Zacks Small-Cap Research

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Virtual Piggy (VPIG-OTCQB)

VPIG: *Music and Games Potential Catalysts to Drive Subscriber Growth, Usage*

Current Recommendation	**Hold**
Prior Recommendation	Buy
Date of Last Change	12/15/2014
Current Price (04/6/15)	$0.36
Six- Month Target Price	**$1.00**

OUTLOOK

Assisted by music producer Rodney Jerkins, Virtual Piggy intends to increase its focus on the music world in 2015 to drive consumer adoption within the youth market. We believe focusing on the music and gaming industries to promote *Oink* is strategic. The company expects Rodney Jerkins to help it develop the music and digital goods market. Our positive outlook on Virtual Piggy is based on the expected benefits of enhanced promotional efforts within music as well as gaming, the recently launched prepaid *Oink* Discover card and the company's partnership with Facebook.

SUMMARY DATA

52-Week High	**$1.35**
52-Week Low	**$0.25**
One-Year Return (%)	**-71.7**
Beta	**-3.27**
Average Daily Volume (sh)	**42,915**
Shares Outstanding (mil)	**117**
Market Capitalization ($mil)	**$42**
Short Interest Ratio (days)	**0.7**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**16.6**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**N/A**
P/E using 2015 Estimate	**N/A**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	0.0 A	0.0 A	0.0 A	0.0 A	0.0 A
2013	0.0 A	0.0 A	0.0 A	0.0 A	0.0 A
2014	0.0 A	0.0 A	0.0 A	0.0 A	0.0 A
2015					0.3 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.02 A	-$0.06 A	-$0.02 A	-$0.01 A	-$0.11 A
2013	-$0.03 A	-$0.03 A	-$0.05 A	-$0.04 A	-$0.15 A
2014	-$0.07 A	-$0.05 A	-$0.03 A	$0.00 A	-$0.14 A
2015					-$0.19 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Disclosures begin on page 8.

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KEY POINTS

- Assisted by music producer Rodney Jerkins, a recent advisory board member, Virtual Piggy intends to focus on the music world in 2015 to drive consumer adoption within the youth market. Rodney Jerkins is well-connected within the music industry. He is the chairman of Evolve Music Group and is a Grammy award winning record producer.
- We believe that focusing on the music industry as well as the gaming industry to promote *Oink* to the youth market is strategic. The company expects Rodney Jerkins to help develop the music and digital goods market, including developing a rewards program that provides access to music and events through collaborations with Evolve Music and individual artists. According to trade publications, Rodney Jerkins has worked with Sam Smith, Michael Jackson, Beyoncé, Justin Bieber, Lady Gaga and Mary J. Blige, among other artists.
- We believe the company needs to build awareness of the *Oink* service in order to drive consumer usage and transaction volumes. Management intends to ramp-up its promotional efforts, including campaigns with Rodney Jerkins and co-marketing with existing merchants. In turn, this is expected to raise awareness of *Oink* and drive customer registration and usage.
- Virtual Piggy recently reported 2014 results, with 2014 revenue of $5,708 up 132% from $2,456 registered in 2013. Management expects the Discover Card, which launched in the fourth quarter of 2014, to boost transaction volumes and revenue in 2015.
- Virtual Piggy has also announced deals with several gaming companies including Gaia, Habbo, Ubisoft, WarGaming, Crytek, WoozWorld, Playerize, CrossFire and Fantage, among others, and has integrated with more than 1,000 Facebook games.

MUSIC WORLD: A GROWING ELEMENT OF MARKETING STRATEGY

Virtual Piggy (VIG-OTCQB) intends to focus on the music world in 2015 to drive consumer adoption within the youth market. Rodney Jerkins, who joined Virtual Piggy's advisory board in December 2014, is well-connected within the music industry. He is the chairman of Evolve Music Group and is a Grammy award winning record producer.

We believe that focusing on the music industry as well as the gaming industry to promote *Oink* to the youth market is strategic. The company expects Rodney Jerkins to help develop the music and digital goods market, including developing a rewards program that provides access to music and events through collaborations with Evolve Music and individual music artists. According to trade publications, Rodney Jerkins has worked with Sam Smith, Michael Jackson, Beyoncé, Justin Bieber, Lady Gaga and Mary J. Blige, among other artists.

