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Transcript of
Blue Calypso
First Quarter 2016 Earnings Conference Call
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Participants
Andrew Levi – Chief Executive Officer
Chris Fameree – Chief Financial Officer

Analysts
Andrew D'Silva – Merriman Capital
Dallas Salazar – Atlas Consulting

Presentation

Operator
Good afternoon. Welcome to Blue Calypso's First Quarter 2016 Earnings Conference Call. My name is Ben, and I'll be your operator for today.

Joining us for today's presentation is Founder and CEO, Andrew Levi; and CFO, Chris Fameree. Following their remarks, we will open up your call for questions. Then before we conclude today's call, I'll provide the necessary disclaimers and cautions regarding the forward-looking statements made by management during this call. I would like to remind everyone that this call will be recorded and made available for replay via link in the Investors section in the company's website.

Now, I would like to turn the call over to Blue Calypso's Chief Executive Officer, Andrew Levi. Please proceed.

Andrew Levi – Chief Executive Officer
Thanks, operator. Thank you, all, for joining us today on our First Quarter 2016 Earnings Conference Call.

Our focus in the first quarter of 2016 has been primarily around three areas. First, deploying our KIOSentrix Platform with Fortune 500 retailers. Second, continuing to innovate and advance the state of our mobile consumer engagement solutions and the intellectual property necessary to protect our competitive advantages; and third, fortifying our balance sheet and capital structure. We made significant progress on all three of these areas in the first quarter that will enable us to achieve the level of growth we're targeting in the coming years.

Before I dive into all these exciting opportunities I want to discuss the elephant in the room that I'm sure most investors are concerned about with regard to our IP litigation with Groupon and Foursquare. As you may be aware, on Friday, May 6th, per the advice and recommendation of our legal team at Fish & Richardson, we elected to settle our dispute with Groupon in the Eastern District of Texas Court. This was the primary reason for postponing our scheduled earnings call as we wanted to allow as much time to finalize the settlement and be in a position to discuss freely with our shareholders.

Currently our legal team is working vigorously to complete an agreed-upon settlement with Groupon, but we're not quite there yet. Here's what I can speak to you today. On May 5th, the company entered into a binding memorandum of settlement with Groupon pursuant to which it has, in principle, settled all outstanding litigation with Groupon. The terms of this settlement are confidential.

On May 6, 2016, the court held a hearing regarding the Federal Circuit's decision issued on March 1, 2016, and the pending motion for summary judgment related to subject matter eligibility. The court heard arguments from the company and Foursquare Labs and took the matter under advisement. During the hearing, Judge Gilstrap set a trial date of September 12, 2016. The court also required the parties to submit briefing on certain collateral estoppel issues at a joint docket control order within 15 days. We look forward to working together to determine the best course of action with Foursquare Labs.

While I cannot get into the details on the terms of the Groupon settlement, what I can say is that we worked very closely with our legal counsel to arrive at this decision. Amongst a variety of items, we factored in the current software patent environment and state of the trial when considering the long-term costs and benefits to the company when determining whether to settle or continue the litigation process. Ultimately we concluded it was in the company's best long-term interest to settle this current matter with Groupon.

In addition, we feel strongly that the current state of patent litigation and patent awards is not encouraging for software at this time as nationwide district courts are invalidating software patents at approximately 70% rate under 35 USC 101 commonly referred to as Alice according to a presentation of IBM's patent counsel provided at the Innography Insights 2016 Conference this past April.

Although the Eastern District has been far more favorable for patent owners with only approximately 30% invalidation rate, this does not preclude defendants from taking us through PTAB under 35 USC 101 where claims once instituted by PTAB are being invalidated at over 70% through CBM review which everybody knows we've gone through once. One question that's come up is since we've been through this once, is it possible that we could end up in a CBM review again? And the answer to that is yes, as there's no limit on the number of CBM reviews a defendant can take a company through. This stat of 70% CBM review according to a 2015 study conducted by Fitzpatrick, Cella, Harper & Scinto LLP, a leading national intellectual property firm, and even as the Eastern District has recently shown a propensity to invalidate software patents at an increasing rate.

We also considered a scenario where if we were successful in the Eastern District, there exists a high likelihood of an appeal to the Federal Circuit where 101 invalidation rates are currently very high as well. The agreed-upon settlement closes the chapter with Groupon, but it does not close the book for Blue Calypso's future patent asset monetization with other parties, and in fact, preserves the IP portfolio until the landscape pendulum swings back to normalcy.

