneys general who were given authority to enforce HIPAA under HITECH, and who have authority to enforce state-specific data privacy and security laws. If regulations change, if we expand the territorial scope of our operations, or if it is determined that we are not in compliance with privacy regulations, we may be required to modify aspects of our program, which may adversely affect program results and our business or profitability.

Certain of our professional healthcare employees, such as nurses, must comply with individual licensing requirements.

All of our healthcare professionals who are subject to licensing requirements, such as our care coaches, are licensed in the state in which they provide professional services in person. While we believe our nurses provide coaching and not professional services, one or more states may require our 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 we could be required to pay those fines on behalf of our healthcare professionals. If we are required to obtain licenses for our nurses in states where they provide telephonic coaching, it would significantly increase the cost of providing our 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 our business.

Security breaches, loss of data and other disruptions could compromise sensitive information related to our business, prevent us from accessing critical information or expose us to liability, which could adversely affect our business and our reputation.

In the ordinary course of our business, we collect and store sensitive data, including legally protected patient health information, personally identifiable information about our employees, intellectual property, and proprietary business information. We manage and maintain our 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 our operations and business strategy, and we devote significant resources to protecting such information. Although we take measures to protect sensitive information from unauthorized access or disclosure, our information technology and infrastructure may be vulnerable to attacks 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. We may be subject to distributed denial of service (DDOS) attacks by hackers aimed at disrupting service to patients and customers. Our response to such DDOS attacks may be insufficient to protect our network and systems. In addition, there has been a continuing increase in the number of malicious software attacks in the technology industry, including malware and ransomware. Any such virus, breach or interruption could compromise our networks and the information stored there could be accessed by unauthorized parties, publicly disclosed, lost or stolen. We have measures in place that are designed to detect and respond to such security incidents and breaches of privacy and security mandates. Nonetheless, we cannot guarantee our backup systems, regular data backups, security protocols, network protection mechanisms and other procedures currently in place, or that may be in place in the future, will be adequate to prevent or remedy network and service interruption, system failure, damage to one or more of our systems, data loss, security breaches or other data security incidents. We might be required to expend significant capital and resources to protect against or address such incidents. Any 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 and state data security laws), government enforcement actions and regulatory penalties. We may also be required to indemnify our customers for costs associated with having their data on our system breached. Unauthorized access, loss or dissemination could also interrupt our operations, including our ability to bill our customers, provide customer support services, conduct research and development activities, process and prepare company financial information, manage various general and administrative aspects of our business and damage our reputation, or we may lose one or more of our customers, especially if they felt their data may be breached, any of which could adversely affect our business.

Risks related to our Note Agreement

The terms of our Note Agreement place restrictions on our operating and financial flexibility, and failure to comply with covenants or to satisfy certain conditions of the agreement may result in acceleration of our repayment obligations, which could significantly harm our liquidity, financial condition, operating results, business and prospects and cause the price of our securities to decline.

On September 24, 2019 (the “Closing Date”), we entered into a Note Agreement (the “Note Agreement”), by and among us, certain of our subsidiaries as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. (with any other purchasers party thereto from time to time, collectively the “Holder”) and Goldman Sachs Specialty Lending Group, L.P., as collateral agent, in connection with the sale of up to $45.0 million aggregate principal amount of senior secured notes (the “Notes”). On the Closing Date, we issued an aggregate of $35.0 million in principal amount of Notes and, subject to the achievement of threshold trailing six month annualized revenue targets and certain other conditions, the Holder is obligated to purchase up to an additional $10.0 million in principal amount of Notes during the period from the Closing Date until September 24, 2021.

The Note Agreement contains customary covenants, including, among others, covenants that restrict the our ability to incur debt, grant liens, make certain investments and acquisitions, pay dividends, repurchase equity interests, repay certain debt, amend certain contracts, enter into affiliate transactions and asset sales or make certain equity issuances, and covenants that require the us to, among other things, provide annual, quarterly and monthly financial statements, together with related compliance certificates, maintain its property in good repair, maintain insurance and comply with applicable laws. The Note Agreement also includes covenants with respect to our maintenance of certain financial ratios, including a fixed charge coverage ratio, leverage ratio and consolidated liquidity as well as minimum levels of consolidated adjusted EBITDA and revenue.

The Note Agreement and the Notes could have important consequences for us and our stockholders. For example, the Notes require a balloon payment at maturity in September 2024, which may require us to dedicate a substantial portion of our uncommitted cash flow from operations to this future payment if we feel we cannot be successful in our ability to refinance in the future, thereby further reducing the availability of our cash flow to fund working capital, capital expenditures, and acquisitions, and for other general corporate purposes. In addition, our indebtedness could:

- increase our vulnerability to adverse economic and competitive pressures in our industry;

- place us at a competitive disadvantage compared to our competitors that have less debt;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry; and
- limit our ability to borrow additional funds on terms that are acceptable to us or at all.

The Note Agreement contains restrictive covenants that will restrict our operational flexibility and require that we maintain specified financial ratios. If we cannot comply with these covenants, we may be in default under the Note Agreement.

The Note Agreement contains restrictions and limitations on our ability to engage in activities that may be in our long-term best interests. The Note Agreement contains affirmative and negative covenants that limit and restrict, among other things, our ability to:

- incur additional debt;
- sell assets;
- issue equity securities;
- pay dividends or repurchase equity securities;
- incur liens or other encumbrances;
- make certain restricted payments and investments;
- acquire other businesses; and
- merge or consolidate.

The Note Agreement contains a fixed charge coverage ratio covenant, a leverage ratio covenant and minimum revenue and liquidity covenants. Events beyond our control could affect our ability to meet these and other covenants under the Note Agreement. The Note Agreement also contains customary events of default, including, among others, payment default, bankruptcy events, cross-default, breaches of covenants and representations and warranties, change of control, judgment defaults and an ownership change within the meaning of Section 382 of the Code. Our failure to comply with our covenants and other obligations under the Note Agreement may result in an event of default thereunder. A default, if not cured or waived, may permit acceleration of the Notes. If the indebtedness represented by the Notes is accelerated, we cannot be certain that we will have sufficient funds available to pay the accelerated indebtedness (together with accrued interest and fees), or that we will have the ability to refinance the accelerated indebtedness on terms favorable to us or at all. This could have serious consequences to our financial condition, operating results, and business, and could cause us to become insolvent or enter bankruptcy proceedings, and shareholders may lose all or a portion of their investment because of the priority of the claims of our creditors on our assets.

If we are unable to generate or borrow sufficient cash to make payments on our indebtedness, our financial condition would be materially harmed, our business could fail, and shareholders may lose all of their investment.

Our ability to make scheduled payments on or to refinance our obligations will depend on our financial and operating performance, which will be affected by economic, financial, competitive, business, and other factors, some of which are beyond our control. We cannot assure you that our business will generate sufficient cash flow from operations to service our indebtedness or to fund our other liquidity needs. If we are unable to meet our debt obligations or fund our other liquidity needs, we may need to restructure or refinance all or a portion of our indebtedness on or before maturity or sell certain of our assets. We cannot assure you that we will be able to restructure or refinance any of our indebtedness on commercially reasonable terms, if at all, which could cause us to default on our debt obligations and impair our liquidity. Any refinancing of our indebtedness could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations.

Increases in interest rates could adversely affect our results from operations and financial condition.

The Notes bear interest at either a floating rate plus an applicable margin in the case of Notes subject to cash interest payments or a floating rate plus a slightly higher applicable margin in the case of Notes as to which current interest has been capitalized during the first twelve months following the Closing Date, at the Company’s option. The applicable margins are subject to stepdowns, in each case, following the achievement of certain financial ratios. As a result, an increase in prevailing interest rates would have an effect on the interest rates charged on the Notes, which rise and fall upon changes in interest rates. If prevailing interest rates or other factors result in higher interest rates, the increased interest expense would adversely affect our cash flow and our ability to service our indebtedness.

Risks related to our common stock

Our common stock has limited trading volume, and it is therefore susceptible to high price volatility.

Our common stock is listed on the NASDAQ Capital Market under the symbol “CATS” and has at times experienced limited trading volumes. As such, our common stock may be more susceptible to significant and sudden price changes than stocks that are widely followed by the investment community and actively traded. The liquidity of our common stock depends upon the presence in the marketplace of willing buyers and sellers. We cannot assure you that you will be able to find a buyer for your shares. We could also subsequently fail to satisfy the standards for continued NASDAQ listing, 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 our securities should regard them as a long-term investment and should be prepared to bear the economic risk of an investment in our securities for an indefinite period.

Failure to maintain effective internal controls could adversely affect our operating results and the market for our common stock.

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

More than 50% of our outstanding common stock is beneficially owned by our chairman and chief executive officer, who has the ability to substantially influence the election of directors and other matters submitted to stockholders.

10,419,788 shares are beneficially held of record by Acuitas Group Holdings, LLC (“Acuitas”), whose sole managing member is our Chairman and Chief Executive Officer, which represents beneficial ownership of approximately 50% of our 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 our Board of Directors and the outcome of all other matters submitted to our stockholders. His interest may not always coincide with our interests or the interests of other stockholders, and he may act in a manner that advances his 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 our 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.

Our stock price may be subject to substantial volatility, and the value of our stockholders' investment may decline.

The price at which our common stock trades fluctuates as a result of a number of factors, including the number of shares available for sale in the market, quarterly variations in our operating results and actual or anticipated announcements of our On*Trak* solution, announcements regarding new or discontinued On*Trak* solution contracts, new products or services by us or competitors, regulatory investigations or determinations, acquisitions or strategic alliances by us or our competitors, recruitment or departures of key personnel, the gain or loss of significant customers, changes in the estimates of our operating performance, actual or threatened litigation, market conditions in our industry and the economy as a whole.

Numerous factors, including many over which we have no control, may have a significant impact on the market price of our common stock, including:

- announcements of new products or services by us or our competitors;
- current events affecting the political, economic and social situation in the United States;
- trends in our industry and the markets in which we operate;
- changes in financial estimates and recommendations by securities analysts;
- acquisitions and financings by us or our 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 our securities; and
- issuances of stock.

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

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

The market price of our common stock could decline as a result of sales by, or the perceived possibility of sales by, our existing stockholders. Most of our outstanding shares are eligible for public resale pursuant to Rule 144 under the Securities Act of 1933, as amended. As of December 31, 2019, approximately 9.2 million shares of our common stock are held by our 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 our common stock.

Future issuances of common stock and hedging activities may depress the trading price of our common stock.

