

BLUE CALYPSO, INC.  
Form 10-Q  
November 08, 2013

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

**FORM 10-Q**

(Mark  
One)

x

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

**For the quarterly period ended September 30, 2013**

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: 000-53981**

**BLUE CALYPSO, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
(State or other jurisdiction of incorporation or  
organization)

**20-8610073**  
(I.R.S. Employer Identification No.)

**19111 North Dallas Parkway, Suite 200**

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**Dallas, Texas 75287**

(Address of principal executive offices) (Zip Code)

**(972) 695-4776**

(Registrant's telephone number, including area code)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

(Do not check if a smaller reporting company)

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 November 8, 2013, there were 167,232,688 shares of registrant's common stock outstanding.

**BLUE CALYPSO, INC.**

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**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30,	December 31,
	2013	2012
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 720,085	\$ 218,798
Accounts receivable, net	16,600	43,868
Prepaid expenses	108,025	3,052
Total current assets	844,710	265,718
Property and equipment, net	12,092	16,628
Other assets:		
Capitalized software development costs, net	1,025,612	923,449
Deferred financing costs, net of amortization of \$46,579 as of September 30, 2013	187,921	-
Total assets	\$ 2,070,335	\$ 1,205,795
<b>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b>		
Current liabilities:		
Accounts payable	\$ 167,096	\$ 84,947
Accrued expenses	79,878	209,575
Deferred revenue	-	10,000
Convertible notes payable	-	465,000
Convertible notes payable-affiliate, net of discount of \$244,705 as of December 31, 2012	-	278,186
Conversion option liability	-	109,802
Warrant liabilities	6,343	10,854,204
Total current liabilities	253,317	12,011,714
Convertible notes payable, net of discount of \$334,320 and \$213,500 as of September 30, 2013 and December 31, 2012, respectively	2,665,680	236,500
Total liabilities	2,918,997	12,248,214
Commitments and contingencies		
Stockholders' deficiency:		
Preferred stock, \$0.0001 par value, 5,000,000 shares authorized		
Series A convertible preferred stock, \$0.0001 par value; 1,700,000 shares designated; 750,068 and 1,700,000 shares issued and outstanding as of September 30, 2013 and December 31, 2012,	75	170

respectively

Common stock, \$0.0001 par value; 680,000,000  
 shares authorized, 155,686,534 and 125,135,113  
 shares issued and outstanding as of September 30,  
 2013 and December 31, 2012, respectively

	15,569	12,514
Additional paid in capital	19,992,113	6,552,878
Deficit accumulated during development stage	(20,856,419)	(17,607,981)
Total stockholders' deficiency	(848,662)	(11,042,419)
Total liabilities and stockholders' deficiency	\$ 2,070,335	\$ 1,205,795

The accompanying notes are an integral part of these condensed consolidated financial statements

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	Three months ended September 30,		Nine months ended September 30,		From September 11, 2009 (date of inception)
	2013	2012	2013	2012	Through September 30, 2013
REVENUE	\$ 235,483	\$ 9,547	\$ 250,483	\$ 10,307	\$ 376,694
Cost of revenue	153,989	8,717	160,815	154,233	427,348
Gross profit (loss)	81,494	830	89,668	(143,926)	(50,654)
<b>OPERATING EXPENSES:</b>					
Sales and marketing	192,350	123,604	523,122	787,364	2,041,713
General and administrative	1,346,477	811,283	3,185,185	4,063,904	8,844,169
Depreciation and amortization	81,990	57,170	218,646	168,474	599,257
Total operating expenses	1,620,817	992,057	3,926,953	5,019,742	11,485,139
Loss from operations	(1,539,323)	(991,227)	(3,837,285)	(5,163,668)	(11,535,793)
Other income (expense):					
Change in fair value of derivative liabilities	66,492	149,793	7,626,121	2,141,178	(990,531)
Loss on settlement or modification of debt	-	-	(5,459,582)	-	(5,459,582)
Interest expense	(151,672)	(15,185)	(1,577,692)	(599,694)	(2,870,513)
Total other income (expense)	(85,180)	134,608	588,847	1,541,484	(9,320,626)
NET LOSS	\$ (1,624,503)	\$ (856,619)	\$ (3,248,438)	\$ (3,622,184)	\$(20,856,419)
Net loss per common share, basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.03)	

Weighted average  
common shares  
outstanding, basic and  
diluted

151,019,307

138,431,367

137,142,426

131,461,321

The accompanying notes are an integral part of these condensed consolidated financial statements



**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY**  
**For the nine months ended September 30, 2013**  
**(unaudited)**

	Preferred Stock		Common Stock		Additional Paid in Capital	Accumulated	Total Stockholders' Deficiency
	Shares	Amount	Shares	Amount		Deficit during	
						Development Stage	
Balance-January 1, 2013	1,700,000	\$ 170	125,135,113	\$ 12,514	\$ 6,552,878	\$(17,607,981)	\$(11,042,419)
Return of shares from Founder	-	-	(3,686,634)	(369)	-	-	(369)
Conversion of note payable-Affiliate to equity at \$0.15 per share	-	-	3,686,634	369	552,994	-	553,363
Beneficial conversion feature associated with notes payable	-	-	-	-	493,115	-	493,115
Conversion of preferred shares to common shares at \$0.0679 per share	(949,932)	(95)	13,991,162	1,399	(1,304)	-	-
Return of shares from Founder	-	-	(12,886,346)	(1,289)	-	-	(1,289)
Conversion of notes payable and accrued interest into common stock at \$0.03 per share	-	-	20,000,000	2,000	543,764	-	598,239
Shares issued to third party as debt discount in connection with notes payable at \$0.18 per share	-	-	1,200,000	120	229,571	-	229,691
Shares issued as deferred financing costs in connection with notes payable at \$0.172 per share	-	-	1,000,000	100	171,900	-	172,000
Shares issued for consulting services at \$0.231 per share	-	-	486,401	49	112,451	-	112,500

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Shares issued for consulting services at \$0.155 per share	-	-	192,770	19	29,981	-	30,000
Shares issued for legal services at \$0.15 per share	-	-	115,000	12	17,239	-	17,251
Shares issued to acquire software at \$0.15 per share	-	-	1,000,000	100	149,900	-	150,000
Stock based compensation	-	-	-	-	425,133	-	425,133
Vesting of restricted stock at \$0.40 per share (prior year accrual of \$872,387)	-	-	5,452,434	545	1,308,040	-	1,308,585
Reclassification of derivative liabilities to equity	-	-	-	-	6,384,814	-	6,384,814
Reclassification of warrants as derivative liabilities	-	-	-	-	(2,013,972)	-	(2,013,972)
Loss on debt modification of notes payable	-	-	-	-	5,035,609	-	5,035,609
Net loss	-	-	-	-	-	(3,248,438)	(3,248,438)
Balance-September 30, 2013	750,068	\$ 75	155,686,534	\$ 15,569	\$ 19,992,113	\$(20,856,419)	\$ (848,662)

The accompanying notes are an integral part of these condensed consolidated financial statements

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

	Nine months ended September 30,		From September 11, 2009 (date of inception) Through September 30, 2013
	2013	2012	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net loss	\$(3,248,438)	\$(3,622,184)	\$(20,856,419)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	218,646	168,473	599,257
Amortization of debt discount	388,682	571,184	1,644,251
Amortization of deferred financing costs	46,579	-	46,579
Change in fair value of derivative liabilities	(7,626,121)	(2,141,178)	990,531
Loss on modification of warrants	1,027,371	-	1,027,371
Loss on settlement of notes payable	5,459,582	-	5,459,582
Stock based compensation	1,893,469	3,540,573	4,929,996
Changes in operating assets and liabilities:			
Accounts receivable	27,268	7,532	(16,600)
Prepaid expenses	(104,973)	10,555	(108,025)
Accounts payable	187,692	216,017	708,489
Accounts payable-affiliate	-	(162,005)	21,958
Accrued liabilities	(129,697)	29,859	79,878
Deferred revenue	(10,000)	13,004	-
Net cash used in operating activities	(1,869,940)	(1,368,170)	(5,473,152)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			

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Software development costs	(166,273)	(216,317)	(1,340,697)
Purchase of fixed assets	-	-	(23,781)
Net cash used in investing activities	(166,273)	(216,317)	(1,364,478)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from notes payable	2,600,000	300,000	7,030,172
Proceeds from notes payable, affiliate	-	357,707	
Contributed capital received	-	7,154	
Fees paid to third party in connection with issuance of notes payable	(62,500)	-	(62,500)
Proceeds from sale of preferred stock	-	200,000	200,000
Proceeds from sale of common stock	-	400,022	390,043
Net cash provided by financing activities	2,537,500	1,264,883	7,557,715
Net increase (decrease) in cash and cash equivalents	501,287	(319,604)	720,085
Cash and cash equivalents at beginning of period	218,798	371,393	-
Cash and cash equivalents at end of period	\$ 720,085	\$ 51,789	\$ 720,085
<b>SUPPLEMENTAL INFORMATION</b>			
Cash paid for interest	\$ 63,510	\$ -	\$ 63,510
Cash paid for income taxes	\$ -	\$ -	\$ -
<b>Non-cash investing and financing activities:</b>			
Conversion of notes payable and accounts payable-former affiliate to common stock	\$ 532,892	\$ -	\$ 954,850
Acquisition of technology in exchange for issuance of stock	\$ 150,000	\$ -	\$ 150,000
Former affiliate payable converted to note payable	\$ -	\$ 344,993	\$ 545,958
Conversion of notes payable to common and preferred stock	\$ 515,000	\$ -	\$ 3,284,214

