

BLACKHAWK NETWORK HOLDINGS, INC  
Form 10-Q  
October 19, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 10, 2016

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 43-2099257  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

6220 Stoneridge Mall Road 94588  
Pleasanton, CA (Zip Code)  
(Address of Principal Executive Offices) (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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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  (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

As of October 12, 2016, there were 55,377,000 shares of the Registrant's common stock outstanding.



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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)

|   | September 10,<br>2016 | January 2,<br>2016 | September 12,<br>2015 |
|---|-----------------------|--------------------|-----------------------|
| <b>ASSETS</b>                           |                       |                    |                       |
| Current assets:                         |                       |                    |                       |
| Cash and cash equivalents               | \$ 300,349            | \$914,576          | \$ 214,722            |
| Restricted cash                         | 2,500                 | 3,189              | 43,043                |
| Settlement receivables, net             | 275,471               | 626,077            | 240,273               |
| Accounts receivable, net                | 199,552               | 241,729            | 188,912               |
| Other current assets                    | 123,919               | 103,319            | 107,950               |
| Total current assets                    | 901,791               | 1,888,890          | 794,900               |
| Property, equipment and technology, net | 168,865               | 159,357            | 154,085               |
| Intangible assets, net                  | 293,034               | 240,898            | 230,213               |
| Goodwill                                | 508,607               | 402,489            | 382,803               |
| Deferred income taxes                   | 352,683               | 339,558            | 361,284               |
| Other assets                            | 69,039                | 81,764             | 78,294                |
| <b>TOTAL ASSETS</b>                     | <b>\$ 2,294,019</b>   | <b>\$3,112,956</b> | <b>\$ 2,001,579</b>   |

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS (continued)  
 (In thousands, except par value)  
 (Unaudited)

|  | September 10,<br>2016 | January 2,<br>2016  | September 12,<br>2015 |
|--|-----------------------|---------------------|-----------------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                     |                       |
| Current liabilities:   |                       |                     |                       |
| Settlement payables  | \$ 522,133            | \$ 1,605,021        | \$ 469,590            |
| Consumer and customer deposits   | 115,085               | 84,761              | 102,633               |
| Accounts payable and accrued operating expenses  | 103,920               | 119,087             | 112,753               |
| Deferred revenue   | 113,867               | 113,458             | 91,474                |
| Note payable, current portion  | 9,846                 | 37,296              | 37,378                |
| Notes payable to Safeway   | 3,239                 | 4,129               | 13,129                |
| Bank line of credit  | —                     | —                   | 100,000               |
| Other current liabilities  | 48,630                | 57,342              | 43,320                |
| Total current liabilities  | 916,720               | 2,021,094           | 970,277               |
| Deferred income taxes  | 19,930                | 18,652              | 14,735                |
| Note payable   | 137,848               | 324,412             | 325,151               |
| Convertible notes payable  | 425,833               | —                   | —                     |
| Other liabilities  | 25,429                | 14,700              | 4,867                 |
| Total liabilities  | 1,525,760             | 2,378,858           | 1,315,030             |
| Commitments and contingencies (see Note 9)   |                       |                     |                       |
| Stockholders' equity:  |                       |                     |                       |
| Preferred stock: \$0.001 par value; 10,000 shares authorized; no shares outstanding                                    | —                     | —                   | —                     |
| Common stock: \$0.001 par value; 210,000 shares authorized; 55,368, 55,794 and 54,641 shares outstanding, respectively | 55                    | 56                  | 55                    |
| Additional paid-in capital   | 594,739               | 561,939             | 547,230               |
| Accumulated other comprehensive loss   | (34,398)              | (40,195)            | (31,535)              |
| Retained earnings  | 203,791               | 207,973             | 166,370               |
| Total Blackhawk Network Holdings, Inc. equity  | 764,187               | 729,773             | 682,120               |
| Non-controlling interests  | 4,072                 | 4,325               | 4,429                 |
| Total stockholders' equity   | 768,259               | 734,098             | 686,549               |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 2,294,019</b>   | <b>\$ 3,112,956</b> | <b>\$ 2,001,579</b>   |
| See accompanying notes to condensed consolidated financial statements  |                       |                     |                       |