Management has indicated that it has a number or promotional campaigns planned that are expected to launch in spring 2015, including with Rodney Jerkins. We believe that the company needs to build awareness of the *Oink* service. In turn, this is expected to raise awareness of *Oink* and drive customer registration and usage.

Separately, Virtual Piggy has indicated that it is exploring strategic alternatives. We believe the company could be an interesting acquisition candidate for a larger technology company or payment provider seeking to expand within the youth market in a regulatory compliant way. The high fraud rate of Apple Pay is one example, in our view, that points to the need for greater security for the youth market. **Management believes that *Oink* is the only COPPA compliant solution for children under the age of 18.**

2014 FINANCIAL REVIEW

Revenue More Than Doubles; Management Expects Significant Upside as it Markets *Oink*

Virtual Piggy recently reported 2014 results. The company generated revenue of $5,708 in 2014, up 132% from $2,456 registered in 2013. The volume of *Oink* transactions in 2014 increased roughly 4-fold compared to 2013, although we believe volume continues to trend below the level management expects to achieve as it promotes *Oink*. In addition, as Virtual Piggy expands the pool of merchants that accept *Oink* as a payment mechanism, with a continued focus on online gaming companies and the music industry, management expects transaction volumes to increase. Management also expects the Discover Card, which launched in the fourth quarter of 2014, to boost transaction volumes.

In September 2014, Virtual Piggy launched the *Oink* app v2.0, which includes deals and offers from affiliates and has enabled the company to create a new revenue category, Affiliate revenue. The app is free to use and users do not have to be members of *Oink* to access the deals, although Virtual Piggy encourages them to enroll as members. The program has more than 200 affiliated domestic retailers and *Oink* gets a percentage fee generally ranging from 2% to 8% of the value of the transaction.

The company also expects Partner revenue to increase in 2015. This is a relatively new revenue stream that began at the end of the third quarter of 2014. In 2014, *Oink* signed several agreements with e-commerce platform partners and receives referral fees when a merchant or gaming publisher signs up with the partner. Reflecting the expected benefits of the *Oink* Discover card, increased promotional efforts and these new revenue categories, we remain optimistic about the company's long-term prospects.

Operating Expenses

Virtual Piggy's Sales and marketing expenses were $5.1 million in 2014, down 30% from $7.3 million registered in 2013. This decline primarily reflected management's cost containment efforts. This was offset by a 22% increase in Product development expenses to $3.2 million, as Virtual Piggy expanded its product development team to support the launch and maintenance of mobile and other applications. Over the same period, General and administrative expenses grew 18% to $5.4 million, which includes non-recurring items such as the write-off of $255,368 of capitalized patent and trademark costs, an unfavorable foreign currency translation adjustment of $165,649, and a settlement with a former employee. The company reported a net loss of ($16.6 million) for the year ended December 31, 2014 compared to a net loss of ($16.0 million) in 2013.

DISCOVER CARD

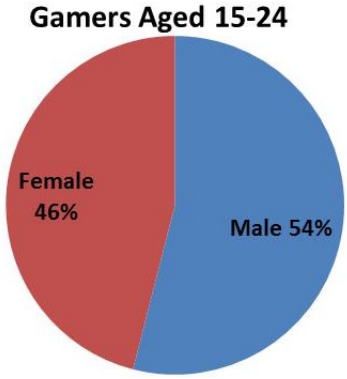
In the fourth quarter of 2014, the company launched an *Oink* prepaid card, following a February 2014 agreement with Discover Financial Services (DFS-not rated). The ***Oink*-branded Discover card** is linked to the online account. It will enable *Oink* users to shop in the more than 25 million locations worldwide that accept the Discover Card, enhancing the flexibility and usefulness of the *Oink* service, in our view.

Discover Financial Services has indicated that the Discover brand has the highest acceptance among the top 100 U.S. retailers and adds 5,000+ additional merchants daily. Children will be able to use the card at bricks-and-mortar stores under the same parental controls that parents have established for their online accounts. Parents will be able to control payments through the *Oink* dashboard, add funds, monitor spending, authorize and prohibit categories, just as they control online spending. The company believes the card will drive both user registration and merchant signings.