Any future issuance of equity securities, including the issuance of shares upon direct registration, upon satisfaction of our obligations, compensation of vendors, exercise of outstanding warrants, or effectuation of a reverse stock split, could dilute the interests of our existing stockholders, and could substantially decrease the trading price of our common stock. As of March 6, 2020, we have outstanding options to purchase approximately 3,964,118 shares of our common stock and warrants to purchase approximately 1,539,926 shares of our common stock at prices ranging from $1.80 to $105.60 per share. We may issue equity securities in the future for a number of reasons, including to finance our operations and business strategy, in connection with acquisitions, to adjust our ratio of debt to equity, to satisfy our obligations upon the exercise of outstanding warrants or options or for other reasons.

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

In the future, we 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 shares of our common stock. Holders of shares of our 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. The market price of our common stock could decline as a result of sales of shares of our common stock made after this offering or the perception that such sales could occur. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our common stock and diluting their interests in our Company.

Provisions in our certificate of incorporation and Delaware law could discourage a change in control, or an acquisition of us by a third party, even if the acquisition would be favorable to you.

Our amended and restated certificate of incorporation and the Delaware General Corporation Law contain provisions (including the Section 382 Ownership Limit) that may have the effect of making more difficult or delaying attempts by others to obtain control of our Company, even when these attempts may be in the best interests of stockholders. In addition, our amended and restated certificate of incorporation authorizes our 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 our 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.

We do not expect to pay dividends in the foreseeable future.

We have paid no cash dividends on our common stock to date, and we intend to retain our future earnings, if any, to fund the continued development and growth of our business. As a result, we do not expect to pay any cash dividends in the foreseeable future. Further, any payment of cash dividends will also depend on our financial condition, results of operations, capital requirements and other factors, including contractual restrictions to which we may be subject, and will be at the discretion of our Board of Directors.

A few of our outstanding warrants contain anti-dilution provisions that, if triggered, could cause dilution to our then-existing stockholders and adversely affect our stock price.

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

The exercise of our outstanding warrants may result in a dilution of our 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 our stock.

The exercise of some or all of our outstanding warrants could significantly dilute the ownership interests of our existing stockholders. As of March 6, 2020, we had outstanding warrants to purchase an aggregate of 1,539,926 shares of common stock at exercise prices ranging from $1.80 to $18.71 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 our shares.

Certain of our outstanding warrants contain anti-dilution provisions that, if triggered, could cause dilution to our then-existing stockholders and adversely affect our stock price.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

Our principal executive and administrative offices are located in leased office space in Santa Monica, California.

We believe that the current office space is adequate to meet our needs.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are subject to various legal proceedings that arise in the normal course of our business activities. As of the date of this Annual Report on Form 10-K, we are not a party to any litigation the outcome of which, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our results of operations or financial position.

ITEM 4. MINE SAFETY AND DISCLOSURE

Not Applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Unregistered Sales of Securities

All sales of unregistered securities during the year ended December 31, 2019 were previously disclosed in a Quarterly Report on Form 10-Q or Current Report on Form 8-K.

Issuer Purchase of Equity Securities

None.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed due to factors such as, among others, limited operating history, difficulty in developing, exploiting and protecting proprietary technologies, intense competition and substantial regulation in the healthcare industry. Additional information concerning factors that could cause or contribute to such differences can be found in the following discussion, as well as in Item 1.A. -"Risk Factors."

OVERVIEW

General

We harness proprietary big data predictive analytics, artificial intelligence and telehealth, combined with human interaction, to deliver improved member health and cost savings to health plans. We identify, engage and treat health plan members with unaddressed behavioral health conditions that worsen medical comorbidities. Our mission is to help improve the health and save the lives of as many people as possible.

We apply advanced data analytics and predictive modeling to identify members with untreated behavioral health conditions, whether diagnosed or not, and coexisting medical conditions that may be impacted through treatment in the On*Trak* program. We then uniquely engage health plan members who do not typically seek behavioral healthcare by leveraging proprietary enrollment capabilities built on deep insights into the drivers of care avoidance. Our technology enabled On*Trak* solution is an integrated suite of services that includes evidence-based psychosocial and medical interventions delivered either in-person or via telehealth, nurse-led care coaching and local community support. We believe that the program is currently improving member health and, at the same time, driving a reduction in total health plan costs after completion of the On*Trak* program.

We operate as one segment and we have contracted with leading national and regional health plans to make On*Trak* available to eligible members in 28 states.

Metrics

The following table sets forth our key metrics that we use to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions (in thousands):

- Revenues. Our revenues are mostly generated from fees charged to members in our On*Trak* program. Our contracts are generally designed to provide cash fees to us on a monthly basis, an upfront case rate, or fee for service based on enrolled members. The Company’s performance obligation is satisfied over the 12 month period of the On*Trak* program.

- Effective outreach pool. Effective Outreach Pool are individuals insured by our health plan customers who have been identified through our advanced data analytics and predictive modeling with untreated behavioral health conditions that may be impacted through treatment in the On*Trak* program.

- Cash flow from operations. Our current business activities result in an outflow of cash flow from operations as we invest strategically into our business to help continue the growth of our operations.

	Year Ended December 31,			
	2019	2018	Change	% Change
Revenue	$ 35,095	$ 15,177	$ 19,918	131 %
Effective outreach pool	108,000	41,000	67,000	163 %
Cash flow from operations	$ (16,901)	$ (8,574)	$ (8,327)	(97) %

Key Components of Our Results of Operations

Revenue

Revenue from contracts with customers is recognized when, or as, we satisfy our performance obligations by transferring the promised goods or services to the customers. Revenue from a performance obligation satisfied over time is recognized by measuring our progress in satisfying the performance obligation in a manner that depicts the transfer of the goods or services to the customer. Revenue from customers enrolled in our program is recognized over the term of the program, which is typically twelve months.

Cost of Revenue

Cost of healthcare services consists primarily of salaries related to our care coaches, member engagement specialists and other staff directly involved in member care, healthcare provider claims payments, and fees charged by our third party administrators for processing these claims. Salaries and fees charged by our third-party administrators for processing claims are expensed when incurred and healthcare provider claims payments are recognized in the period in which an eligible member receives services.

Operating Expenses

Our operating expenses consists our sales and marketing, research and development and general and administrative expenses. Sales and marketing expenses consist primarily of personnel and related expenses for our sales and marketing staff, including salaries, benefits, bonuses, stock-based compensation and commissions; costs of marketing and promotional events, corporate communications, online marketing, product marketing and other brand-building activities. Research and development expenses consist primarily of personnel and related expenses for our research and development staff, including salaries, benefits, bonuses and stock-based compensation; the cost of certain third-party service providers. Research and development costs are expensed as incurred. General and administrative expenses consist primarily of personnel and related expenses for administrative, legal, finance and human resource staff, including salaries, benefits, bonuses and stock-based compensation; professional fees; insurance premiums; and other corporate expenses.

Interest Expense

Interest expense consists primarily of interest expense from our note agreements, accretion of debt discount and amortization of debt issuance costs.

Table of Contents

Other Expenses

Other expenses consists primarily of debt termination costs, write-off of deferred debt issuance costs associated with the loan payoff and employee severance costs.

Results of Operations

The table below and the discussion that follows summarize our results of operations and certain selected operating statistics for each of the periods indicated (in thousands):

	Year Ended December 31,	
	2019	2018
Revenue	$ 35,095	$ 15,177
Cost of revenue	20,408	11,119
Gross profit	14,687	4,058
Operating expenses	34,701	17,684
Operating loss	(20,014)	(13,626)
Other income (expense)	(2,538)	40
Interest expense	(3,047)	(570)
Change in fair value of warrant liability	(60)	(56)
Net loss	$ (25,659)	$ (14,212)

Revenue

The mix of our revenues between commercial and government insured members remained consistent year over year. The following table sets forth our sources of revenue for each of the periods indicated (in thousands, except percentages):

	Year Ended December 31,	
	2019	2018
Commercial revenue	$ 21,753	$ 9,495
Percentage of commercial revenue to total revenue	62 %	63 %
Government revenue	$ 13,342	$ 5,682
Percentage of government revenue to total revenue	38 %	37 %
Total revenue	$ 35,095	$ 15,177

Revenue increased $19.9 million, or 131% in 2019 when compared to 2018. Enrolled members increased 4,043, or 137% in 2019 when compared to 2018. The increase is attributable to the continued expansion of our On*Trak* program with our existing health plan customers.

Cost of Revenue, Gross Profit and Gross Margin

	Year Ended December 31,			
(in thousands)	2019	2018	Change	% Change
Cost of revenue	$ 20,408	$ 11,119	$ 9,289	84 %
Gross profit	$ 14,687	$ 4,058	$ 10,629	262 %
Gross profit margin	41.8 %	26.7 %		

Cost of revenue increased $9.3 million, or 84%, in 2019 as compared to 2018. The increase in cost of revenue was primarily due to $6.1 million in higher employee-related costs due to higher headcount and $2.5 million in third party administrators for processing claims.

We expect our cost of revenues to increase as our revenue increases, but expect our gross margin to increase over time as we optimize the efficiency of our operations and continue to scale our business.

Operating Expenses

	Year Ended December 31,			
(in thousands)	**2019**	**2018**	**Change**	**% Change**
Operating expense	$ 34,701	$ 17,684	$ 17,017	96 %
Operating loss	$ (20,014)	$ (13,626)	$ (6,388)	47 %
Operating loss margin	(57.0)%	(89.8)%		

Total operating expense increased $17.0 million, or 96%, in 2019 as compared to 2018. The increase in operating expenses was primarily due to $7.5 million of higher employee-related costs due to higher headcount, $8.2 million of higher vendor related costs to support our growing operations and $1.5 million related to a severance payment made to a former employee.

We expect our operating expenses to increase for the foreseeable future as we continue to grow our business, but expect our operating expenses to decrease as a percentage of revenue over time. Our operating expenses may fluctuate as a percentage of our total revenue from period to period due to the timing and extent of our operating and strategic initiates.

Other Expenses

	Year Ended December 31,			
(in thousands)	**2019**	**2018**	**Change**	**% Change**
Other expense	$ 5,645	$ 586	$ 5,059	863 %

Other expense increased $5.1 million, or 863%, in 2019 as compared to 2018. The increase in other expenses was primarily due to a $2.5 million increase in interest expenses for our notes and $2.6 million for the termination of existing notes.

Liquidity and Capital Resources

Cash and cash equivalents was $13.6 million as of December 31, 2019. We had working capital of approximately $6.3 million as of December 31, 2019. We have incurred significant net losses and negative operating cash flows since our inception. We expect our current cash resources to cover expenses through at least the next twelve months, however, delays in cash collections, revenue, or unforeseen expenditures could impact this estimate.