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Conversion of accrued interest on notes payable to common stock	\$ 59,579	\$ -	\$ 59,579
Fair value of warrants issued in connection with preferred, common stock and notes payable	\$ -	\$ 4,766,716	\$ 15,889,449
Fair value of conversion option issued in connection with notes payable	\$ -	\$ -	\$ 787,192
Reclassification of derivative liability to equity	\$ 6,384,814	\$ -	\$ 6,384,814
Reclassification of warrants as derivative liability	\$ 2,013,972	\$ -	\$ 2,013,972
Fair value of warrants issued in settlement of accounts payable	\$ -	\$ -	\$ 45,206
Issuance of stockholder subscription receivable	\$ -	\$ (120,000)	\$ -

The accompanying notes are an integral part of these condensed consolidated financial statements

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**  
**(unaudited)**

**NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

Blue Calypso, Inc. (a development stage company) (the Company) is engaged in the development and monetization of technology and intellectual property focused on digital word-of-mouth marketing and advertising. The Company has developed a patented platform which enables brands to leverage customer and employee relationships in order to increase brand loyalty and drive revenue.

The Company has been presented as a "development stage enterprise. The Company's primary activities since inception, have been the design and development of its products, negotiating strategic alliances and other agreements, and raising capital. The Company has not commenced its principal operations, nor has it generated significant revenues from its operations since inception.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information. Accordingly, they do not include all of the information and disclosures required by GAAP for annual financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the condensed consolidated financial statements of the Company as of September 30, 2013, for the three and nine months ended September 30, 2013 and 2012, and for the period from September 11, 2009 (inception) to September 30, 2013. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the operating results for the full year ending December 31, 2013. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related disclosures of the Company as of December 31, 2012 and for the year then ended, which were filed with the Securities and Exchange Commission on Form 10-K/A on October 9, 2013.

**NOTE 2 GOING CONCERN AND MANAGEMENT'S LIQUIDITY PLANS**

As of September 30, 2013, the Company had cash and cash equivalents of \$720,085 and working capital of \$591,393. During the nine months ended September 30, 2013, the Company used net cash in operating activities of approximately \$1,870,000. The Company has not yet generated any significant revenues, and has incurred net losses since inception. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Subsequent to September 30, 2013, the Company raised approximately \$1,501,000 in cash proceeds from the sale of common stock. See Note 11. The Company believes that its current cash on hand will be sufficient to fund its projected operating requirements through June 2014.

The Company's primary source of operating funds since inception has been cash proceeds from the issuance of common shares and preferred shares to its initial investors, proceeds from the issuance of convertible secured debentures and the sale of common stock and debentures in private placements. The Company intends to raise additional capital through private debt and equity investors, but there can be no assurance that these funds will be available on terms acceptable to the Company, or will be sufficient to enable the Company to fully complete its development activities or sustain operations. If the Company is unable to raise sufficient additional funds, it will have to develop and implement a plan to further extend payables, reduce overhead, or scale back its current business plan until sufficient additional capital is raised to support further operations. There can be no assurance that such a plan will be successful.

Accordingly, the accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern and the realization of assets and satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the financial statements do not necessarily purport to represent realizable or settlement values. The condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(unaudited)**

**NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation*

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Revenue Recognition*

The Company recognizes revenue in accordance with ASC 605 (Accounting Standards Codification) Revenue Recognition when persuasive evidence of an arrangement exists, the fee is fixed or determinable, delivery of the product has occurred or services have been rendered and all obligations have been performed pursuant to the terms of the arrangement and collectability is reasonably assured. Revenue includes fees received from customers for advertising and marketing services provided by us and is recognized as earned when performances of agreed to products, activities and services have been delivered.

Licensing fees are the result of grants of licenses and settlements reached from legal enforcement of the Company's patent rights. Revenue is recognized when the arrangement with the licensee has been signed and the license has been delivered and made effective, provided license fees are fixed or determinable and collectability is reasonably assured. Revenue from settlements reached on legal enforcement of the Company's patent rights and the release of the licensee from certain legal claims, is recognized on receipt of the settlement amounts. The Company does not assume future performance obligations in its license arrangements.



Legal costs incurred in connection with intellectual property and patent enforcement litigation are recognized as cost of revenue. Other legal expenses incurred in the normal course of the Company's business are expensed when incurred as selling, general and administrative expenses.

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the recoverability and useful lives of long-lived assets, the fair value of the Company's stock, stock-based compensation, fair values relating to warrant and other derivative liabilities, debt discounts and the valuation allowance related to deferred tax assets. Actual results may differ from these estimates.

*Reclassifications*

Certain amounts in the prior period condensed consolidated financial statements have been reclassified for comparison purposes to conform to the presentation of the current period condensed consolidated financial statements. These reclassifications had no effect on the previously reported net loss.

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**  
**(unaudited)**

*Net Loss per Share*

The Company computes basic net income (loss) per share by dividing net income (loss) per share available to common stockholders by the weighted average number of common shares outstanding for the period and excludes the effects of any potentially dilutive securities. Diluted earnings per share, if presented, would include the dilution that would occur upon the exercise or conversion of all potentially dilutive securities into common stock using the treasury stock and/or if converted methods as applicable. The computation of basic and diluted loss per share as of September 30, 2013 and 2012 excludes potentially dilutive securities when their inclusion would be anti-dilutive, or if their exercise prices were greater than the average market price of the common stock during the period.

Potentially dilutive securities excluded from the computation of basic and diluted net income (loss) per share are as follows:

	September 30, 2013	September 30, 2012
Convertible notes payable	21,461,538	-
Series A convertible preferred stock	11,045,655	25,036,820
Options to purchase common stock	14,839,073	9,938,210
Warrants to purchase common stock	32,495,753	32,008,518
Restricted stock units	13,456,667	13,456,667
Totals	93,298,686	80,440,215

*Preferred Stock*

Preferred shares subject to mandatory redemption (if any) are classified as liability instruments and are measured at fair value. The Company classifies conditionally redeemable preferred shares, which includes preferred shares that feature redemption rights that are either within the control of the holder or subject to redemption upon the occurrence of uncertain events not solely within the Company's control, as temporary equity. At all other times, the Company classifies its preferred shares in stockholders' deficiency. As of September 30, 2013, the Company does not have any preferred shares subject to mandatory redemption outstanding.

*Convertible Instruments*

GAAP requires companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments according to certain criteria. The criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. An exception to this rule is when the host instrument is deemed to be conventional, as that term is described under applicable GAAP.

When the Company has determined that the embedded conversion options should not be bifurcated from their host instruments, the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their stated date of redemption. The Company also records, when necessary, deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the transaction and the effective conversion price embedded in the preferred shares.

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**  
**(unaudited)**

*Common Stock Warrants and Other Derivative Financial Instruments*

The Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) provide the Company with a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement) providing that such contracts are indexed to the Company's own stock. The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the Company's control) or (ii) gives the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement). The Company assesses classification of its common stock purchase warrants and other free standing derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required.

The Company's free standing derivatives consist of warrants to purchase common stock that were issued in connection with its private placement transactions (see Note 4) and embedded conversion options with convertible notes. The Company evaluated these derivatives to assess their proper classification in the condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012 using the applicable classification criteria enumerated under GAAP. The Company determined that certain common stock purchase warrants and the embedded conversion features do not contain fixed settlement provisions. The exercise price of such warrants is subject to adjustment in the event that the Company subsequently issues equity securities or equity linked securities with exercise prices lower than the exercise price in these warrants. The convertible notes contained a conversion feature such that the Company could not ensure it would have adequate authorized shares to meet all possible conversion demands.

As such, the Company was required to record the warrants and debt derivative which do not have fixed settlement provisions as liabilities and mark to market all such derivatives to fair value at the end of each reporting period.

The Company has adopted a sequencing policy that reclassifies contracts (from equity to assets or liabilities) with the most recent inception date first. Thus any available shares are allocated first to contracts with the most recent inception dates.

*Stock-Based Compensation*

The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, the fair value of the award is measured on the grant date and for non-employees, the fair value of the award is generally re-measured on vesting dates and interim financial reporting dates until the service period is complete. The fair value amount is then recognized over the period during which

services are required to be provided in exchange for the award, usually the vesting period. Stock-based compensation expense is recorded by the Company in the same expense classifications in the condensed consolidated statements of operations, as if such amounts were paid in cash.

