BLACKHAWK NETWORK HOLDINGS, INC
Form 10-Q
July 25, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 June 15, 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: 001-35882

BLACKHAWK NETWORK HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware **(State or Other Jurisdiction of Incorporation or Organization)**	**43-2099257** **(I.R.S. Employer Identification No.)**
6220 Stoneridge Mall Road	
Pleasanton, CA **(Address of Principal Executive Offices)**	**94588** **(Zip Code)**

(925) 226-9990

(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 x No ¨

Indicate by checkmark 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 during the preceding 12 months (or for such shorter time period that the registrant was required to submit and post such files). Yes x 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	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 x

As of July 17, 2013, there were 11,519,463 shares of the Registrant s Class A common stock outstanding and 40,424,050 shares of the Registrant s Class B common stock outstanding.

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Blackhawk Network Holdings, Inc.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	June 15, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 104,383	$ 172,665
Overnight cash advances to Parent	65,000	495,000
Settlement receivables, net ($30,510 and $75,124 from Parent)	223,848	510,853
Accounts receivable, net ($3,580 and $4,229 from Parent)	86,359	101,001
Deferred income taxes	10,499	10,499
Prepaid expenses and other current assets	45,255	53,968
Total current assets	535,344	1,343,986
Property, equipment and technology, net	70,415	66,998
Intangible assets, net	23,404	1,699
Goodwill	42,729	42,729
Restricted cash		8,968
Deferred income taxes	983	1,937
Other assets ($4,962 and $0 from Parent)	66,132	67,394
TOTAL ASSETS	$ 739,007	$ 1,533,711
LIABILITIES, REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY		
Current liabilities:		
Settlement payables ($2,371 and $4,952 to Parent)	$ 452,137	$ 1,231,429
Accounts payable and accrued liabilities ($1,316 and $23,839 to Parent)	100,222	154,542
Total current liabilities	552,359	1,385,971
Warrant and common stock liabilities		26,675
Deferred income taxes	9,962	266
Other liabilities ($0 and $3,072 to Parent)	17,775	23,152
Total liabilities	580,096	1,436,064
Commitments and contingencies (see Note 5)		
Redeemable equity		34,997
Stockholders equity:		
Preferred stock: $0.001 par value; 10,000 shares authorized; no shares issued		
Class A common stock: $0.001 par value; 125,000 and 0 shares authorized, respectively; 11,520 and 0 shares issued, respectively	11	
	41	51

Class B common stock: $0.001 par value; 125,000 and 140,000 shares authorized; 40,852 and 51,681 shares issued, respectively		
Additional paid-in capital	93,435	31,542
Treasury stock	(29)	
Accumulated other comprehensive income (loss)	(1,517)	298
Retained earnings	66,720	30,669
Total Blackhawk Network Holdings, Inc. equity	158,661	62,560
Non-controlling interest	250	90
Total stockholders equity	158,911	62,650
TOTAL LIABILITIES, REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY	$ 739,007	$ 1,533,711

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except for per share amounts)

(Unaudited)

	12 Weeks Ended		24 Weeks Ended	
	June 15, 2013	June 16, 2012	June 15, 2013	June 16, 2012
OPERATING REVENUES:				
Commissions and fees	$ 176,819	$ 156,904	$ 321,294	$ 277,363
Program, interchange, marketing and other fees	28,907	18,417	53,265	37,823
Product sales	20,136	14,701	36,353	26,335
Total operating revenues	225,862	190,022	410,912	341,521
OPERATING EXPENSES:				
Distribution partner commissions	118,153	100,878	214,135	178,582
Processing and services	34,258	29,697	66,394	55,812
Sales and marketing	39,948	27,543	68,289	49,369
Costs of products sold	18,579	14,303	34,500	25,831
General and administrative	9,545	8,632	21,915	18,549
Total operating expenses	220,483	181,053	405,233	328,143
OPERATING INCOME	5,379	8,969	5,679	13,378
OTHER INCOME (EXPENSE):				
Interest income and other income, net	96	303	373	710
Interest expense		(9)		(10)
INCOME BEFORE INCOME TAX EXPENSE	5,475	9,263	6,052	14,078
INCOME TAX EXPENSE	2,110	3,442	2,428	5,382
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	3,365	5,821	3,624	8,696
Add: Loss attributable to non-controlling interest (net of tax)	126	33	213	33
NET INCOME ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.	$ 3,491	$ 5,854	$ 3,837	$ 8,729
EARNINGS PER SHARE CLASS A AND CLASS B:				
Basic	$ 0.07	$ 0.11	$ 0.07	$ 0.17
Diluted	$ 0.07	$ 0.11	$ 0.07	$ 0.17
Weighted average shares outstanding basic	51,056	50,066	50,713	50,053
Weighted average shares outstanding diluted	52,240	50,766	51,746	50,744

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	12 Weeks Ended		24 Weeks Ended	
	June 15, 2013	**June 16, 2012**	**June 15, 2013**	**June 16, 2012**
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	$ 3,365	$ 5,821	$ 3,624	$ 8,696
Other comprehensive income (loss):				
Currency translation adjustments	(507)	(1,125)	(1,815)	(114)
COMPREHENSIVE INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	2,858	4,696	1,809	8,582
Add: Comprehensive loss attributable to non-controlling interest (net of tax)	126	33	213	33
COMPREHENSIVE INCOME ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.	$ 2,984	$ 4,729	$ 2,022	$ 8,615

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	24 Weeks Ended	
	June 15, 2013	June 15, 2012
OPERATING ACTIVITIES:		
Net income before allocation to non-controlling interest	$ 3,624	$ 8,696
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	10,651	8,069
Program development cost amortization	8,748	7,663
Change in allowance for doubtful accounts and sales adjustments	2	(294)
Employee stock-based compensation expense	3,462	2,187
Distribution partner mark-to-market expense	6,995	1,292
Change in fair value of contingent consideration	(903)	101
Excess tax benefit from stock-based awards	(398)	
Other		261
Changes in operating assets and liabilities:		
Settlement receivables	285,006	46,959
Settlement payables	(775,899)	(582,569)
Accounts receivable, current and long-term	21,560	10,128
Prepaid expenses and other current assets	7,420	1,602
Other assets	(10,119)	(6,035)
Accounts payable and accrued liabilities	(30,394)	(28,875)
Other liabilities	(607)	(205)
Income taxes, net	(17,817)	(17,534)
Net cash used in operating activities	(488,669)	(548,554)
INVESTING ACTIVITIES:		
Change in overnight cash advances to Parent	430,000	448,971
Expenditures for property, equipment and technology and intangible assets	(15,110)	(10,681)
Change in restricted cash	8,968	
Other	(250)	90
Net cash provided by investing activities	423,608	438,380
FINANCING ACTIVITIES:		
Dividends paid	(133)	
Payments for acquisition liability	(1,881)	
Payments for initial public offering costs	(4,694)	
Reimbursement for initial public offering costs	5,540	
Proceeds from exercise of stock options	235	40
Excess tax benefit from stock-based awards	398	
Payments for surrendered stock-based awards for taxes	(504)	(227)
Repurchase of redeemable common stock	(171)	(936)
Contribution from non-controlling interest	324	
Net cash used in financing activities	(886)	(1,123)

EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(2,335)	252
DECREASE IN CASH AND CASH EQUIVALENTS	(68,282)	(111,045)
CASH AND CASH EQUIVALENTS Beginning of year	172,665	153,674
CASH AND CASH EQUIVALENTS End of period	$ 104,383	$ 42,629
NON-CASH FINANCING AND INVESTING ACTIVITIES		
Reclassification of warrant and common stock liabilities to additional paid-in capital upon initial public offering	$ 27,121	$
Reclassification of redeemable equity to stockholders equity upon initial public offering	$ 36,171	$
Intangible assets recognized for the issuance of fully vested warrants	$ 22,183	$

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENT OF REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY

(In thousands)

(Unaudited)

	Redeemable	Class A Common Stock		Class B Common Stock		Additional Paid-In	Treasury	Accumulated Other Comprehensive Income	Retained	Total Blackhawk Network Holdings, Inc.	Non-Controlling	Total Stock-holders
	Equity	Shares	Amount	Shares	Amount	Capital	Stock	(loss)	Earnings	Equity	Interest	Equity
BALANCE December 29, 2012	$ 34,997		$	51,681	$ 51	$ 31,542	$	$ 298	$ 30,669	$ 62,560	$ 90	$ 62,650
Comprehensive income								(1,815)	3,837	2,022	(213)	1,809
Stock-based employee compensation expense						3,462				3,462		3,462
Exercise of options	66			30		169				169		169
Surrender of stock-based equity awards for taxes	(465)	9		(9)		(10)	(29)			(39)		(39)
Excess tax benefit from stock-based awards, net						339				339		339
Repurchase of redeemable common stock	(171)											
Issuance of restricted stock awards		11		228								
Issuance of common stock upon vesting of restricted stock units				15								
Mark-to-market adjustment on common stock and warrants issued to distribution partners						6,401				6,401		6,401
Issuance of fully vested warrants to distribution partners						22,332				22,332		22,332
Reclassification of warrant and common stock liabilities upon initial public offering					1	27,120				27,121		27,121
Exercise of warrant				407								
Contribution from minority interest											373	373
Dividends paid									(133)	(133)		(133)
Adjustment to redeemable equity	1,744								(1,744)	(1,744)		(1,744)

Reclassification of redeemable equity upon initial public offering	(36,171)					2,080			34,091	36,171		36,171
Conversion of Class B common stock to Class A common stock upon initial public offering		11,500	11	(11,500)	(11)							
BALANCE June 15, 2013	$	11,520	$ 11	40,852	$ 41	$ 93,435	$ (29)	$ (1,517)	$ 66,720	$ 158,661	$ 250	$ 158,911

See accompanying notes to the condensed consolidated financial statements.

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BLACKHAWK NETWORK HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Significant Accounting Policies

The Company

Blackhawk Network Holdings, Inc., together with its subsidiaries (Blackhawk or the Company), is a majority-owned subsidiary of Safeway Inc. (Safeway or Parent). As of June 15, 2013, Safeway owned approximately 72.9% of Blackhawk s outstanding common stock. Blackhawk is a prepaid payments network utilizing proprietary technology to offer a broad range of gift cards, other prepaid products and payment services. The Company s payment network supports its three primary constituents: consumers who purchase the products and services the Company offers, content providers who offer branded products that are redeemable for goods and services, and distribution partners who sell those products. The Company s product offerings include gift cards, prepaid telecom products and prepaid financial services products, including general purpose reloadable (GPR) cards and the Company s reload network (collectively prepaid products). The Company offers gift cards from leading consumer brands (known as closed loop) as well as branded gift cards from leading payment network card associations such as American Express, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom brands. The Company also distributes GPR cards, including Green Dot and NetSpend branded cards, as well as PayPower, the Company s proprietary GPR card. The Company operates a proprietary reload network named REloadit, which allows consumers to reload funds onto their previously purchased GPR cards. The Company distributes products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as distribution partners) in the Americas, Europe, Australia and Asia.

Initial Public Offering

On April 24, 2013, the Company completed an initial public offering (the Offering) of 11,500,000 shares of the Company s Class A common stock at a price of $23.00 per share, which included 1,500,000 shares pursuant to the underwriters full exercise of their right to purchase additional shares. All such shares were sold by existing stockholders, and the Company received no proceeds from the sale of Class A common stock in the Offering. Immediately prior to the Offering, all then-outstanding shares of common stock were converted into Class B common stock on a share-for-share basis. All common share numbers and per common share data related to common stock before such conversion are reflected as Class B common stock in the accompanying condensed consolidated financial statements and related notes. Shares of Class B common stock sold in the Offering were converted into Class A common stock. Shares of Class A and Class B common stock are substantially identical except that Class A common stock has one vote per share and Class B common stock has ten votes per share. Immediately after the Offering, Safeway held 72.9% of shares outstanding and 91.0% of voting power (see *Note 3 Capital Stock*).

Basis of Presentation

The accompanying condensed consolidated financial statements of Blackhawk Network Holdings, Inc. are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Prospectus filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the Securities Act), with the SEC on April 18, 2013 (the Prospectus). These condensed consolidated financial statements have been prepared on the same basis as the annual audited consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company s financial position and results of operations for the interim periods presented. The results of the interim periods are not necessarily reflective of the results to be expected for the year ending December 28, 2013 or for any other interim period or other future year. The condensed consolidated balance sheet as of December 29, 2012, included herein was derived from the audited consolidated financial statements as of that date but does not include all disclosures required by GAAP, including notes to the financial statements.

These condensed consolidated financial statements include Blackhawk Network Holdings, Inc., a Delaware corporation, and its wholly- or majority-owned domestic and foreign subsidiaries, including Blackhawk Network, Inc., an Arizona corporation, which is wholly-owned and the primary operating subsidiary of Blackhawk Network Holdings, Inc. All intercompany transactions and balances among Blackhawk and its subsidiaries have been eliminated in consolidation. These condensed consolidated financial statements have been prepared as if Blackhawk existed on a stand-alone basis for the periods presented, but may not necessarily reflect the results of operations, financial position or cash flows that would have been achieved if the Company had existed on a stand-alone basis separate from its Parent during the periods presented.