In September 2019, the Company entered into a Note Agreement dated September 24, 2019 (the “Note Agreement”) with certain subsidiaries of the Company party thereto as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. and any other purchasers party thereto from time to time (collectively, the “Holders”). Under the Note Agreement, the Company initially issued $35.0 million aggregate principal amount of senior secured notes (the "2024 Notes"), which bear interest at either a floating rate plus an applicable margin in the case of 2024 Notes subject to cash interest payments or a floating rate plus a slightly higher applicable margin in the case of 2024 Notes as to which current interest has been capitalized during the period ending September 24, 2020. The Company has elected for the $35 million in aggregate principal amount of 2024 Notes issued on the date of the Note Agreement that such interest shall be payable in cash. The Holder is obligated to purchase up to an additional $10.0 million in principal amount of 2024 Notes during the period from the date of the Note Agreement until the second anniversary thereof. The entire principal amount of the 2024 Notes is due and payable on the fifth anniversary of the Note Agreement unless earlier redeemed upon the occurrence of certain mandatory prepayment events, including with the proceeds of equity or debt issuances, 50% of excess cash flow, asset sales and the amount by which total debt exceeds an applicable leverage multiple.

Our ability to fund our ongoing operations is dependent on increasing the number of members that enroll in the On*Trak* program. We currently operate our On*Trak* solutions in twenty seven states. We provide services to commercial (employer funded), managed Medicare Advantage, and managed Medicaid and duel eligible (Medicare and Medicaid) populations.

Historically, we have seen and continue to see net losses, net loss from operations, negative cash flow from operating activities, and historical working capital deficits as we continue through a period of rapid growth. The accompanying financial statements do not reflect any adjustments that might result if we were unable to continue as a going concern. We have alleviated substantial doubt by both entering into contracts for additional revenue-generating health plan customers and expanding our On*Trak* program within existing health plan customers. To support this increased demand for services, we invested and will continue to invest in additional headcount needed to support the anticipated growth.

We have a growing customer base and believe we are able to fully scale our operations to service the contracts and future enrollment providing leverage in these investments that will generate positive cash flow by in the near future. We believe we will have enough capital to cover expenses through the foreseeable future and we will continue to monitor liquidity. If we add more health plans than budgeted, increase the size of the outreach pool by more than we anticipate, decide to invest in new products or seek out additional growth opportunities, we would consider financing these options with either a debt or equity financing.

The following table sets forth a summary of our cash flows for the periods indicated (in thousands):

	Year Ended December 31,	
	2019	**2018**
Net cash used in operating activities	$ (16,901)	$ (8,574)
Net cash provided by investing activities	$ —	$ 62
Net cash provided by financing activities	$ 27,349	$ 7,303

We used $16.9 million of cash from operating activities during the year ended December 31, 2019 compared with $8.6 million during the same period in 2018. The increase primarily relates to the increase in members being treated, the addition of care coaches, outreach specialists, community care coordinators and other staff to manage the increasing number of enrolled members, and investments in data science, IT and software development to support growth and drive efficiency.

Capital expenditures for the year ended December 31, 2019 and 2018 were not significant. We anticipate that capital expenditures will increase in the future as we replace our computer systems that are reaching the end of their useful lives, upgrade equipment to support our increased number of enrolled members, and enhance the reliability and security of our systems. These future capital expenditure requirements will depend upon many factors, including obsolescence or failure of our systems, progress with expanding the adoption of our solutions, our marketing efforts, the necessity of, and time and costs involved in obtaining, regulatory approvals, competing technological and market developments, and our ability to establish collaborative arrangements, effective commercialization, marketing activities and other arrangements.

Our net cash provided by financing activities was $27.3 million for the year ended December 31, 2019, compared with net cash provided by financing activities of $7.3 million for the year ended December 31, 2018. Cash provided by financing activities for the year ended December 31, 2019 consisted of the gross proceeds from the issuance of debt in the amount of $44 million, proceeds from option exercises of $1.9 million, warrant exercises of $1.1 million, partially offset by loan repayment of $16.9 million, debt issuance costs of $2.8 million and debt termination costs of $2.0 million.

As a result of the above our cash and cash equivalents as of December 31, 2019 is $13.6 million.

We expect our current cash resources to cover our operations through at least the next twelve months, however, delays in cash collections, revenue, or unforeseen expenditures could impact this estimate.

Contractual Obligations

Our principal commitments consist of obligations for outstanding debt, leases for our office space, contractual commitments for professional service projects and third-party consulting firms. The following table summarizes our contractual obligations at December 31, 2019 (in thousands):

	Total	Less than a year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations	$ 36,502	$ —	$ —	$ 36,502	$ —
Lease obligations	$ 3,184	$ 737	$ 1,475	$ 972	$ —
Other contractual obligations	$ 377	$ 309	$ 68	$ —	$ —

Off-Balance Sheet Arrangements

As of December 31, 2019, we had no off-balance sheet arrangements.

Critical Accounting Policy and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). U.S. GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that may not be readily apparent from other sources. On an on-going basis, we evaluate the appropriateness of our estimates and we maintain a thorough process to review the application of our accounting policies. Our actual results may differ from these estimates.

We consider our critical accounting estimates to be those that (1) involve significant judgments and uncertainties, (2) require estimates that are more difficult for management to determine, and (3) may produce materially different results when using different assumptions. We have discussed these critical accounting estimates, the basis for their underlying assumptions and estimates, and the nature of our related disclosures herein with the audit committee of our Board of Directors. We believe our accounting policies related to revenue recognition and share-based compensation expense involve our most significant judgments and estimates that are material to our consolidated financial statements. They are discussed further below.

Revenue Recognition

Revenue from contracts with customers is recognized when, or as, we satisfy our performance obligations by transferring the promised goods or services to the customers. A good or service is transferred to a customer when, or as, the customer obtains control of that good or service. A performance obligation may be satisfied over time or at a point in time. Revenue from a performance obligation satisfied over time is recognized by measuring our progress in satisfying the performance obligation in a manner that depicts the transfer of the goods or services to the customer. Revenue from a performance obligation satisfied at a point in time is recognized at the point in time that we determine the customer obtains control over the promised good or service. The amount of revenue recognized reflects the consideration we expect to be entitled to in exchange for those promised goods or services (*i.e.*, the “transaction price”). In determining the transaction price, we consider multiple factors, including the effects of variable consideration. Variable consideration is included in the transaction price only to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainties with respect to the amount are resolved. In determining when to include variable consideration in the transaction price, we consider the range of possible outcomes, the predictive value of our past experiences, the time period of when uncertainties expect to be resolved and the amount of consideration that is susceptible to factors outside of our influence, such as the judgment and actions of third parties.

Catasys contracts are generally designed to provide cash fees to us on a monthly basis, an upfront case rate, or fee for service based on enrolled members. The Company’s performance obligation is satisfied over time as the On*Trak* service is provided continuously throughout the service period. The Company recognizes revenue evenly over the service period using a time-based measure because the Company is providing a continuous service to the customer. Contracts with minimum performance guarantees or price concessions include variable consideration and are subject to the revenue constraint. The Company uses an

expected value method to estimate variable consideration for minimum performance guarantees and price concessions. The Company has constrained revenue for expected price concessions during the year ended December 31, 2019.

Cost of Revenue

Cost of revenue consists primarily of salaries related to our care coaches, outreach specialists and other staff directly involved in member care, healthcare provider claims payments, and fees charged by our third party administrators for processing these claims. Salaries and fees charged by our third party administrators for processing claims are expensed when incurred and healthcare provider claims payments are recognized in the period in which an eligible member receives services.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Financial instruments that potentially subject us to a concentration of credit risk consist of cash and cash equivalents. Cash is deposited with what we believe are highly credited, quality financial institutions. The deposited cash may exceed Federal Deposit Insurance Corporation (“FDIC”) insured limits. The Company cannot provide assurance that we will not experience losses on these deposits.

Commissions

We defer commissions paid to our sales force and engagement specialists as these amounts are incremental costs of obtaining a contract with a customer and are recoverable from future revenue that gave rise to the commissions. Commissions for initial contracts and member enrollments are deferred on the consolidated balance sheets and amortized on a straight-line basis over a period of benefit that has been determined to be six years and one year, respectively.

Share-Based Compensation

Stock Options – Employees and Directors

We measure and recognize compensation expense for all share-based payment awards made to employees and directors based on estimated fair values on the date of grant. We estimate the fair value of share-based payment awards using the Black-Scholes option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the consolidated statements of operations. We recognize forfeitures when they occur.

Stock Options and Warrants – Non-employees

We account for the issuance of stock options and warrants for services from non-employees by estimating the fair value of stock options and warrants issued using the Black-Scholes pricing model. This model’s calculations incorporate the exercise price, the market price of shares on grant date, the weighted average risk-free interest rate, expected life of the option or warrant, expected volatility of our stock and expected dividends.

For options and warrants issued as compensation to non-employees for services that are fully vested and non-forfeitable at the time of issuance, the estimated value is recorded in equity and expensed when the services are performed and benefit is received. For unvested shares, the change in fair value during the period is recognized in expense using the graded vesting method.

From time to time, we have retained terminated employees as part-time consultants upon their departure from the company. Because the employees continue to provide services to us, their options continue to vest in accordance with the original terms. Due to the change in classification of the option awards, the options are considered modified at the date of termination. The modifications are treated as exchanges of the original awards in return for the issuance of new awards. At the date of termination, the unvested options are no longer accounted for as employee awards under FASB’s accounting rules for share-based expense but are instead accounted for as new non-employee awards. The accounting for the portion of the total grants that have already vested and have been previously expensed as equity awards is not changed. There were no employees moved to consulting status for the years ended December 31, 2019 and 2018, respectively.

Income Taxes

We account for income taxes using the liability method in accordance with Accounting Standards Committee (“ASC”) 740 “Income Taxes”. To date, no current income tax liability has been recorded due to our accumulated net losses. Deferred tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of assets and liabilities and the amounts that are reported in the tax returns. Deferred tax assets and liabilities are recorded on a net basis; however, our net deferred tax assets have been fully reserved by a valuation allowance due to the uncertainty of our ability to realize future taxable income and to recover our net deferred tax assets.

Recently Issued or Newly Adopted Accounting Pronouncements

For additional information regarding recent accounting pronouncements adopted and under evaluation, refer to Note 2 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and related financial information required to be filed hereunder are indexed under Item 15 of this report and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have evaluated, with the participation of our principal executive officer and our principal financial officer, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our principal executive officer and our principal financial officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control

There were no changes in our internal controls over financial reporting during the fourth quarter of our year ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) and for assessing the effectiveness of our internal control over financial reporting. Our internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with United States generally accepted accounting principles (GAAP).