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BLACKHAWK NETWORK HOLDINGS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)  
 (In thousands, except for per share amounts)  
 (Unaudited)

|   | 12 weeks ended     |                    | 36 weeks ended     |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 12, 2016 | September 12, 2015 | September 12, 2016 | September 12, 2015 |
| <b>OPERATING REVENUES:</b>  |                    |                    |                    |                    |
| Commissions and fees  | \$248,138          | \$ 231,492         | \$750,693          | \$ 709,339         |
| Program and other fees  | 64,857             | 61,416             | 207,718            | 171,942            |
| Marketing   | 17,943             | 16,311             | 52,098             | 59,112             |
| Product sales   | 30,622             | 43,446             | 108,719            | 104,251            |
| Total operating revenues  | 361,560            | 352,665            | 1,119,228          | 1,044,644          |
| <b>OPERATING EXPENSES:</b>  |                    |                    |                    |                    |
| Partner distribution expense  | 178,363            | 161,852            | 541,749            | 494,193            |
| Processing and services   | 75,090             | 68,246             | 224,331            | 198,272            |
| Sales and marketing   | 52,327             | 49,954             | 166,176            | 156,653            |
| Costs of products sold  | 29,122             | 40,577             | 103,163            | 97,593             |
| General and administrative  | 22,501             | 22,136             | 70,130             | 62,186             |
| Transition and acquisition  | 2,574              | 5,275              | 4,160              | 6,091              |
| Amortization of acquisition intangibles                                   | 10,376             | 6,875              | 35,533             | 18,352             |
| Change in fair value of contingent consideration                          | 1,300              | —                  | 2,100              | (7,567 )           |
| Total operating expenses  | 371,653            | 354,915            | 1,147,342          | 1,025,773          |
| <b>OPERATING INCOME (LOSS)</b>  | <b>(10,093 )</b>   | <b>(2,250 )</b>    | <b>(28,114 )</b>   | <b>18,871 )</b>    |
| <b>OTHER INCOME (EXPENSE):</b>  |                    |                    |                    |                    |
| Interest income and other income (expense), net                           | 2,360              | (1,421 )           | 3,258              | (1,938 )           |
| Interest expense  | (5,684 )           | (3,231 )           | (13,868 )          | (8,566 )           |
| <b>INCOME (LOSS) BEFORE INCOME TAX EXPENSE</b>                            | <b>(13,417 )</b>   | <b>(6,902 )</b>    | <b>(38,724 )</b>   | <b>8,367 )</b>     |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>                                       | <b>(8,357 )</b>    | <b>(3,290 )</b>    | <b>(18,884 )</b>   | <b>4,435 )</b>     |
| <b>NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS</b>   | <b>(5,060 )</b>    | <b>(3,612 )</b>    | <b>(19,840 )</b>   | <b>3,932 )</b>     |
| Loss (income) attributable to non-controlling interests, net of tax       | (42 )              | (3 )               | (152 )             | 63 )               |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.</b> | <b>\$(5,102 )</b>  | <b>\$(3,615 )</b>  | <b>\$(19,992 )</b> | <b>\$ 3,995 )</b>  |
| <b>EARNINGS (LOSS) PER SHARE:</b>   |                    |                    |                    |                    |
| Basic   | \$(0.09 )          | \$(0.07 )          | \$(0.36 )          | \$ 0.07 )          |
| Diluted   | \$(0.09 )          | \$(0.07 )          | \$(0.36 )          | \$ 0.07 )          |
| Weighted average shares outstanding—basic                                 | 55,668             | 54,467             | 55,851             | 53,941             |
| Weighted average shares outstanding—diluted                               | 55,668             | 54,467             | 55,851             | 55,994             |
| See accompanying notes to condensed consolidated financial statements     |                    |                    |                    |                    |

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BLACKHAWK NETWORK HOLDINGS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (In thousands)  
 (Unaudited)

|   | 12 weeks ended     |                    | 36 weeks ended     |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 12, 2016 | September 12, 2015 | September 12, 2016 | September 12, 2015 |
| NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS                  | \$ (5,060)         | \$ (3,612)         | \$ (19,840)        | \$ 3,932           |
| Other comprehensive income (loss):  |                    |                    |                    |                    |
| Currency translation adjustments  | (2,504)            | (7,104)            | 5,547              | (12,386)           |
| COMPREHENSIVE INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS        | (7,564)            | (10,716)           | (14,293)           | (8,454)            |
| Comprehensive loss (income) attributable to non-controlling interests, net of tax | 129                | 361                | 98                 | 384                |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.      | \$ (7,435)         | \$ (10,355)        | \$ (14,195)        | \$ (8,070)         |
| 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)