Blackhawk s condensed consolidated financial statements include an allocation of expenses arising from certain shared services and infrastructure provided by Safeway. These expenses primarily relate to facilities rental and tax services and are allocated using actual costs or estimates based on the portion of services used by Blackhawk. Management believes that the allocation methodology is reasonable and considers the charges to be a reasonable reflection of the cost of benefits received. Blackhawk also provides certain marketing, distribution and program management services to Safeway for which it receives program fees or expense reimbursements. Generally, such amounts are recorded as revenue in *Program, interchange, marketing and other fees* when rendered to Safeway as a content provider or as a reduction to expense in *Processing and services* when rendered to Safeway as a distribution partner. See *Note 6 Related-Party Transactions*.

Significant Accounting Policies

There have been no material changes to the Company s significant accounting policies, as compared to the significant accounting policies described in the audited consolidated financial statements and related notes included in the Prospectus.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes to the condensed consolidated financial statements. The Company generally bases its estimates and assumptions on a combination of historical factors, current circumstances, and the experience and judgment of management. Significant estimates and assumptions include, among other things, allowances for doubtful accounts and sales adjustments, useful lives of assets, card redemption patterns and lives, delivery timing for product sales and valuation assumptions with respect to acquisition liabilities, goodwill, other intangible assets, common stock and income taxes. Actual results could differ from the Company s estimates.

Seasonality

A significant portion of gift card sales occurs in late December of each year during the holiday selling season. As a result, the Company earns a significant portion of revenues, net income and cash inflows during the fourth fiscal quarter of each year and remits the majority of the cash, less commissions, to the Company s content providers in January of the following year. The timing of the fiscal year-end, December holiday sales and the related January cash settlement with content providers significantly increases the Company s *Cash and cash equivalents*, *Overnight cash advances to Parent*, *Settlement receivables* and *Settlement payables* balances at the end of each fiscal year relative to normal daily balances. The cash settlement with the Company s content providers in January accounts for the majority of the use of cash from operating activities in its condensed consolidated statements of cash flows during its first three fiscal quarters. Additionally, operating income may fluctuate significantly during the first three fiscal quarters due to lower revenues and timing of certain expenses during such fiscal periods. As a result, quarterly financial results are not necessarily reflective of the results to be expected for the year, any other interim period or other future year.

Treasury Stock

Prior to the Offering, the Company recognized the repurchase of common stock related to employee equity awards as a settlement of *Redeemable equity* (see *Note 2 Fair Value Measurements*). After the Offering, the Company uses the cost method when it purchases its own common stock as treasury shares and presents treasury stock as a reduction of *Stockholders equity*. As of June 15, 2013, treasury shares totaled approximately 430,000 shares.

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Stock-Based Employee Compensation

The Company accounts for all stock-based awards to employees, including grants of employee stock options, stock appreciation rights, restricted stock and restricted stock units, as compensation based on the fair value of the award at the grant date and amortizes the grant date fair value to expense over the requisite service period, which is generally the vesting period. The Company determines the fair value of restricted stock and restricted stock units as the grant date fair value of Blackhawk stock and determines the fair value of stock options and stock appreciation rights using the Black-Scholes option pricing model. The Black-Scholes option pricing model incorporates certain assumptions, such as the risk-free interest rate, expected volatility, expected dividend yield and the expected life of options and appreciation rights in order to arrive at a fair value estimate. Stock-based employee compensation expense is classified in the *Operating expenses* line items corresponding to the applicable employee compensation expenses.

Prior to the Offering, the Company s Board of Directors (the Board) periodically determined and established the fair value of the Company s stock. Because there had been no public market for Blackhawk common stock prior to April 18, 2013, the Board determined the fair value of Blackhawk common stock at the time of grant by considering a number of objective and subjective factors, including discounted cash flow analysis, comparable company analysis, regular periodic valuations from an independent third-party valuation firm, overall market conditions, and the Company s current, historical and expected future operating performance. This approach is consistent with the methods outlined in the AICPA Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*.

The factors considered by the Board include periodic independent third-party valuation analyses, which were based upon a combination of market and income approaches. Under the market approach, consideration was given to pricing information for similar public companies, referred to as the guideline public company method, and to relevant transactions involving the sales of similar companies, called the mergers and acquisitions method. The income approach discounted expected future cash flows to their present value at a discount rate based upon our weighted-average cost of capital that considered the risk free rate, as well as risks associated with an investment in the business. The projections used in connection with the market and income valuation approaches were based on the Company s expected operating results and cash flows over the forecast period. In determining the enterprise value, the Company has placed relatively equal weighting on the guideline public company method, the mergers and acquisitions method and the income approach. Since 2011, the Company weighted its valuation 100% on the guideline public company method due to the number of public company comparables, how closely they related to the Company, the Company s consistently positive EBITDA generation and the expected EBITDA growth over the following years. The Company s peer group comprised a number of U.S.-based publicly traded companies primarily focused on prepaid cards and processing of electronic payment transactions. There is inherent uncertainty and subjectivity in these fair value estimates. If different peer companies, discount rates and other assumptions had been used, the valuations would have been different.

2. Fair Value Measurements

For disclosure purposes, the Company measures certain assets, liabilities and equity instruments at fair value on a recurring basis. The table below summarizes the fair value of these assets, liabilities and equity instruments as of June 15, 2013 and December 29, 2012 (in thousands):

		June 15, 2013			
		Level 1	**Level 2**	**Level 3**	**Total**
Assets					
Cash and cash equivalents	Money market mutual funds	$ 30,000	$	$	$ 30,000
Liabilities					
Contingent consideration		$	$	$ 17,149	$ 17,149

		December 29, 2012			
		Level 1	**Level 2**	**Level 3**	**Total**
Assets					
Cash and cash equivalents	Money market mutual funds	$ 91,000	$	$	$ 91,000
Liabilities					
Contingent consideration		$	$	$ 18,947	$ 18,947
Redeemable equity		$	$	$ 34,997	$ 34,997

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities. Level 1 investments include money market mutual funds.

Level 2 Inputs other than quoted prices included in Level 1 that are either directly or indirectly observable. The Company did not classify any amounts within Level 2 as of June 15, 2013 or December 29, 2012.

In the 24 weeks ended June 15, 2013, there were no transfers between Level 1 and Level 2.

Level 3 Unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the inputs that market participants would use in pricing.

Contingent Consideration The fair value of contingent consideration is determined using a discounted cash flows methodology with discount rates ranging from 0.7% to 7.3% as of June 15, 2013, which reflect the time value of money, non-performance risk, the risk due to the uncertainty in the cash flows and the Company s estimated probability of achieving the relevant financial and operational milestones. A significant decrease (increase) in the Company s credit standing, an increase (decrease) in the risk due to the uncertainty in the cash flows or a decrease (increase) in the Company s estimate of the probability of achieving the relevant financial and operational milestones could materially decrease (increase) the fair value of contingent consideration. Contingent consideration is recorded in *Accounts payable and accrued liabilities* and *Other liabilities* in the accompanying condensed consolidated balance sheets.

The change in fair value of contingent consideration classified as Level 3 for the 24 weeks ended June 15, 2013 is as follows (in thousands):

	2013
Contingent Consideration	
Balance as of December 29, 2012	$ 18,947
Decrease in fair value of contingent consideration	(903)
Settlements	(895)
Balance as of June 15, 2013	$ 17,149

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The decrease in the fair value of the business acquisition liability is recognized in *General and administrative* expense, is presented as a non-cash adjustment to net income in the accompanying condensed consolidated statements of cash flows and reflects the changes in the passage of time, expected timing of the contingent payments and the Company s estimate of the probability of achieving the applicable financial and operational milestones. Settlements reflect the resolution of the contingency based on achievement of financial and operational milestones, and $0.4 million was payable as of June 15, 2013. Settlements totaling $1.9 million, of which $1.4 million resulted from fiscal 2012 financial and operational performance, were paid during the 24 weeks ended June 15, 2013 and are presented as a financing outflow at the acquisition-date fair value in the accompanying condensed consolidated statements of cash flows.

Redeemable Equity The redemptive value of instruments classified as *Redeemable equity* was based on the fair value of Blackhawk common stock. As a result of the Offering, the redemption feature of these instruments was terminated, and the Company reclassified *Redeemable equity* of $36.2 million to *Stockholders equity*.

The change in fair value of *Redeemable equity* classified as Level 3 for the 24 weeks ended June 15, 2013 is as follows (in thousands):

	2013
Redeemable Equity	
Balance as of December 29, 2012	$ 34,997
Additions	1,810
Settlements	(36,807)
Balance as of June 15, 2013	$

For *Redeemable equity*, additions resulted from the vesting of equity awards, which were accreted from *Retained earnings*, and the exercise of stock options. Settlements reflect the Company s satisfaction of the put right whereby the shares become treasury shares, the purchase of surrendered equity awards for taxes and the termination of the redemption features as a result of the Offering.

3. Capital Stock

Classes of Common Stock and Shares Authorized and Issued

After the Offering, the Company s common stock consists of Class A common stock and Class B common stock. Authorized Class A common stock consists of 125 million shares of $0.001 par value per share common stock. Class A common stock issued as of June 15, 2013 was approximately 11,520,000 shares, of which all shares were outstanding. Authorized Class B common stock consists of 125 million shares of $0.001 par value per share common stock. Class B common stock issued as of June 15, 2013 was approximately 40,852,000 shares, and Class B common stock outstanding was approximately 40,423,000 shares. The Company also has 10 million shares of authorized preferred stock with no shares outstanding.

Reverse Split

On April 1, 2013, the Company effected a 1-for-2 reverse stock split (the Reverse Split) by filing an amendment to its Certificate of Incorporation with the Delaware Secretary of State. As a result of the Reverse Split, the Company also adjusted the share amounts under its employee incentive plans and common stock and warrant agreements with third parties. All common share numbers and per common share data in the accompanying condensed consolidated financial statements and related notes have been retroactively adjusted to reflect the Reverse Split and the amendment to the Certificate of Incorporation.

Shares Issued in Conjunction with Initial Public Offering

As discussed in *Note 1*, on April 24, 2013, the Company completed the Offering of 11,500,000 shares of the Company s Class A common stock. In conjunction with the Offering, the Company issued 406,957 shares of Class B common stock as a result of the net exercise of a warrant to purchase 750,000 shares at an exercise price of $10.52 per share. Of the shares issued, 172,431 shares were sold in the Offering and accordingly converted to Class A common stock. The Company also issued 20,423 shares of Class B common stock as a result of the exercise of outstanding options at a weighted average exercise price of $6.78 per share, all of which shares were sold in the Offering and accordingly converted to Class A common stock. The Company received $0.1 million in cash as a result of the exercise of these options.

Equity Awards Issued to Distribution Partners

As a result of the Offering, the put and call rights with respect to 1,069,665 shares of Class B common stock issued to a distribution partner and a warrant to purchase 750,000 shares of Class B common stock issued to another distribution partner were

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terminated. The termination of the call rights eliminated the performance conditions of these equity instruments, and, accordingly, the Company expensed the remaining unamortized fair value of $6.0 million at the time of the Offering, determined as the excess of the Offering price of $23.00 per share over the put price of the common stock of $18.90 per share or the exercise price of the warrant of $10.52 per share, less amounts previously expensed, with an offsetting increase to *Additional paid-in capital*. Further, the Company reclassified *Warrant and common stock liabilities* related to these put rights of $27.1 million to *Additional paid-in capital*. The Offering also terminated the restriction on the cash that the Company had received for purchase of the Class B common stock issued to the distribution partner, and therefore the Company reclassified *Restricted cash* of $9.0 million to *Cash and cash equivalents*.

On April 2, 2013, in conjunction with extending marketing and distribution services agreements with two distribution partners, the Company issued fully vested warrants to purchase 1,500,000 and 750,000 shares, respectively, at an exercise price of $20.00 per share with no service or performance conditions. As a result of the Offering, these warrants will become exercisable on October 16, 2013, which is 181 days after the date on which the Company s registration statement filed in connection the Offering was declared effective by the SEC. The Company measured the fair value of the warrants using a Black-Scholes option pricing model as of the date of the Offering as $14.9 million and $7.3 million for the warrants to purchase 1,500,000 and 750,000 shares, respectively. The Company recorded the full values of the warrants in *Additional paid-in capital* with an offset to *Intangible assets* and amortizes the assets over the term of the related marketing and distribution services agreements of approximately five years to *Sales and marketing* expense. Additionally, on April 30, 2013, pursuant to a distribution partner s anti-dilutive rights, the Company issued a warrant to purchase 15,306 shares at an exercise price of $20.00 per share. The Company recorded the fair value of the warrant of $0.1 million in *Additional paid-in capital* with an offset to *Sales and marketing* expense.