Our internal control over financial reporting is supported by written policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and that our receipts and expenditures are being made only in accordance with authorizations of our management and our Board of Directors; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2019, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013). Management's assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of our internal control over financial reporting. Based upon this assessment, our management believes that, as of December 31, 2019, our internal control over financial reporting was effective based on those criteria.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions and that the degree of compliance with the policies or procedures may deteriorate.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2019 has been audited by EisnerAmper LLP, the Company's independent registered certified public accounting firm. Their report, which is set forth in Part II, Item 8, *Financial Statements*, of this Annual Report on Form 10-K, expresses an unqualified opinion of the effectiveness of the Company's internal control over financial reporting as of December 31, 2019.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item will be included in our Proxy Statement for the 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be included in our Proxy Statement for the 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item will be included in our Proxy Statement for the 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item will be included in our Proxy Statement for the 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

Table of Contents

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item will be included in our Proxy Statement for the 2020 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1),(2) **Financial Statements**

The Financial Statements and Financial Statement Schedules listed on page F-1 of this document are filed as part of this filing.

(a)(3) **Exhibits**

The following exhibits are filed as part of this report:

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of Catasys, Inc., incorporated by reference to Appendix A to Catasys, Inc.'s Definitive Schedule 14 C filed with the Securities and Exchange Commission on October 4, 2019
3.6*	By-Laws of Catasys, Inc., a Delaware corporation, incorporated by reference to Exhibit 3.6 of Catasys, Inc
4.1	Specimen Common Stock Certificate, incorporated by reference to exhibit of the same number to Catasys Inc.'s annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2005, on March 16, 2016.
4.2	Form of Heritage Warrant, incorporated by reference to Exhibit 4.1 of Catasys, Inc.'s Form 8-K filed with the Securities and Exchange Commission on June 15, 2018.
4.3	Form of Horizon Warrant, incorporated by reference to Exchibit 4.1 of Catasys, Inc.'s Form 8-K filed with the Securities and Exchange Commission on March 14, 2019.
4.4	Form of Senior Secured Note, incorporated by reference to Catasys, Inc's Form 8-K filed with the Securities Exchange Commission on September 25, 2019.
4.5	Purchase Warrant for Common Shares issued in favor of Special Situations Investing Group II, LLC, dated September 24, 2019.
4.6*	Description of Securities
10.1#	Employment Agreement between Catasys, Inc. and Terren S. Peizer, dated September 29, 2003, incorporated by reference to Exhibit 10.2 of Catasys Inc.'s annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2005, on March 16, 2016.
10.2#	Employment Agreement between Catasys, Inc. and Christopher Shirley, dated May 16, 2017, incorporated by reference to Exhibit 10.1 of Catasys, Inc.'s current report on Form 8-K filed with the Securities and Exchange Commission on May 16, 2017.
10.3#	Form of Stock Option Grant Notice incorporated by reference to exhibit 10.4 of Catasys, Inc.'s Form 10-K filed with the Securities and Exchange Commission on March 31, 2015.
10.4#	2017 Stock Incentive Plan, incorporated by reference to Exhibit B of Catasys, Inc.'s Preliminary Information Statement on Schedule 14C filed with the Securities and Exchange Commission on February 28, 2017.
10.7#	Amended Employment Agreement, by and between the Company and Mr. Richard A. Anderson dated April 10, 2018, incorporated by reference to Exhibit 10.1 of Catasys Inc.'s Form 8-K filed with the Securities and Exchange Commission on April 16, 2018.

10.8	Note Agreement, dated as of September 24, 2019, by and among Catasys, Inc., certain of its subsidiaries party thereto as guarantors, Goldman Sachs Specialty Lending Group, LP, as purchaser and any other purchasers party thereto from time to time and Goldman Sachs Specialty Lending Group, LP, as collateral agent.
10.9#	Modification of Employment Agreement dated December 16, 2019 by and between Catasys, Inc. and Mr. Christopher Shirley, incorporated by reference to Exhibit 10.1 of Catasys, Inc.'s Form 8-K filed with the Securities and Exchange Commission on December 20, 2019.
10.10#	Employment Agreement dated November 15, 2019 by and between the Company and Mr. Curtis Medeiros, incorporated by reference to Exhibit 10.1 of Catasys, Inc.'s Form 8-K filed with the Securities and Exchange Commission on December 6, 2019.
14.1	Code of Conduct and Ethics, incorporated by reference to exhibit of the same number of Catasys Inc.'s annual report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2003.
21.1*	Subsidiaries of the Company.
23.2*	Consent of Independent Registered Public Accounting Firm – EisnerAmper LLP
31.1*	Certification by the Chief Executive Officer, pursuant to Rule 13-a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification by the Chief Financial Officer, pursuant to Rule 13-a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification by the Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification by the Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.
** Furnished herewith.
# Management contract or compensatory plan or arrangement.

ITEM 16. FORM 10-K SUMMARY

Not applicable

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CATASYS, INC.

Date: March 16, 2020

By: /s/ TERREN S. PEIZER
Terren S. Peizer
Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title(s)	Date
/s/ TERREN S. PEIZER Terren S. Peizer	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	March 16, 2020
/s/ CURTIS MEDEIROS Curtis Medeiros	President, Chief Operating Officer	March 16, 2020
/s/ CHRISTOPHER SHIRLEY Christopher Shirley	Chief Financial Officer (Principal Financial and Accounting Officer)	March 16, 2020
/s/ RICHARD A. BERMAN Richard Berman	Director	March 16, 2020
/s/ EDWARD ZECCHINI Edward Zecchini	Director	March 16, 2020
/s/ MICHAEL SHERMAN Michael Sherman	Director	March 16, 2020
/s/ ROBERT REBAK Robert Rebak	Director	March 16, 2020
/s/ GUSTAVO GIRALDO Gustavo Giraldo	Director	March 16, 2020
/s/ DIANE SELOFF Diane Seloff	Director	March 16, 2020

CATASYS, INC.
Index to Consolidated Financial Statements and Financial Statement Schedules

Financial Statements

Financial Statement Schedules

All financial statement schedules are omitted because they are not applicable not required, or the information is shown in the Financial Statements or Notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Catasys, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Catasys, Inc. and Subsidiaries (the "Company") as of December 31, 2019 and 2018, and the related consolidated statements of operations, stockholders' deficit, and cash flows for each of the years then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, and the consolidated results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework* (*2013*) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report dated March 16, 2020 expressed an unqualified opinion.

Change in Accounting Principle

As discussed in Note 2 to the financial statements, the Company has changed its method of accounting for leases effective January 1, 2019 due to the adoption of Accounting Standards Codification Topic 842, *Leases.*

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ EisnerAmper LLP

We have served as the Company's auditor since 2018.

EISNERAMPER LLP
Iselin, New Jersey
March 16, 2020

Opinion on Internal Control over Financial Reporting

We have audited Catasys, Inc. and Subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2019, based on criteria established in the *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in the *Internal Control - Integrated Framework* (*2013*) issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of Catasys, Inc. and Subsidiaries as of December 31, 2019 and 2018, and the related consolidated statements of operations, stockholders' deficit, and cash flows for each of the years then ended and the related notes and our report dated March 16, 2020 expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. An entity's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and directors of the entity; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ EisnerAmper LLP

EISNERAMPER LLP
Iselin, New Jersey
March 16, 2020

CATASYS, INC.
Consolidated Balance Sheets
(in thousands, except share and per share data)

	December 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash, cash equivalents and restricted cash	$ 13,610	$ 3,162
Receivables, net	3,615	1,382
Unbilled receivables	2,093	—
Prepaid expenses and other current assets	1,074	1,108
Total current assets	20,392	5,652
Long-term assets:		
Property and equipment, net	150	263
Restricted cash, long-term	408	408
Deferred commissions	112	—
Right-of-use assets	2,793	—
Total assets	**$ 23,855**	**$ 6,323**
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable	$ 1,385	$ 497
Accrued compensation and benefits	3,640	1,537
Deferred revenue	5,803	4,195
Current portion of lease liabilities	519	—
Other accrued liabilities	2,060	1,501
Warrant liabilities	691	86
Total current liabilities	14,098	7,816
Long-term liabilities:		
Long-term debt, net	31,597	7,472
Long-term lease liabilities	2,069	—
Total liabilities	47,764	15,288
Commitments and contingencies (Note 8)		
Stockholders' deficit:		
Preferred stock, $0.0001 par value; 50,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.0001 par value, 500,000,000 shares authorized; 16,616,165 and 16,185,146 shares issued and outstanding at December 31, 2019 and December 31, 2018, respectively	2	2
Additional paid in capital	307,403	296,688
Accumulated deficit	(331,314)	(305,655)
Total stockholders' deficit	(23,909)	(8,965)
Total liabilities and stockholders' deficit	**$ 23,855**	**$ 6,323**

See accompanying notes to the consolidated financial statements.

CATASYS, INC.
Consolidated Statements of Operations
(in thousands, except per share data)

	Year Ended December 31,	
	2019	**2018**
Revenue	$ 35,095	$ 15,177
Cost of revenue	20,408	11,119
Gross profit	14,687	4,058
Operating expenses	34,701	17,684
Operating loss	(20,014)	(13,626)
Other income (expense)	(2,538)	40
Interest expense	(3,047)	(570)
Change in fair value of warrant liability	(60)	(56)
Net loss	$ (25,659)	$ (14,212)
Net loss per share, basic and diluted	$ (1.56)	$ (0.89)
Weighted-average shares used to compute basic and diluted net loss per share	16,418	15,955

See accompanying notes to the consolidated financial statements.

Table of Contents

CATASYS, INC.
Consolidated Statements of Stockholders' Deficit
(in thousands, except share and per share data)

	Common Stock								
	Shares		Amount		Additional Paid-In Capital		Accumulated Deficit		Total Stockholders' Deficit
Balance at December 31, 2017	15,889,171	$	2	$	294,220	$	(293,324)	$	898
Adoption of accounting standard, ASC 606	—		—		—		1,881		1,881
Balance at Balance at January 1, 2018	15,889,171	$	2	$	294,220		(291,443)	$	2,779
Common stock issued for services	24,000		—		112		—		112
Warrants issued for services	—		—		86		—		86
Warrants issued in connection with A/R facility	—		—		64		—		64
Cashless warrant exercise	241,975		—		—		—		—
Cash warrant exercise	30,000		—		150		—		150
Shared-based compensation expense	—		—		2,056		—		2,056
Net loss	—		—		—		(14,212)		(14,212)
Balance at December 31, 2018	16,185,146	$	2	$	296,688	$	(305,655)	$	(8,965)
Reclassification of warrant liability to equity upon adoption of ASU 2017-11	—		—		86		—		86
Warrants issued for services	—		—		43		—		43
Warrants issued in connection with 2024 notes	—		—		2,354		—		2,354
Exercise of warrant	232,461		—		1,128		—		1,128
Exercise of stock options	195,351		—		1,894		—		1,894
Stock compensation expense	3,207		—		5,210		—		5,210
Net loss	—		—		—		(25,659)		(25,659)
Balance at December 31, 2019	16,616,165	$	2	$	307,403		(331,314)	$	(23,909)

See accompanying notes to the consolidated financial statements.