#### **NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company measures the fair value of financial assets and liabilities based on the guidance of ASC 820 Fair Value Measurements and Disclosures which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1 quoted prices in active markets for identical assets or liabilities

Level 2 quoted prices for similar assets and liabilities in active markets or inputs that are observable

Level 3 inputs that are unobservable based on an entity's own assumptions, as there is little, if any, related market activity. (for example, cash flow modeling inputs based on assumptions)

**BLUE CALYPSO INC. AND SUBSIDIARIES**  
**(A DEVELOPMENT STAGE COMPANY)**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(unaudited)**

Financial liabilities as of September 30, 2013 and December 31, 2012 measured at fair value on a recurring basis are summarized below:

	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative liabilities	\$ 6,343	\$ --	\$ --	\$ 6,343
	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivative liabilities	\$ 10,964,006	\$ --	\$ --	\$ 10,964,006

The Company determined that the warrants issued in connection with certain financing transactions and certain conversion options related to convertible notes did not have fixed settlement provisions and are deemed to be derivative financial instruments, since the exercise prices were subject to adjustment based on certain subsequent equity issuances. Accordingly, the Company was required to record such warrants and conversion option as liabilities and mark all such derivatives to fair value each reporting period. Such instruments were classified within Level 3 of the valuation hierarchy.

The fair value of the warrants and the conversion options was calculated using a binomial lattice formula with the following weighted average assumptions during the three and nine months ended September 30, 2013:

Dividend Yield	0.00%
Volatility	81.98% to 85.43%
Risk-free Interest Rate	0.10% -1.71%
Term	1.07 3.5 years

The risk-free interest rate is the United States Treasury rate on the measurement date having a term equal to the remaining contractual life of the instrument. The volatility is a measure of the amount by which the Company's share price has fluctuated or is expected to fluctuate. Since the Company's common stock has not been publicly traded for a long period of time, an average of the historical volatility of comparative companies was used. The dividend yield is 0% as the Company has not made any dividend payment and has no plans to pay dividends in the foreseeable future.

Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the derivative liabilities. For fair value measurements categorized within Level 3 of the fair value hierarchy, the Company's Chief Financial Officer, who reports to the Chief Executive Officer, determine its valuation policies and procedures.

The development and determination of the unobservable inputs for Level 3 fair value measurements and fair value calculations are the responsibility of the Company's Chief Financial Officer and are approved by the Chief Executive Officer.

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Level 3 financial liabilities consist of the derivative liabilities for which there is no current market for these securities such that the determination of fair value requires significant judgment or estimation. Changes in fair value measurements categorized within Level 3 of the fair value hierarchy are analyzed each period based on changes in estimates or assumptions and recorded as appropriate.

Significant observable and unobservable inputs include stock price, exercise price, annual risk free rate, term, and expected volatility, and are classified within Level 3 of the valuation hierarchy. An increase or decrease in volatility or interest free rate, in isolation, can significantly increase or decrease the fair value of the derivative liabilities. Changes in the values of the derivative liabilities are recorded as a component of other income (expense) on the Company's condensed consolidated statements of operations.

The following table sets forth a summary of the changes in the fair value of the Company's Level 3 financial liabilities that are measured at fair value on a recurring basis for the nine months ended September 30, 2013:

Balance - Beginning of period	\$ 10,964,006
Aggregate fair value of derivative instruments issued	3,053,272
Transfers out due to the expiration and modification of derivative aspect of financial instrument	(6,384,814)
Change in fair value of derivative liabilities	(7,626,121)
Balance - End of period	\$ 6,343

**NOTE 5 INTANGIBLE ASSETS**



Intangible assets consist of the following:

	September 30,		December 31,
	2013		2012
Capitalized Software Development Costs	\$ 1,592,679	\$	1,276,406
Less: Accumulated amortization	(567,067)		(352,957)
Net capitalized development costs	\$ 1,025,612	\$	923,449

During the nine months ended September 30, 2013, the Company issued 1,000,000 shares of its common stock valued at \$150,000 to acquire software based on the share price on the date of the transaction. The Company recorded the fair value of the shares issued as an intangible asset with an estimated useful life of 5 years.

Amortization expense relating to the capitalized development costs was \$79,906 and \$54,152 for the three months ended September 30, 2013 and 2012, respectively and \$214,110 and \$164,906 for the nine months ended September 30, 2013 and 2012, respectively. Amortization for the next five years is estimated to be as follows:

2013 (remaining)	\$	79,199
2014		319,484
2015		296,299
2016		204,648
2017		92,981
Thereafter		33,001
	\$	1,025,612

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**NOTE 6 NOTES PAYABLE**

*May 6, 2013 Convertible Debentures*

On May 6, 2013, the Company issued a convertible debenture in exchange for cash proceeds of \$2,400,000 (the May 2013 Debenture). The May 2013 Debenture bears interest at a rate of 10% per annum, is due two years from the issuance date and is convertible into shares of the Company's common stock at the option of the holder at a conversion price of \$0.25 per share. In connection with the May 2013 Debenture, the Company granted the note holder an aggregate of 1,200,000 shares of common stock with a grant date fair value of \$254,400. The aggregate grant date fair value of the common stock was applied to the principal amount of the May 2013 Debenture to determine the debt discount. Accordingly, the Company allocated \$229,691 of the proceeds to the relative fair value of the common stock on the grant date and recorded such amount as a debt discount on the date of the transaction.

During the three and nine months ended September 30, 2013, the Company recognized \$28,673 and \$45,624 in amortization of the deferred debt discount relating to the May 2013 Debenture, respectively. In connection with the May 2013 Debenture, the Company incurred fees payable to a third party aggregating \$62,500, and issued an aggregate of 1,000,000 shares with a grant date fair value of \$172,000 to a third-party. Such amounts have been recognized as Deferred Financing Costs on the date of the transaction, and are being amortized over the term of the May 2013 Debenture. During the three and nine months ended September 30, 2013, the Company recognized \$29,232 and \$46,579 in amortization of the deferred financing costs relating to the May 2013 Debenture, respectively.

On September 13, 2013, the Company modified certain terms of the May 2013 Debenture in order to induce the holder to convert the May 2013 Debenture into shares of the Company's common stock as well as to eliminate certain restrictive covenants in the May 2013 Debenture. In exchange, the Company provided for a temporary reduction in the conversion price of the May 2013 Debenture to \$0.13 per share through December 31, 2013, after which the conversion price will revert back to the original conversion price of \$0.25 per share. In accordance with ASC 470-20, the fair value of the consideration will be measured and recognized as an expense on the date that the inducement offer is accepted by the holder.

*April 12, 2012 Senior Secured Convertible Debentures*

From April 2012 through January 2013, the Company issued senior secured convertible debentures (the Secured Convertible Debentures ) in exchange for an aggregate cash proceeds of \$515,000 (\$50,000 of which were received on January 15, 2013). The Secured Convertible Debentures had a stated interest rate of 8% per annum, were due on June 30, 2013 and were originally convertible into shares of the Company s common stock at the option of the holder at a conversion price of market on the trading day immediately preceding the date of conversion.

The Company identified an embedded derivative related to a conversion option in the Secured Convertible Debentures. The accounting treatment of derivative financial instruments requires that the Company record the fair value of the derivative as of the inception date of the Secured Convertible Debentures and to fair value the derivative as of each subsequent reporting date.

At the inception of the Secured Convertible Debentures, the Company determined the aggregate fair value of of the embedded derivatives to be \$122,938.

On April 29, 2013, the Company modified the Secured Convertible Debentures and accrued interest, in the aggregate amount of \$545,958 to a fixed conversion price of \$0.03 per share and a maturity date of June 30, 2013. In connection with the debt modification, the Company recorded a loss on debt modification of \$5,459,582 representing the difference between the fair value of the aggregate shares issuable under the new conversion price and the original conversion terms of the Secured Convertible Debenture.

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During the nine months ended September 30, 2013, the holder of the Secured Convertible Debentures converted the aggregate principal amount of \$515,000 and accrued interest and fees aggregating \$30,764 into 20,000,000 shares of common stock. Concurrently with this transaction, a shareholder cancelled 12,886,346 shares of his common stock and returned them to the Company.

*November 15, 2012 Unit Offering*

On November 15, 2012, the Company commenced a private offering of up to \$3,000,000 of units (the "Units") at a purchase price of \$50,000 per unit pursuant to the securities purchase agreement dated November 15, 2012 (the Purchase Agreement ). Each Unit consists of a 10% Convertible Debenture in the principal amount of \$50,000 (the 10% Debenture ) and 12,500 shares of the Company's common stock. The 10% Debenture bears interest at a rate of 10% per annum, is due two years from the issuance date and is convertible into shares of the Company's common stock at a conversion price of \$0.20 per share. Through December 31, 2012, we issued and sold an aggregate of 9 units totaling \$450,000. The 10% Debentures were determined to have an embedded beneficial conversion feature ( BCF ) under the provisions of ASC 470-20, Debt with Conversion and Other Options based on the issue date market value and the exercise price of \$0.20 per share. In accordance with ASC 470-20, an embedded beneficial conversion feature shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid capital. Accordingly, a discount of \$225,000 was recorded at issuance. During the nine months ended September 30, 2013 an additional \$150,000 of 10% Debentures were issued and a discount of \$16,667 was recorded. Amortization expense of \$29,632 and \$88,896 was recorded during the three and nine months ended September 30, 2013, respectively. The note balance was \$449,748 net of discount of \$150,252 at September 30, 2013.

**NOTE 7 - WARRANT DERIVATIVE LIABILITIES**

The Company issued warrants in conjunction with the issuance of convertible debentures and the sale of Series A Convertible Preferred and Common Stock. These warrants contained certain reset provisions. Therefore, in accordance with ASC 815-40, the Company classified the fair value of the warrant as a liability at the date of issuance. Subsequent to the initial issuance date, the Company is required to adjust the warrant to fair value as an adjustment to current period operations.