Equity Awards to Blackhawk Employees

During the 24 weeks ended June 15, 2013, the Board increased the shares available for grant under the Company s equity incentive plans by 3,750,000 shares by increasing the number of shares available for issuance under the 2006 Restricted Stock and Restricted Stock Unit Plan (the 2006 Plan) and the 2007 Stock Option and Stock Appreciation Right Plan (the 2007 Plan) by 250,000 shares of Class B common stock and 500,000 shares of Class B common stock, respectively, and approving the 2013 Equity Incentive Plan (the 2013 Plan) to permit the issuance of up to 3,000,000 shares of Class A common stock. Under the terms of the 2013 Plan, the Company may award stock options, stock appreciation rights, restricted stock, restricted stock units and other incentive awards to Blackhawk employees, consultants, officers and directors. Additionally, following the Offering, the remaining shares reserved for issuance under the 2006 Plan and 2007 Plan, including those that later become available for future issuance as the result of the cancellation of awards, are available for issuance under the 2013 Plan as shares of Class A common stock. After the Offering, the Company ceased to grant awards under the 2006 Plan and 2007 Plan and granted awards under the 2013 Plan.

During the 24 weeks ended June 15, 2013, the Board granted 839,250 stock options at a weighted-average exercise price of $20.01 per share and 239,500 shares of restricted stock.

4. Income Taxes

The Company s effective tax rates were 38.5% and 37.2% for the 12 weeks ended June 15, 2013 and June 16, 2012, respectively, and were 40.1% and 38.2% for the 24 weeks ended June 15, 2013 and June 16, 2012, respectively. The effective rates for the 12 and 24 weeks ended June 15, 2013 were higher primarily due to an operating loss in one of the Company s foreign subsidiaries for which it did not recognize an income tax benefit and higher amounts of non-deductible expenses resulting from mark to market on redeemable common stock, partially offset by an increased benefit for foreign rate differential and other net individually immaterial items.

During the 24 weeks ended June 15, 2013, the Company received a ruling from the Internal Revenue Service (IRS) that permits the current deduction of a content provider fee that was previously amortized for the Company s tax provision. As a result, the Company reclassified $8.1 million of deferred tax assets to income tax receivable from Parent and reduced its unrecognized tax benefit position by $4.4 million. The Company will collect the resulting net receivable of $3.7 million from Safeway when Safeway settles such amounts with the IRS. The gross unrecognized benefit at June 15, 2013 was $2.7 million.

Effective December 30, 2012, the Company and Safeway amended their tax sharing agreement (TSA). The Company does not believe that the terms of the amended TSA will materially affect the Company s consolidated financial statements.

As a result of the Offering, the Company will no longer be included in Safeway s federal tax return and certain state and local tax returns, and will begin to file tax returns and settle amounts due directly with such tax authorities. The Company will settle amounts due to or from Safeway related to fiscal periods prior to the Offering pursuant to the terms of the TSA and will continue to be included with Safeway in certain state and local tax returns and settle such amounts pursuant to the TSA. The Company does not expect that the change in tax status or settlement terms will materially affect its consolidated financial statements.

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5. Commitments and Contingencies

Legal Matters

There are various claims and lawsuits arising in the normal course of business pending against the Company, some of which seek damages and other relief which, if granted, may require future cash expenditures. Management believes that any resulting liability would not materially affect the Company s consolidated financial statements taken as a whole.

Commitments

From time to time, the Company enters into contracts containing provisions that require it to indemnify various parties against certain potential claims from third parties. Under contracts with certain issuing banks, the Company is responsible to the banks for any unrecovered overdrafts on cardholders accounts. Under contracts with certain content and distribution partners, the Company is responsible for potential losses resulting from certain claims from third parties. Because the indemnity amounts associated with these agreements are not explicitly stated, the maximum amount of the obligation cannot be reasonably estimated. Historically, the Company has paid limited amounts pursuant to these indemnification provisions.

6. Related-Party Transactions

Effective December 30, 2012, the Company and Safeway amended their distribution agreements to, among other things, extend the term to December 31, 2017 and to increase the amount of *Distribution partner commissions* expense paid to Safeway.

Effective January 2013, the Company and Safeway increased the Company s line of credit from Safeway from $25.0 million to $50.0 million and extended the term through February 2016.

The following table presents the amounts of *Operating revenues* and *Other income (expense)* from Safeway and *Operating expenses* to (from) Safeway included in the accompanying condensed consolidated statements of operations (in thousands):

	12 Weeks Ended		24 Weeks Ended	
	June 15, 2013	June 16, 2012	June 15, 2013	June 16, 2012
OPERATING REVENUES:				
Commissions and fees	$ 518	$ 565	$ 1,117	$ 1,203
Program, interchange, marketing and other fees	383	373	732	733
Product sales	1,300	1,126	1,883	1,691
Total operating revenues	2,201	2,064	3,732	3,627
OPERATING EXPENSES:				
Distribution partner commissions	11,772	9,371	21,086	16,582
Processing and services	(240)	(164)	(348)	(283)
Sales and marketing	(37)	100	63	184
Costs of products sold				
General and administrative	699	699	1,338	1,297
Total operating expenses	12,194	10,006	22,139	17,780
OTHER INCOME (EXPENSE):				
Interest income and other income, net	16	188	176	437
Interest expense		(9)		(10)

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7. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income available to common stockholders by the weighted average shares outstanding during the period. Diluted EPS is computed by dividing earnings available to common stockholders by the weighted average shares outstanding during the period and the impact of securities that if exercised, would have a dilutive effect on EPS.

The Company computes EPS under the two-class method, which is a method of computing EPS when an entity has both common stock and participating securities. Nonvested stock is considered a participating security because it contains rights to receive nonforfeitable dividends at the same rate as common stock. Under the two-class method, the calculation of basic and diluted EPS excludes the income and distributions attributable to participating securities. Additionally, the weighted average shares outstanding exclude the impact of participating securities.

Class A and Class B common stock have equal rights to dividends as declared by the Board. As a result, basic and diluted EPS are equivalent for Class A and Class B common stock for the 12 and 24 weeks ended June 15, 2013. For the 12 and 24 weeks ended June 16, 2012, Blackhawk s common stock consisted solely of Class B common stock.

The following table provides reconciliations of net income and shares used in calculating basic EPS to those used in calculating diluted EPS (in thousands except per share amounts):

	12 Weeks Ended June 15, 2013		12 Weeks Ended June 16, 2012	
	Basic	Diluted	Basic	Diluted
Net income attributable to Blackhawk Network Holdings, Inc.	$ 3,491	$ 3,491	$ 5,854	$ 5,854
Distributed and undistributed earnings allocated to participating securities	(71)	(70)	(145)	(143)
Net income attributable to common stockholders	$ 3,420	$ 3,421	$ 5,709	$ 5,711
Weighted-average common shares outstanding	51,056	51,056	50,066	50,066
Common share equivalents		1,184		700
Weighted-average shares outstanding		52,240		50,766
Earnings per share Class A and Class B	$ 0.07	$ 0.07	$ 0.11	$ 0.11

	24 Weeks Ended June 15, 2013		24 Weeks Ended June 16, 2012	
	Basic	Diluted	Basic	Diluted
Net income attributable to Blackhawk Network Holdings, Inc.	$ 3,837	$ 3,837	$ 8,729	$ 8,729
Distributed and undistributed earnings allocated to participating securities	(144)	(142)	(219)	(216)
Net income attributable to common stockholders	$ 3,693	$ 3,695	$ 8,510	$ 8,513
Weighted-average common shares outstanding	50,713	50,713	50,053	50,053
Common share equivalents		1,033		691
Weighted-average shares outstanding		51,746		50,744
Earnings per share Class A and Class B	$ 0.07	$ 0.07	$ 0.17	$ 0.17

For the 12 and 24 weeks ended June 15, 2013, distributed and undistributed earnings allocated to participating securities included approximately $25,000 and $74,000, respectively, of payments for the dividend declared by the Board on December 14, 2012 to holders of nonvested stock that vested during the 12 and 24 weeks ended June 15, 2013.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Prospectus filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the Securities Act), with the Securities and Exchange Commission (the SEC) on April 18, 2013 (the Prospectus).

Forward Looking Information

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements are often identified by the use of words such as, but not limited to, anticipate, believe, can, continue, could, estimate, expect, intend, may, plan, project, seek, should, target, will, would, and similar expressions or variations intende forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties, and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed or referenced in the section titled Risk Factors included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Company Overview

Blackhawk Network Holdings, Inc., together with its subsidiaries (we, us or our), is a majority-owned subsidiary of Safeway Inc. (Safeway or Parent). We are a prepaid payment network utilizing proprietary technology to offer a broad range of gift cards, other prepaid products and payment services. Our payment network supports our three primary constituents: consumers who purchase the products and services we offer, content providers who offer branded products that are redeemable for goods and services, and distribution partners who sell those products. Our product offerings include gift cards, prepaid telecom products and prepaid financial services products, including general purpose reloadable (GPR) cards and our reload network (collectively prepaid products). We offer gift cards from leading consumer brands (known as closed loop) as well as branded gift cards from leading network card associations such as American Express, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom brands. We also distribute GPR cards, including Green Dot and NetSpend branded cards, as well as PayPower, our proprietary GPR card. We operate a proprietary reload network named REloadit, which allows consumers to reload funds onto certain of their previously purchased GPR cards. We distribute products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as distribution partners) in the Americas, Europe, Australia and Asia.

Quarterly Results of Operations and Seasonality

Seasonal consumer spending habits, which are most pronounced in December of each year as a result of the holiday selling season, significantly affect our business. We believe this seasonality is important to understanding our quarterly operating results. A significant portion of gift card sales occurs in late December of each year during the holiday selling season. As a result, we earn a significant portion of our revenues, net income and cash flows during the fourth quarter of each year. We also experience an increase in revenues, net income and cash flows during the second quarter of each year, which we primarily attribute to the Mother s Day, Father s Day and graduation gifting season and the Easter holiday. Depending on when the Easter holiday occurs, the associated increase could occur in either the first or second quarter. Additionally, operating income may fluctuate significantly during the first three fiscal quarters due to lower revenues and timing of certain expenses during such fiscal periods. As a result, quarterly financial results are not necessarily reflective of the results to be expected for the year, any other interim period or other future year.

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Revenue Recognition

Description of Our Revenues

Commissions and Fees Commissions and fees consist of content provider commissions, consumer purchase fees, GPR load and reload fees and other transaction-based commissions. We account for total commissions and fees as revenues. The portion we pay to our distribution partners is accounted for as *Distribution partner commissions* in operating expenses.

Content Provider Commissions We earn the majority of our revenues from commissions paid by content providers for the marketing and distribution of their prepaid cards, which we refer to as closed loop gift cards. For closed loop gift cards and prepaid telecom cards, our commissions are based on a contractual percentage of the aggregate load value of the cards recognized during a defined period. This contractual percentage is individually negotiated with each content provider and is generally a fixed percentage. After a closed loop gift card or telecom card is activated, we have no further service obligations and recognize the commissions received as revenue at the time of activation.

Purchase Fees We generate a portion of our revenue from fees related to open loop gift cards, including our proprietary Visa gift card, American Express and MasterCard network-branded gift cards and general-purpose reloadable (GPR) cards provided by Green Dot and NetSpend, the industry leaders in this product category, as well as PayPower, our proprietary GPR card. The consumer pays a purchase fee upon activation of a network-branded card or the initial load to the GPR card. These purchase fees vary based on the type of card purchased and the dollar amount of the load transaction. We serve as the program manager, in conjunction with the issuing banks, for our proprietary Visa gift card and PayPower GPR card and have ongoing customer service obligations after card activation. We recognize revenue for our proprietary Visa gift card purchase fee ratably in proportion to the historical redemption patterns of the card portfolio over the estimated life of the card (currently 12 months), which presently results in the recognition of approximately 90% of the purchase fee within four months of card activation. We recognize the initial load fee on the PayPower GPR card on a straight-line basis over the estimated life of the card (currently four months). For the American Express and MasterCard network-branded gift cards and the Green Dot and NetSpend branded GPR cards, we receive a contractual percentage of the consumer purchase fee, which is recognized as revenue at the time of card activation as we have no future customer service obligations.

Reload Fees The consumer pays a purchase fee and we earn the fee when consumers reload funds onto their PayPower GPR card or another GPR card through our REloadit network. Revenue is recognized when the reload is processed.

Transaction-Based and Other Fees We receive transaction-based fees from certain telecom partners related to the use of our proprietary network. These fees vary with usage or volumes and are recognized at the time our network is accessed. We also receive fees for certain services related to our local, regional and sports team card programs, such as balance tracking, customer service calls and financial settlement. Revenue is recognized in the period the services are performed.

Program, Interchange, Marketing and Other Fees Program, interchange, marketing and other fees consist of post-activation program management fees, settlement network interchange fees, marketing revenues from our content providers, GPR service fees and other fees.