CATASYS, INC.
Consolidated Statements of Cash Flows
(in thousands)

	Year Ended December 31,	
	2019	**2018**
Cash flows used in operating activities		
Net loss	$ (25,659)	$ (14,212)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	5,210	2,056
Write-off of debt issuance costs	1,505	—
Depreciation	133	288
Amortization	696	187
Warrants issued for services	43	86
Change in fair value of warrants	60	56
Common stock issued for consulting services	—	112
Loss on disposal of fixed asset	—	70
Deferred rent	(26)	(91)
Changes in operating assets and liabilities:		
Accounts payable	888	893
Lease liabilities	684	—
Other accrued liabilities	2,529	—
Prepaid and other current assets	(246)	(311)
Deferred revenue	1,608	3,163
Receivables	(2,233)	(871)
Unbilled receivables	(2,093)	—
Net cash used in operating activities	(16,901)	(8,574)
Cash flows provided by investing activities		
Purchases of property and equipment	—	(9)
Deposits and other assets	—	71
Net cash provided by investing activities	—	62
Cash flows provided by financing activities		
Proceeds from secured promissory note	—	7,500
Proceeds from revolving loan	7,500	—
Repayment of revolving loan	(15,000)	—
Proceeds from A/R facility	1,938	—
Repayment of A/R facility	(1,938)	—
Proceeds from loan	36,527	—
Debt issuance costs	(2,813)	(317)
Debt termination related fees	(1,956)	—
Proceed from warrant exercise	1,128	150
Proceed from options exercise	1,894	—
Capital lease obligations	69	(30)
Net cash provided by financing activities	27,349	7,303
Net increase (decrease) in cash and restricted cash	10,448	(1,209)
Cash and restricted cash at beginning of period	3,570	4,779
Cash and restricted cash at end of period	**$ 14,018**	**$ 3,570**
Supplemental disclosure of cash flow information:		
Right of use asset obtained in exchange for lease obligation	$ 2,574	$ —
Interest paid	870	363
Non cash financing and investing activities:		
Reclassification of warrant liability to equity upon amendment of the loan agreement	86	—
Warrant issued in connection with 2024 Note	$ 2,354	$ —

See accompanying notes to the consolidated financial statements.

CATASYS, INC.
Notes to Consolidated Financial Statements

Note 1. Organization

Company Overview

Catasys, Inc. (“Catasys” or the “Company”) is technology-enabled healthcare company whose mission is to help improve the health and save the lives of as many people as possible. The Company’s platform, Catasys PRE™ (Predict-Recommend-Engage), organizes and automates healthcare data integration and analytics through application of machine intelligence to deliver analytic insights. The PRE Platform predicts people whose chronic disease will improve with behavior change, recommends effective care pathways that people are willing to follow, and engages people who are not receiving the care they need. By combining predictive analytics with human engagement, the Company delivers improved member health and validated outcomes and savings to healthcare payers.

The Company’s integrated, technology-enabled On*Trak* solution, a critical component of the Catasys PRE platform, is designed to identify and treat members with behavioral conditions that cause or exacerbate chronic medical conditions such as diabetes, hypertension, coronary artery disease, chronic obstructive pulmonary disease, and congestive heart failure, which result in high medical costs. The Company has the ability to engage these members, who do not otherwise seek behavioral healthcare, leveraging proprietary enrollment capabilities built on deep insights into the drivers of care avoidance. On*Trak* integrates evidence-based psychosocial and medical interventions delivered either in-person or via telehealth, along with care coaching and in-market Community Care Coordinators who address the social and environmental determinants of health, including loneliness.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include Catasys, Inc. and its variable interest entities (VIE's). The accompanying consolidated financial statements for Catasys, Inc. have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) and instructions to Form 10-K and Article 10 of Regulation S-X. All intercompany balances and transactions have been eliminated in consolidation.

At December 31, 2019, cash and cash equivalents was $13.6 million and the Company had a working capital of approximately $6.3 million. The Company could continue to incur negative cash flows and operating losses for the next twelve months. The Company expect its current cash resources to cover expenses through at least the next twelve months from the date of this report, however, delays in cash collections, revenue, or unforeseen expenditures could impact this estimate.

The Company’s ability to fund ongoing operations is dependent on several factors. The Company aims to increase the number of members that are eligible for its solutions by signing new contracts and identifying more eligible members in existing contracts. Additionally, the Company’s funding is dependent upon the success of management’s plan to increase revenue and control expenses. The Company currently operates its On*Trak* solutions in twenty-seven states. The Company provide services to commercial (employer funded), managed Medicare Advantage, and managed Medicaid and dual eligible (Medicare and Medicaid) populations. The Company generates fees from its launched programs and expect to increase enrollment and fees in the near future.

Certain prior year amounts have been reclassified for consistency with the current year presentation.

Management’s Plans

Historically, we have seen and continue to see net losses, net loss from operations, negative cash flow from operating activities, and historical working capital deficits as we continue through a period of rapid growth. The accompanying financial statements do not reflect any adjustments that might result if we were unable to continue as a going concern. We have alleviated substantial doubt by both entering into contracts for additional revenue-generating health plan customers and expanding our On*Trak* program within existing health plan customers. To support this increased demand for services, we invested and will continue to invest in additional headcount needed to support the anticipated growth. Additional management plans include increasing the outreach pool as well as improving our current enrollment rate. We will continue to explore ways to increase operational efficiencies resulting in increase in margins on both existing and new members.

We have a growing customer base and believe we are able to fully scale our operations to service the contracts and future enrollment providing leverage in these investments that will generate positive cash flow in the near future. We believe we will have enough capital to cover expenses through the foreseeable future and we will continue to monitor liquidity. If we add more health plans than budgeted, increase the size of the outreach pool by more than we anticipate, decide to invest in new products or seek out additional growth opportunities, we would consider financing these options with either a debt or equity financing.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and disclosed in the accompanying notes. Significant areas requiring the use of management estimates include expense accruals, accounts receivable allowances, accrued claims payable, the useful life of amortizable assets, revenue recognition, the valuation of warrant liabilities, and shared-based compensation. Actual results could differ from those estimates.

Revenue Recognition

The Company generates healthcare service revenue from contracts with customers as it satisfies its performance obligations to customers and their members. The healthcare service is transferred to a customer when, or as, the customer obtains control of that service. A performance obligation may be satisfied over time or at a point in time. Revenue from a performance obligation satisfied over time is recognized by measuring progress in a manner that depicts the transfer of services to the customer. Revenue from a performance obligation satisfied at a point in time is recognized at the point in time that the Company determines the customer obtains control over the promised service. The amount of revenue recognized reflects the consideration the Company expects to be entitled to in exchange for those promised services (*i.e.*, the “transaction price”). In determining the transaction price, the Company considers multiple factors, including the effects of variable consideration. Variable consideration is included in the transaction price only to the extent it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainties with respect to the amount are resolved. In determining when to include variable consideration in the transaction price, the Company considers the range of possible outcomes, the predictive value of past experiences, the time period of when uncertainties expect to be resolved and the amount of consideration that is susceptible to factors outside the Company's influence, such as the judgment and actions of third parties.

The Company's contracts are generally designed to provide cash fees to us on a monthly basis, an upfront case rate, or fee for service based on enrolled members. The Company’s performance obligation is satisfied over time as the On*Trak* service is provided continuously throughout the service period. The Company recognizes revenue evenly over the service period using a time-based measure because the Company is providing a continuous service to the customer. Contracts with minimum performance guarantees or price concessions include variable consideration and are subject to the revenue constraint. The Company uses an expected value method to estimate variable consideration for minimum performance guarantees and price concessions. The Company has constrained revenue for expected price concessions during the year ended December 31, 2019.

Cost of Revenue

Cost of revenue consists primarily of salaries related to care coaches, outreach specialists and other staff directly involved in member care, healthcare provider claims payments, and fees charged by third party administrators for processing these claims. Salaries and fees charged by third party administrators for processing claims are expensed when incurred and healthcare provider claims payments are recognized in the period in which an eligible member receives services.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less from the date of purchase. The Company's cash balance does not contain any cash equivalents.

Commissions

Commissions paid to our sales force and engagement specialists are deferred as these amounts are incremental costs of obtaining a contract with a customer and are recoverable from future revenue that gave rise to the commissions. Commissions for initial contracts and member enrollments are deferred on the consolidated balance sheets and amortized on a straight-line basis over a period of benefit that has been determined to be six years and one year, respectively.

Share-Based Compensation

Stock Options – Employees and Directors

Stock-based compensation for stock options granted is measured based on the grant-date fair value of the awards and recognized on a straight-line basis over the period during which the employee is required to perform services in exchange for the award (generally the vesting period of the award). The Company estimates the fair value of employee stock options using the Black-Scholes option-pricing model. Forfeitures are recognized as they occur.

Stock Options and Warrants – Non-employees

Stock-based compensation for stock options and warrants granted to non-employees is measured based on the grant-date fair value of the awards and recognized on a straight-line basis over the period during which the employee is required to perform services in exchange for the award (generally the vesting period of the award). The Company estimates the fair value of employee stock options using the Black-Scholes option-pricing model.

For options and warrants issued as compensation to non-employees for services that are fully vested and non-forfeitable at the time of issuance, the estimated value is recorded in equity and expensed when the services are performed and benefit is received. For unvested shares, the change in fair value during the period is recognized in expense using the graded vesting method.

Income Taxes

The Company accounts for income taxes using the liability method, under which deferred tax assets and liabilities are determined based on the future tax consequences attributable to differences between the financial reporting carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carry forwards and net operating loss carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates that are expected to be in effect when the differences are expected to reverse. To date, no current income tax liability has been recorded due to the Company's accumulated net losses.

The Company assesses the likelihood that deferred tax assets will be recovered from future taxable income, and a valuation allowance is established when necessary to reduce deferred tax assets to the amounts more likely than not expected to be realized. The Company's net deferred tax assets have been fully reserved by a valuation allowance.

Basic and Diluted Loss per Share

Basic loss per share is computed by dividing the net loss to common stockholders for the period by the weighted average number of shares of common stock outstanding during the period. Diluted loss per share is computed by dividing the loss for the period by the weighted average number of shares of common stock and dilutive common equivalent shares outstanding during the period.

Common equivalent shares, consisting of approximately 5,557,326 and 5,370,274 of shares as of December 31, 2019 and 2018, respectively, issuable upon the exercise of stock options and warrants, have been excluded from the diluted earnings per share calculation because their effect is anti-dilutive.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure fair value. The fair value hierarchy distinguishes between (1)market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity’s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level I) and the lowest priority to unobservable inputs (Level III). The three levels of the fair value hierarchy are described below:

Table of Contents

Level Input:	Input Definition:
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following tables summarize fair value measurements by level at December 31, 2019 and 2018, respectively, for assets and liabilities measured at fair value on a recurring basis (in thousands):

	Balance at December 31, 2019			
	Level I	Level II	Level III	Total
Letter of credit[1]	$ 408	$ —	$ —	$ 408
Total assets	$ 408	$ —	$ —	$ 408
Warrant liabilities	$ —	$ —	$ 691	$ 691
Total liabilities	$ —	$ —	$ 691	$ 691

[1] $408,000 is included in restricted cash, long-term, on our balance sheet as of December 31, 2019.