We feel strongly that a number of significant events will unfold in the appellate and supreme courts in the coming years that will provide a return on Fish & Richardson's contingent relationship with Blue Calypso. We believe that our decision will reward shareholders over time and protect the patents we work so tirelessly to create. This decision allows us to focus 100% of our human capital on the core business mobile consumer engagement solutions while the United States considers how it will allow software inventors and patent owners to protect their innovations in the future.

We began the first quarter of 2016 being recognized among the top ten merchandising solution providers in 2016 by Retail CIO Outlook for our expertise in providing a unique and flexible platform to connect consumers to brands. The positioning is based on evaluation of Blue Calypso's specialties and providing unique merchandising operations and delivering an innovative, location-centric, mobile software engagement platform across the broad retail sector.

The annual list of companies is selected by a panel of experts and members of Retail CIO Outlook's editorial board to recognize and promote technology, vision, leadership, and innovation. We're excited to be recognized by Retail CIO and its contributing team of industry leaders as noted innovator in 2016.

Moving on to our KIOSentrix Platform, in the first quarter of 2016, we deployed KIOSentrix across 4,000 retail locations and 20,000 product SKUs with our partner, IntegraColor. Our partnership, positioned in this instance for the plant tag industry, was extended to all of the Lowes stores in the US, as well as Monrovia, one of the country's premier wholesale plant growers where we are expanding our rollout to additional plant retailers.

The horticulture industry is generally not a tech innovator, but through extensive proof-of-concept research, we're able to show Lowes that short code messaging was superior to QR codes when buyers of plants wanted real-time care information beyond what is available on traditional plant tags. It is providing to give both Lowes and Monrovia location-based insight into where people are when they are most interested in this information, and it also provides Monrovia's retailer network the ability to add additional product suggestions, reviews, and trackable mobile coupons.

Concluding the first quarter of 2016, we partnered with the Salem Red Sox, a minor league baseball team in Salem, Virginia, to engage fans via mobile at Lewis-Gale Field using Blue Calypso's innovative KIOSentrix Platform. As part of their dedication to providing the best in-stadium fan experience possible, the Salem Red Sox are using SMS to provide game updates in the event of inclement weather, as well as deals and promotions to fans that have opted in. Further down the line, the team plans to eventually experiment with beacons to create more opportunities for sponsorship.

KIOSentrix comprehensive analytics will allow the Salem Red Sox to better understand what fans are looking for and what levels of engagement they are comfortable with. By implementing this mobile fan engagement strategy now, the team will ultimately be able to deliver more relevant and memorable game experiences for their fans throughout the 2016 season. By the way, the Salem Red Sox are in first place in the Carolina League Southern.

Subsequent to closing of the first quarter 2016, we announced our first US patent issued for our new mobile sponsor gamification family with more patent spending and to be filed in 2016. In an environment where software patents in the post-Leahy-Smith America Invents Act era are very difficult to attain from the USPTO, we secured this new patent as something we believe embodies the uniqueness of our gamification intellectual property. In fact, according to Law360, the USPTO is denying over 90% of new software patent applications that have been filed in recent months.

We're committed to innovating technologies that enhance the ROI for our brick-and-mortar retail partners and consumer goods manufacturers when customers are on site and engaged with their brand. Receiving this new patent in future IP protection is an integral part of the strategy as we see strong momentum with consumer engagement and brand affinity over mobile platforms. In fact, US revenue and the US social gaming market are projected to grow at compound annual growth rates of 19.6% from 2016 to 2019 according to research in markets.

From a capital structure perspective, in the first quarter, we repaid and retired all outstanding convertible debt held by Magna Equities, thus avoiding potential dilutions to our existing shareholders. We've made strong progress on all three areas of the first quarter, and as a result, are positioned in 2016 for significant growth in our business.

Before we take a look at other exciting developments in the second quarter of 2016, I'll have our CFO, Chris Fameree, review the first quarter 2016 financial results. Chris?

Chris Fameree – Chief Financial Officer
Thank you, Andrew. I will now run through the first quarter 2016 financial results. First and foremost, the first quarter was highlighted with improved topline growth. Revenue for the three months ended March 31, 2016 was approximately $263,000 as compared to $116,000 for the same period in 2015 or a 128% increase year-over-year. The increase is primarily attributable to project-based revenue and is subject to timing of development projects.