Post-Activation Program Management Fees We receive a program management fee from our issuing banks related to our proprietary Visa gift card products. This fee is generally based on a contractually stated percentage of load value and represents a portion of our compensation for the overall management and customer support of our proprietary Visa gift card programs. The fees are deferred and recognized over the estimated life of the cards in proportion to historical redemption patterns. The fee percentage is subject to periodic review and may be adjusted based on recent changes in the underlying redemption patterns, escheat obligations, regulations and other factors that change the underlying economics of the card portfolio.

Interchange Fees We earn payment network fees related to the cardholder s usage of our proprietary Visa gift card and PayPower GPR card. Merchants are charged by our issuing banks at varying rates established by Visa. These fees are contractually passed through to us by the issuing banks net of any fees paid to Visa. We recognize revenues when cardholders make purchases.

Marketing Revenues We receive funds from our content providers to promote their prepaid cards throughout our distribution partner network. We generally recognize revenue ratably over the period of the related marketing campaign.

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GPR Service Fees We earn a monthly fee and other transaction-based service fees on our PayPower GPR card. These consumer-paid service fees are collected by reducing the card balance and are recognized as revenue at the time the card balance is reduced.

Other Fees In some instances, we may receive a portion of other fees such as account maintenance, interchange or referral fees for open loop cards and GPR cards other than our proprietary Visa gift card and PayPower GPR card. We also receive other fees related to certain of our Visa gift cards sold internationally, Safeway-branded gift cards and certain local, regional and sports team card programs. Typically, these fees are recognized when earned. For one open loop content provider, we receive a fee, under deferred payment terms, based on a percentage of load value and pay the content provider a fee (a portion of which is also under deferred payment terms) for meeting certain activation targets. We recognize the net amount of these fees upon activation.

Product Sales Product sales consist of our card production sales, secondary card market sales and telecom handset sales.

Card Production We provide card design, development and third-party production services for certain content providers that are separate from the standard content provider contract. We outsource the physical card production to a third party and charge the content provider actual cost plus a margin for managing this process. Revenue is recognized when the cards are received by our content providers, at our distribution partners locations or by us at our third-party warehouse.

Secondary Card Market We generate revenue through our wholly-owned subsidiary Cardpool, Inc. (Cardpool) by acquiring previously owned closed loop gift cards at a discount from load value and then selling them at a mark-up over our costs (but still at a discount to load value) to consumers. Revenue is recognized when the cards are delivered to the purchaser.

Telecom Handsets We earn revenue from the sale of telecom handsets to our distribution partners to facilitate and supplement the sale of our prepaid telecom content providers airtime cards. Revenue is generally recognized upon handset shipment to or receipt by the distribution partner based upon the shipping terms.

Description of Our Expenses

Distribution Partner Commissions Distribution partner commissions represent the amounts paid to members of our distribution partner network for their distribution services related to our content providers cards and our proprietary Visa gift card and PayPower GPR card. We compensate our distribution partners by paying them a negotiated share of the commission we receive from our content providers or the consumer purchase fee associated with open loop cards.

Processing and Services Processing and services costs are the direct costs of generating *Commissions and fees*, and *Program, interchange, marketing and other fees* and include costs of development, integration, maintenance, depreciation and amortization of technology platforms; card distribution, fulfillment, merchandising and fixture displays; card production primarily for our Visa gift card and PayPower GPR card; data communication costs; customer support services; quality assurance functions; risk monitoring services; third-party processing; data center facilities costs and compensation costs for processing and services personnel.

Sales and Marketing We incur costs, both discretionary and contractual, in the form of marketing allowances, direct advertising campaigns, general marketing and trade promotions to promote content providers prepaid cards and our Visa gift card and PayPower GPR card at our distribution partner locations. Sales and marketing expenses consist of program marketing and advertising costs, distribution partner program development expenses, compensation and travel costs for marketing and sales personnel, communication costs, mark-to-market charges related to equity instruments issued to certain distribution partners, facilities costs and outside consulting fees.

Costs of Products Sold Costs of products sold include the direct costs of card production efforts, the costs to acquire previously issued prepaid cards and other direct costs related to our Cardpool secondary gift card market business and costs to acquire telecom handsets.

General and Administrative General and administrative expenses include compensation and benefits for administrative staff, corporate facilities costs, telecommunications costs and professional service fees.

Key Operating Statistics

The following table sets forth key operating statistics that directly affect our financial performance for the 12 and 24 weeks ended June 15, 2013 and June 16, 2012:

	12 Weeks Ended		24 Weeks Ended	
	June 15, 2013	June 16, 2012	June 15, 2013	June 16, 2012
	(in thousands, except percentages and average load transaction value)			
Load value	$ 1,919,384	$ 1,734,547	$ 3,529,225	$ 3,042,927
Commissions and fees as a % of load value	9.2%	9.0%	9.1%	9.1%
Distribution partner commissions paid as a % of commissions and fees	66.8%	64.3%	66.6%	64.4%
Number of load transactions	46,640	43,481	83,446	76,177
Average load transaction value	$ 41.15	$ 39.89	$ 42.29	$ 39.95
Adjusted operating revenues(1)	$ 107,709	$ 89,144	$ 196,777	$ 162,939
Adjusted EBITDA(1)	$ 18,528	$ 15,118	$ 25,884	$ 25,027
Adjusted EBITDA margin(1)	17.2%	17.0%	13.2%	15.4%
Adjusted net income(1)	$ 8,611	$ 7,309	$ 10,485	$ 11,317

(1) Our Adjusted operating revenues, EBITDA, Adjusted EBITDA, Adjusted EBITDA margin and Adjusted net income are non-GAAP financial measures. Generally, a non-GAAP financial measure is a numerical measure of a company s performance, financial position or cash flow that either excludes or includes amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP. These measures, however, should be considered in addition to, and not as a substitute for or superior to, operating revenues, operating income, operating margin, cash flows, or other measures of the financial performance prepared in accordance with GAAP. See Reconciliation of Non-GAAP Measures section below.

Load Value Represents the total dollar amount of value loaded onto any of our prepaid products during the period. The dollar amount and volume of card sales directly affect the amount of our revenues and direct costs. We measure and monitor Load value by distribution partner channel and content provider program. The growth in Load value has been driven by increased consumer use of prepaid products, partly in response to distribution partner loyalty and incentive programs, expansion of product content and services we offer and addition of new partners into our distribution partner network in the United States and internationally.

Commissions and Fees as a Percentage of Load Value Represents the total amount of *Commissions and fees* recognized during the period as a percentage of Load value for the same period. Commissions as a percentage of Load value is generally higher for closed loop and telecom products than the purchase, load and reload fees as a percentage of Load value for open loop and GPR products. For certain GPR products, we do not earn *Commissions and fees* when funds are loaded or reloaded. As a result, overall Commissions and fees as a percentage of load value is directly affected by the mix of Load value among our closed loop, open loop and GPR product offerings. This metric helps us understand and manage overall margins from our product offerings.

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Distribution Partner Commissions Paid as a Percentage of Commissions and Fees Represents *Distribution partner commissions* expense divided by *Commissions and fees* revenue during the period. This metric represents the expense recognized for the share of content provider commissions and purchase or load fees we pay to our distribution partners as a percentage of total *Commissions and fees* revenue recognized during the period. Distribution partner commission share percentages are individually negotiated with our distribution partners and are independent of the commission rates negotiated between us and our content providers. The distribution partner commissions paid percentage is affected by changes in the proportion of Load value and resulting *Commissions and fees* revenue between distribution partners with differing share percentages and contractual changes to distribution partner share percentages.

Number of Load Transactions Represents the total number of load transactions (including reloads) for all of our prepaid products during the period.

Average Load Transaction Value Represents Load value divided by the Number of load transactions during the period.

Non-GAAP Measures We regard Adjusted operating revenues, EBITDA, Adjusted EBITDA, Adjusted EBITDA margin and Adjusted net income as useful measures of operational and financial performance of the business. We regard Adjusted EBITDA margin as an important financial metric that we use to evaluate the operating efficiency of our business. Adjusted EBITDA and Adjusted net income measures are prepared and presented to eliminate the effect of items from EBITDA and net income that we do not consider indicative of our core operating performance within the period presented. Adjusted operating revenues are prepared and presented to eliminate the commissions paid to our distribution partners. Adjusted EBITDA margin represents Adjusted EBITDA as a percentage of Adjusted operating revenues. Our Adjusted operating revenues, Adjusted EBITDA, Adjusted EBITDA margin and Adjusted net income may not be comparable to similarly titled measures of other organizations because other organizations may not calculate these measures in the same manner as we do.

We believe Adjusted operating revenues, EBITDA, Adjusted EBITDA, Adjusted EBITDA margin and Adjusted net income are useful to evaluate our operating performance for the following reasons:

- adjusting our operating revenues for the commissions paid to our distribution partners is useful to understanding our operating margin;

- EBITDA and Adjusted EBITDA are widely used by investors and securities analysts to measure a company s operating performance without regard to items that can vary substantially from company to company and from period to period depending upon their financing, accounting and tax methods, the book value of their assets, their capital structures and the method by which their assets were acquired;

- Adjusted EBITDA margin provides a measure of operating efficiency based on Adjusted operating revenues and without regard to items that can vary substantially from company to company and from period to period depending upon their financing, accounting and tax methods, the book value of their assets, their capital structures and the method by which their assets were acquired;

- non-cash equity issued to employees and distribution partners at a certain price and point in time do not necessarily reflect how our business is performing at any particular time and the related expenses are not key measures of our core operating performance;

- intangible asset amortization expenses can vary substantially from company to company and from period to period depending upon the applicable financing and accounting methods, the fair value and average expected life of the acquired intangible assets, the capital structure and the method by which the intangible assets were acquired and, as such, we do not believe that these adjustments are reflective of our core operating performance; and

- non-cash fair value adjustments to contingent business acquisition liability do not directly reflect how our business is performing at any particular time and the related expense adjustment amounts are not key measures of our core operating performance.

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Reconciliation of Non-GAAP Measures:

The following tables present a reconciliation of *Total operating revenues* to Adjusted operating revenues, a reconciliation of *Net income* to EBITDA and Adjusted EBITDA, a reconciliation of Operating income margin to Adjusted EBITDA margin and a reconciliation of *Net income* to Adjusted net income, in each case reconciling the most comparable GAAP measure to the adjusted measure, for each of the periods indicated.

	12 Weeks Ended		24 Weeks Ended	
	June 15, 2013	June 16, 2012	June 15, 2013	June 16, 2012
	(in thousands, except percentages)			
Adjusted operating revenues:				
Total operating revenues	$ 225,862	$ 190,022	$ 410,912	$ 341,521
Distribution partner commissions	(118,153)	(100,878)	(214,135)	(178,582)
Adjusted operating revenues	$ 107,709	$ 89,144	$ 196,777	$ 162,939
Adjusted EBITDA:				
Net income before allocation to non-controlling interest	$ 3,365	$ 5,821	$ 3,624	$ 8,696
Interest income and other income, net	(96)	(303)	(373)	(710)
Interest expense		9		10
Income tax expense	2,110	3,442	2,428	5,382
Depreciation and amortization	5,924	4,130	10,651	8,069
EBITDA	11,303	13,099	16,330	21,447
Adjustments to EBITDA:				
Employee stock-based compensation	1,828	1,167	3,462	2,187
Distribution partner mark-to-market expense(a)	6,878	829	6,995	1,292
Change in fair value of contingent consideration(b)	(1,481)	23	(903)	101
Adjusted EBITDA	$ 18,528	$ 15,118	$ 25,884	$ 25,027
Adjusted EBITDA margin:				
Total operating revenues	$ 225,862	$ 190,022	$ 410,912	$ 341,521
Operating income	$ 5,379	$ 8,969	$ 5,679	$ 13,378
Operating margin	2.4%	4.7%	1.4%	3.9%
Adjusted operating revenues	$ 107,709	$ 89,144	$ 196,777	$ 162,939
Adjusted EBITDA	$ 18,528	$ 15,118	$ 25,884	$ 25,027
Adjusted EBITDA margin	17.2%	17.0%	13.2%	15.4%
Adjusted net income:				
Net income before allocation to non-controlling interest	$ 3,365	$ 5,821	$ 3,624	$ 8,696
Employee stock-based compensation	1,828	1,167	3,462	2,187
Distribution partner mark-to-market expense(a)	6,878	829	6,995	1,292
Change in fair value of contingent consideration(b)	(1,481)	23	(903)	101
Amortization of intangibles(c)	897	181	1,078	363
Total pretax adjustments	8,122	2,200	10,632	3,943
Tax expense on adjustments(d)	(2,876)	(712)	(3,771)	(1,322)
Adjusted net income	$ 8,611	$ 7,309	$ 10,485	$ 11,317

(a) Distribution partner equity instruments are generally marked to market at each reporting date to fair value until the instrument is settled or expired.

(b) Adjustments to reflect a contingent business acquisition liability at its estimated fair value.
(c) Non-cash expense resulting from the amortization of intangible assets.
(d) Assumes our statutory tax rate adjusted for certain amounts that are not deductible for tax purposes.