	Balance at December 31, 2018			
	Level I	Level II	Level III	Total
Letter of credit[2]	$ 479	$ —	$ —	$ 479
Total assets	$ 479	$ —	$ —	$ 479
Warrant liabilities	$ —	$ —	$ 86	$ 86
Total liabilities	$ —	$ —	$ 86	$ 86

[2] $71,000 is included in cash and restricted cash and $408,000 is included in restricted cash, long-term, on our balance sheet as of December 31, 2018.

Financial instruments classified as Level III in the fair value hierarchy as of December 31, 2019, represent liabilities measured at market value on a recurring basis which include warrant liabilities. In accordance with current accounting rules, the warrant liabilities are being marked-to-market each quarter-end until they are completely settled or expire. The warrants are valued using the Black-Scholes option-pricing model, using both observable and unobservable inputs and assumptions consistent with those used in the estimate of fair value of employee stock options. See *Warrant Liabilities* below.

The carrying value of the Senior Secured Notes is estimated to approximate their fair value as the variable interest rate of the Senior Secured Notes approximates the market rate for debt with similar terms and risk characteristics.

The fair value measurements using significant Level III inputs, and changes therein, for the years ended December 31, 2019 and 2018 are as follows:

		Level III Warrant Liabilities
Balance as of December 31, 2017	$	30
Issuance of warrants		—
Change in fair value		56
Balance as of December 31, 2018	$	86
ASU Adoption APIC Reclassification		(86)
Issuance of warrants		631
Change in fair value		60
Balance as of December 31, 2019	$	691

Capital Leases

Assets held under capital leases include computer equipment, and are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. All lease agreements meet at least one of the five requirements of a capital lease in accordance with ASC 842 of the codification.

Variable Interest Entities

Generally, an entity is defined as a Variable Interest Entity ("VIE") under current accounting rules if it either lacks sufficient equity to finance its activities without additional subordinated financial support, or it is structured such that the holders of the voting rights do not substantively participate in the gains and losses of the entity. When determining whether an entity that meets the definition of a business, qualifies for a scope exception from applying VIE guidance, the Company considers whether: (i) it has participated significantly in the design of the entity, (ii) it has provided more than half of the total financial support to the entity, and (iii) substantially all of the activities of the VIE are conducted on its behalf. A VIE is consolidated by its primary beneficiary, the party that has the power to direct the activities that most significantly affect the economics of the VIE and has the right to receive benefits or the obligation to absorb losses of the entity that could be potentially significant to the VIE. The primary beneficiary assessment must be re-evaluated on an ongoing basis.

As discussed under the heading *Management Services Agreement* ("MSA") below, the Company has an MSA with a Texas nonprofit health organization ("TIH") and a California Professional Corporation ("CIH"). Under the MSA's, the equity owners of TIH and CIH have only a nominal equity investment at risk, and the Company absorbs or receives a majority of the entity's expected losses or benefits. The Company participates significantly in the design of these MSA's. The Company also agrees to provide working capital loans to allow for TIH and CIH to fund their day to day obligations. Substantially all of the activities of TIH and CIH include its decision making, approval or are conducted for its benefit, as evidenced by the facts that (i) the operations of TIH and CIH are conducted primarily using the Company's licensed network of providers and (ii) under the MSA, the Company agrees to provide and perform all non-medical management and administrative services for the entities. Payment of the Company's management fee is subordinate to payments of the obligations of TIH and CIH, and repayment of the working capital loans is not guaranteed by the equity owner of the affiliated medical group or other third party. Creditors of TIH and CIH do not have recourse to the Company's general credit.

Based on the design of the entity and the lack of sufficient equity to finance its activities without additional working capital loans the Company has determined that TIH and CIH are VIE's. The Company is the primary beneficiary required to consolidate the entities as it has power and potentially significant interests in the entities. Accordingly, the Company is required to consolidate the assets, liabilities, revenues and expenses of the managed treatment centers.

Management Services Agreement

In April 2018, the Company executed an MSA with TIH and in July 2018, the Company executed an MSA with CIH. Under the MSA's, the Company licenses to TIH and CIH the right to use its proprietary treatment programs and related trademarks and provide all required day-to-day business management services, including, but not limited to:

- general administrative support services;
- information systems;

- recordkeeping;
- billing and collection;
- obtaining and maintaining all federal, state and local licenses, certifications and regulatory permits.

All clinical matters relating to the operation of TIH and CIH and the performance of clinical services through the network of providers shall be the sole and exclusive responsibility of the TIH and CIH Board free of any control or direction from the Company.

TIH pays the Company a monthly fee equal to the aggregate amount of (a) its costs of providing management services (including reasonable overhead allocated to the delivery of its services and including salaries, rent, equipment, and tenant improvements incurred for the benefit of the medical group, provided that any capitalized costs will be amortized over a five-year period), (b) 10%-15% of the foregoing costs, and (c) any performance bonus amount, as determined by TIH at its sole discretion. The Company's management fee is subordinate to payment of the entities’ obligations.

CIH pays the Company a monthly fee equal to the aggregate amount of (a) its costs of providing management services (including reasonable overhead allocated to the delivery of its services and including salaries, rent, equipment, and tenant improvements incurred for the benefit of the entity, provided that any capitalized costs will be amortized over a five-year period), and (b) any performance bonus, as determined by CIH at its sole discretion.

The Company's consolidated balance sheets include the following assets and liabilities from its VIE's (in thousands):

	December 31, 2019	December 31, 2018
Cash and cash equivalents	$ 379	$ 45
Accounts receivable	564	94
Prepaid and other current assets	26	29
Total assets	$ 969	$ 168
Accounts payable	$ 9	$ 7
Accrued liabilities	100	14
Deferred revenue	73	—
Intercompany payable	685	147
Total liabilities	$ 867	$ 168

Warrant Liabilities

The assumptions used in the Black-Scholes option-pricing model are determined as follows:

	December 31, 2019	December 31, 2018
Volatility	98.04 %	102.90 %
Risk-free interest rate	1.81 %	2.63 %
Weighted average expected life (in years)	6.25	1.29
Dividend yield	0 %	0 %

For the years ended December 31, 2019 and 2018, losses related to the revaluation of warrant liabilities were $0.1 million, respectively.

Concentration of Credit Risk

Financial instruments, which potentially subject us to a concentration of risk, include cash, restricted cash and accounts receivable. All of our customers are based in the United States at this time and we are not subject to exchange risk for accounts receivable.

The Company maintains its cash in domestic financial institutions subject to insurance coverage issued by the Federal Deposit Insurance Corporation (FDIC). Under FDIC rules, the company is entitled to aggregate coverage as defined by the Federal regulation per account type per separate legal entity per financial institution. The Company has incurred no losses as a result of any credit risk exposures.

For the year ended December 31, 2019, four customers accounted for approximately 85% of revenues and four customers accounted for approximately 89% of accounts receivable.

For the year ended December 31, 2018, four customers accounted for approximately 76% of revenues and four customers accounted for approximately 88% of accounts receivable.

Recently Adopted Accounting Standards

Effective January 1, 2019, the Company adopted Accounting Standards Codification ("ASC") Topic 842, Leases. Under this guidance, arrangements meeting the definition of a lease are classified as operating or financing leases and are recorded on the consolidated balance sheet as both a right-of-use asset and lease liability, calculated by discounting fixed lease payments over the lease term at the rate implicit in the lease or the Company's incremental borrowing rate. Lease liabilities are increased by interest and reduced by payments each period, and the right-of-use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right-of-use asset result in straight-line rent expense over the lease term. For finance leases, interest on the lease liability and the amortization of the right-of-use asset results in front-loaded expense over the lease term. Variable lease expenses are recorded when incurred.

In calculating the right-of-use asset and lease liability, the Company elected to combine lease and non-lease components. The Company also elected to exclude short-term leases having initial terms of 12 months or less from the new guidance as an accounting policy election and recognizes rent expense on a straight-line basis over the lease term.

In June 2018, the FASB issued ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting ("ASU 2018-07"), which supersedes ASC 505-50 and expands the scope of ASC 718 to include all share-based payments arrangements related to the acquisition of goods and services from both employees and nonemployees. For public companies, the amendments are effective for annual reporting periods beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted, but no earlier than a company's adoption date of ASC 606. The adoption of this ASU 2018-07 on January 1, 2019 did not have a material impact on its financial statements.

In July 2017, the FASB issued ASU 2017-11, Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception ("ASU 2017-11"). The amendments in this update are intended to simplify the accounting for certain equity linked financial instruments and embedded features with down round features that result in the strike price being reduced on the basis of the pricing of future equity offerings. Under the new guidance, a down round feature will no longer need to be considered when determining whether certain financial instruments or embedded features should be classified as liabilities or equity instruments. That is, a down round feature will no longer preclude equity classification when assessing whether an instrument or embedded feature is indexed to an entity's own stock. In addition, the amendments clarify existing disclosure requirements for equity-classified instruments. These amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The adoption of this ASU 2017-11 on January 1, 2019 did not have a material impact on its financial statements.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued Accounting Standard Update ("ASU") No. 2018-13, *Fair Value Measurement (Topic 820)*, which modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, including, among

other changes, the consideration of costs and benefits when evaluating disclosure requirements. For public companies, the amendments are effective for annual reporting periods beginning after December 15, 2019, including interim periods within those annual periods. Early adoption is permitted. We are currently assessing the impact that adopting this new accounting guidance will have on our financial statements and footnote disclosures.

In December 2019, the FASB issued ASU No. 2019-12, "Simplifying the Accounting for Income Taxes" which enhances and simplifies various aspects of income tax accounting guidance. The guidance is effective for the Company in the first quarter of 2021, although early adoption is permitted. The Company is currently evaluating the impact of adoption of ASU 2019-12 on its consolidated financial statements and related footnote disclosures.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, “Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments,” (“ASU 2016-13”). The ASU requires recognition of an estimate of lifetime expected credit losses as an allowance. The Company is currently evaluating the impact of adoption of ASU 2016-13 on its consolidated financial statements and related footnote disclosures.

Note 3. Common Stock

Net loss per share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is computed by giving effect to all potential shares of common stock, preferred stock and outstanding stock options and warrants, to the extent dilutive. Basic and diluted net loss per share was the same for each period presented as the inclusion of all potential shares of common stock outstanding would have been anti-dilutive.

