Zacks Small-Cap Research

December 16, 2014

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Virtual Piggy (VPIG-OTCQB)

VPIG: *Believe Larger Partner Could Help Grow Oink*

Current Recommendation	**Neutral**
Prior Recommendation	Buy
Date of Last Change	12/15/2014
Current Price (09/16/14)	$0.53
Six- Month Target Price	**$0.75**

OUTLOOK

Last week, Virtual Piggy announced that its board had authorized management to evaluate strategic alternatives. We believe Virtual Piggy could be an interesting acquisition candidate or partner for a larger technology company or payment provider seeking to expand within the YA (young adult) market in a regulatory compliant way.

SUMMARY DATA

52-Week High	**$1.75**
52-Week Low	**$0.46**
One-Year Return (%)	**-48.0**
Beta	**-2.96**
Average Daily Volume (sh)	**58,281**
Shares Outstanding (mil)	**117**
Market Capitalization ($mil)	**$62**
Short Interest Ratio (days)	**8.9**
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**
Zacks Rank	**N/A**

Risk Level	**High**
Type of Stock	**Small-Growth**
Industry	**Internet-Services**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	0.0 A	0.0 A	0.0 A	0.0 A	0.0 A
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 E	0.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.01 A	-$0.01 A	-$0.01 A	-$0.01 A	-$0.04 A
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	-$0.05 E	-$0.17 E

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

Disclosures begin on page 11.

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KEY POINTS

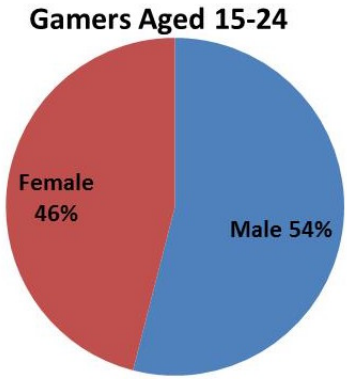
- Last week, Virtual Piggy announced that its board had authorized management to explore strategic alternatives. We believe Virtual Piggy could be an interesting acquisition candidate for a larger technology company or payment provider seeking to expand within the YA (young adult) market in a regulatory compliant way.
- Management has a track record of building and selling new tech companies. Prior to founding Virtual Piggy, the company's co-founder and CEO Dr. Jo Webber served as CEO of privately-held InnaPhase Inc., which was sold to Thermo Electron (TMO-not rated) under her leadership.
- Management also has strong incentive to achieve shareholder value. Insiders, including board members, hold 16.6% of the shares. Additionally, two large shareholders hold an additional 26.8%, for 43.4% in the hands of executives, board members and large shareholders.
- Earlier this week, Virtual Piggy announced it had entered into a partnership to integrate Oink into Playerize, a monetization network for the social and mobile gaming industry. 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, as online gaming is a popular activity for Virtual Piggy's target demographic.
- The company recently launched an Oink prepaid card with Discover Financial Services (DFS-not rated). The *Oink*-branded Discover card will enable *Oink* users to shop in the more than 25 million locations worldwide that accept the Discover Card.

GAMING: A CRITICAL COMPONENT OF GROWTH STRATEGY FOR OINK

Earlier this week, Virtual Piggy (VPIG-OTCQB) announced it had entered into a **partnership to integrate its Oink payment solution into Playerize,** a network focused on monetization for the social and mobile gaming industry. According to management, the Playerize network has registered more than two billion gaming interactions from gamers in over 200 markets.

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

In addition to the Playerize agreement, Virtual Piggy has announced deals with several gaming companies to leverage the gaming group, including 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 Rising Star Games, Funcom, Gaia, Habbo, Ubisoft, WarGaming, Crytek, WoozWorld and Fantage.

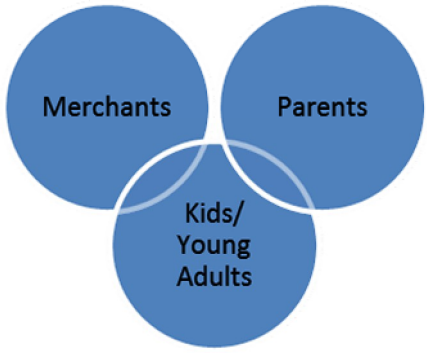
Announcements of new gaming deals has increased following E2 in June 2014 and Virtual Piggy has indicated that it is also working with BANDAI NAMCO Games America to make mobile content such as *Pac-Man* available. The company has announced agreements with several online gaming sites such as Ubisoft [UBSFY- 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.