|  | 36 weeks ended     |                    |
|--|--------------------|--------------------|
|  | September 30, 2016 | September 12, 2015 |
| <b>OPERATING ACTIVITIES:</b>   |                    |                    |
| Net income (loss) before allocation to non-controlling interests                     | \$(19,840)         | \$ 3,932           |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |                    |                    |
| Depreciation and amortization of property, equipment and technology                  | 33,096             | 27,765             |
| Amortization of intangibles  | 38,988             | 21,634             |
| Amortization of deferred program and contract costs                                  | 18,805             | 20,032             |
| Employee stock-based compensation expense  | 24,865             | 19,856             |
| Change in fair value of contingent consideration                                     | 2,100              | (7,567 )           |
| Deferred income taxes  | —                  | 13,371             |
| Other  | 5,780              | 5,496              |
| Changes in operating assets and liabilities:   |                    |                    |
| Settlement receivables   | 359,398            | 274,941            |
| Settlement payables  | (1,091,151)        | (906,181 )         |
| Accounts receivable, current and long-term   | 44,585             | (3,573 )           |
| Other current assets   | 3,940              | (20,562 )          |
| Other assets   | (9,299 )           | (9,996 )           |
| Consumer and customer deposits   | 13,963             | (31,140 )          |
| Accounts payable and accrued operating expenses                                      | (28,775 )          | (9,695 )           |
| Deferred revenue   | 2,703              | (8,105 )           |
| Other current and long-term liabilities  | (24,912 )          | 4,385              |
| Income taxes, net  | (13,883 )          | (15,492 )          |
| Net cash used in operating activities  | (639,637 )         | (620,899 )         |
| <b>INVESTING ACTIVITIES:</b>   |                    |                    |
| Expenditures for property, equipment and technology                                  | (33,522 )          | (37,310 )          |
| Business acquisitions, net of cash acquired  | (144,284 )         | (78,394 )          |
| Investment in unconsolidated entities  | (3,901 )           | —                  |
| Change in restricted cash  | 689                | (38,043 )          |
| Other  | 4,000              | (561 )             |
| Net cash used in investing activities  | (177,018 )         | (154,308 )         |

See accompanying notes to condensed consolidated financial statements



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BLACKHAWK NETWORK HOLDINGS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 (In thousands)  
 (Unaudited)

|  | 36 weeks ended     |                    |
|--|--------------------|--------------------|
|  | September 26, 2016 | September 12, 2015 |
| <b>FINANCING ACTIVITIES:</b>   |                    |                    |
| Payments for acquisition liability   | —                  | (1,811 )           |
| Repayment of debt assumed in business acquisitions   | (8,964 )           | —                  |
| Proceeds from issuance of note payable   | 250,000            | —                  |
| Repayment of note payable  | (463,750 )         | (11,250 )          |
| Payments of financing costs  | (15,926 )          | (724 )             |
| Borrowings under revolving bank line of credit   | 1,959,749          | 1,536,083          |
| Repayments on revolving bank line of credit  | (1,959,749 )       | (1,436,083 )       |
| Proceeds from convertible debt   | 500,000            | —                  |
| Payments for bond hedges   | (75,750 )          | —                  |
| Proceeds from warrants   | 47,000             | —                  |
| Repayment on notes payable to Safeway  | (890 )             | (6,320 )           |
| Proceeds from issuance of common stock from exercise of employee stock options and employee stock purchase plans | 4,491              | 8,055              |
| Other stock-based compensation related   | (2,135 )           | (675 )             |
| Repurchase of common stock   | (34,845 )          | —                  |
| Other  | (155 )             | (1,494 )           |
| Net cash provided by financing activities  | 199,076            | 85,781             |
| Effect of exchange rate changes on cash and cash equivalents   | 3,352              | (7,467 )           |
| Decrease in cash and cash equivalents  | (614,227 )         | (696,893 )         |
| Cash and cash equivalents—beginning of period  | 914,576            | 911,615            |
| Cash and cash equivalents—end of period  | \$300,349          | \$ 214,722         |
| <b>NONCASH FINANCING AND INVESTING ACTIVITIES</b>  |                    |                    |
| Net deferred tax assets recognized for tax basis step-up with offset to Additional paid-in capital               | \$—                | \$ 366,306         |
| Note payable to Safeway contributed to Additional paid-in capital  | \$—                | \$ 8,229           |
| Financing of business acquisition with contingent consideration  | \$20,100           | \$ —               |
| Intangible assets recognized for warrants issued   | \$—                | \$ 3,147           |
| See accompanying notes to 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 (we, us, our, the Company), is a leading prepaid payment network utilizing proprietary technology to offer a broad range of prepaid gift, telecom and debit cards, in physical and electronic forms, as well as related prepaid products and payment services in the United States and 23 other countries. Our product offerings include single-use gift cards; loyalty, incentive and reward products and services; 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 and incentive cards from leading payment network card associations such as American Express, Discover, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom carriers. We also distribute GPR cards and operate a proprietary reload network named Reloadit, which allows consumers to reload funds onto their previously purchased GPR cards. We distribute these prepaid products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as retail distribution partners) in the Americas, Europe, Africa, Australia and Asia and provide these prepaid products and related services to business clients for their loyalty, incentive and reward programs.