Basic and diluted net loss per share (in thousands, except per share amounts) are as follows:

	December 31, 2019	**December 31, 2018**
Net loss	$ (25,659)	$ (14,212)
Weighted-average shares of common stock outstanding	16,418	15,955
Net loss per share - basic and diluted	$ (1.56)	$ (0.89)

The following common equivalent shares as of December 31, 2019 and 2018, respectively, issuable upon the exercise of stock options and warrants have been excluded from the diluted earnings per share calculation as their effect is anti-dilutive:

	December 31, 2019	**December 31, 2018**
Warrants to purchase common stock	1,550,975	1,608,996
Options to purchase	4,006,351	3,761,278
Total shares excluded from net loss per share	5,557,326	5,370,274

Note 4. Debt

2024 Notes

In September 2019, the Company entered into a Note Agreement dated September 24, 2019 (the “Note Agreement”) with certain subsidiaries of the Company party thereto as guarantors, Goldman Sachs Specialty Lending Holdings, Inc. and any other purchasers party thereto from time to time (collectively, the “Holders”). Under the Note Agreement, the Company initially issued

$35.0 million aggregate principal amount of senior secured notes (the "2024 Notes"), which bear interest at either a floating rate plus an applicable margin in the case of 2024 Notes subject to cash interest payments or a floating rate plus a slightly higher applicable margin in the case of 2024 Notes as to which current interest has been accrued during the period ending September 24, 2020, which resulted in interest rate of 15.75% for the year-ended December 31, 2019. The applicable margins are subject to stepdowns, in each case, following the achievement of certain financial ratios. The Company has elected for the $35 million in aggregate principal amount of 2024 Notes issued on the date of the Note Agreement that such interest shall be payable in cash. The Holder is obligated to purchase up to an additional $10.0 million in principal amount of 2024 Notes during the period from the date of the Note Agreement until the second anniversary thereof. The entire principal amount of the 2024 Notes is due and payable on the fifth anniversary of the Note Agreement unless earlier redeemed upon the occurrence of certain mandatory prepayment events, including with the proceeds of equity or debt issuances, 50% of excess cash flow, asset sales and the amount by which total debt exceeds an applicable leverage multiple.

The Note Agreement contains customary covenants, including, among others, covenants that restrict the Company’s ability to incur debt, grant liens, make certain investments and acquisitions, pay dividends, repurchase equity interests, repay certain debt, amend certain contracts, enter into affiliate transactions and asset sales or make certain equity issuances, and covenants that require the Company to, among other things, provide annual, quarterly and monthly financial statements, together with related compliance certificates, maintain its property in good repair, maintain insurance and comply with applicable laws. The Note Agreement also includes covenants with respect to the Company’s maintenance of certain financial ratios, including a fixed charge coverage ratio, leverage ratio and consolidated liquidity as well as minimum levels of consolidated adjusted EBITDA and revenue. The Note Agreement also contains customary events of default, including, among others, payment default, bankruptcy events, cross-default, breaches of covenants and representations and warranties, change of control, judgment defaults and an ownership change within the meaning of Section 382 of the Internal Revenue Code. In the case of an event of default, the Holder may, among other remedies, accelerate the payment of all obligations under the 2024 Notes and all assets of the Company serves as collateral. Any prepayment of the 2024 Notes or reduction of the purchase commitments made on or prior to the second anniversary of the Closing Date must be accompanied by a yield maintenance premium and on or prior to the third anniversary of the Closing Date must be accompanied by a prepayment premium.

In accounting for the issuance of the 2024 Notes, the Company separated the 2024 Notes into liability and equity components. The fair value of the liability component was estimated using an interest rate for debt with terms similar to the 2024 Notes. The carrying amount of the equity component was calculated by measuring the fair value based on the Black-Scholes model. The gross proceeds from the transaction was allocated between liability and equity based on the proportionate value. The debt discount is accreted to interest expense over the term of the 2024 Notes using the interest method. The equity component is not re-measured as long as it continues to meet the conditions for equity classification.

The assumptions used in the Black-Scholes option-pricing model are determined as follows:

	December 31, 2019
Volatility	98.01 %
Risk-free interest rate	1.58 %
Expected life (in years)	7
Dividend yield	0 %

The Company is in compliance with all debt covenants at December 31, 2019.

2022 Loan

In June 2018, the Company entered into a venture loan and security agreement (the “2022 Loan”) with Horizon Technology Finance Corporation (“Horizon”), which provides for up to $7.5 million in loans to the Company. In addition, in June 2018, the Company entered into a loan and security agreement (the “A/R Facility”) in connection with a $2.5 million receivables financing facility with Corporate Finance, a division of Heritage Bank of Commerce (“Heritage”). The Company borrowed and subsequently repaid $1.9 million on the A/R Facility during the six months ended June 30, 2019.

In March 2019, the Company entered into an amended and restated 2022 Loan with Horizon, which provides for up to $15.0 million in loans to the Company, including initial term loans in the amount of $7.5 million previously funded under the original agreement and an additional up to $7.5 million loan in three revolving tranches of $2.5 million in availability, subject to the Company's achievement of trailing three month billings exceeding $5.0 million, $7.0 million and $8.0 million, respectively (collectively, the “Billing Requirements”). An initial advance of $2.5 million was funded upon the execution and delivery of the Amended Loan Agreement, subject to repayment if the foregoing $5.0 million threshold is not reached by July 1, 2019. The Company concurrently entered into an amendment to the previously disclosed $2.5 million A/R Facility with Heritage intended primarily to reflect the amendment and restatement of the Amended Loan Agreement. The Company have met all three of the Billing Requirements and as a result have incurred the full $7.5 million under the Amended Loan Agreement. In connection with our entry into the Amended Loan Agreement, the Company issued Horizon 40,279 seven-year warrants to purchase an aggregate of $600,000 (depending on the level of availability under the Amended Loan Agreement) at the trailing volume weighted average price (“VWAP”) of our common stock on the NASDAQ Capital Market for the five days preceding the relative dates of grants at a per share exercise price equal to the lower of (i) $9.93 or (ii) the price per share of any securities that may be issued by us in an equity financing during the 18 months following the agreement date.

The 2022 Loan bears interest at a floating coupon rate of the amount by which one-month LIBOR exceeds 2.00% plus 9.75%. After September 30, 2020, upon the earlier of (i) payment in full of the principal balance of the 2022 Loan, (ii) an event of default and demand by Lender of payment in full or (iii) on the Loan Maturity Date (September 30, 2022), as applicable, the Company shall pay to Lender a payment equal to the greater of $150,000 or 6% of the outstanding principal balance on August 31, 2020.

Upon the issuance of the 2024 Notes, the balance of the 2022 Loan was repaid and terminated. As part of the termination, the Company incurred $1.1 million of early termination costs and wrote off deferred debt issuance costs of $1.5 million, which has been recorded in other income/(expense) in the consolidated statement of operations.

2024 Notes and 2022 Loan

The 2024 Notes and 2022 Loan consist of the following (in thousands):

Liability component	**December 31, 2019**	**December 31, 2018**
Principal	$ 36,502	$ 7,950
Less: debt discount	(4,905)	(478)
Net carrying amount	$ 31,597	$ 7,472

The following table sets forth total interest expense recognized related to the 2024 Notes and 2022 Loan (in thousands):

	December 31, 2019	**December 31, 2018**
Contractual interest expense	$ 2,653	$ 388
Accretion of debt discount	394	182
Total	$ 3,047	$ 570

Note 5. Stock Based Compensation

Our 2017 Stock Incentive Plan (the “2017 Plan”) and 2010 Stock Incentive Plan (the “2010 Plan”) provides for the issuance of 4,530,071 shares of our common stock. We have granted stock options to executive officers, employees, members of our board of directors, and certain outside consultants. The terms and conditions upon which options become exercisable vary among grants; however, option rights expire no later than ten years from the date of grant and employee and Board of Director awards generally vest over three to five years on a straight-line basis. As of December 31, 2019, we had 4,006,351 vested and unvested stock options outstanding and 328,369 shares reserved for future awards.

Share-based compensation expense was approximately $5.2 million and $2.1 million for the years ended December 31, 2019 and 2018, respectively.

The assumptions used in the Black-Scholes option-pricing model are determined as follows:

	December 31, 2019	December 31, 2018
Volatility	100.34 %	100.34% - 102.90
Risk-free interest rate	1.63%-2.60%	2.56% - 2.85%
Expected life (in years)	2.85-6.08	2.4 - 6.08
Dividend yield	0 %	0 %

The expected volatility assumptions have been based on the historical and expected volatility of our stock, measured over a period generally commensurate with the expected term. The weighted average expected option term for the year ended December 31, 2019, reflects the application of the simplified method prescribed in Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 107 (as amended by SAB 110), which defines the life as the average of the contractual term of the options and the weighted average vesting period for all option tranches.

Stock Options – Employees and Directors

A summary of stock option activity for employee and director grants is as follows:

	Number of Shares Outstanding	Weighted-Average Exercise Price
Balance, December 31, 2017	1,885,383	$ 11.46
Stock options granted	1,985,539	7.70
Stock options forfeited and canceled	(109,644)	14.29
Balance, December 31, 2018	3,761,278	$ 9.44
Exercisable at December 31, 2018	721,766	$ 17.14
Stock options granted	1,459,289	14.18
Stock options exercised	(195,351)	9.69
Stock options forfeited and canceled	(1,068,865)	10.36
Balance at December 31, 2019	3,956,351	$ 10.93
Exercisable at December 31, 2019	1,062,178	$ 11.24

Share-based compensation expense relating to stock options granted to employees and directors was $5.1 million and $2.1 million for the years ended December 31, 2019 and 2018, respectively.

As of December 31, 2019, there was $18.0 million of unrecognized compensation costs related to non-vested share-based compensation arrangements granted to employees and directors under the Plan. These costs are expected to be recognized over a weighted-average period of 2.67 years.

Stock Options and Warrants – Non-employees

The Company issued 50,000 stock options to consultants as of December 31, 2019 at a weighted average exercise price of $9.93. Stock option expense related to consultants was $0.1 million for the year ended December 31, 2019.

In addition to stock options granted under the Plan, we have also granted warrants to purchase common stock to certain non-employees that have been approved by our Board of Directors.