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Results of Operations

Comparison of the 12 Weeks Ended June 15, 2013 and June 16, 2012

The following table sets forth the revenue and expense amounts as a percentage of total operating revenues by the line items in our condensed consolidated statements of income for the 12 weeks ended June 15, 2013 and June 16, 2012.

	12 Weeks Ended June 15, 2013	% of Total Operating Revenues	12 Weeks Ended June 16, 2012	% of Total Operating Revenues
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 176,819	78.3%	$ 156,904	82.6%
Program, interchange, marketing and other fees	28,907	12.8%	18,417	9.7%
Product sales	20,136	8.9%	14,701	7.7%
Total operating revenues	225,862	100.0%	190,022	100.0%
OPERATING EXPENSES:				
Distribution partner commissions	118,153	52.3%	100,878	53.1%
Processing and services	34,258	15.2%	29,697	15.6%
Sales and marketing	39,948	17.7%	27,543	14.5%
Costs of products sold	18,579	8.2%	14,303	7.5%
General and administrative	9,545	4.2%	8,632	4.5%
Total operating expenses	220,483	97.6%	181,053	95.3%
OPERATING INCOME	5,379	2.4%	8,969	4.7%
OTHER INCOME (EXPENSE):				
Interest income and other income, net	96	0.0%	303	0.2%
Interest expense		%	(9)	%
INCOME BEFORE INCOME TAX EXPENSE	5,475	2.4%	9,263	4.9%
INCOME TAX EXPENSE	2,110	0.9%	3,442	1.8%
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	3,365	1.5%	5,821	3.1%
Add: Loss attributable to non-controlling interest (net of tax)	126	0.1%	33	%
NET INCOME ATTRIBUTABLE TO BLACKHAWK	$ 3,491	1.5%	$ 5,854	3.1%

Operating Revenues

The following table sets forth our consolidated operating revenues for the 12 weeks ended June 15, 2013 and June 16, 2012.

	12 Weeks Ended June 15, 2013	12 Weeks Ended June 16, 2012	Change	
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 176,819	$ 156,904	$ 19,915	12.7%
Program, interchange, marketing and other fees	28,907	18,417	10,490	57.0%
Product sales	20,136	14,701	5,435	37.0%

Total operating revenues	$ 225,862	$ 190,022	$ 35,840	18.9%

Commissions and Fees

Commissions and fees revenue increased 12.7%, or $19.9 million, to $176.8 million for the 12 weeks ended June 15, 2013 from $156.9 million for the 12 weeks ended June 16, 2012. This increase was primarily due to a 10.7%, or $184.8 million, increase in Load value. Commissions and fees as a percentage of load value increased 20 basis points, or 0.2 percentage points, to 9.2% for the 12 weeks ended June 15, 2013 from 9.0% for the 12 weeks ended June 16, 2012. The increase in Load value was primarily due to a 7.3% increase in the Number of load transactions and a 3.2% increase in the Average load transaction value. The increase in Number of load transactions reflects increased average per-store productivity for most distribution partners in the United States and internationally and the addition of new distribution partners in the United States and internationally, partially offset by a reduction in certain low margin promotional programs and the discontinuation of our wholesale telecom business. The increase in Commissions and fees as a percentage of load value was attributable to the mix of prepaid products sold and an increase in the portion of our products sold internationally, which generally have higher Commissions and fees as a percentage of load value.

Program, Interchange, Marketing and Other Fees

Program, interchange, marketing and other fees increased 57.0%, or $10.5 million, to $28.9 million for the 12 weeks ended June 15, 2013 from $18.4 million for the 12 weeks ended June 16, 2012. This increase was driven primarily by a $3.4 million increase in other fees on certain Visa gift cards sold internationally, for which we had minimal revenues for the 12 weeks ended June 16, 2012, a 38.2%, or $2.7 million, increase in program management fees related to our Visa gift cards, and a 36.0%, or $2.5 million, increase in marketing revenues.

Product Sales

Product sales increased 37.0%, or $5.4 million, to $20.1 million for the 12 weeks ended June 15, 2013 from $14.7 million for the 12 weeks ended June 16, 2012. This increase was due to a 36.9%, or $3.3 million, increase in sales from Cardpool, which we acquired in the fourth quarter of 2011, and a 95.6%, or $2.7 million, increase in card production sales, partially offset by an 18.7%, or $0.6 million, decrease in telecom handset sales.

Operating Expenses

The following table sets forth our consolidated operating expenses for the 12 weeks ended June 15, 2013 and June 16, 2012.

	12 Weeks Ended			
	June 15, 2013	June 16, 2012	Change	
	(in thousands, except percentages)			
OPERATING EXPENSES:				
Distribution partner commissions	$ 118,153	$ 100,878	$ 17,275	17.1%
Processing and services	34,258	29,697	4,561	15.4%
Sales and marketing	39,948	27,543	12,405	45.0%
Costs of products sold	18,579	14,303	4,276	29.9%
General and administrative	9,545	8,632	913	10.6%
Total operating expenses	$ 220,483	$ 181,053	$ 39,430	21.8%

Distribution Partner Commissions

Distribution partner commissions expense increased 17.1%, or $17.3 million, to $118.2 million for the 12 weeks ended June 15, 2013 from $100.9 million for the 12 weeks ended June 16, 2012, primarily due to a 12.7%, or $19.9 million, increase in *Commissions and fees* revenue. In addition, Distribution partner commissions expense as a percentage of commissions and fees revenue increased 2.5 percentage points to 66.8% for the 12 weeks ended June 15, 2013 from 64.3% in the 12 weeks ended June 16, 2012 primarily due to increased commissions paid to Safeway as a result of amendments to our distribution partner agreements with Safeway (see *Note 6 Related-Party Transactions* in the notes to our condensed consolidated financial statements), changes to the distribution partner mix and an increase in the portion of our products sold internationally, which have higher average Distribution partner commissions paid as a percentage of load value. These amendments with Safeway increased the amount of *Distribution partner commissions* expense for the 12 weeks ended June 15, 2013 by $1.8 million as compared to what the expense would have been before the amendments.

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Processing and Services

Processing and services expenses increased 15.4%, or \$4.6 million, to \$34.3 million for the 12 weeks ended June 15, 2013 from \$29.7 million for the 12 weeks ended June 16, 2012. The increase is primarily due to a 7.3% increase in the total number of load transactions for the 12 weeks ended June 15, 2013 from the 12 weeks ended June 16, 2012. The \$4.6 million increase includes increases of \$1.5 million in merchandising costs, \$1.1 million in depreciation, equipment and data center lease expenses related to capitalized software projects and related hardware, \$0.9 million in supply chain costs, \$0.7 million in net employee and contractor compensation, benefits and travel related costs, and a \$0.4 million net increase in other costs. Processing and services expenses decreased as a percentage of total operating revenue to 15.2% in the 12 weeks ended June 15, 2013 from 15.6% in the 12 weeks ended June 16, 2012 due to improved leverage of our technology infrastructure.

Sales and Marketing

Sales and marketing expenses increased 45.0%, or \$12.4 million, to \$39.9 million for the 12 weeks ended June 15, 2013 from \$27.5 million for the 12 weeks ended June 16, 2012. The majority of the increase was due to a \$6.7 million increase in mark-to-market and amortization expense related to equity instruments held by distribution partners, recognized during the quarter primarily as a result of our Offering (see *Note 3 Capital Stock* in the notes to our condensed consolidated financial statements). Additionally, program marketing and development expenses increased by \$3.8 million, and the remainder of the \$1.8 million increase was attributable to increased employee compensation, benefits and travel related costs, and net increases for other costs.

Costs of Products Sold

Costs of products sold increased 29.9%, or \$4.3 million, to \$18.6 million for the 12 weeks ended June 15, 2013 from \$14.3 million for the 12 weeks ended June 16, 2012. Cardpool, which we acquired in the fourth quarter of 2011, accounted for \$2.8 million of the increase. In addition, telecom handset and other hardware costs decreased by \$0.9 million, and card production costs increased by \$2.4 million. Costs of products sold decreased to 92.3% of *Product sales* in the 12 weeks ended June 15, 2013 compared from 97.3% in the 12 weeks ended June 16, 2012 primarily due to an increase in Cardpool s gross margin percentage, partially offset by a decrease in gross margin percentage for card production sales.

General and Administrative

General and administrative expenses increased 10.6%, or \$0.9 million, to \$9.5 million for the 12 weeks ended June 15, 2013 from \$8.6 million for the 12 weeks ended June 16, 2012, primarily due to a \$1.4 million increase in employee compensation, benefits and travel related costs and a \$1.1 million net increase in other costs, partially offset by a \$1.5 million decrease in the expense resulting from the change in the estimated fair value of the Cardpool contingent consideration liability.

Other Income (Expense) and Income Tax Expense

The following table sets forth our consolidated other income (expense), and income tax expense and effective tax rates for the 12 weeks ended June 15, 2013 and June 16, 2012.

	12 Weeks Ended June 15, 2013	12 Weeks Ended June 16, 2012	Change	
	(in thousands, except percentages)			
OTHER INCOME (EXPENSE):				
Interest income and other income, net	\$ 96	\$ 303	\$ (207)	-68.3%
Interest expense		(9)	9	-100.0%
Total other income (expense)	\$ 96	\$ 294	\$ (198)	-67.3%
INCOME TAX EXPENSE	\$ 2,110	\$ 3,442	\$ (1,332)	-38.7%
EFFECTIVE TAX RATE	38.5%	37.2%	1.3%	

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Other Income (Expense)

Other income (expense) consists of interest and other income, other non-operating gains (losses) and interest expense. Interest and other income is earned primarily on *Overnight cash advances to Parent* balances, which is calculated based on average overnight commercial paper rates, and short-term investments. Interest and other income has fluctuated with the amount and duration of our cash available for short-term investments or *Overnight cash advances to Parent* and changes in short-term interest rates.

Income Tax Expense

Prior to the Offering, income tax expense, deferred income taxes and income taxes receivable and payable are calculated assuming that we file a hypothetical stand-alone income tax return for both federal and state purposes. After the Offering, income tax expense, deferred income taxes and income taxes receivable and payable are calculated on a stand-alone basis except for a hypothetical stand-alone income tax return for certain states where we will continue to be included in Safeway s consolidated tax return. We have historically been included in Safeway s consolidated group for U.S. federal income tax purposes and in certain consolidated, combined or unitary groups for state and local income tax purposes. We are also party to a tax sharing agreement with Safeway, or the TSA. Prior to our Offering, the TSA was generally designed to approximate the tax liability that for (i) U.S. federal income tax purposes, would be incurred if we filed our own federal consolidated income tax return separate from the Safeway consolidated group and (ii) state and local income tax purposes, would represent our proportionate share of the tax liability shown due on any state or local combined, consolidated or unitary state or local income tax return filed by Safeway in which we or any of our subsidiaries were included. As a result of our Offering, we will no longer be included in Safeway s federal tax return and certain state and local tax returns, and will begin to file tax returns and settle amounts due directly with such tax authorities. We will settle amounts due to or from Safeway related to fiscal periods prior to our Offering pursuant to the terms of the TSA and will continue to be included with Safeway in certain state and local tax returns and settle such amounts pursuant to the TSA. We do not expect that the change in tax status or settlement terms will materially affect our consolidated financial statements.

Our effective tax rate in the 12 weeks ended June 15, 2013 was 38.5%, compared to 37.2% in the 12 weeks ended June 16, 2012. The higher effective tax rate was attributable to an operating loss in one of our foreign subsidiaries for which we did not recognize an income tax benefit and higher amounts of non-deductible expenses resulting from mark-to-market expense on redeemable common stock, partially offset by an increased benefit for foreign rate differential and other net individually immaterial items.