Basis of Presentation

The accompanying condensed consolidated financial statements of Blackhawk Network Holdings, Inc. are unaudited. We have prepared our unaudited interim condensed consolidated financial statements 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. We have condensed or omitted certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP pursuant to such rules and regulations. Accordingly, our interim condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K, filed with the SEC on March 2, 2016 (the Annual Report). We have prepared our condensed consolidated financial statements on the same basis as our annual audited consolidated financial statements and, in the opinion of management, have reflected all adjustments, which include only normal recurring adjustments, necessary to present fairly our financial position and results of operations for the interim periods presented. Our results for the interim periods are not necessarily reflective of the results to be expected for the year ending December 31, 2016 or for any other interim period or other future year. Our condensed consolidated balance sheet as of January 2, 2016, included herein was derived from our audited consolidated financial statements as of that date but does not include all disclosures required by GAAP for annual financial statements, including notes to the financial statements.

Seasonality

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, 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. Additionally, our operating income may fluctuate significantly during our 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.

Recently Issued or Adopted Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which provides additional guidance on the presentation and classification of certain items in the statement of cash flows. Early adoption is permitted and the standard shall be applied retrospectively. We early adopted ASU 2016-15 during our third quarter of 2016. Adoption did not result in significant changes to our existing accounting policies or presentation.

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In April and May 2016, the FASB issued ASU 2016-10, and ASU 2016-12, Revenue from Contracts with Customers (Topic 606), which provides additional guidance, narrow-scope improvements and practical expedients to the new revenue standard (Topic 606) that will be applicable for reporting periods beginning after December 15, 2017. Early adoption is not permitted. Management is evaluating the impact of this guidance on our financial statements.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments, which clarifies the requirements for assessing certain contingent put or call options in debt instruments. Early adoption is permitted and the standard shall be applied using a modified retrospective basis. We early adopted ASU 2016-06 during our third quarter of 2016 in conjunction with our issuance of the Convertible Senior Notes (see Note 3—Financing). Adoption did not result in significant changes to our existing accounting policies.

In March 2016, the FASB issued ASU 2016-04 Liabilities—Extinguishment of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Cards, effective for fiscal years beginning after December 15, 2017. ASU 2016-04 defines liabilities related to the sale of certain prepaid stored-value cards as financial liabilities and provides guidance for the derecognition of liabilities and recognition of revenue related to the portion of the stored value that ultimately is not redeemed by customers (breakage). Early adoption is permitted and the standard shall be applied using either a modified retrospective basis or a retrospective basis. We early adopted ASU 2016-04 during our first quarter of 2016 on a modified retrospective basis because we believe that derecognition of these liabilities more accurately reflects the economics of such transactions. Accordingly, we recognized a cumulative adjustment benefit of \$6.1 million, net of income taxes, to beginning Retained earnings as of January 3, 2016.

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718). The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. ASU 2016-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. We early adopted ASU 2016-09 during our first quarter of 2016 on a modified retrospective basis for the income statement impact of forfeitures and income taxes and have retrospectively applied ASU 2016-09 to our condensed consolidated statements of cash flows for the impact of excess tax benefits. Accordingly, we recognized a cumulative adjustment charge of \$0.3 million for the adoption of the impact of forfeitures, net of income taxes, and a cumulative adjustment benefit of \$10.1 million for the excess tax benefit for the exercise of warrants from prior fiscal years to beginning Retained earnings as of January 3, 2016.