Total operating expenses, including cost of revenue for the first quarter of 2016, increased to $1.1 million versus $724,000 in the first quarter of 2015. In addition to the increase in cost of revenue, the increase in operating expenses is due to the 179% increase in sales and marketing expenses as the company has invested in sales personnel and other marketing efforts, and a 49% increase in general and administrative expense primarily associated with stock-based compensation.

Net loss in the first quarter of 2016 totaled $884,000 or $0.16 per basic and diluted share compared to a net loss of $609,000 or $0.12 per basic and diluted share in the same period a year ago. The increase in net loss resulted primarily from an increase in operating costs of $411,000 and interest cost of $114,000, net worth of gain unchanged in derivative liabilities of $101,000, and an increase in revenue of $148,000.

As Andrew previously mentioned, during the first quarter the company also extinguished our outstanding convertible notes payable and associated accrued interest. Cash on hand at March 31, 2016 totaled $212,000 compared to $730,000 at December 31, 2015. However, subsequent to the first quarter of 2016, the company raised an additional $1 million in a private placement with a strategic investor which we plan to use for additional marketing and working capital purposes. Andrew Levi, our CEO, will further discuss this important investment later on in our call.

On that positive note, I will turn it now back over to Andrew. Andrew?

Andrew Levi – Chief Executive Officer
Thanks, Chris. Subsequent to the first quarter of 2016, we announced that Hal Brierley, a 30-year veteran and loyalty advisor to Fortune 500 consumer brands, was appointed as a senior advisor to Blue Calypso in conjunction with his $1 million strategic investment. As an existing investor, Hal has been following our evolution for some time and made a strategic bet on the management team and the company after we pivoted the business model entirely to our mobile shopper engagement platform. We believe that Hal's human capital and extensive relationship with Fortune 500 retailers will not only accelerate the rollout of our solution, but also prepare our organization for the next phase of its growth cycle.

Our focus on mobile shopper engagement for product manufacturers in multi-location brick-and-mortar retailers comes at a time when retailers are reporting their worst financial performance in decades due to the Amazon effect. In fact, some retail analysts on Wall Street are only recommending retailers that are un-Amazon-able like jewelry and fitness brands. The disruption with today's consumer purchasing habits is a result of new technology, but also the lack of big box retailers creating a more experiential shopping journey when they are in store engaging with their brands.

We and our new partners believe our KIOSentrix Platform provides a rich and scalable platform that embraces product manufacturers, retailers, and consumers alike, while supporting all methods of activation such as beacons, short codes, NFC, Wi-Fi, and mobile apps, as well as distributed content. We believe that our success in 2016 will be demonstrated with new partnerships and marquee customers, and we expect to expand our roster to include additional Fortune 500 brick-and-mortar retailers in the near term.

We believe the balance of 2016 and beyond will be transformational for Blue Calypso on an operational and financial level. Already in the second quarter of 2016, we have strengthened our balance sheet, expanded our solution offerings, and aligned our company with the innovator and loyalty programs. Moreover, our current pipeline has never been more robust as we are preparing to deploy several proof-of-concept demonstrations with major Fortune 500 brands in the United States. The combination of these recent achievements set the stage for significant growth later in 2016 and beyond.

As always, all of us at Blue Calypso thank each of you as a shareholder for your trust and continued support. You own the company, we work for you, and we believe our hard work and commitment to produce the returns for us all.

This concludes my remarks. Now with that, we're ready to open the call for your questions. Operator?

Operator
Thank you. At this time, we will be conducting a question-and-answer session. (Operator instructions.) One moment please while we poll for questions. The first question comes from Andrew D'Silva of Merriman Capital. Please go ahead.

Q: Good afternoon. Just a couple quick questions. First off, as far as the pipeline goes, I'm glad to see you're making progress with starting pilots. Is part of that acceleration that we're seeing right now, at least compared to previous quarters related to the initial critical reference customers you've already launched with? And then what could some of the larger opportunities in your pipeline that you're about to start pilots with be worth, maybe from a topline perspective if you were to land them and they were to become customers?