A summary of warrants granted to non-employees outstanding as of December 31, 2019 and 2018 is as follows:

	Number of Warrants Outstanding		Weighted-Average Exercise Price
Warrants issued in connection with debt agreements	224,440	$	16.04
Warrants issued for services	4,167		13.82
Balance at December 31, 2019	228,607	$	16.00

	Number of Warrants Outstanding		Weighted-Average Exercise Price
Warrants issued in connection with debt agreements	9,720	$	7.72
Warrants issued for services	24,000		4.68
Balance at December 31, 2018	33,720	$	5.56

A summary of warrant activity for the years ended December 31, 2019 and 2018 is as follows:

	Number of Warrants Outstanding		Weighted-Average Exercise Price
Balance at December 31, 2017	2,011,528	$	4.85
Warrants granted	33,720		5.56
Warrants exercised	(436,252)		(4.70)
Balance at December 31, 2018	1,608,996	$	4.71
Warrants granted	228,607		16.00
Warrants exercised	(232,461)		(4.85)
Warrants expired	(54,167)		(12.46)
Balance at December 31, 2019	1,550,975	$	6.08

Performance-Based and Market-Based Awards

The Company's Compensation Committee designed a compensation structure to align the compensation levels of certain executives to the performance of the Company through the issuance of performance-based and market-based stock options. The performance-based options vest upon the Company meeting certain revenue targets and the total amount of compensation expense recognized is based on the number of shares that the Company determines are probable of vesting. The market-based options vest upon the Company's stock price reaching a certain price at a specific performance period and the total amount of compensation expense recognized is based on a Monte Carlo simulation that factors in the probability of the award vesting.

Issuances under this structure are as follows:

Grant Date	Performance Measures	Vesting Term	Performance Period	# of Shares	Exercise Price
December 2017	Weighted Average Price of our common stock is $15.00 for at least twenty trading days within a period of thirty consecutive trading days ending on the trading day prior to January 1, 2023.	Fully vest on January 1, 2023	January 1, 2023	642,307	$ 7.50
August 2018	Weighted Average Price of our common stock is $15.00 for at least twenty trading days within a period of thirty consecutive trading days ending on the trading day prior to January 1, 2023.	Fully vest on January 1, 2023	January 1, 2023	397,693	$ 7.50
April 2018	The Options will be divided into five equal tranches and Performance Targets to be established by Board of Directors for each tranche at the beginning of the fiscal year	Amended and vested 115,950 options based on severance agreement	Amended and vested 115,950 options based on severance agreement	115,950	$ 7.50
August 2018	The Options will be divided into five equal tranches and Performance Targets to be established by Board of Directors for each tranche at the beginning of the fiscal year	Amended and fully forfeited based on severance agreement	Amended and fully forfeited based on severance agreement	—	$ 7.50

During the quarter ended September 30, 2019, the Company determined that it is not probable to achieve its internal performance targets for the tranche issued for the fiscal year 2019, resulting the reversal of the compensation expense recognized previously for the shares that did not vest.

During the quarter ended December 31, 2019, the company entered into a separation agreement with a key executive as part of restructuring the organization. As part of the agreement, 115,950 of previously forfeited awards were immediately vested. As a result, $1.1 million of stock compensation expense was recorded during the quarter and has been classified in operating expenses' within the consolidated statement of operations. The remaining awards has been forfeited.

Note 6. Leases

Operating leases

In September 2018, the Company signed an operating lease for the new corporate headquarters in Santa Monica, CA ("Santa Monica Headquarters"). The lease agreement includes 7,869 square feet for 60 months commencing in July 2019, which is 30 days following date the premises were ready for occupancy. The base annual rent is approximately $0.6 million subject to annual adjustments.

The Company's lease liability resulted from the lease of the Santa Monica Headquarters which expires in 2024. This lease does not require any contingent rental payments, impose any financial restrictions, or contain any residual value guarantees. The lease includes renewal options and escalation clauses; renewal options have not been included in the calculation of the lease liability and right-of-use asset as the Company is not reasonably certain to exercise the options. Variable expenses generally represent the Company's share of the landlord's operating expenses. The Company does not act as a lessor or have any leases classified as financing leases. The discount rate used in measuring the lease liability and right of use assets were determined by reviewing our incremental borrowing rate at the measurement date.

As of December 31, 2019, the Company has an operating lease liability of approximately $2.2 million and right-of-use asset of approximately $2.4 million, which are included in the consolidated balance sheets.

As of December 31, 2019, supplemental information related to operating leases was as follows (in thousands):

Consolidated Statement of Operations		Operating Leases
Operating lease expense	$	443
Short-term lease rent expense		58
Total rent expense	$	501
Consolidated Statements of Cash Flows		
Operating cash flows from operating leases	$	381
Right-of-use assets obtained in exchange for lease obligations	$	2,574
Other Information		
Weighted-average remaining lease term		4.5 years
Weighted-average discount rate		10.15 %

As of December 31, 2019, the future minimum lease payments under operating leases are as follows (in thousands):

		Operating Leases
2020	$	581
2021		603
2022		623
2023		644
2024		329
Total lease payments	$	2,780
Less: imputed interest		(570)
Present value of lease liabilities	$	2,210
Less: current portion		(374)
Lease liabilities, non-current	$	1,836

Total rent expense under operating leases was approximately $0.4 million and $0.3 million for the years ended December 31, 2019 and 2018, respectively.

Capital leases

The Company entered into agreements to lease computer equipment during the year ended December 31, 2019. The computer equipment under capital leases is included in right of use asset within the consolidated balance sheets and was $0.4 million as of December 31, 2019. Lease amortization at December 31, 2019 was approximately $0.1 million.

As of December 31, 2019, the future minimum lease payments under capital leases are as follows (in thousands):

	Capital Leases
Total lease payments	$ 406
Less: interest	(28)
Present value of lease liabilities	$ 378
Less: current portion	(145)
Lease liabilities, non-current	$ 233

Note 7. Income Taxes

As of December 31, 2019, the Company had net federal operating loss carry forwards and state operating loss carry forwards of approximately $277 million and $39 million, respectively. The net federal operating loss carry forwards begin to expire in 2023, and net state operating loss carry forwards begin to expire in 2019.

Due to such uncertainties surrounding the realization of the deferred tax assets, the Company maintains a valuation allowance of $70.1 million and $64.1 million against all of its deferred tax assets as of December 31, 2019 and 2018, respectively. For the years ended December 31, 2019 and 2018, the total change in valuation allowance was $6.0 million and $1.7 million, respectively. Realization of the deferred tax assets will be primarily dependent upon the Company's ability to generate sufficient taxable income.

Net deferred tax assets and liabilities for the years ended December 31, 2019 and 2018 are as follows (in thousands):

	2019	2018
Net operating losses	$ 66,405	$ 62,800
Stock-based compensation	1,648	873
Interest expense	1,494	—
Accrued liabilities and reserves	744	218
Fixed assets	51	72
Lease liability	658	—
Other temporary differences	23	315
Prepaid expenses	(186)	(176)
Right-of-use asset	(710)	—
Valuation allowance	(70,127)	(64,102)
Net deferred tax asset	$ —	$ —

The Company has provided a valuation allowance in full on its net deferred tax assets in accordance with ASC 740 Income Taxes. Because of the Company's continued losses, management assessed the realizability of its net deferred tax assets as being less than the more-likely-than-not criteria set forth by ASC 740. Furthermore, certain portions of the Company's net operating loss carryforwards were acquired, and therefore subject to further limitation set forth under the federal tax code, which could further limit the Company's ability to realize its deferred tax assets.

A reconciliation between the statutory federal income tax rate and the effective income tax rate for the years ended December 31, 2019 and 2018 is as follows:

	2019	2018
Tax at federal statutory rate	21.0 %	21.0 %
Stock-based compensation	(1.2)%	(29.3)%
Deferred revenue	— %	(2.8)%
Change in Foreign NOLS due to liquidation	— %	(8.3)%
Other	(0.2)%	3.3 %
Change in federal valuation allowance	(19.6)%	16.1 %
Change in federal NOLs due to 382 study results	— %	— %
Tax provision	— %	— %

The Company has adopted guidance issued by the FASB that clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold of more likely than not and a measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In making this assessment, a company must determine whether it is more likely than not that a tax position will be sustained upon examination, based solely on the technical merits of the position and must assume that the tax position will be examined by taxing authorities. Our policy is to include interest and penalties related to unrecognized tax benefits in income tax expense. There were no interest and penalties for the years ended December 31, 2019 and 2018, respectively. The Company files income tax returns with the Internal Revenue Service ("IRS") and various states with sufficient nexus. For jurisdictions in which tax filings are prepared, the Company is no longer subject to income tax examinations by state tax authorities for tax years prior to 2014, and by the IRS for tax years through 2016. The Company's net operating loss carryforwards are subject to IRS examination until they are fully utilized and such tax years are closed.

There are currently no income tax audits in any jurisdictions for open tax years and, as of December 31, 2019, there have been no material changes to our tax positions.

Under Section 382 of the Internal Revenue Code of 1986, as amended, or the IRC, substantial changes in our ownership may limit the amount of net operating loss and research and development income tax credit carryforwards that could be utilized annually in the future to offset taxable income. Specifically, this limitation may arise in the event of a cumulative change in ownership of the company of more than 50% within a three-year testing period. Any such annual limitation may significantly reduce the utilization of the net operating loss carryforwards before they expire.

Since the Company's formation, the Company has raised capital through the issuance of capital stock on several occasions which, may have resulted in such an ownership change, or could result in an ownership change in the future upon subsequent disposition. The Company intends to complete a study in the future to assess whether an ownership change has occurred or whether there have been multiple ownership changes since the Company's formation.

Note 8. Commitments and Contingencies

The Company has various non-cancelable operating leases for its offices and its managed hosting facilities and services. These leases expire at various times through 2025. Certain lease agreements contain renewal options, rent abatement and escalation clauses. The Company recognizes rent expense on a straight-line basis over the lease term, commencing when the Company takes possession of the property. Certain of the Company's office leases entitle the Company to receive a tenant allowance from the landlord. The Company records tenant allowances as a deferred rent credit, which the Company amortizes on a straight-line basis, as a reduction of rent expense, over the term of the underlying lease. Total rent expense under operating leases was approximately $0.4 million and $0.3 million for the years ended December 31, 2019 and 2018, respectively. The Company entered into financing agreements for computer equipment for $0.4 million. Interest is expensed straight line over three years.

Future minimum lease payments under capital leases and non-cancelable operating leases at December 31, 2019 are as follows (in thousands):

Year	Amount	
2020	$	737
2021		757
2022		717
2023		644
2024		328
	$	3,183

Note 9. Related Party Transactions

Accounts payable outstanding with Mr. Peizer for travel and expenses is approximately $0.4 million and $0.4 million as of December 31, 2019 and 2018, respectively.

Note 10. Restricted Cash

In September 2018, the Company entered into a lease agreement for the new corporate office space in Santa Monica, California which required a stand-by letter of credit as guarantee for future rent in the amount of $0.4 million. As of December 31, 2019, long-term restricted cash related to the Santa Monica lease totaled $0.4 million.

The following table provides a reconciliation of cash, cash equivalents and restricted cash total as presented in the consolidated statement of cash flows for the years ended December 31, 2019 and 2018 (in thousands):

	2019		2018	
Cash and cash equivalents	$	13,610	$	3,091
Restricted cash (current and long-term)		408		479
Total cash, cash equivalents and restricted cash	$	14,018	$	3,570