### Significant Accounting Policies

There have been no material changes to our significant accounting policies, as compared to the significant accounting policies described in the audited consolidated financial statements and related notes included in the Annual Report. As a result of early adopting ASU 2016-04 and ASU 2016-09 (discussed above), we provide below our policies with respect to breakage and stock-based compensation.

#### Breakage Revenue

We refer to the portion of the dollar value of prepaid-stored value cards that consumers do not ultimately redeem as breakage. Where we expect to be entitled to a breakage amount, we recognize revenue using estimated breakage rates ratably over the estimated card life, provided that a significant reversal of the amount of breakage revenue recognized is not probable and record adjustments to such estimates when redemption is remote or we are legally defeased of the obligation, if applicable. We estimate breakage rates based on historical redemption patterns, market-specific trends, escheatment rules and existing economic conditions for each program. In card programs where we do not expect to be entitled to a breakage amount, we recognize breakage revenue when we consider redemption remote or we are legally defeased of the obligation, if applicable.

#### Stock-based Compensation

As a result of our adoption of ASU 2016-09, we recognize the impact of forfeitures when they occur with no adjustment for estimated forfeitures and recognize excess tax benefits as a reduction of income tax expense regardless of whether the benefit reduces income taxes payable. Additionally, we recognize the cash flow impact of such excess tax benefits in operating activities in our condensed consolidated statements of cash flows.

#### Reclassification

In our condensed consolidated statements of income (loss), we have reclassified Marketing revenue to a separate line item, previously reported in Program, interchange, marketing and other fees and have renamed such line as Program and other fees.

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As a result of our retrospective adoption ASU 2015-17 in the fourth quarter of 2015 to classify all deferred income taxes as long-term assets or liabilities, we have retrospectively applied the guidance to our deferred income taxes as of September 12, 2015.

## 2. Business Acquisitions

## 2016 Acquisitions

## Omni Prepaid

On January 5, 2016, we acquired Omni Prepaid, LLC and its subsidiaries GiftCards.com, LLC, which sells digital and physical prepaid gift card solutions to consumers through a high-trafficked gift card U.S. website, and OmniCard, LLC, which sells customized prepaid incentive and reward solutions for business clients (collectively, GiftCards). The new sites and customers will expand our e-commerce businesses.

The purchase consideration totaled \$103.9 million in cash which we funded using a combination of cash on hand and borrowings under our Credit Agreement. The following table presents our initial estimates of the purchase price allocation, and we may make adjustments to these amounts through the one year measurement period as we finalize information regarding our forecasts, valuation assumptions, income taxes and contingencies (in thousands):

|   |           |   |
|---|-----------|---|
| Cash  | \$3,985   |   |
| Consumer and customer deposits                  | (5,429    | ) |
| Accounts payable and accrued operating expenses | (9,860    | ) |
| Other tangible assets, net                      | 893       |   |
| Debt  | (5,807    | ) |
| Identifiable technology and intangible assets   | 52,460    |   |
| Goodwill  | 67,706    |   |
| Total purchase consideration                    | \$103,948 |   |

At closing, we repaid the assumed debt, which we present in financing activities in our condensed consolidated statements of cash flows, and paid \$8.1 million of GiftCards' transaction expenses included above within accounts payable and accrued operating expenses, which we present in operating activities in our condensed consolidated statements of cash flows.

Goodwill primarily represents the value of cash flows from future customers. We expect to deduct goodwill and the identifiable technology and intangible assets for tax purposes.

The following table presents the components of the identifiable technology and intangible assets and the estimated useful lives (in thousands):

|   | Fair Value | Useful Life |
|---|------------|-------------|
| Customer relationships                              | \$27,570   | 10 years    |
| Backlog   | 10,780     | 3 years     |
| Domain name   | 10,520     | 10 years    |
| Technology  | 3,590      | 5 years     |
| Total identifiable technology and intangible assets | \$52,460   |             |

Customer relationships represent the estimated fair value of the underlying relationships and agreements with GiftCards' business clients and consumers. Backlog represents the estimated fair value resulting from cards issued before the acquisition date, resulting from revenues, including interchange and account service fees. Domain name represents the estimated fair value of the giftcards.com domain name. Technology represents internal-use software used for the order, fulfillment and management of customer orders.

We valued customer relationships, backlog and domain name using the income approach and the technology using the cost approach. Significant assumptions include forecasts of revenues, costs of revenue, development costs and sales, general and administrative expenses and estimated attrition rates for business clients and consumers. We discounted the cash flows at various rates from 6.0% to 11.0%, reflecting the different risk profiles of the assets.