DRIVING BRAND AWARENESS TO FUEL REVENUE GROWTH

Virtual Piggy reported third quarter 2014 results recently, with revenue of $736 below our $2,005 forecast and down from $1,382 registered in the same quarter of 2013. Lumpy interim revenue does not surprise us, as Virtual Piggy is an emerging company and it is still building the infrastructure to make its business successful. **We also believe that the company must build awareness of the Oink service in order to drive consumer usage.**

Management as noted that it intends to ramp-up its promotional efforts. The company plans to co-market with existing merchants to raise awareness of *Oink* and drive customer registration and usage. Ongoing promotional efforts include garnering press coverage in trade publications and blogs and joint marketing with advocacy groups for protecting children's privacy.

Virtual Piggy Marketing Strategy Targets Key Demos



Source: Company reports

VPIG's marketing strategy includes a B2B outreach program and leveraging social media to raise awareness of *Oink*. The company also attends trade shows to meet with target merchants. We believe merchants will be receptive.

As Virtual Piggy's consumer marketing efforts are in the early stages, we believe, the company has not yet generated much revenue to-date. As the pool of merchants that accept *Oink* grows, we would also expect the registered user base to grow, as the site begins to offer a broader selection of services and products and therefore becomes more useful. Using PayPal as an analogy, PayPal also struggled to grow user registration in its early days.

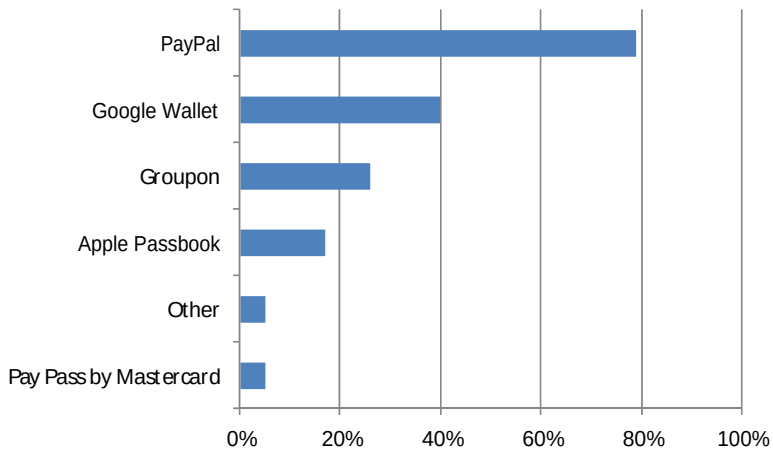
Additionally, the company recently launched an *Oink* prepaid card, following a February 2014 agreement with Discover Financial Services (DFS-not rated). The ***Oink*-branded Discover card** is linked to the online account. It will enable *Oink* users to shop in the more than 25 million locations worldwide 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.

Virtual Piggy reported a net operating loss of ($4,154,391) compared to ($5,308,825) registered in the third quarter of 2013 and a loss per share of ($0.03) compared to ($0.05). These metrics included a noncash benefit of $1,194,600 for the change in fair value of derivative instruments.

EXPLORING STRATEGIC ALTERNATIVES

Last week, Virtual Piggy announced that its board had authorized management to evaluate strategic alternatives. The company has engaged an investment bank to help with this process. We believe Virtual Piggy could be an interesting acquisition candidate for a larger technology company or payment provider seeking to expand within the YA market in a regulatory compliant way.

Share of Respondents Using Digital Wallet



Source: Statista 2014

Many online payment services have launched offerings for younger consumers. PayPal introduced a PayPal Student Account and Visa has Visa Buxx or Teen Visa, a prepaid card for teens. However, neither is for the 8-to-14 year old market that *Oink* targets. In fact, Virtual Piggy management believes that no other payment mechanism offers a solution that is compliant with government regulations concerning 8-to-14 year olds. Other services also do not allow parents to control spending by determining how much buying power they authorize on the card. **Management believes that *Oink* is the only COPPA compliant solution for children under the age of 18.**

Payment providers are extending their services to younger consumers, while at the same time, major technology companies increasingly are targeting younger demographics. For example, Google is considering allowing children to sign up for Google accounts, according to trade publications, including a child safe version of YouTube that offers a dashboard allowing parents to monitor their children's activities. Yahoo allows children to sign up for its services if their parents provide consent. As noted, Facebook, which is currently restricted to users 13 and older, is also interested in expanding to younger people, according to trade publications. These initiatives to target teens and tweens underscore how attractive the YA consumer market is, in our view.