On April 19, 2013, the reset provisions of an aggregate of 22,091,310 warrants expired. Accordingly, the fair value at the date of expiration of \$4,027,945 was reclassified from liabilities to equity.

On April 29, 2013, in connection with an amendment to the Secured Convertible Debentures, the Company reinstated the reset provisions of an aggregate of 11,045,655 warrants and extended their term from August 31, 2016 to April 30, 2018. The fair value of the modified warrants of \$3,041,343 was recorded as a liability with \$2,013,972 reclassified from equity (based on original terms) and \$1,027,381 charged to current period interest (based on term modifications). The fair values were determined using the binomial lattice model.

On September 13, 2013, in connection with an amendment to the Secured Convertible Debentures, the Company modified the terms of 11,045,655 warrants as described above, 2,945,508 warrants issued on March 31, 2012 and 6,500,000 warrants issued on April 12, 2012, reducing the exercise prices from \$0.10 per share to \$0.05 per share; and eliminating the embedded reset provisions. Accordingly, the Company determined the change in fair values of \$64,017 to current period expense and reclassified the adjusted liability to equity of \$2,356,870. The fair values were determined using the binomial lattice model.

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**NOTE 8 STOCKHOLDERS DEFICIENCY**

*Common Stock*

During the nine months ended September 30, 2013, 949,932 shares of the Company's Series A Convertible Preferred Stock were converted into an aggregate of 13,991,162 shares of common stock at the stated conversion price of \$0.0679 per share.

During the nine months ended September 30, 2013, the Company issued an aggregate of 794,171 shares of common stock to consultants valued at approximately \$160,000 for services previously rendered.

*Stock Options*

During the nine months ended September 30, 2013, the Company granted options to purchase an aggregate of 4,578,530 shares of common stock to certain employees and directors. These options vest over a 2 to 3 year period, have a term of 10 years, and contain exercise prices between \$0.14 and \$0.24 per share. The options had an aggregate grant fair date value of \$484,186.

During the nine months ended September 30, 2013, the Company granted options to purchase an aggregate of 800,000 shares of common stock to certain consultants. These options vest over a 3 year period, have a term of 10 years, and contain an exercise price of \$0.24 per share. The options had an aggregate grant date fair value of \$84,880.

Option valuation models require the input of highly subjective assumptions. The fair value of stock-based payment awards was estimated using the Black-Scholes option model with a volatility figure derived from an index of

historical stock prices of comparable entities until sufficient data exists to estimate the volatility using the Company's own historical stock prices. Management determined this assumption to be a more accurate indicator of value. The Company accounts for the expected life of options in accordance with the simplified method which enables the use of the simplified method for plain vanilla share options as defined in Staff Accounting Bulletin No. 107. The risk-free interest rate was determined from the implied yields of U.S. Treasury zero-coupon bonds with a remaining life consistent with the expected term of the options. The fair value of stock-based payment awards during the three and nine months ended September 30, 2013 was estimated using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	0.64%-1.39%
Dividend yield	0%
Stock price volatility	75%-87%
Expected life	2 years

In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. In estimating the Company's forfeiture rate, the Company analyzed its historical forfeiture rate, the remaining lives of unvested options, and the number of vested options as a percentage of total options outstanding. If the Company's actual forfeiture rate is materially different from its estimate, or if the Company reevaluates the forfeiture rate in the future, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period. The Company estimated forfeitures related to option grants at a weighted average annual rate of 0% per year, as the Company does not yet have adequate historical data, for options granted during the three and nine months ended September 30, 2013 and 2012, respectively.

The stock-based compensation expense related to option grants was \$312,666 and \$13,872 during the three months ended September 30, 2013 and 2012, respectively and \$390,894 and \$2,958,980 during the nine months ended September 30, 2013 and 2012.

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The following table summarizes the stock option activity for the nine months ended September 30, 2013:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding, January 1, 2013	9,460,543	\$0.25		
Granted	5,378,530	\$0.24		
Outstanding, September 30, 2013	14,839,073	\$0.24	8.9 \$	532,634
Exercisable, September 30, 2013	8,474,992	\$0.22	8.5 \$	490,791

As of September 30, 2013, stock-based compensation of \$614,557 remains unamortized and is expected to be amortized over the weighted average remaining period of 2.5 years.

*Restricted Stock*

The following table summarizes the restricted stock activity for the nine months ended September 30, 2013:

Restricted shares issued as of December 31, 2012	13,456,667
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Granted during nine months ended September 30, 2013	-
Forfeited during nine months ended September 30, 2013	-
Total Restricted Shares Issued at September 30, 2013	13,456,667
Vested at September 30, 2013	(5,693,052)
Unvested restricted shares as of September 30, 2013	7,763,615

Stock based compensation expense related to restricted stock grants was \$470,436 and \$436,194 for the three months ended September 30, 2013 and 2012, respectively; and \$1,342,824 and \$581,593 the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, the stock-based compensation relating to restricted stock of \$2,912,245 remains unamortized and is expected to be amortized over the remaining period of approximately 2 years.

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**NOTE 9 RELATED PARTY TRANSACTIONS**

Aztec Systems, Inc. ( Aztec ) was an affiliate of the Company that provided administrative and technical support services to the Company. The majority owner of Aztec was also the majority stockholder of the Company until the sale of Aztec on June 15, 2012. During the nine months ended September 30, 2013, Aztec converted convertible debentures aggregating \$522,891 and accrued interest aggregating approximately \$30,000 into 3,686,634 shares of common stock. Concurrently with this issuance a shareholder cancelled 3,686,634 shares of his common stock and returned them to the Company. During the nine months ended September 30, 2013, the Company recorded amortization of the debt discount relating to this note aggregating approximately \$254,162.

**NOTE 10 COMMITMENTS AND CONTINGENCIES**

In the normal course of business the Company may be involved in legal proceedings, claims and assessments arising in the ordinary course of business. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Legal fees for such matters are expensed as incurred and we accrue for adverse outcomes as they become probable and estimable.

On October 17, 2012, the Company filed patent infringement complaints against YELP, Inc. (Case No. 6:12-cv-00788) and IZEA, Inc. (Case No.6:12-cv-00786) The suits allege infringement of two of the Company's patents, Nos. 7,664,516 and 8,155,679. The complaints were filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On August 2, 2013, YELP, Inc. filed a counterclaim for declaratory judgment of noninfringement, invalidity, and unenforceability for all asserted patents. The cases are presently in the early stages of discovery.

**NOTE 11 SUBSEQUENT EVENTS**

Management has evaluated subsequent events or transactions occurring through the date on which the condensed consolidated financial statements were issued.

Subsequent to September 30, 2013, the Company entered into securities purchase agreements with certain investors and sold an aggregate of 11,546,154 shares of common stock at a purchase price of \$0.13 per share in consideration of gross proceeds of \$1,501,000.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

### Cautionary Statement Regarding Forward-Looking Statements

This report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical facts included or incorporated by reference in this quarterly report on Form 10-Q, including without limitation, statements regarding our future financial position, business strategy, budgets, projected revenues, projected costs and plans and objective of management for future operations, are forward-looking statements. In addition, forward-looking statements generally can be identified by the use of forward-looking terminology such as "may," "will," "expects," "intends," "plans," "projects," "estimates," "anticipates," or "believes" or the negative thereof or any variation thereon or similar terminology or expressions.

We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are not guarantees and are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially from our expectations include, but are not limited to:

- our ability to raise additional capital;
- the absence of any operating history or revenue;
- our ability to attract and retain qualified personnel;
- market acceptance of our platform;
- our limited experience in a relatively new industry;
- regulatory and competitive developments;
- intense competition with larger companies;
- general economic conditions
- failure to adequately protect our intellectual property;
- technological obsolescence of our products and services;
- technical problems with our products and services;
- loss or retirement of key executives, and
- other factors set forth under the caption "Risk Factors" in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012 filed with the Securities and Exchange Commission.

All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the foregoing. Except as required by law, we assume no duty to update or revise our forward-looking statements.

## **Business Overview**

We are engaged in the innovation, development and monetization of technology and intellectual property focused on digital word-of-mouth marketing and advertising. We have developed a patented platform which enables brands to leverage customer and employee relationships in order to increase brand loyalty and drive revenue. Our intellectual property portfolio consists of five patents and four pending patent applications that cover methods and systems for communicating advertisements and electronic offers between communication devices, including mobile and desktop devices.

We have developed a proprietary technology platform that facilitates the delivery of advertising campaigns, content and promotions across social media channels using multiple device types. Our technology facilitates the connection of brands to consumers and matches them using attributes such as geo-location or demographic profile. Our platform tracks performance, monitors engagement and deploys robust analytics that deliver acute insight regarding the return on investment of our client's promotions. Our technology is designed to help clients spread their marketing messages, acquire new customers, increase awareness and drive product sales. Campaigns facilitated through our platform can encourage consumers to learn more about our client's products and watch promotional videos about particular products. Our platform can also assist in increasing likes on Facebook, followers on Twitter encouraging consumers to join our client's email lists. All of this is accomplished by encouraging advocates of a company to interact and personalize messages to people that they think would like to hear about a particular brand or product. Our clients are able to thank advocates for sharing, including offering incentives, coupons and other perks to advocates who share. Our technology platform creates multiple opportunities for companies to interact with their most vocal brand advocates and reward them for their loyalty.