GAMING: A KEY COMPONENT OF GROWTH STRATEGY

Management believes that integrating with a growing number of online gaming sites could be a catalyst to drive active usage of Virtual Piggy's *Oink* service. Statistics show that the online gaming industry continues to grow and remains a popular activity for Virtual Piggy's target demographic. The U.S. contains the highest number of gamers in the 13-34 demographic, with the U.K., France and Germany registering higher percentages of 13-34 year olds who play online. NPD Group's Online Gaming 2013 report found significant year-over-year growth in the number of gamers playing online, as well the number of hours they spent gaming each week. According to the survey of more than 8,800 domestic respondents, 72% played games online, up from 67% noted in the prior year's survey. Gamers also reported playing for longer periods of time, with the average weekly time spent playing online up 6%. The PC was the most popular device for playing, but almost all devices registered increased online playtime in 2013, according to NPD. Not surprisingly, reflecting growing penetration, mobile devices registered a double digit percentage point increase.

Of the universe of online gamers under the age of 24, 54% are males and 46% are females. Importantly for Virtual Piggy, in our view, **35% of U.S. online gamers purchased virtual goods in 2011, up 50% from those who made such purchases in 2010.** Of this group, 50% of U.S. online males 24 and under and 15% of females 24 and under purchased virtual goods in 2011. According to the Entertainment Software Association, a rising percentage of parents are involved in some capacity in their children's purchases and game play.



Source: NPD

Virtual Piggy has announced deals with several gaming companies to leverage the gaming group, including Playerize, Free-to-play (F2P) sites. F2P games require no money upfront. However, players encounter limits to the game unless they pay for additional levels or new accessories. The company has announced agreements with Gaia, Habbo, Ubisoft, WarGaming, Crytek, WoozWorld and Fantage.

Following E2 in June 2014, Virtual Piggy indicated that it is also working with BANDAI NAMCO Games America to make mobile content such as *Pac-Man* available. The company has announced agreements with several online gaming sites such as Ubisoft [UBSFY- not rated], which has more than 74 million users and Wargaming, which has over 75 million users. The company expects *Oink* to benefit from the engagement and regular usage that many of these sites enjoy. Last month, the company announced that it was integrated with CrossFire. ***Oink* has integrated with more than 1,000 Facebook games and expects to benefit from Facebook traffic.**

RECENT NEWS

In November 2014, Virtual Piggy's CEO Jo Webber won a Silver Stevie Award for Woman of the Year in the Technology, Business Services & Financial Services category.

In November 2014, the company announced that it had launched the *Oink* Discover prepaid card.

In December 2014, the company announced that Rodney Jerkins had joined its advisory board.

RISKS

We believe risks include the following, among others:

- A better capitalized competitor could develop a COPPA compliant solution.
- The company has indicated that it likely will pursue additional financings, which could be dilutive to current shareholders.
- Merchant integration and user adoption of *Oink* could be slower than anticipated or never materialize at all in a meaningful way if the company's target market continues using their current payment methods.
- Increased spending on marketing and technology could drive operating losses higher and also delay Virtual Piggy's reaching break-even.
- The company may encounter headwinds in signing new merchants and technology companies.

PROJECTED INCOME STATEMENT & BALANCE SHEET

Virtual Piggy, Inc. Income Statement and Projections ($)