Tweens and tweens represent an attractive market for merchants. With annual income of $2,767 for 12-14 year olds and of $4,923 for 15-17 year olds, teens have access to disposable income of $91.1 billion, according to a Rand youth poll.[1] Moreover, parents spend more than $150 billion on care for their teenage kids, including clothes, food, shelter, entertainment and personal accessories and the child has significant influence directing where this money is spent. According to a 2011 Harris Poll, kids have a greater amount of money to spend than ever before and also have a greater influence on their parents' purchases, as well. Between what they earn and spend and what their parents spend on them, the domestic teen market is estimated at nearly $259 billion annually. Global teenage purchasing power is estimated at $819 billion, according to TRU Insights research.[2]

This age group is also one of the first generations to grow up with e-commerce, as the launch of the online retail market dates to the mid-1990s and Amazon and eBay. Teens spend a substantial amount of their time online or on mobile devices. Statistics indicate that 74% of teens access the internet via mobile devices versus 55% of adults. Moreover, nearly 80% of teens browse for goods online and 52% of teens under age 18 have shopped online, according to Forrester Research.

The market for mobile payment transactions is estimated to reach over $235 billion in 2015, according to Forrester Research and others. The company believes that the growing use of mobile payment mechanisms also increases the importance of *Oink*, with the *Oink* dashboard accessible through mobile devices, as well as online. Mobile technology penetration has grown dramatically over the past decade. Adoption rates of mobile devices such as smartphones and tablets are tracking significantly ahead of that of other technology platforms such as PCs or broadband. There were 1.2 billion smartphones and tablets shipped in 2013 according to IDC, with 218 million designated for business use. Smartphone penetration reached 65.2% of the U.S. mobile subscriber market during the fourth quarter of 2013, according to comScore, up more than 11% points from the same time frame a year earlier. Smartphones took only 8-years to reach 20+% penetration globally.

As early adopters of technology, teens spend a significant amount of time on mobile devices and are increasingly using their smart devices for e-commerce. To exploit this trend, retailers are enabling mobile commerce opportunities. In fact, launching a mobile strategy has been the most important initiative for retailers in 2014, according to Forrester Research. We believe that as this trend continues, it could be another factor to help drive *Oink* growth.

[1] *The Richest*, August 1, 2014
[2] *Diamonds Magazine*

Children's Online Privacy Protection Act

The Children's Online Privacy Protection Act (COPPA) imposes restrictions on online sites directed to children under the age of 13, including requiring that they obtain verifiable parental consent. COPPA seeks to protect children from companies that store their data. It became effective in 2000 to regulate the online collection of personal information from children under the age of 13. The COPPA rules mandate that online retailers and service providers inform parents and obtain their permission before they collect, use or disclose children's personal data. The FTC expanded this legislation in December 2012 so that third parties also could not collect personal information from children through plug-ins without parental notice and consent on behalf of apps and websites marketed to children.

COPPA regulates information including full name, home address, email address, telephone number and other personally identifiable information that would allow someone to identify or contact the child. In addition, COPPA also covers other types of information such as geolocation metrics, photos, videos and audio files that contain a child's image or voice, as well as personal interests or hobbies that are collected through cookies and which can be used to identify the child. **With *Oink*, the merchant never sees the child's personal information**; the merchant only sees a child's *Oink* username and password.

Management has a strong track record of building and selling new tech companies. Prior to founding Virtual Piggy, the company's co-founder and CEO Dr. Jo Webber served as CEO of privately-held InnaPhase Inc., which was sold to Thermo Electron (TMO-not rated) for $71 million in 2004 under her leadership. She then became the CEO of Energy Solutions International, which supplied software for the management of oil and gas pipelines. GFI Energy Ventures, now part of Oaktree Capital Management, acquired Energy Solutions International in 2010.