## **Recent Developments**

### *General*

On May 6, 2013, we entered into a securities purchase agreement with an accredited investor pursuant to which we issued and sold a 10% Convertible Debenture (the "May 2013 Debenture") in the principal amount of \$2,400,000 and 1,200,000 shares of our common stock in consideration of gross proceeds of \$2,400,000. The Debenture bears interest at a rate of 10% per annum, is due two years from the issuance date and is convertible into shares of our common stock at a conversion price of \$0.25 per share. On September 13, 2013, we entered into a series of agreements with the holder of the May 2013 Debenture and certain of our outstanding warrants. Pursuant to such agreements, we agreed to provide for a temporary reduction in the conversion price of the May 2013 Debenture from \$0.25 to \$0.13 per share through December 31, 2013 and the holder agreed to the elimination of certain restrictive covenants in the May 2013 Debenture. In addition, we agreed to amend the terms of certain of our outstanding warrants in order to induce the holder to exercise such warrants as well as to eliminate the cashless exercise feature and certain anti-dilution protections contained in such warrants. In exchange, we agreed to provide for a temporary reduction in the exercise

price of such warrants from \$0.10 to \$0.05 through the later of December 31, 2013 or 45 days after a registration statement covering the underlying shares is declared effective by the Securities and Exchange Commission.

On October 7, 2013, we entered into a securities purchase agreement with an accredited investor pursuant to which we issued and sold 7,700,000 shares of our common stock at a purchase price of \$0.13 per share in consideration of gross proceeds of \$1,001,000. On October 15, 2013, we entered into a securities purchase agreement with an accredited investor pursuant to which we issued and sold 3,846,154 shares of our common stock at a purchase price of \$0.13 per share in consideration of gross proceeds of \$500,000.

### *Litigation*

We initiated litigation in the United States District Court, Eastern District of Texas, against Groupon, Inc., Living Social, Inc., YELP, Inc., IZEA, Inc., MyLikes Inc., and Foursquare Labs, Inc. for patent infringement of two of our patents (U.S. Patent Nos. 7,664,516 and 8,155,679), which cover peer-to-peer advertising. We subsequently amended our complaints to add claims of infringement on our three other patents (U.S. Patent Nos. 8,438,055, 8,452,646, and 8,457,670). A summary of each of the cases is set forth below. With the payment of all maintenance fees, all of our patents will expire on December 27, 2024.

On July 31, 2012, we filed a patent infringement complaint against Groupon, Inc. (*Case No. 6:2012-cv-00486*) alleging infringement of two of our patents, 7,664,516 and 8,155,679, focused on our peer-to-peer marketing technology. The complaint was filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by Groupon of three additional patents, U.S. Patent 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 as a result of the three additional patents being added to the case. The case is presently in the early stages of discovery.

On August 24, 2012, we filed a patent infringement complaint against Living Social, Inc. (*Case No. 2:2012-cv-00518*) alleging infringement of two of our patents, U.S. Patent 7,664,516 and U.S. Patent 8,155,679. The complaint was filed in the U.S. District Court in the Eastern District of Texas, Marshall Division. In March 2013, the Court issued a Scheduling Order setting the Markman hearing date for August 27, 2013 and trial for August 7, 2014. On June 14, 2013, we amended our complaint and added claims for infringement by LivingSocial of three additional patents, U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent 8,457,670. Living Social had until August 19, 2013 to file an amended answer, affirmative defenses and any counterclaims related to the amended complaint. We provided our preliminary infringement contentions for all five asserted patents on June 25, 2013. The parties were to file proposals for a case schedule on or before August 29, 2013. As a result of the addition of the additional patents to the case, the Markman hearing was extended until February 11, 2014 as to all patents. On August 16, 2013, we dismissed our patent infringement action against Living Social pursuant to the terms of an otherwise confidential settlement and license agreement.





On October 17, 2012, we filed patent infringement complaints against YELP, Inc. (*Case No. 6:2012-cv-00788*) and IZEA, Inc. (*Case No. 6:2012-cv-00786*) The suits allege infringement of two of our patents, 7,664,516 and 8,155,679. The complaints were filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by Yelp and IZEA of three additional patents, U.S Patent 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 due to the addition of the three new patents to the case. The cases are presently in the early stages of discovery.

On November 6, 2012, we filed patent infringement complaints against MyLikes (*Case No. 6:2012-cv-00838*) and Foursquare (*Case No. 6:2012-cv-00837*). The suits allege infringement of two of our patents, 7,664,516 and 8,155,679. The complaints were filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by MyLikes and Foursquare of three additional patents, U.S Patent 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 due to the addition of the three new patents to the case. In an ancillary action, Foursquare filed a declaratory judgment action against us in the Southern District of New York that alleged that U.S Patent 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent 8,457,670 were not infringed and were invalid. That case was transferred to the Eastern District of Texas on August 2, 2013. On July 23, 2013, we entered into a settlement agreement and license agreement with MyLikes to resolve the case. MyLikes agreed to pay us the equivalent of a 3.5% royalty for the use of our patents. The case against MyLikes was subsequently dismissed on July 31, 2013. The case against Foursquare is presently in the early stages of discovery.

The court dockets for each case, including the parties' briefs are publicly available on the Public Access to Court Electronic Records website, or PACER, [www.pacer.gov](http://www.pacer.gov), which is operated by the Administrative Office of the U.S. Courts.

#### Critical Accounting Policies

#### *Development Stage Company*

We are a development stage company as defined by Accounting Standards Codification (ASC) 915, Development Stage Entities and are still devoting substantial efforts to establishing our business. Our principal operations have commenced but there has been no significant revenue thus far. All losses accumulated since inception have been considered part of our development stage activities.

#### *Revenue Recognition*

The Company recognizes revenue in accordance with ASC 605 (Accounting Standards Codification) Revenue Recognition when persuasive evidence of an arrangement exists, the fee is fixed or determinable, delivery of the product has occurred or services have been rendered and all obligations have been performed pursuant to the terms of the arrangement and collectability is reasonably assured. Revenue includes fees received from customers for advertising and marketing services provided by us and is recognized as earned when performances of agreed to products, activities and services have been delivered.

Licensing fees are the result of grants of licenses and settlements reached from legal enforcement of the Company's patent rights. Revenue is recognized when the arrangement with the licensee has been signed and the license has been delivered and made effective, provided license fees are fixed or determinable and collectability is reasonably assured. Revenue from settlements reached on legal enforcement of the Company's patent rights and the release of the licensee from certain legal claims, is recognized on receipt of the settlement amounts. The Company does not assume future performance obligations in its license arrangements.

Legal costs incurred in connection with intellectual property and patent enforcement litigation are recognized as cost of revenue. Other legal expenses incurred in the normal course of the Company's business are expensed when incurred as selling, general and administrative expenses.

### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the recoverability and useful lives of long-lived assets, the fair value of the Company's stock, stock-based compensation, fair values relating to warrant and other derivative liabilities, debt discounts and the valuation allowance related to deferred tax assets. Actual results may differ from these estimates.

### *Intangible Assets*

Software development costs are accounted for in accordance with ASC 350-40, *Intangibles – Goodwill and Other: Internal Use Software*. According to ASC 350-40, capitalization of costs related to a computer software project should begin when both of the following occur: (a) the preliminary project stage is complete; and (b) management, with relevant authority, implicitly or explicitly authorizes and commits to funding the project and it is probable that the project will be completed and the software will be used to perform the function intended. The costs capitalized include: fees paid to third parties for services provided to develop the software during the application development stage; payroll and payroll-related costs, such as costs of employee benefits for employees who are directly associated with and who devote time to the software project on activities that include coding and testing during the application development stage; and interest costs incurred while developing the software (in accordance with ASC 835-20). The costs are amortized using straight-line amortization over the estimated useful life of up to five years, once the software is ready for its intended use. The unamortized capitalized cost of the software is compared annually to the net realizable value. The amount by which the unamortized capitalized costs of the internal use software exceed the net realizable value of that asset is written off.

### *Fair Value Measurements*

We have adopted ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability.

*Stock-Based Compensation*

We measure the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, the fair value of the award is measured on the grant date and for non-employees, the fair value of the award is generally re-measured on vesting dates and interim financial reporting dates until the service period is complete. The fair value amount is then recognized over the period during which services are required to be provided in exchange for the award, usually the vesting period. Stock-based compensation expense is recorded by the Company in the same expense classifications in the condensed consolidated statements of operations, as if such amounts were paid in cash.

*Comparison of Three Months Ended September 30, 2013 and 2012*

*Results of Operations*

*Net Loss.* For the three months ended September 30, 2013, we had a net loss of \$1,624,503, as compared to a net loss of \$856,619 for the three months ended September 30, 2012. The increase in net loss resulted primarily from: increased stock based compensation in the current quarter aggregating \$333,056 and increased professional fees of approximately \$90,000 associated with the restatement of the financial statements and legal and investor relations fees. Additionally the Company incurred increased professional fees for investment banking, investment relations and legal fees of approximately \$125,000. Finally, the Company had increased salary expense related to increased staffing costs, specifically the addition of a new COO and CTO totaling approximately \$90,000.