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Comparison of the 24 Weeks Ended June 15, 2013 and June 16, 2012

The following table sets forth the revenue and expense amounts as a percentage of total operating revenues by the line items in our condensed consolidated statements of income for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended June 15, 2013	% of Total Operating Revenues	24 Weeks Ended June 16, 2012	% of Total Operating Revenues
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 321,294	78.2%	$ 277,363	81.2%
Program, interchange, marketing and other fees	53,265	13.0%	37,823	11.1%
Product sales	36,353	8.8%	26,335	7.7%
Total operating revenues	410,912	100.0%	341,521	100.0%
OPERATING EXPENSES:				
Distribution partner commissions	214,135	52.1%	178,582	52.3%
Processing and services	66,394	16.2%	55,812	16.3%
Sales and marketing	68,289	16.6%	49,369	14.5%
Costs of products sold	34,500	8.4%	25,831	7.6%
General and administrative	21,915	5.3%	18,549	5.4%
Total operating expenses	405,233	98.6%	328,143	96.1%
OPERATING INCOME	5,679	1.4%	13,378	3.9%
OTHER INCOME (EXPENSE):				
Interest income and other income, net	373	0.1%	710	0.2%
Interest expense		%	(10)	%
INCOME BEFORE INCOME TAX EXPENSE	6,052	1.5%	14,078	4.1%
INCOME TAX EXPENSE	2,428	0.6%	5,382	1.6%
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	3,624	0.9%	8,696	2.5%
Add: Loss attributable to non-controlling interest (net of tax)	213	0.1%	33	%
NET INCOME ATTRIBUTABLE TO BLACKHAWK	$ 3,837	0.9%	$ 8,729	2.6%

Operating Revenues

The following table sets forth our consolidated operating revenues for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended June 15, 2013	24 Weeks Ended June 16, 2012	Change	
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 321,294	$ 277,363	$ 43,931	15.8%
Program, interchange, marketing and other fees	53,265	37,823	15,442	40.8%
Product sales	36,353	26,335	10,018	38.0%
Total operating revenues	$ 410,912	$ 341,521	$ 69,391	20.3%

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Commissions and Fees

Commissions and fees revenue increased 15.8%, or $43.9 million, to $321.3 million for the 24 weeks ended June 15, 2013 from $277.4 million for the 24 weeks ended June 16, 2012. This increase was primarily due to a 16.0%, or $486.3 million, increase in Load value. Commissions and fees as a percentage of load value remained consistent at 9.1% for the 24 weeks ended June 15, 2013 and the 24 weeks ended June 16, 2012. The increase in Load value was primarily due to a 9.5% increase in the Number of load transactions and a 5.9% increase in the Average load transaction value. The increase in Number of load transactions reflects improved store productivity in the United States and internationally and the addition of new distribution partners in the United States and internationally, partially offset by a discontinuation of certain low-margin promotional programs and the discontinuation of our wholesale telecom business. The increase in Average load transaction value is primarily driven by tax refunds deposited onto our PayPower GPR cards. Commissions and fees as a percentage of load value was flat due to an increase in the portion of our products sold internationally, which generally have higher Commissions and fees as a percentage of load value, offset by tax refunds deposited onto our PayPower GPR cards, for which we do not earn *Commissions and fees* revenue.

Program, Interchange, Marketing and Other Fees

Program, interchange, marketing and other fees increased 40.8%, or $15.4 million, to $53.3 million for the 24 weeks ended June 15, 2013 from $37.8 million for the 24 weeks ended June 16, 2012. This increase was driven primarily by a 28.8%, or $4.5 million, increase in program management fees related to our Visa gift cards, a 32.0%, or $3.7 million, increase in marketing revenues, a $3.3 million increase in other fees on certain Visa gift cards sold internationally, for which we had minimal revenues for the 24 weeks ended June 16, 2012, and a 65.4%, or $2.0 million, increase in net interchange fees.

Product Sales

Product sales increased 38.0%, or $10.0 million, to $36.4 million for the 24 weeks ended June 15, 2013 from $26.3 million for the 24 weeks ended June 16, 2012. This increase was due to a 42.4%, or $7.4 million, increase in sales from Cardpool, which we acquired in the fourth quarter of 2011, and a 60.0%, or $2.9 million, increase in card production sales, partially offset by a 7.4%, or $0.3 million, decrease in telecom handset sales.

Operating Expenses

The following table sets forth our consolidated operating expenses for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended June 15, 2013	24 Weeks Ended June 16, 2012	Change	
	(in thousands, except percentages)			
OPERATING EXPENSES:				
Distribution partner commissions	$ 214,135	$ 178,582	$ 35,553	19.9%
Processing and services	66,394	55,812	10,582	19.0%
Sales and marketing	68,289	49,369	18,920	38.3%
Costs of products sold	34,500	25,831	8,669	33.6%
General and administrative	21,915	18,549	3,366	18.1%
Total operating expenses	$ 405,233	$ 328,143	$ 77,090	23.5%

Distribution Partner Commissions

Distribution partner commissions expense increased 19.9%, or $35.6 million, to $214.1 million for the 24 weeks ended June 15, 2013 from $178.6 million for the 24 weeks ended June 16, 2012, primarily due to a 15.8%, or $43.9 million, increase in *Commissions and fees* revenue. In addition, Distribution partner commissions expense as a percentage of commissions and fees revenue increased 2.2 percentage points to 66.6% in the 24 weeks ended June 15, 2013 from 64.4% in the 24 weeks ended June 16, 2012, primarily due to increased commissions paid to Safeway as a result of amendments to our distribution partner agreements with Safeway (see *Note 6 Related-Party Transactions* in the notes to our condensed consolidated financial statements) and changes to the distribution partner mix and an increase in the portion of our products sold internationally, which have higher average Distribution partner commissions paid as a percentage of load value. These amendments with Safeway increased the amount of *Distribution partner commissions* expense for the 24 weeks ended June 15, 2013 by $3.2 million as compared to what the expense would have been before the amendments.

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Processing and Services

Processing and services expenses increased 19.0%, or $10.6 million, to $66.4 million for the 24 weeks ended June 15, 2013 from $55.8 million for the 24 weeks ended June 16, 2012. The increase is primarily due to a 9.5% increase in Number of load transactions for the 24 weeks ended June 15, 2013 from the 24 weeks ended June 16, 2012. The $10.6 million increase includes increases of $2.9 million in net employee and contractor compensation, benefits and travel related costs, $2.3 million in depreciation, equipment and data center lease expenses related to capitalized software projects and related hardware, $1.5 million in merchandising costs, $1.4 million in supply chain costs, $1.3 million in in-store fixture amortization and other fixture costs, $0.9 million for card production costs, primarily related to our Visa Gift and PayPower GPR cards, and $0.3 million net increase in other costs. Processing and services expenses decreased as a percentage of total operating revenue to 16.2% in the 24 weeks ended June 15, 2013 from 16.3% in the 24 weeks ended June 16, 2012 due to increased leverage of our technology infrastructure.

Sales and Marketing

Sales and marketing expenses increased 38.3%, or $18.9 million, to $68.3 million for the 24 weeks ended June 15, 2013 from $49.4 million for the 24 weeks ended June 16, 2012. Program marketing and development expenses increased by $10.3 million from the 24 weeks ended June 16, 2012 to the 24 weeks ended June 15, 2013, and mark-to-market and amortization expense related to equity instruments held by distribution partners increased $6.4 million, primarily as a result of our Offering (see *Note 3 Capital Stock* in the notes to our condensed consolidated financial statements). The remainder of the $2.2 million increase was attributable to increased employee compensation, benefits and travel related costs, and net increases for other costs.

Costs of Products Sold

Costs of products sold increased 33.6%, or $8.7 million, to $34.5 million for the 24 weeks ended June 15, 2013 from $25.8 million for the 24 weeks ended June 16, 2012. Cardpool, which we acquired in the fourth quarter of 2011, accounted for $6.6 million of the increase. In addition, card production costs increased by $2.7 million, and telecom handset and other hardware costs decreased by $0.6 million. Costs of products sold decreased to 94.9% of product sales in the 24 weeks ended June 15, 2013 compared to 98.1% in the 24 weeks ended June 16, 2012 primarily due to an increase in Cardpool s gross margin percentage, partially offset by a decrease in gross margin percentage for card production sales.

General and Administrative

General and administrative expenses increased 18.1%, or $3.4 million, to $21.9 million in the 24 weeks ended June 15, 2013 from $18.5 million for the 24 weeks ended June 16, 2012, primarily due to a $2.5 million increase in employee compensation, benefits and travel related costs, a $0.9 million increase in bad debt expense, and $1.1 million net increase in other costs, partially offset by a $1.1 million decrease in the expense resulting from the change in the estimated fair value of the Cardpool contingent consideration liability.

Other Income (Expense) and Income Tax Expense

The following table sets forth our consolidated other income (expense), and income tax expense and effective tax rates for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended			
	June 15, 2013	June 16, 2012	Change	
	(in thousands, except percentages)			
OTHER INCOME (EXPENSE):				
Interest income and other income, net	$ 373	$ 710	$ (337)	-47.5%
Interest expense		(1 0)	10	-100.0%
Total other income (expense)	$ 373	$ 700	$ (327)	-46.7%
INCOME TAX EXPENSE	$ 2,428	$ 5,382	$ (2,954)	-54.9%
EFFECTIVE TAX RATE	40.1%	38.2%	1.9%	

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Other Income (Expense)

Other income (expense) consists of interest and other income, other non-operating gains (losses) and interest expense. Interest and other income is earned primarily on *Overnight cash advances to Parent* balances, which is calculated based on average overnight commercial paper rates, and short-term investments. Interest and other income has fluctuated with the amount and duration of our cash available for short-term investments or the *Overnight cash advances to Parent* and changes in short-term interest rates.

Income Tax Expense

Prior to the Offering, income tax expense, deferred income taxes and income taxes receivable and payable are calculated assuming that we file a hypothetical stand-alone income tax return for both federal and state purposes. After the Offering, income tax expense, deferred income taxes and income taxes receivable and payable are calculated on a stand-alone basis except for a hypothetical stand-alone income tax return for certain states where we will continue to be included in Safeway s consolidated tax return. We have historically been included in Safeway s consolidated group for U.S. federal income tax purposes and in certain consolidated, combined or unitary groups for state and local income tax purposes. We are also party to a tax sharing agreement with Safeway, or the TSA. Prior to our Offering, the TSA was generally designed to approximate the tax liability that for (i) U.S. federal income tax purposes, would be incurred if we filed our own federal consolidated income tax return separate from the Safeway consolidated group and (ii) state and local income tax purposes, would represent our proportionate share of the tax liability shown due on any state or local combined, consolidated or unitary state or local income tax return filed by Safeway in which we or any of our subsidiaries were included. As a result of our Offering, we will no longer be included in Safeway s federal tax return and certain state and local tax returns, and will begin to file tax returns and settle amounts due directly with such tax authorities. We will settle amounts due to or from Safeway related to fiscal periods prior to our Offering pursuant to the terms of the TSA and will continue to be included with Safeway in certain state and local tax returns and settle such amounts pursuant to the TSA. We do not expect that the change in tax status or settlement terms will materially affect our consolidated financial statements.

Our effective tax rate in the 24 weeks ended June 15, 2013 was 40.1%, compared to 38.2% in the 24 weeks ended June 16, 2012. The higher effective tax rate was attributable to an operating loss in one of our foreign subsidiaries for which we did not recognize an income tax benefit and higher amounts of non-deductible expenses resulting from mark-to-market expense on redeemable common stock, partially offset by an increased benefit for foreign rate differential and individually immaterial items.

Liquidity and Capital Resources

The following table sets forth the major sources and uses of cash for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended	
	June 15, 2013	June 16, 2012
	(in thousands)	
Net cash used in operating activities	$ (488,669)	$ (548,554)
Net cash provided by investing activities	423,608	438,380
Net cash used in financing activities	(886)	(1,123)
Effect of exchange rates on cash and cash equivalents	(2,335)	252
Net decrease in cash and cash equivalents	$ (68,282)	$ (111,045)

Free Cash Flow

Free cash flow is calculated as the net cash flow from operating activities adjusted to exclude the impact from changes in *Settlement payables* and *Settlement receivables*, less expenditures for property, equipment and technology. Cash from the sale of prepaid products is held for a short period of time and then remitted, less our commissions, to our content providers, and is significantly impacted by the portion of gift card sales that occur in late December. Because this cash flow is temporary and highly seasonal, it is not available for other uses, and it is therefore excluded from our calculation of free cash flow. Free cash flow provides information regarding the cash that our business generates without the fluctuations resulting from the timing of cash inflows and outflows from gift card sales in late December, which we believe is useful to understanding our business. Please see Liquidity and Capital Resources Cash Flows from Operating Activities for additional information. The following table sets forth our free cash flow for the 24 weeks ended June 15, 2013 and June 16, 2012.

	24 Weeks Ended	
	June 15, 2013	June 16, 2012
	(in thousands)	
Net cash used in operating activities	$ (488,669)	$ (548,554)
Decrease in settlement payables, net of settlement receivables	490,893	535,610
Net cash provided by (used in) operating activities, as adjusted	2,224	(12,944)
Expenditures for property, equipment and technology and intangible assets	(15,110)	(10,681)
Free cash flow (1)	$ (12,886)	$ (23,625)

(1) Our Free cash flow is a non-GAAP financial measure. Generally, a non-GAAP financial measure is a numerical measure of a company s performance, financial position or cash flow that either excludes or includes amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP. This measure, however, should be considered in addition to, and not as a substitute for or superior to cash flows or other measures of the financial performance prepared in accordance with GAAP.

Cash Flows from Operating Activities

A significant portion of gift card sales occurs in late December of each year during the holiday selling season. As a result, we earn a significant portion of revenues, net income and cash inflows during the fourth fiscal quarter of each year and remit the majority of the cash, less commissions, to our content providers in January of the following year. The timing of our fiscal year-end, December holiday sales and the related January cash settlement with content providers significantly increases our *Cash and cash equivalents*, *Overnight cash advances to Parent*, *Settlement receivables* and *Settlement payables* balances at the end of each fiscal year relative to normal daily balances. The cash settlement with our content providers in January accounts for the majority of the use of cash from operating activities in our condensed consolidated statements of cash flows during our first three fiscal quarters. As a result, the year over year comparison of cash generated by operating activities and total changes in cash can vary significantly. Please see Liquidity and Capital Resources Free Cash Flow for additional information.