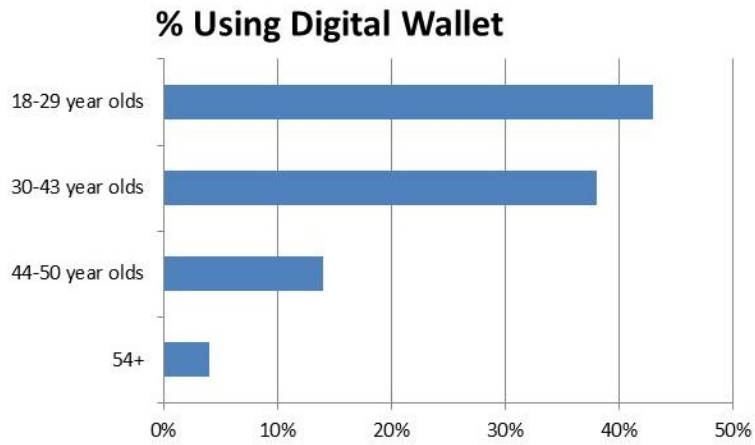
Management also has strong incentive to achieve shareholder value, we believe. Insiders, including board members, hold 16.6% of the shares, of which the CEO holds a 7.2% stake. Additionally, two large shareholders hold an additional 26.8%, for 43.4% in the hands of executives, board members and large shareholders.

Given that the company intends to ramp-up its promotional efforts and has also indicated that it expects to do additional financings, Virtual Piggy may believe that a partnership or merger with a larger, better capitalized company will facilitate market penetration of the Oink service. We believe Oink has several benefits that could drive market penetration and consumer adoption, particularly with a larger partner.

We see the benefits to parents, merchants and minors of using *Oink* as an online and mobile payment mechanism. Virtual Piggy provides what it believes is the only e-commerce payment solution that is regulation compliant for teens and tweens, a market that has surprisingly robust spending power and is increasingly targeted by merchants. The site allows teens and tweens to make online expenditures without a credit card. Parents authorize funds to their child's account, effectively providing a digital allowance to their children. They can also set limits on how much a child can spend on a daily, weekly or monthly basis or even in a single transaction. The site keeps track of all spending and parents can access the information. Parents can also use the site as a financial teaching tool, allowing their children to budget their own spending.

A key benefit to parents and kids, in our view, is that *Oink* protects kids' identities. Moreover, *Oink* is easy for children to use. A dashboard provides a snapshot of his or her financial position, i.e. how much money the account had originally, what the current balance is, what has been spent, what has been earned and what has been donated. The dashboard is accessible online and through mobile devices. Children get access to their own funds and learn how to budget their spending.

We believe kids would choose to use an *Oink* digital wallet if they were given access. As illustrated in the chart below, the percentage of people who use digital wallets is highly correlated to age group. Not surprisingly, a higher percentage of younger respondents – who are more comfortable with online and mobile applications – indicate that they use a digital wallet.



Source: Statista 2014

Virtual Piggy's business model is to provide *Oink* for free to parents and children and to collect a fee from merchants. The 2%-3% fee is similar to fees that merchants pay to credit card companies or online payment mechanisms such as PayPal. We also believe there are significant benefits merchants derive from using *Oink*. *Oink* allows them to collect payment from children and teens using technology that complies with regulatory privacy rules. This also makes it easier for them to market to this attractive market, in our view, and drive traffic and e-commerce and m-commerce.

Oink also helps merchants reduce *friendly fraud* or chargeback fraud, which occurs when a consumer makes a purchase online using their credit card and then cites it as an unauthorized transaction and receives a refund. Visa (V-not rated) estimates that in 2012, $11.8 billion was lost to friendly fraud. It represents roughly 18% of total fraud reported by online merchants, according to the September 2013 LexisNexis *Trust Cost of Fraud* study. Moreover, a merchant that has more than 1% of their charges reversed is at risk of being dropped by major credit card companies.

Oink is also easy for merchants to use, as it is integrated with the major U.S. payment processing portals, including Chase Paymentech, CyberSource, Authorize.Net and PayPal and can process transactions from major credit and debit cards. In addition, it has also integrated with many of the leading e-commerce platforms including Ebay's Magento, Demandware, Oracle ATG and Live Gamer.

CONCLUSION

Oink is still a "show me" story at this early stage, in our view. We are lowering our rating on shares of Virtual Piggy to Hold from Buy. Although we remain enthusiastic about the company prospects, with the year-over-year decline in revenue registered in the third quarter, we believe investors may step to the sidelines until there is greater revenue momentum. We are reducing our price target to $0.75, which equates to a roughly 2x multiple of anticipated revenue at the 15 million user level (see our report dated September 17, 2014).