*Revenue.* Revenue for the three months ended September 30, 2013 was \$235,483, as compared to \$9,547 in revenues for the same period in 2012. The current quarter reflects revenue from licensing settlements in addition to product sales. We are a development stage company and have had modest revenue to date.

*Cost of Revenue.* Our cost of revenue was \$153,989 for the three months ended September 30, 2013, as compared to \$8,717 for the same period in 2012. Cost of revenue for the three months ended September 30, 2012 was primarily comprised of payments to endorsers for promoting advertiser content. In the current quarter cost of revenue includes the costs of services including legal costs associated with licensing fees and settlements generate in the quarter totaling \$128,542.

*Sales and Marketing.* For the three months ended September 30, 2013, sales and marketing expenses increased by \$68,746 to \$192,350 as compared to the same period in 2012. Sales and marketing expenses were lower in the later part of 2012 and into 2013 but have increased to early 2012 levels. Sales and marketing included the compensation and benefit expense of the five sales and marketing staff members as well as travel, entertainment and advertising expense directly attributable to the sales and marketing function.

*General and Administrative.* For the three months ended September 30, 2013, general and administrative expenses were \$1,346,577 as compared to \$811,283 for the three months ended September 30, 2012. This was primarily associated with stock compensation associated with certain vested stock incentives aggregating \$333,056 during the three months ended September 30, 2013 and increased professional fees associated with the restatement of the financial statements and legal and investor relations fees.

*Depreciation and Amortization.* Depreciation and amortization expenses relate primarily to the amortization of capitalized software development. Depreciation and amortization expenses were \$81,990 for the three months ended September 30, 2013 as compared to \$57,170 for the three months ended September 30, 2012, representing an increase of \$24,820 which was due primarily to increased investment in software development of our systems platform.

For the three months ended September 30, 2013, we incurred \$60,133 of software development costs that were capitalized as they were associated with improvements to our commercial platform. In addition, we acquired software through the issuance of 1,000,000 of our common stock with a fair value of \$150,000. This compares to \$24,175 of capitalized software development costs for the quarter ended September 30, 2012, as we had reduced our development efforts for the period to conserve cash reserves. In the quarter ended September 30, 2012, our development activities were outsourced to Aztec Systems, Inc., a company that was majority owned by Mr. Levi, our chief technology officer and a member of our board of directors prior to its sale in the second quarter of 2012.

*Change in fair value of derivative liabilities.* We issued warrants and convertible debt that contain certain reset provisions in connection with financing and debt settlements. As such, we are required to record these reset provisions as a liability and mark them to market each reporting period. For the three months ended September 30, 2013, we recorded a gain of \$66,492 in change in the fair value of these reset provisions versus a gain for the three months ended September 30, 2012 of \$149,793.

*Interest Expense.* Interest expense was \$151,672 for the three months ended September 30, 2013 as compared to \$15,185 for the three months ended September 30, 2012. The primary increase in interest cost was related to 1) our non-cash amortization of our debt discounts associated to our convertible debentures in 2013 and 2) \$75,000 of interest expense related to our aggregate \$3.0 million in outstanding notes payable at 10%.

*Comparison of Nine Months Ended September 30, 2013 and 2012*

*Results of Operations*

*Net Loss.* For the nine months ended September 30, 2013, we had net loss of \$3,248,438 as compared to a net loss of \$3,622,184 in the nine months ended September 30, 2012. The largest components of net loss were a gain attributed to the fair value of our derivative liabilities of \$7,626,121 offset by the loss on the settlement of debt and warrant modification of \$5,459,582, and a one-time interest cost on the warrant term modification of \$1,027,381 charged to current period interest. Also the Company had lower general and administrative expenses of \$878,719 primarily related to lower stock incentive expenses in the current year.

*Revenue.* Revenue for the nine months ended September 30, 2013 was \$250,483, as compared to \$10,307 in revenues for the same period in 2012. Revenue was realized from sales of services and license fees during this period. We are a development stage company and have had modest revenue to date.

*Cost of Revenue.* Our cost of revenue was \$160,815 for the nine months ended September 30, 2013, as compared to \$154,233 for the same period in 2012. Cost of revenue for the nine months ended September 30, 2012 was primarily comprised of payments to endorsers for promoting advertiser content. The current period includes costs of revenue including legal fees associated with license /settlement and services revenue totaling \$128,542. The prior year cost of revenue includes costs associated with an endorser fee model that we have not incurred such costs in the current year.

*Sales and Marketing.* For the nine months ended September 30, 2013, sales and marketing expenses decreased by \$264,242 to \$523,122 as compared to the same period in 2012. Sales and marketing expense includes the compensation and benefit expense of the five sales and marketing staff members as well as travel, entertainment and advertising expense directly attributable to the sales and marketing function. During the prior year, we incurred higher stock option expense of \$233,237.

*General and Administrative.* For the nine months ended September 30, 2013, general and administrative expenses decreased by \$878,719 to \$3,185,185 as compared to the nine months ended September 30, 2012. The decrease was primarily related to a net decrease in stock incentive costs. The prior year included \$1.7 million in stock option expense associated with the hiring of our new CEO at the time. In the current year we have incurred a \$0.7 million increase in restricted stock expense in comparison to the prior year. This represents a decrease of \$1.0 million. This is offset by increased professional fees associated with the recent restatement of our financial reports

aggregating \$90,000.

*Depreciation and Amortization.* Depreciation and amortization expenses relate primarily to the amortization of capitalized software development. Depreciation and amortization expenses were \$218,646 for the nine months ended September 30, 2013 as compared to \$168,474 for the nine months ended September 30, 2012, representing an increase of \$50,172 which was due primarily to an increase due to additional capitalized software during the period.

*Change in fair value of derivative liabilities.* We issued warrants and convertible notes that contain certain reset provisions in connection with financing and debt settlements. As such, we are required to record these reset provisions as a liability and mark them to market each reporting period. For the nine months ended September 30, 2013, we recorded a gain of \$7,626,121 in change in the fair value of these reset provisions versus a gain for the nine months ended September 30, 2012 of \$2,141,178.

*Loss on settlement of debt* During the nine months ended September 30, 2013, we modified the terms of convertible debentures aggregating \$2,915,000 and accrued interest of \$30,948. In connection with the modification, the Company incurred a loss on settlement of debt of \$5,459,582 during the nine months ended September 30, 2013.

*Interest Expense.* Interest expense was \$1,577,692 for the nine months ended September 30, 2013 as compared to \$599,694 for the nine months ended September 30, 2012. The primary increase in interest cost was from a one-time interest cost on warrant term modification of \$1,027,381 charged to current period interest. In addition, the increase in interest expense was also attributable to the issuance of a 10% Convertible Debenture in the principal amount of \$2,400,000 on May 6, 2013, the issuance of 8% Senior Secured Convertible Debentures in the aggregate principal amount of \$600,000 between April 19, 2012 and February 4, 2013, and the issuance of 10% Convertible Debentures in the aggregate principal amount of \$600,000 between November 15, 2012 and March 27, 2013.

#### Cash Flows

Net cash used in operating activities during the nine months ended September 30, 2013 was \$1,869,940 as compared to \$1,368,170 for the nine months ended September 30, 2012. Cash used in operations for the nine months ended September 30, 2013 were comprised of: a net loss of \$3,248,438 offset by non-cash changes in the fair value of our warrant liabilities of \$(7,626,121); a one-time interest cost on warrant term modifications of \$1,027,371; a loss on the modification of the convertible debentures of \$5,459,582 and stock based compensation expense of \$1,893,469.





Net cash used in investing activities during the nine months ended September 30, 2013 was \$166,273, as compared to \$216,317 for the nine months ended September 30, 2012. This decrease was attributable to reduced expenditures on the development of our software platform related to a more cost effective operating model.

Net cash provided by financing activities during the nine months ended September 30, 2013 was \$2,537,500, as compared to \$1,264,883 for the same period in 2012. During the nine months ended September 30, 2013, net cash of \$2,537,500 was provided from issuance of convertible debentures.

*Off Balance Sheet Arrangements*

None

*Liquidity and Capital Resources*

The Company has not yet generated any significant revenues, and has incurred net losses since inception. As of September 30, 2013, the Company had cash and cash equivalents of \$720,085 and working capital of \$591,393. During the nine months ended September 30, 2013, the Company used net cash in operating activities of approximately \$1,869,940. The Company believes that its current cash on hand will be sufficient to fund its projected operating requirements through December 2013. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Company's primary source of operating funds since inception has been cash proceeds from the issuance of common shares and preferred shares to its initial investors, proceeds from the issuance of convertible secured debentures, the sale of common stock and debentures in private placements and the issuance of common stock as payment of fees for services from third parties. The Company intends to raise additional capital through private debt and equity investors, but there can be no assurance that these funds will be available on terms acceptable to the Company, or will be sufficient to enable the Company to fully complete its development activities or sustain operations. If the Company is unable to raise sufficient additional funds, it will have to develop and implement a plan to further extend payables, reduce overhead, or scale back its current business plan until sufficient additional capital is raised to support further operations. There can be no assurance that such a plan will be successful.