Andrew Levi – Chief Executive Officer
Sure. Few great questions. Thanks, Andy. Reference accounts as you're building a business are critical. I think as anybody that has gone through the process of creating and launching a technology or any type of a business, the first 10 to 20 accounts that are willing to go to say great things about the effect you've had on their business are really the difference between reaching high acceleration or being flat. So, there's no doubt that some of the reference accounts that we're bringing in now help pave the road for the future opportunities that we're adding to the pipeline.

And to your question about what some of these opportunities look like. Because of the nature of a horizontal approach to retail, the sizes of business that our technology appeals to if you consider consumer-packaged goods and retailers can be all over the map. It can be very, very small, all the way up to, as you've seen us today talk about Lowes and big box retail. But we also mentioned that we're about to embark on several trials and proof of concepts with several Fortune 500 product manufacturers and retailers and some of those opportunities are seven-figure deals per year. So we're really, I believe, at this juncture, very well positioned, better than we ever have been to really grow and land some of these marquee accounts that generate not just topline growth revenue, but the profit margins that we need at some point here in the not-too-distant future to be self-sustainable and cash flow positive.

Q: Just to recap you said $1 million plus in potential revenue from some of the bigger customers or potential customers in the pipeline?

Andrew Levi – Chief Executive Officer
That's correct, yes. I want to be real clear. That is not a typical size deal, but we have some of that size in the pipeline right now. We've also got some that are $1,000. So, I want to make sure that nobody thinks that every one of our deals is going to be a million dollar deal. I wish that it was, but the fact that we're now appealing to and

attracting the interest of Fortune 500 accounts that really see our technology as critical and can and will write a million dollar check to solve a very critical problem for themselves is very exciting to us.

Q: Thanks for that color. That was great. Then as it relates to the competitive landscape, since the last time when we talked, has it changed at all or is it still just a handful of outside companies targeting that emerging market, and then retailers, some of them which are looking to have internally driven solutions?

Andrew Levi – Chief Executive Officer
Yes, it's still really, really thin on the competitive landscape which is great. There are two sides to that coin. We're fairly early in, I'd say first inning in solving this problem that exists in this retail space. Therefore the landscape is fairly wide open. There are a small handful of folks that we're seeing out in the market doing something similar, and I would say, I have yet to find an organization that's approaching from a platform perspective appealing to product manufacturers, retailers, and consumers alike, like we are. But as you know, as success happens, there will be more competition we anticipate that lenders face, but right now the opportunities are just running as fast as we can and grab land is pretty wide open as we see it.

Q: That first entry's pivotal I think right now. Just last question for you guys. Actually for Chris in particular, and I'm sorry if I missed it in your prepared remarks, but since the strategic investment with Hal Brierley took place after the quarter, can you give us a sense of what kind of working capital runway you have right now, let's just say in a steady state scenario?

Chris Fameree – Chief Financial Officer
We believe with what we have in the pipeline, and it's disclosed in our Q that we can certainly make it through the end of the year. We hope that we have sustainable revenue at that point that'll carry us through. Obviously we've got to deliver on our pipeline and some of our plans, but right now we're forecasting certainly through the end of 2016.

Q: Got it. Great. Thank you very much for answering my questions, and good luck going forward through the rest of the year.

Andrew Levi – Chief Executive Officer
Thanks, Andy.

Operator
The next question comes from Dallas Salazar of Atlas Consulting. Please go ahead.

Q: Hi, guys, thanks for taking the questions here. I just had a few. First off, from a headcount standpoint, specifically sales related, how do you guys feel? Do you feel like this is a good level to be at? Do you have some hiring to do? Can you comment on that?

Andrew Levi – Chief Executive Officer
Yes, sure. We have a two-prong strategy going and shaping that new business. We've got a brand-direct approach which requires us to go find every retailer and every product manufacturer individually. But I would say that the strategy that is providing, I think, the most traction and is the most appealing is our partner channel.

We've added and continued to cultivate a handful of very influential partners. IntegraColor, we've talked about repeatedly. They're the organization that has taken us to Lowes and Monrovia and another handful of accounts. But I think we're up to six partners now that are taking us into a myriad of organizations of all sizes. If we continue to work closely and work well with our partners, ultimately that precludes our need for adding sales folks that are tasked with chasing brands direct.