For investors who can assume higher than average risk, we believe the shares represent on attractive option on *Oink*'s fundamental growth prospects, as well as on the potential of a transaction with a larger player.

RECENT NEWS

On December 15, Virtual Piggy announced a partnership to integrate Oink into the Playerize network. The Playerize network has seen over 2 billion interactions from gamers to date and spans over 200 countries and territories with over 49,000 game publishers.

On December 8, Virtual Piggy announced that its board had authorized management to evaluate strategic alternatives to enhance shareholder value.

On November 21, the company announced that it had launched the Oink Discover prepaid card.

On October 30, the company issued 28,378 shares of series B convertible preferred stock and warrants to purchase 2,837,800 common shares for $2,554,020.

On 28-October 28, the company file its third quarter 2014 10-Q.

On October 2, the company announced it had partnered with Rising Star Games, a privately-held video games publisher with titles such as *Hello Kitty* and *Harvest Moon*.

On October 1, Virtual Piggy partnered with Funcom, a publisher of MMO games.

RISKS

We believe risks include the following, among others:

- 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.
- 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.
- 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 ($)

	2012	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14A	3Q14A	4Q14E	2014E
Revenue	1,213	88	58	1,382	928	2,456	425	1,253	736	20,000	22,414
Sales and marketing	2,092,551	894,647	1,114,440	3,049,709	2,217,019	7,275,815	1,197,412	1,490,016	1,195,440	1,207,394	5,090,262
Product development	1,530,348	461,385	619,750	742,425	827,040	2,650,600	885,974	818,598	871,093	879,804	3,455,469
Integration and customer suppo	465,277	119,197	199,859	178,482	214,813	712,351	187,039	188,102	281,409	284,223	940,773
General and administrative	3,368,675	1,035,071	1,148,697	1,329,347	1,054,321	4,567,436	1,217,303	1,284,536	1,555,652	1,571,209	5,628,700
Strategic consulting	4,499,232	176,794	297,561	10,244	292,376	776,975	-	280,048	251,533	254,048	785,629
Other	-	-	-	-	-	-	-	-	-	-	-
Total operating expenses	11,956,083	2,687,094	3,380,307	5,310,207	4,605,569	15,983,177	3,487,728	4,061,300	4,155,127	4,196,678	15,900,833
Operating loss	(11,954,870)	(2,687,006)	(3,380,249)	(5,308,825)	(4,604,641)	(15,980,721)	(3,487,303)	(4,060,047)	(4,154,391)	(4,176,678)	(15,878,419)
Interest income	5,704	3,489	2,825	3,167	1,250	10,731	1,502	2,439	1,959	1,979	7,879
Interest expense	(90,560)				(6,382)	(6,382)	(94,280)	(285)		-	(94,565)
Chg fair value embedded deriva	-	-	-	-	-	-	(2,185,375)	2,184,750	1,194,600	1,206,546	2,400,521
Total other	(84,856)	3,489	2,825	3,167	(5,132)	4,349	(2,278,153)	2,186,904	1,196,559	1,208,525	2,313,835
Net loss	(12,039,726)	(2,683,517)	(3,377,424)	(5,305,658)	(4,609,773)	(15,976,372)	(5,765,456)	(1,873,143)	(2,957,832)	(2,968,154)	(13,564,585)
Less: Deemed dividend distributions							(2,366,419)	(3,489,000)	(439,397)	(443,791)	(6,738,607)
Net to shareholders	(12,039,726)	(2,683,517)	(3,377,424)	(5,305,658)	(4,609,773)	(15,976,372)	(8,131,875)	(5,362,143)	(3,397,229)	(3,411,945)	(20,303,192)
LPS	($0.14)	($0.03)	($0.03)	($0.05)	($0.04)	($0.15)	($0.07)	($0.05)	($0.03)	($0.03)	($0.17)
Avg. shares out.	85,325,709	101,792,509	106,261,607	111,372,435	111,393,433	107,704,996	114,818,293	117,041,436	117,117,626	118,288,802	116,816,539

Virtual Piggy, Inc. Balance Sheet ($)

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

Source: Company reports, Zacks Small Cap Research

HISTORICAL ZACKS RECOMMENDATIONS



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