Accordingly, the accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern and the realization of assets and satisfaction of liabilities in the normal course of

business. The carrying amounts of assets and liabilities presented in the financial statements do not necessarily purport to represent realizable or settlement values. The condensed consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

On April 29, 2013, we entered into a series of agreements with the holder of our 8% Senior Secured Convertible Debentures (the 8% Debentures). The Debentures were due on November 30, 2012. As of April 29, 2013, the aggregate amount outstanding under the Debentures, including all accrued and unpaid interest and fees, was \$600,000. Pursuant to Amendment No. 1 to the 8% Debentures, the conversion price of the Debentures was amended such that the aggregate amount outstanding under the Debentures was convertible into an aggregate of 20,000,000 shares of our common stock. The issuance of the shares of common stock underlying our 8% Debentures did not result in any dilution to our existing stockholders as our Founder and Chief Technology Officer, Andrew Levi, committed 20,000,000 shares of common stock currently held by him in connection with this transaction. The holder of our 8% Debentures also agreed to immediately terminate the Security Agreement dated April 19, 2012 by and between us, our subsidiaries and the holder, the Intellectual Property Security Agreement dated April 19, 2012 by and between us, our subsidiaries and the holder, and the Subsidiary Guarantee executed by us, our subsidiary, Blue Calypso, LLC, and all of the security interests created thereby. The maturity dates of the 8% Debentures were extended to June 30, 2013. As of the date of this report, the holder of the 8% Debentures has converted the full principal amount of the 8% Debentures into an aggregate of 20,000,000 shares of our common stock. Of the shares held in the Andrew Levi stock escrow, 2,231,221 remain in the escrow at the balance sheet date.

In connection with the Amendment to 8% Debentures, we also agreed to amend the terms of certain warrants currently held by the holder of the 8% Debentures. We also agreed to extend the maturity date of the warrants originally issued to the holder of the 8% Debentures in September 2011 to April 30, 2018 and to extend the anti-dilution protection of such warrants for the life of the warrants. We also agreed to extend the maturity date of the warrants originally issued to the holder of the 8% Debentures in April 2012 to April 30, 2018 and to extend the anti-dilution protection of such warrants for the life of the warrants.

On May 6, 2013, we entered into a Securities Purchase Agreement with an accredited investor pursuant to which we issued and sold a 10% Convertible Debenture in the principal amount of \$2,400,000 (the May 2013 Debenture ) and 1,200,000 shares of common stock in consideration of gross proceeds to the Company of \$2,400,000. The May 2013 Debenture bears interest at a rate of 10% per annum, is due two years from the issuance date and is convertible into shares of our common stock at a conversion price of \$0.25 per share.

On September 13, 2013, the Company modified certain terms of the May 2013 Debenture in order to induce the Holder to convert the May 2013 Debenture into shares of the Company's common stock as well as to eliminate certain restrictive covenants in the May 2013 Debenture. In exchange, the Company will provide for a temporary reduction in the conversion price of the May 2013 Debenture to \$0.13 per share through December 31, 2013, after which the conversion price will revert back to the original conversion price of \$0.25 per share.

On September 13, 2013, in connection with an amendment to the May 2013 Debenture, the Company modified the terms of 11,045,655 warrants as described above, 2,945,508 warrants issued on March 31, 2012 and 6,500,000 warrants issued on April 12, 2012, reducing the exercise prices from \$0.10 per share to \$0.05 per share; and eliminating the embedded reset provisions.

As a development stage company, we have been and continue to be dependent upon outside sources of cash to pay operating expenses. We have had only nominal revenue and we expect operating losses to continue through the foreseeable future. Until we develop a consistent source of revenue to achieve a profitable level of operations that generates sufficient cash flow, we will need additional capital resources to fund growth and operations. We are continuing our efforts to raise capital through equity and/or debt offerings. However, there can be no assurance that we will be able to raise equity or debt capital on terms we consider reasonable and prudent, or at all. The availability of capital to us may be subject to the volatility in the financial markets, our future financial condition and credit rating, and whether sufficient assets are available to be used as debt collateral in connection with any future debt financing, among other factors. Future financings through equity investments are likely to be dilutive to the existing stockholders. Also, the terms of securities we issue in future capital transactions may be more favorable for our new investors. Newly issued securities may include preferences, superior voting rights, and the issuance of warrants or other derivative securities, which may have additional dilutive effects. Further, we may incur substantial costs in pursuing future capital and/or financing, including investment banking fees, legal fees, accounting fees, securities law compliance fees, printing and distribution expenses and other costs. We may also be required to recognize non-cash expenses in connection with certain securities we may issue, such as convertible notes and warrants, which may adversely impact our financial condition.

### **ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not required under Regulation S-K for smaller reporting companies.

**ITEM 4 - CONTROLS AND PROCEDURES.**

Evaluation of Disclosure Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the Exchange Act )) as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report, that our disclosure controls and procedures were not effective.

As of December 31, 2012, we had identified certain matters that constituted a material weakness in our internal controls over financial reporting that continued to exist as of September 30, 2013. Specifically, we have limited segregation of duties within our accounting and financial reporting functions. Segregation of duties within our company is limited due to the small number of employees that are assigned to positions that involve the processing of financial information.

In addition, prior to the engagement of an outside financial reporting consultant in August 2013, we lacked adequately trained accounting personnel with appropriate expertise in complex transactions under United States generally accepted accounting principles. While we believe that the addition of a consultant with such experience has assisted us in mitigating this weakness as of September 30, 2013, we need to perform a full evaluation of our disclosure controls and procedures before we deem the weakness to be fully remediated. Management is currently in the process of determining how to implement a more effective system to insure that information required to be disclosed in the Company's periodic reports has been recorded, processed, summarized and reported accurately. Our management acknowledges the existence of this problem, and intends to develop procedures to address them to the extent possible given limitations in manpower resources. While management is working on a plan, no assurance can be made at this point that the implementation of such controls and procedures will be completed in a timely manner or that they will be adequate once implemented.



*Restatement of Previously Issued Financial Statements.* On August 27, 2013, after consulting with the Company's Audit Committee and with the Company's newly appointed Independent Registered Public Accounting Firm, Marcum LLP, management changed its accounting for certain of the Company's warrants and conversion features related to previously issued convertible notes and preferred stock which were recorded in periods prior to the engagement of Marcum LLP in order to comply with US GAAP. Such warrants and the embedded conversion options should have been reflected as liabilities on the consolidated balance sheets included in the Company's previously filed Annual Report on Form 10-K for the year ended December 31, 2012 (the "Annual Report") and the Quarterly Reports on Form 10-Q for the periods ended March 31, 2012, June 30, 2012, September 30, 2012 and March 31, 2013 (the "Quarterly Reports"), rather than as a component of equity. In addition, the Company determined that the Company had not properly accreted compensation expense for certain restricted stock grants in 2012.

*Remediation plan.* Since the determination regarding this deficiency, we have devoted significant effort and resources to remediation and improvement of our internal control over financial reporting. While we had processes in place to identify and apply developments in accounting standards, we enhanced these processes to better evaluate our research of the nuances of complex accounting standards and engaged a third party financial reporting and consulting firm to assist the Company in its financial reporting compliance. Our enhancements included retaining a third party consultant, who is a technical accounting professional, to assist us in the interpretation and application of new and complex accounting guidance. The firm has been engaged to assist in the analysis of complex financial instruments. Management will continue to review and make necessary changes to the overall design of our internal control environment.

(b) *Changes in internal control over financial reporting.* There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2013, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting, other than the hiring of the third party financial reporting and consulting firm discussed above.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

We initiated litigation in the United States District Court, Eastern District of Texas, against Groupon, Inc., Living Social, Inc., YELP, Inc., IZEA, Inc., MyLikes Inc., and Foursquare Labs, Inc. for patent infringement of two of our patents (U.S. Patent Nos. 7,664,516 and 8,155,679), which cover peer-to-peer advertising. We subsequently amended our complaints to add claims of infringement on our three other patents (U.S. Patent Nos. 8,438,055, 8,452,646, and 8,457,670). A summary of each of the cases is set forth below. With the payment of all maintenance fees, all of our patents will expire on December 14, 2026.

On July 31, 2012, we filed a patent infringement complaint against Groupon, Inc. (*Case No. 6:12-cv-00486*) alleging infringement of two of our patents, Nos. 7,664,516 and 8,155,679, focused on our peer-to-peer marketing technology. The complaint was filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling and Discovery Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by Groupon of three additional patents, U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent No. 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 as a result of the three additional patents being added to the case. On August 2, 2013, Groupon, Inc. filed a counterclaim for declaratory judgment of noninfringement and invalidity for all asserted patents. The case is presently in the early stages of discovery.

On August 24, 2012, we filed a patent infringement complaint against Living Social, Inc. (*Case No. 2:12-cv-00518*) alleging infringement of two of our patents, U.S. Patent No. 7,664,516 and U.S. Patent No. 8,155,679. The complaint was filed in the U.S. District Court in the Eastern District of Texas, Marshall Division. In January 2013, the Court issued a Docket Control Order setting the Markman hearing date for August 1, 2013 and trial for April 7, 2014. On June 14, 2013, we amended our complaint and added claims for infringement by LivingSocial of three additional patents, U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent No. 8,457,670. Living Social had until August 19, 2013 to file an amended answer, affirmative defenses and any counterclaims related to the amended complaint. We provided our preliminary infringement contentions for U.S. Patent Nos. 7,664,516 and 8,155,679 on June 25, 2013. The parties are to file proposals for a case schedule on or before August 29, 2013. As a result of the addition of the additional patents to the case, the Markman hearing was extended until February 11, 2014 as to all patents. On August 16, 2013, we dismissed our patent infringement action against Living Social pursuant to the terms of an otherwise confidential settlement and license agreement.