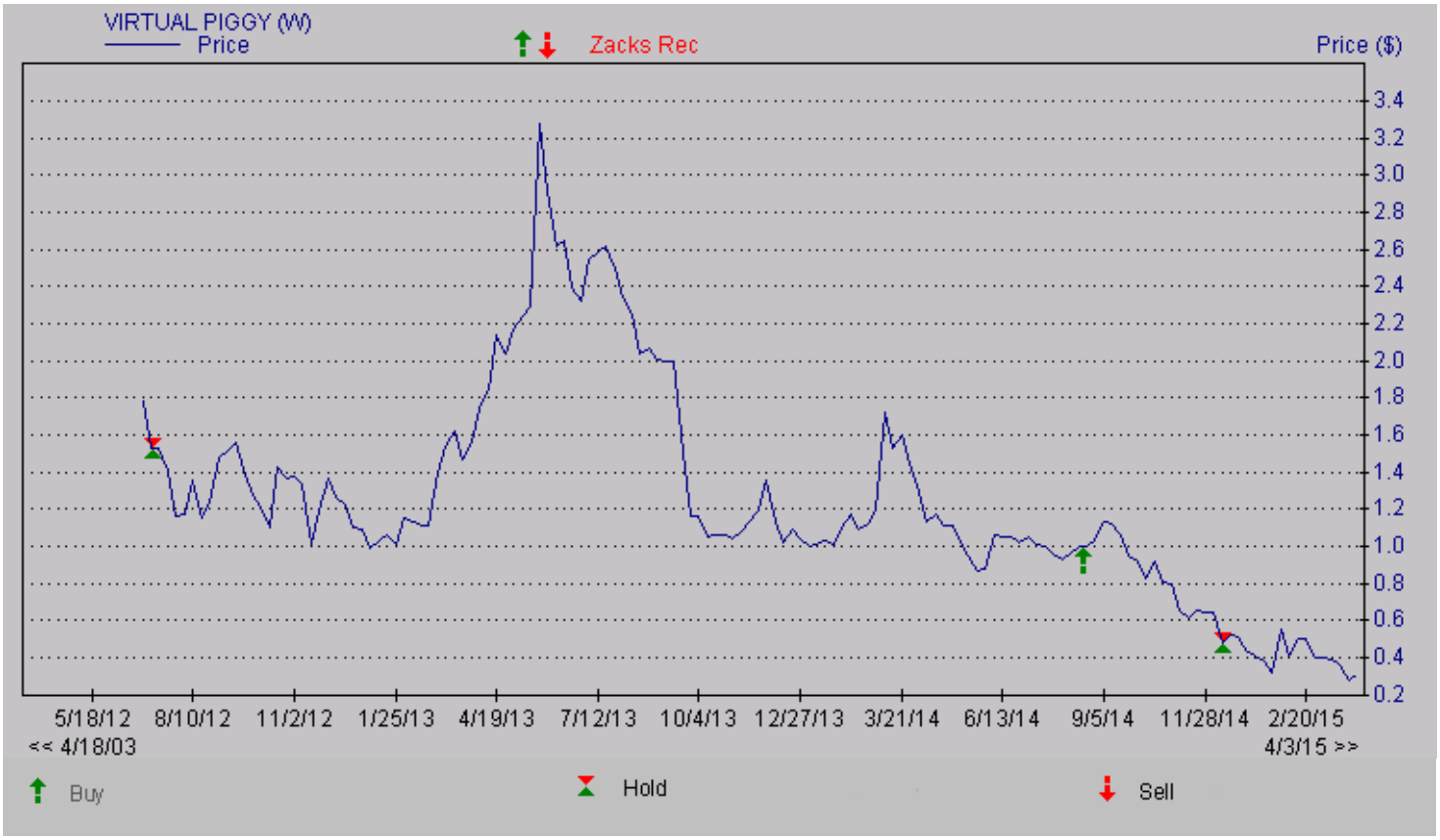
	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14A	3Q14A	4Q14A	2014A	2015E
Revenue	88	58	1,382	928	2,456	425	1,253	736	3,294	5,708	322,400
Sales and marketing	894,647	1,114,440	3,049,709	2,217,019	7,275,815	1,197,412	1,490,016	1,195,440	1,213,166	5,096,034	5,045,074
Product development	461,385	619,750	742,425	827,040	2,650,600	885,974	818,598	871,093	681,614	3,257,279	3,322,425
Integration and customer suppo	119,197	199,859	178,482	214,813	712,351	187,039	188,102	281,409	158,533	815,083	978,100
General and administrative	1,035,071	1,148,697	1,329,347	1,054,321	4,567,436	1,217,303	1,284,536	1,555,652	1,321,153	5,378,644	5,432,430
Strategic consulting	176,794	297,561	10,244	292,376	776,975	-	280,048	251,533	7,627	539,208	544,600
Total operating expenses	2,687,094	3,380,307	5,310,207	4,605,569	15,983,177	3,487,728	4,061,300	4,155,127	3,382,093	15,086,248	15,322,628
Operating loss	(2,687,006)	(3,380,249)	(5,308,825)	(4,604,641)	(15,980,721)	(3,487,303)	(4,060,047)	(4,154,391)	(3,378,799)	(15,080,540)	(15,000,228)
Interest income	3,489	2,825	3,167	1,250	10,731	1,502	2,439	1,959	702	6,602	6,668
Interest expense				(6,382)	(6,382)	(94,280)	(285)		(1)	(94,566)	(95,512)
Chg fair value embedded deriva	-	-	-	-	-	(2,185,375)	2,184,750	1,194,600	4,319,691	5,513,666	1,654,100
Total other	3,489	2,825	3,167	(5,132)	4,349	(2,278,153)	2,186,904	1,196,559	4,320,392	5,425,702	1,565,256
Net (loss)/ income	(2,683,517)	(3,377,424)	(5,305,658)	(4,609,773)	(15,976,372)	(5,765,456)	(1,873,143)	(2,957,832)	941,593	(9,654,838)	(13,434,972)
Less: Deemed dividend distributions						(2,366,419)	(3,489,000)	(439,397)	63,556	(6,231,260)	(6,293,573)
Less: Accrued preferred dividends										(723,649)	(2,532,772)
Net to shareholders	(2,683,517)	(3,377,424)	(5,305,658)	(4,609,773)	(15,976,372)	(8,131,875)	(5,362,143)	(3,397,229)	281,500	(16,609,747)	(22,261,316)
LPS	($0.03)	($0.03)	($0.05)	($0.04)	($0.15)	($0.07)	($0.05)	($0.03)	$0.00	($0.14)	($0.19)
Avg. shares out.	101,792,509	106,261,607	111,372,435	111,393,433	107,704,996	114,818,293	117,041,436	117,117,626	117,784,293	116,690,412	117,158,442