So we're really looking at both very closely. I'm not sure at this juncture if we're going to change our effort and mix in going brand direct, but in the event that we just continue to focus our energies as they are, I think we're at a pretty decent size right now. If we grow some, we may need some folks that are responsible for helping with the onboarding of new accounts which obviously is a good problem to have, but I think what you're looking for is as we start to achieve revenue traction, are we going to have lay up a bunch of additional overhead and expenses associated with personnel, and the answer to that is no. There's not a direct correlation between adding accounts and adding headcount. We think we can scale pretty well with a very lean organization.

Q: Okay, no, I appreciate that. And along those same lines, I know it's really early in the process here, but do you have any expectation for the maturation cycle for your sales team? So for instance, maybe you don't expect them to be productive, whatever that means to your model over the first 12 months, but after that you expect them to be at cash G&A breakeven or better, right? So do you have any expectations for, again, just a maturation cycle for the sales team?

Andrew Levi – Chief Executive Officer
I would expect the new add to the sales force to be bringing revenue in the door within 90 days. And my expectation of performance, assuming that we make the right hires, is that a new add would be cash flow positive or beyond within six months.

I think because of the way our model works, it's really an enterprise sales cycle meaning it takes a sales pursuit process that in and of itself regardless of your experience level or tenure with the company is longer than most. It's not transactional. We're not selling ads here, we're selling [indiscernible] system. That in and of itself takes longer than something transactional.

That being the case, if we make the right decisions in hiring, which we hope that we will, there are scenarios where we hire the right people that have industry expertise in mobile, have relationships with retailers or product manufacturers and understand digital marketing that could come into the organization and can be an immediate contributor.

Q: Thank you for that. I guess just the last question I have would be is there anything that I'm missing here that has been backed out or has run its cycle? Do you have any costs rolling off or anything that will improve overall, I guess, drop down in productivity in the income statement? Is there anything in here as a result of maybe—I know that the patent litigation wasn't a cost for you all, but just in general, is there anything here that—you guys have had a lot of transactions, you guys have done a lot, obviously last 12 months, so is there anything year-over-year that we should see will help provide leverage the next three quarters or into the future?

Andrew Levi – Chief Executive Officer
Chris, you want to take a shot at that?

Chris Fameree – Chief Financial Officer
Sure. I think inherently, based on milestones of the company, obviously we have stock-based compensation that you can look at as relatively lumpy, and so I would expect—know that our operating expense improves a little bit in the second quarter, but I think, in general, what we've had is a significant amount of investment in our platform, and, as you know, really our back-end as a software service-type platform.

It's a very scalable platform, and I think we'll see a significant amount of leverage off of our effort going forward as we continue to grow revenue. I think our cost structure is pretty set. We continue to look for ways, obviously, to make sure that we're deploying resources efficiently and effectively. That's my thought on that topic.

Q: Sure, I can appreciate that, and you guys have done well, been active, and it seems like you got things going the right direction, so appreciate it. Look forward to talking to you next quarter. Thank you.

Andrew Levi – Chief Executive Officer
Thanks, Dallas. Appreciate it.

Operator
This concludes time allocated for questions on today's call. I'd now like to turn the call back over to Mr. Andrew Levi for his closing remarks.

Andrew Levi – Chief Executive Officer
Thanks, everyone, for joining us today. We have many dedicated and hardworking people throughout the company, from our financial department that grinds it out every day, to our BC Labs team who keep our solutions constantly evolving. My sincere thanks from all of management to all of you, we could not do without you. Lastly, if we weren't able to address all your questions today on today's call, feel free to contact us or our investor relations firm, MZ Group, who'd be happy to answer them for you. We look forward to speaking with you soon. Operator?

Operator
Before we conclude today's call, I would like to provide Blue Calypso's Safe Harbor Statement that includes important cautions regarding forward-looking statements made during this call. Statements made during today's call that are not statements of historical or current fact constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

Such forward-looking statements involve known and unknown risks, uncertainties, and other unknown factors that could cause actual results of the company to be materially different from historical results or from any future results expressed or implied by such forward-looking statements.

In addition to statements which explicitly describe such risks and uncertainties, readers are urged to consider statements labeled with the terms believes, belief, expects, intends, anticipates, will, or plans to be uncertain and forward looking. The forward-looking statements contained herein are also subject generally to other risks and uncertainties that are described from time to time in the company's reports filed with the Securities and Exchange Commission.

Finally, I would like to remind everyone that a recording of today's call will be available for replay immediately after the call and through June 11, 2016. Please refer to today's press release for dial-in instructions.

Thank you for joining us for today's presentation.