The $488.7 million of net cash used in operating activities in the 24 weeks ended June 15, 2013 resulted from $3.6 million of net income, the adjustment for non-cash operating expenses of $28.6 million (including $10.7 million for depreciation and amortization, $8.7 million for program development cost amortization, $3.5 million for employee stock-based compensation and $7.0 million for distribution partner mark-to-market expense, partially offset by $0.9 million for a mark-to-market decrease in the fair value of the Cardpool contingent consideration liability) and cash flow increases of $285.0 million, $21.6 million and $7.4 million from changes in settlement receivables, accounts receivable, current and long-term, and prepaid expenses and other current assets, and cash flow decreases of $775.9 million, $30.4 million, $17.8 million, $10.1 million and $0.6 million from changes in settlement payables, accounts payable and accrued liabilities, income taxes, net, other assets and other liabilities, respectively.

The $548.6 million of net cash used in operating activities in the 24 weeks ended June 16, 2012 resulted from $8.7 million of net income, the adjustment for non-cash operating expenses of $19.3 million (including $8.1 million for depreciation and amortization, $7.7 million for program development cost amortization, $2.2 million for employee stock-based compensation and $1.3 million for distribution partner mark-to-market expense), cash flow increases of $47.0 million, $10.1 million and $1.6 million from changes in settlement receivables, accounts receivable, current and long-term and prepaid expenses and other current assets, respectively, and cash flow decreases of $582.6 million, $28.9 million, $17.5 million and $6.0 million from changes in settlement payables, accounts payable and accrued liabilities, income taxes, net and other assets, respectively.

Cash Flows from Investing Activities

Safeway may borrow a portion of our cash balances and invest these amounts in overnight investments. As of June 15, 2013 and June 16, 2012, *Overnight cash advances to Parent* were $65.0 million and $149.7 million, respectively. The average daily *Overnight cash advances to Parent* during the 24 weeks ended June 15, 2013 and June 16, 2012 were $77.4 million and $174.3 million, respectively. Other than the change in *Overnight cash advances to Parent*, net cash used in investing activities consisted of expenditures for property, equipment and technology and intangible assets of $15.1 million and $10.7 million for the 24 weeks ended June 15, 2013 and June 16, 2012, respectively, and a cash flow increase for the change in restricted cash of $9.0 million for the 24 weeks ended June 15, 2013, which was released as a result of our Offering.

Cash Flows from Financing Activities

The net cash used in financing activities for the 24 weeks ended June 15, 2013 was $0.9 million, primarily consisting of payments of $1.9 million for our Cardpool acquisition liability, partially offset by $0.8 million for reimbursements, net of payments, for costs related to the Offering. The net cash used in financing activities for the 24 weeks ended June 16, 2012 was $1.1 million, consisting primarily of the repurchase of employee equity awards and common stock.

Off- Balance Sheet Arrangements

From time to time, we enter into contracts containing provisions that contingently require us to indemnify various parties against certain potential claims from third parties. Under contracts with certain issuing banks, we are responsible to the banks for any unrecovered overdrafts on cardholders accounts. Under contracts with certain content and distribution partners, we are responsible for potential losses resulting from certain claims from third parties. Because the indemnity amounts associated with these types of agreements are not explicitly stated, the maximum amount of the obligation cannot be reasonably estimated. Historically, we have paid limited amounts pursuant to these indemnification provisions.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to certain market risks in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in foreign currency exchange rates. We do not hedge this exposure as, to date, it has not been significant. We also have exposure to interest rate risk to the extent we invest our cash with third-party financial institutions. Safeway may also borrow our cash through overnight advances.

Interest Rate Risk

We are exposed to interest rate risk associated with the investment of available cash. We invest available cash in conservative short-term instruments and are primarily subject to changes in short-term interest rates.

Currency Risk

We currently have international operations in countries which include Australia, Canada, Mexico, the United Kingdom, other countries in the European Union and Asia. Commercial bank accounts denominated in the local currency for operating purposes are maintained in each country. The functional currency in each location is the local currency. Fluctuations in exchange rates of the U.S. dollar against foreign currencies can result, and have resulted, in foreign exchange translation gains and losses. We had unrealized foreign currency translation losses of approximately $1.8 and $0.1 million for the 24 weeks ended June 15, 2013 and June 16, 2012, respectively. Our realized foreign transaction gains and losses were immaterial in the 24 weeks ended June 15, 2013 and June 16, 2012. If exchange rates on such currencies were to fluctuate 10%, we believe that our consolidated financial position, results of operations and cash flows would not be materially affected.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 15, 2013. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of June 15, 2013, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more persons or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved from time to time in various legal proceedings arising in the ordinary course of business, including the matters described below. Although the outcome of any pending matters, including the matters described below, and the amount, if any, of our ultimate liability and any other forms of remedies with respect to these matters, cannot be determined or predicted with certainty, we do not believe that the ultimate outcome of these matters will have a material adverse effect on our business, results of operations or financial condition.

We have been the subject of other claims and litigation in the past, and could be the subject of additional litigation and regulatory or judicial proceedings or investigations in the future.

For example, a trademark opposition proceeding was filed with the Trademark Trial and Appeal Board on January 3, 2012, challenging our right to register the trademark PayPower (PowerPay LLC v. Blackhawk Network, Inc., Opposition No. 91203215). We presently expect the matter to be resolved by early 2014. Although the outcome of this proceeding may affect whether or not we are or will be entitled to use the PayPower mark in the U.S., we do not expect the resolution of the proceeding to have a material adverse effect on our business or financial condition.

Our industry has seen an increase in patent litigation in recent years, as there are a wide array of patents and pending patent applications related to the technologies used in the prepaid industry. As a result, third parties have asserted infringement claims against many participants in the prepaid industry. One example is a litigation being prosecuted against a number of our content providers: Alexsam, Inc. v. Best Buy Co., Inc. et al, filed in the United States District Court for the Eastern District of Texas in March 2010, alleging patent infringement in connection with activation of prepaid cards. Alexsam was successful in other patent litigation in 2011. The defendants have denied the claims and are vigorously defending the infringement allegations. Initial consolidated trials upheld the validity and enforceability of the Alexsam patents in late April 2013 and early May 2013. Separate infringement trials started in May 2013. The first litigation was settled in May 2013, and the next two trials resulted in verdicts of non-infringement by the defendants in June 2013. Four additional trials are pending. The next is set to begin in October 2013. We believe that a judgment or settlement with Alexsam that would have a material adverse effect on our business, results of operations or financial condition is currently not probable. In addition, due to a number of factors including the complexity of the case, number of entities involved and unpredictability of the outcome, we believe that the range of reasonably possible losses is not estimable. However, if Alexsam succeeds, our content providers (including those not subject to the litigation) may be required to pay past and future royalties or future license fees (and may rely on us for indemnification of some of those payments) which could have a material adverse effect on our business, results of operations and financial condition.

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ITEM 1A. RISK FACTORS

You should carefully consider the risks described below and the other information in this Quarterly Report on Form 10-Q. The occurrence of any of the events or circumstances described below or other adverse events could have a material adverse effect on our business, results of operations and financial condition. Additional risks or uncertainties not presently known to us or that we currently deem immaterial may also harm our business.

Risks Related to Our Business and Industry

We may not be able to grow at historic rates in the future, if at all.

Our revenues have grown rapidly, increasing from $577.7 million in 2010 to $959.1 million in 2012, representing a compound annual growth rate of 28.8%. There can be no assurance that we will be able to continue our historic growth rates in future periods. Our ability to maintain and grow our business depends on a number of factors, many of which are outside our control. These include:

- changes in consumer preferences and demand for the products and services that we offer;
- our ability to retain and attract new customers, both in-store and online;
- our ability to maintain and expand our distribution network;
- our ability to maintain and expand the supply and variety of products and services that we distribute and offer;
- our ability to increase the productivity of our distribution partners stores, including through in-store execution of marketing, loyalty and merchandising programs;
- our ability to anticipate and adapt to technological changes in the industry, as well as to develop new technologies to deliver our product and service offerings;
- our ability to maintain our relationships with issuing banks and other industry participants;
- pricing pressure in the face of increasing competition and other market forces;
- regulatory changes or uncertainty that increase compliance costs, decrease the attractiveness of the products and services we offer or make it more difficult or less attractive for us, our distribution partners or our content providers, including issuing banks, to participate in our industry; and
- consumer acceptance of our product and services offerings in international markets, and our ability to grow our international operations and manage related regulatory compliance and foreign currency risk.

Even if we are successful in increasing our operating revenues through our various initiatives and strategies, we may experience a decline in growth rates and/or an increase in expenses, which could have a material adverse effect on our business, results of operations and financial condition.

Our operating revenues may decline if we lose one or more of our top distribution partners, fail to maintain existing relationships with our distribution partners or fail to attract new distribution partners to our network, or if the financial performance of our distribution partners businesses declines.

The success of our business depends in large part upon our relationships with distribution partners, including Safeway. During 2012, 2011 and 2010, Safeway was our largest distribution partner, measured by operating revenues, and represented approximately 12.2%, 14.5% and 16.6% of our operating revenues, respectively, and our top four largest distribution partners excluding Safeway (each also a conventional grocery retailer), represented approximately 35.6%, 36.4% and 35.8% of our operating revenues, respectively.

Many of our distribution partner agreements are subject to renewal every three to five years. Upon expiration of their agreements with us, our distribution partners may enter into relationships with our competitors instead of renewing their agreements with us, renew their agreements with us on less favorable terms or establish direct relationships with our content providers. There is no assurance that we will be able to continue our relationships with these distribution partners on the same terms, or at all, in future periods. Among other things, many of our distribution partner agreements, including our agreement with Safeway, contain varying degrees of exclusivity for us as the provider of prepaid products in their stores, and it is important to our competitive positioning to maintain those exclusive relationships. Our operating results could be materially and adversely affected if any of our significant distribution partners terminates, fails to renew or fails to renew on similar or more favorable terms, its agreement with us. In addition, exclusive relationships between potential distribution partners and our competitors as well as other commercial arrangements may make it difficult for us to attract new distribution partners to our network.

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The success of our business also depends on the continued success of our distribution partners businesses. Accordingly, our operating results may fluctuate with the performance of our partners businesses, including their ability to maintain and increase consumer traffic in their stores.

We rely on our content providers for our product and service offerings, and the loss of one or more of our top content providers or a decline in demand for their products, or our failure to maintain existing exclusivity arrangements with content providers or to attract new content providers to our network, could have a material adverse effect on our business, results of operations and financial condition.

The success of our business depends, in large part, on our ability to offer a wide array of quality content. Our agreements with our content providers generally range from one to three years in length. There can be no assurance that we will be able to negotiate a renewal of those agreements on satisfactory terms or at all. Some of these agreements also permit the content providers to terminate their agreements with us prior to expiration if we fail to meet certain operational performance standards, among other reasons. In addition, we distribute the open loop gift and reloadable products of certain of our competitors, such as American Express, Green Dot and NetSpend. These content providers may choose to cease doing business with us for competitive or other reasons.

Many of our content provider agreements specify varying degrees of exclusivity for Blackhawk as a third-party distributor. Failure to maintain the same level of exclusivity of any of our agreements, whether upon renewal with our content providers or otherwise, could adversely affect our business, results of operations and financial condition. The exclusive arrangements that we have been able to negotiate vary widely, and in many instances exclusivity is limited to particular channels, such as conventional grocery retailer channels, or more narrowly. Our content providers with limited or no exclusivity arrangements may decide to establish direct relationships with our distribution partners or use other third-party distributors to sell through existing or other channels. Our content providers may also eliminate their third-party distribution relationships entirely and offer their cards only in their own physical and online retail locations. Certain of our content providers represent a significant portion of our revenues, one of which represented 12% in 2012.

Some of our contracts with content providers require a guarantee of our payment obligations by Safeway, our parent company. These guarantees were to expire upon certain events, such as the consummation of our initial public offering. Some of these guarantees have been extended for various periods to allow for us to provide other adequate security or demonstrate sufficient financial viability to eliminate the need for such guarantees. Failure to provide adequate security or our failure to demonstrate our independent financial viability to certain content providers, or to any new content providers who may require security in the future, may adversely affect our ability to maintain our relationships with our content providers or adversely affect our cash flows.

Our ability to grow our business depends, in large part, on our ability to expand our product offerings by adding new content providers. Exclusive relationships between other content providers and our competitors may make it more difficult for us to attract new content providers to our network. In addition, some of our agreements with content providers prohibit us from offering products of those providers competitors. If we are not able to attract new content providers due to exclusivity arrangements, competitive factors or otherwise, our business may suffer.