Virtual Piggy, Inc. Balance Sheet ($)

	Dec-12	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Cash & equivalents	$7,371,036	$4,583,551	$1,752,461	$4,108,065	$5,914,803	$2,431,915	$1,652,392
Accounts Receivable	53	955	1,000	1,285	1,264	2,356	7,607
Insurance receivable	75,000	-	4,325	-	-		
Prepaid expenses	20,500	200,771	220,908	280,526	677,527	446,806	591,929
Total current assets	7,466,589	4,785,277	1,978,694	4,389,876	6,593,594	2,881,077	2,251,928
Computer equipment	70,149	99,156	89,021	93,654	103,868	106,250	109,978
Furniture and fixtures	46,130	53,714	57,238	83,981	99,710	99,710	79,634
Leasehold Improvements	-	-	-	8,350	54,700	75,135	81,659
Less: accumulated depreciation	(19,580)	(40,054)	(41,544)	(46,016)	(57,915)	(73,379)	(91,742)
Net property & equipment	96,699	112,816	104,715	139,969	200,363	207,716	179,529
Deposit	65,000	63,510	118,118	346,949	313,010	248,649	46,483
Patents and trademarks	362,496	604,572	739,657	784,152	705,717	769,212	636,230
Total assets	**$7,990,784**	**$5,566,175**	**$2,941,184**	**$5,660,946**	**$7,812,684**	**$4,106,654**	**$3,114,170**
Accounts payable & accrued exp	704,602	1,393,206	2,149,681	1,596,488	1,124,240	1,211,658	829,372
Deferred revenue							2,685
Litigation settlement	450,000	-	-	-	-		
Notes payable	-		913,913	-	-	439,397	
Preferred stock dividend liability							723,649
Embedded derivative liability	-	-	-	3,834,200	5,138,450	3,943,850	-
Total current liabilities	1,154,602	1,393,206	3,063,594	5,430,688	6,262,690	5,594,905	1,555,706
Stockholders' equity	**$6,836,182**	**$4,172,969**	**($122,410)**	**$230,258**	**$1,549,994**	**($1,488,251)**	**$1,558,464**
Liabilities & stockholders' equity	**$7,990,784**	**$5,566,175**	**$2,941,184**	**$5,660,946**	**$7,812,684**	**$4,106,654**	**$3,114,170**

Source: Company reports, Zacks Small Cap Research

HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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