On October 17, 2012, we filed patent infringement complaints against YELP, Inc. (*Case No. 6:12-cv-00788*) and IZEA, Inc. (*Case No. 6:12-cv-00786*). The suits allege infringement of two of our patents, Nos. 7,664,516 and 8,155,679. The complaints were filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling and Discovery Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by Yelp and IZEA of three additional patents, U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent No. 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 due to the addition of the three new patents to the case. On August 2, 2013, YELP, Inc. filed a counterclaim for declaratory judgment of noninfringement, invalidity, and unenforceability for all asserted patents. The cases are presently in the early stages of discovery.

On October 31, 2012, we filed patent infringement complaints against MyLikes (*Case No. 6:12-cv-00838*) and Foursquare (*Case No. 6:12-cv-00837*). The suits allege infringement of two of our patents, Nos. 7,664,516 and 8,155,679. The complaints were filed in the U.S. District Court in the Eastern District of Texas, Tyler Division. On April 26, 2013, the Court issued a Scheduling and Discovery Order setting the Markman hearing for November 7, 2013 and trial for July 9, 2014. On June 13, 2013, we moved to amend our complaint and add claims for infringement by MyLikes and Foursquare of three additional patents, U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent No. 8,457,670. On July 19, 2013, the Court granted our motion. In addition, the Court extended the Markman hearing date to February 5, 2014 and the trial date to October 6, 2014 due to the addition of the three new patents to the case. In an ancillary action, Foursquare filed a declaratory judgment action against us in the Southern District of New York that alleged that U.S. Patent No. 8,438,055, U.S. Patent No. 8,452,646 and U.S. Patent No. 8,457,670 were not infringed and were invalid. That case was transferred to the Eastern District of Texas on August 2, 2013. On July 23, 2013, we entered into a settlement agreement and license agreement with MyLikes to resolve the case. MyLikes agreed to pay us the equivalent of a 3.5% royalty for the use of our patents. The case against MyLikes was subsequently dismissed on July 31, 2013. The case against Foursquare is presently in the early stages of discovery.

The court dockets for each case, including the parties' briefs are publicly available on the Public Access to Court Electronic Records website, or PACER, [www.pacer.gov](http://www.pacer.gov), which is operated by the Administrative Office of the U.S. Courts.

Other than as noted above, the Company is not a party to any pending legal proceeding nor is its property the subject of any pending legal proceeding that is not in the ordinary course of business or otherwise material to the financial condition of its business. Further, to the knowledge of management, no director or executive officer is party to any action in which any has an interest adverse to us.

## **ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors associated with the Company's business previously disclosed in Part I, Item 1A of the Company's 2012 Form 10-K and in Part II, Item 1A of the Form 10-Q for the quarter ended

June 30, 2013, in each case under the heading Risk Factors.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

**ITEM 5. OTHER DISCLOSURES**

None.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.**

Copies of the following documents are included as exhibits to this report pursuant to Item 601 of Regulation S-K.

Exhibit

Number	Description
2.1	Agreement and Plan of Merger and Reorganization, dated as of September 1, 2011, by and among Blue Calypso, Inc., Blue Calypso Acquisition Corp., and Blue Calypso Holdings, Inc. (incorporated by reference to Exhibit 2.1 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
2.2	Agreement and Plan of Merger, dated September 9, 2011, by and between Blue Calypso, Inc., a Nevada corporation, and Blue Calypso, Inc., a Delaware corporation (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 15, 2011)
2.3	Asset Purchase Agreement Between Picture Assassin, LLC, Each Member of Picture Assassin, LLC and Blue Calypso, Inc. dated September 13, 2013 (incorporated by reference to Exhibit 2.1 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 18, 2013)
3.1	Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed with the Securities and Exchange Commission on October 19, 2011)
3.2	Certificate of Designation of Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.2 to Current Report on Form 8-K filed with the Securities and Exchange Commission on October 19, 2011)
3.3	Bylaws of Blue Calypso, Inc., a Delaware corporation, adopted September 9, 2011 (incorporated by reference to Exhibit 3.3 to Current Report on Form 8-K filed with the Securities and Exchange Commission on October 19, 2011)
10.1	2011 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.2	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.3	Form of Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.4	Form Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.4 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.5	Agreement of Conveyance, Transfer and Assignment of Assets and Assumption of Obligations, dated as of September 1, 2011 (incorporated by reference to Exhibit 10.5 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.6	Stock Purchase Agreement, by and between Blue Calypso, Inc. and Deborah Flores, dated as of September 1, 2011 (incorporated by reference to Exhibit 10.6 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.7	Securities Purchase Agreement, dated as of September 1, 2011, by and among Blue Calypso, Inc. and certain purchasers set forth therein (incorporated by reference to Exhibit 10.7 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
10.8	

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- Registration Rights Agreement, dated as of September 1, 2011, by and among Blue Calypso, Inc. and certain purchasers set forth therein (incorporated by reference to Exhibit 10.9 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
- 10.9 Form of Warrant (incorporated by reference to Exhibit 10.10 to Current Report on Form 8-K filed with the Securities and Exchange Commission on September 8, 2011)
- 10.10 Letter Agreement, dated January 16, 2012, by and between Blue Calypso, Inc. and Aztec Systems, Inc. (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on January 20, 2012)
- 10.11 Promissory Note, dated January 17, 2012, issued by Blue Calypso, Inc. to Aztec Systems, Inc. (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on January 20, 2012)
- 10.12 Securities Purchase Agreement, dated April 19, 2012, by and between Blue Calypso, Inc. and the Buyer thereto (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.13 Senior Secured Convertible Note issued April 19, 2012 (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.14 Common Stock Purchase Warrant issued April 19, 2012 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.15 Security Agreement, dated April 19, 2012, by and between the Company, Blue Calypso, LLC and the Buyer (incorporated by reference to Exhibit 10.4 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.16 Intellectual Property Security Agreement, dated April 19, 2012, by and between the Company, Blue Calypso, LLC, and the Buyer (incorporated by reference to Exhibit 10.5 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.17 Subsidiary Guarantee, dated April 19, 2012, by Blue Calypso, LLC, in favor of the Buyer (incorporated by reference to Exhibit 10.6 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.18 Form of Lock-Up Agreement (incorporated by reference to Exhibit 10.7 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.19 Amendment No. 1 to Common Stock Purchase Warrant (incorporated by reference to Exhibit 10.8 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.20 Stockholder s Agreement, dated April 19, 2012, by and between Andrew Levi and the Company (incorporated by reference to Exhibit 10.9 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2012)
- 10.21 Letter Agreement dated June 1, 2012, between Blue Calypso, Inc. and Bill Ogle effective as of June 1, 2012 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on June 4, 2012)
- 10.22 Form of Subscription Agreement - June 2012 Private Placement (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on July 30, 2012)
- 10.23 Form of Warrant - June 2012 Private Placement (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on July 30, 2012)

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- 10.24 Exchange Agreement dated November 9, 2012 between Blue Calypso, Inc. and Aztec Systems, Inc. (incorporated by reference to Exhibit 10.24 to our Quarterly Report on Form 10-Q for the period ended September 30, 2012 filed with the Securities and Exchange Commission on November 19, 2012)
- 10.25 8% Convertible Note dated November 9, 2012 (incorporated by reference to Exhibit 10.24 to our Quarterly Report on Form 10-Q for the period ended September 30, 2012 filed with the Securities and Exchange Commission on November 19, 2012)
- 10.25 Amendment No. 1 to 8% Senior Secured Convertible Debentures between Blue Calypso, Inc. and the Holder dated April 29, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on May 3, 2013)
- 10.26 Amendment No. 2 to Common Stock Purchase Warrants between the Company and the Holder dated April 29, 2013 (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on May 3, 2013)
- 10.27 Amendment No. 2 to Common Stock Purchase Warrants between the Company and the Holder dated April 29, 2013 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on May 3, 2013)
- 10.28 Securities Purchase Agreement dated May 6, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2013)
- 10.29 10% Convertible Debenture dated May 6, 2013 (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2013)
- 10.30 Amendment No. 1 to 10% Convertible Debenture between Blue Calypso, Inc. and the Holder dated September 13, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on September 16, 2013)
- 10.31 Amendment No. 3 to Common Stock Purchase Warrants between the Company and the Holder dated September 13, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on September 16, 2013)
- 10.32 Amendment No. 2 to Common Stock Purchase Warrant between the Company and the Holder dated September 13, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on September 16, 2013)
- 10.33 Securities Purchase Agreement dated October 7, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed with the Securities and Exchange Commission on October 11, 2013)

SIGNATURES

Pursuant to the requirements 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.

BLUE CALYPSO, INC.

Date: November 8, 2013

By: /s/ David S. Polster  
Name: David S. Polster  
Title: Chief Financial Officer