The success of our business is heavily dependent on consumer demand for our content providers products and services. Any factors negatively affecting our content providers or their industries, including those discussed elsewhere in this Risk Factors section, could have a material adverse effect on our business, results of operations and financial condition.

We rely on relationships with card issuing banks for services related to products for which we act as program manager, and our business, results of operations and financial condition could be materially and adversely affected if we fail to maintain these relationships or if we maintain them under new terms that are less favorable to us.

We rely on issuing banks for critical services, such as membership in the Visa card association and provision of Federal Deposit Insurance Corporation, or FDIC, insured depository accounts tied to our program-managed GPR cards. MetaBank is one of the issuing banks for our proprietary GPR products and open loop products and, in 2011, was the issuing bank for substantially all of our proprietary open loop gift and GPR products. If our relationship with MetaBank deteriorates, it could hinder our ability to grow our business and have a material adverse effect on our business, results of operations and financial condition.

According to the public disclosures of MetaBank, a Supervisory Directive issued in 2010 by the Office of Thrift Supervision, or the OTS, now the Office of the Comptroller, or the OCC, and a Cease and Desist Order issued in July 2011, require MetaBank to obtain prior written approval of the OCC in order to, among other things, enter into any new third-party relationship agreements concerning any credit or deposit product (including prepaid access), materially amend any such existing agreements and publicly announce any new third-party relationship agreements or material amendments to existing agreements. These directives and orders have limited or prevented our ability to offer MetaBank-issued cards to new distribution partners. If, as a result of the 2010 Supervisory Directive, the 2011 Cease and Desist Order or further OCC actions, MetaBank is unable to continue to service our existing needs or support our future growth, we may be forced to move our cards issued through MetaBank to another issuing bank.

Although we have entered into an agreement with University National Bank as a second issuing bank for proprietary Visa gift cards and with The Bancorp Bank, or Bancorp, as a second issuing bank for Visa-branded GPR cards, there can be no assurance that we will be able to reduce the risk associated with our reliance on MetaBank. We continue to use MetaBank as the issuing bank for a substantial majority of our proprietary Visa gift cards, and we cannot provide any guarantee that we will continue to achieve comparable financial terms related to these programs if we are required, or elect, to reduce or eliminate our issuances through MetaBank. Further, we may not be able to renew our existing agreements with issuing banks or enter into relationships with additional banks on acceptable terms, or at all, in which case we would incur significant transition and other costs and expenses, and users of our products and services could be significantly affected. In addition, there has been increased regulatory scrutiny of products and services that are offered by issuing banks (including our issuing banks) in conjunction with third parties. To the extent that our bank-issued products become the subject of such regulation, we may face increased compliance costs and limits on our product offerings, among other consequences. If any material adverse event were to affect MetaBank, University National Bank, Bancorp or any other issuing bank with whom we have a relationship, including a decline in their financial condition, a decline in the quality of their services, loss of their deposits, their failure or inability to comply with applicable banking and financial regulatory requirements (including the 2010 Supervisory Directive or further regulatory actions), a systems failure or their inability to pay us fees or outstanding receivable balances, then our business, results of operations and financial condition could be materially and adversely affected.

If our distribution partners fail to actively and effectively promote our products and services, our future growth and results of operations may suffer.

Substantially all of our operating revenues are derived from sales of our products and services at the locations of our distribution partners. Our success depends heavily on the retail execution of our distribution partners in promoting the prepaid products supplied by our content providers, which we can facilitate but do not control. For example, the in-store placement and size of our prepaid card displays, as well as the marketing and merchandising efforts of our distribution partners for our products and services, all have an impact on the number and load value of products and services sold. Although we advise our distribution partners concerning optimal display of the card content, our contracts allow distribution partners to exercise significant discretion over the placement and promotion of our products in their stores. In addition, those of our distribution partners who only have basic displays of our products may not be willing or able to implement enhanced displays and marketing efforts, which could significantly harm our ability to grow our business. If our distribution partners give more favorable placement or promotion to the products and services of our competitors, or otherwise fail to effectively market our products and services, our results of operations may suffer.

Historically, inclusion of our products and services in certain of our distribution partners customer loyalty programs has resulted in significant increases in sales of our products and services for certain of such partners. An important part of our growth strategy is to continue to implement and expand these loyalty programs. However, customer participation in these loyalty programs may decline, or our distribution partners may fail to adopt new loyalty programs that include our distributed products and services, change their existing loyalty programs in a manner that reduces or eliminates inclusion of our products and services or reduces the programs effectiveness or terminate their existing loyalty programs altogether. For example, some of these loyalty programs provide for discounts on gasoline. To the extent fuel prices decline or our distribution partners reduce the discount, customer participation in these loyalty programs may also decline. Any of these events could have a material adverse effect on our business, results of operations and financial condition.

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We operate in a highly and increasingly regulated environment, and failure by us or the businesses that participate in our distribution network to comply with applicable laws and regulations could have a material adverse effect on our business, results of operations and financial condition.

We and our content providers and distribution partners are subject to a wide variety of federal, state, local and foreign laws and regulations. This legal and regulatory landscape has significantly expanded and has become increasingly complex in recent years, and we expect such trends to continue. These laws and regulations presently include, among others:

- federal anti-money laundering laws and regulations, including the USA PATRIOT Act, the Bank Secrecy Act, anti-terrorist financing laws and anti-bribery and corrupt practice laws and regulations;
- federal and state consumer protection laws and regulations;
- state unclaimed property laws and money transmitter licensing requirements; and
- foreign jurisdiction payment services industry regulations.

Costs of compliance or penalties for failure to comply with these laws and regulations could have a material adverse effect on our business, financial condition and results of operations.

The laws and regulations applicable to our business, and to the businesses of our content providers and distribution partners, are often unclear and may differ or conflict between jurisdictions, rendering compliance difficult and costly. Failure by us and our regulated subsidiaries or businesses that participate in our distribution network to comply with all applicable laws and regulations could result in fines and penalties, limitations on our ability to conduct our business, or governmental or third-party actions. Regulatory agencies in these matters may seek recovery of large or indeterminate amounts or seek to have aspects of our business or that of our business partners modified or suspended. The outcome of regulatory proceedings or investigations is difficult to predict. Any fines, penalties or limitations on our business could significantly harm our reputation with consumers and other program participants, as well as the reputation of the banks that issue open loop cards that we manage, any and all of which could materially and adversely affect our business, operating results and financial condition, including potentially decreasing acceptance and use of, and loyalty to, our products and services. In addition, if our content providers and distribution partners have adverse experiences resulting from regulatory compliance obligations arising from their relationships with us, they may seek to curtail, terminate or adversely modify those relationships, which could harm our business, operating results and financial condition. In addition, we perform various compliance functions on behalf of our issuing banks, and any failure to perform those functions properly could result in contractual claims brought against us by our issuing banks.

We are increasingly facing more stringent anti-money laundering rules and regulations, compliance with which may increase our costs of operation, decrease our operating revenues and disrupt our business.

We are subject to the Bank Secrecy Act, or the BSA, as amended by the USA PATRIOT Act, or the Patriot Act. Our wholly-owned subsidiary, Blackhawk Network California, Inc., is a registered money services business subject to reporting requirements related to anti-money laundering compliance obligations arising under the Patriot Act and its implementing regulations. A more aggressive enforcement of the BSA and other federal anti-money laundering and terrorist financing prevention laws or more onerous regulation could increase our or our distribution partners compliance costs or require changes in, or place limits upon, the products and services we offer, which in turn could have a material adverse effect on our business, results of operations and financial condition.

In the event that we were to become a provider of prepaid access in the future, either due to a change in Financial Crimes Enforcement Network s, or FinCEN s, position or our introduction of new products and services, we would be required to comply with the requirements of FinCEN s Prepaid Access Rule as they apply to providers of prepaid access, which include obligations to obtain personal identifying information for each person that purchases a prepaid access product through our programs and retain access to such information for five years after the last use of such product, serve as a central source of information for law enforcement and file reports of suspicious transactions with the U.S. Treasury Department. Registration as a provider under the Prepaid Access Rule would result in increased costs and diversion of resources away from our core operations.

If any of our content providers is unwilling or unable to make any required operational changes to fall within the exclusions provided under the Prepaid Access Rule, we would no longer be able to distribute such products of the content provider for sale through our program without our or our retail distribution partners taking on an obligation to comply with the Prepaid Access Rule in full. Moreover, the compliance costs and risks associated with the Prepaid Access Rule may discourage content providers and distribution partners from participating in our network, which could have a material adverse effect on our business, results of operations and financial condition. In addition, abuse of our prepaid products for purposes of money laundering or terrorist financing could cause reputational or other harm that could have a material adverse effect on our business, results of operations and financial condition. Please see the risk factor titled Fraudulent and other illegal activity involving our products and services could lead to reputational and financial harm to us and reduce the use and acceptance of our prepaid access products and services for additional information.

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Abuse of our prepaid products for purposes of financing sanctioned countries or corruption could cause reputational or other harm that could have a material adverse effect on our business, results of operations and financial condition.

We are subject to an array of federal anti-terrorism and anti-bribery legislation such as a series of laws administered by the U.S. Treasury Department s Office of Foreign Assets Control and the Foreign Corrupt Practices Act. Abuse of our prepaid products for purposes of financing sanctioned countries or corruption could cause reputational or other harm that could have a material adverse effect on our business, results of operations and financial condition. Increasing regulatory scrutiny of our industry with respect to terrorist financing or corruption could result in more aggressive enforcement of such laws or more onerous regulation, which could increase our compliance costs or require changes in, or place limits upon, the products and services we offer, and which in turn could have a material adverse effect on our business, results of operations and financial condition.

Failure to comply with, or further expansion of, consumer protection regulations could have a material adverse effect on our business, results of operations and financial condition.

We are subject to federal regulation aimed at consumer protection. For example, the Credit Card Accountability, Responsibility, and Disclosure Act of 2009, or the CARD Act, imposes requirements relating to disclosures, fees and expiration dates that are generally applicable to gift certificates and prepaid cards. We believe that GPR cards and the maintenance fees charged on our GPR cards are exempt from these requirements under an express exclusion for cards that are reloadable and not marketed or labeled as a gift card or gift certificate. However, this exclusion is not available if the issuer, the distribution partner or the program manager promotes, even if occasionally, the use of the card as a gift card or gift certificate. We provide our distribution partners with instructions and policies regarding the display and promotion of our GPR cards so that retailers do not market our GPR cards as gift cards. For example, we instruct retailers to separate or otherwise distinguish our GPR cards from gift cards on their displays. However, we do not control our distribution partners and cannot assure that they will comply with our instructions and policies. If displayed incorrectly, it is possible that our GPR cards would lose their eligibility for this exclusion from the CARD Act requirements, and therefore could be deemed to be in violation of the CARD Act, which could result in the imposition of fines, the suspension of our ability to offer GPR cards, civil liability, criminal liability and the inability of our issuing banks to apply certain fees to our GPR cards, each of which could have a material adverse effect on our business, results of operations and financial condition.

Furthermore, on May 24, 2012, the Consumer Financial Protection Bureau, or the CFPB, published an advance notice of proposed rulemaking regarding GPR cards, in which the CFPB posed a series of questions relating to potential application of certain provisions of the Electronic Funds Transfer Act and Regulation E (such as those related to disclosure requirements, periodic reporting, error resolution procedures and liability limitations) to GPR products. While we believe that it is appropriate to apply a limited set of Regulation E provisions to GPR products that are intended for repeated self-use, other components of Regulation E compliance (such as those that would require obtaining customer information at the time of sale) would be highly disruptive to our distribution partners business and may materially increase our or our distribution partners costs of operation or disrupt our business. For that reason, we have advocated for alternative methods of providing account transaction information currently used by many payroll card providers, such as information available by telephone or online. However, there can be no assurance that the ultimate rule will adopt the position we have advocated. Other aspects of Regulation E compliance could impose additional obligations on our issuing banks or us, which could increase our costs of operations or make our issuing banks unwilling to engage in the GPR business.

We may become subject to further regulation by the CFPB, which was created under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act. On July 17, 2012, the CFPB issued a final rule defining certain nonbank larger participants in markets for consumer financial products or services. It is uncertain whether the CFPB will include money transmission, check cashing and prepaid cards within the definition of larger participant as well as what criteria and which thresholds should be used to define larger participants. At this time, we are not certain whether we will be considered a larger participant under the CFPB s final rules. It is possible that the CFPB could propose and adopt rules that would give the CFPB regulatory, supervisory and enforcement powers over us. The CFPB can obtain cease and desist orders, which may include orders for restitution or rescission of contracts as well as other kinds of affirmative relief, and monetary penalties ranging from $5,000 per day for ordinary violations of federal consumer financial laws to $25,000 per day for reckless violations and $1 million per day for knowing violations. Also, where a company has violated the Dodd-Frank Act or CFPB regulations, the Dodd-Frank Act empowers state attorneys general and state regulators to bring civil actions for the type of cease and desist orders available to the CFPB. Expanded CFPB jurisdiction over our business may increa