Acquisition-related expenses totaled \$0.4 million, which we report in Transition and acquisition expense.



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## Other 2016 Acquisitions

During the first quarter of 2016, we also acquired NimbleCommerce, a digital commerce platform and network for promotions. NimbleCommerce also allows merchants and brands to manage their own prepaid offer and gift card programs, or resell through a network of retailer and publisher branded sites. During the second quarter of 2016, we acquired substantially all of the net assets of Extrameasures, a prepaid consumer promotions and incentives company. Through its customized rebate programs, Extrameasures offers Visa prepaid cards and private label merchant-specific reward and gift cards with a proprietary platform to help businesses drive consumer acquisition, engagement and loyalty.

The purchase consideration for NimbleCommerce and Extrameasures totaled \$78.6 million, consisting of \$58.5 million in cash and \$20.1 million in the estimated fair value of contingent consideration. Contingent consideration resulting from our acquisition of Extrameasures consists of three cash payments of up to \$15 million each, based on the financial performance of Extrameasures for each of the three annual post-acquisition periods. Approximately 10% of the earnout payments will be allocated to employees. Accordingly, we exclude such amounts from the estimated fair value of the contingent consideration and accrue estimated amounts due over the service period. We estimated the fair value of contingent consideration using the income approach at a discount rate of 17%.

The following table presents our initial estimates of the purchase price allocation, and we may make adjustments to these amounts through the one year measurement period as we finalize information regarding our forecasts, valuation assumptions, income taxes and contingencies (in thousands):

|   |           |
|---|-----------|
| Cash  | \$ 14,191 |
| Settlement receivables                        | 4,884     |
| Settlement payables                           | (3,272 )  |
| Consumer and customer deposits                | (18,009 ) |
| Other tangible liabilities, net               | (1,155 )  |
| Debt  | (3,157 )  |
| Deferred income taxes                         | 2,066     |
| Identifiable technology and intangible assets | 45,540    |
| Goodwill                                      | 37,525    |
| Total purchase consideration                  | \$ 78,613 |

At closing, we repaid the assumed debt, which we present in financing activities in our condensed consolidated statements of cash flows, and paid \$1.0 million of transaction expenses, which we present in operating activities in our condensed consolidated statements of cash flows.

Goodwill primarily represents the value of cash flows from future customers. We expect to deduct approximately \$1.4 million of the total \$10.4 million goodwill from our acquisition of NimbleCommerce for tax purposes and may currently deduct up to \$2.3 million of the total \$27.2 million goodwill from our acquisition of Extrameasures for tax purposes. For Extrameasures, we will be able to deduct additional goodwill based on the actual payments made under the contingent earnout and settlement of contingent liabilities.

The following table presents the components of the identifiable technology and intangible assets and the estimated useful lives (in thousands):

|   | Fair Value | Useful Life |
|---|------------|-------------|
| Customer relationships                              | \$39,230   | 10 years    |
| Backlog   | 1,610      | 3 years     |
| Technology  | 4,700      | 5 years     |
| Total identifiable technology and intangible assets | \$45,540   |             |

We valued customer relationships, backlog and certain technology using the income approach and certain technology using the cost approach. Significant assumptions include forecasts of revenues, costs of revenue, development costs and sales, general and administrative expenses and estimated attrition rates for business clients. We discounted the cash flows at various rates from 9.0% to 16.0%, reflecting the different risk profiles of the assets.

Acquisition-related expenses totaled \$0.9 million, which we include in Transition and acquisition expense.





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## Pro Forma Financial Information

The following pro forma financial information summarizes the combined results of operations of us, GiftCards and Extrameasures as though we had been combined as of the beginning of fiscal 2015 (in thousands, except per share amounts):

|  | 12 weeks ended |           | 36 weeks ended |             |
|--|----------------|-----------|----------------|-------------|
|  | September      | September | September      | September   |
|  | 10, 2016       | 12, 2015  | 10, 2016       | 12, 2015    |
| Total revenues   | \$364,129      | \$364,400 | \$1,127,178    | \$1,068,882 |
| Net income (loss) attributable to Blackhawk Network Holdings, Inc. | (3,626 )       | (3,959 )  | (14,469 )      | (1,124 )    |
| Pro forma EPS—Basic  | \$(0.07 )      | \$(0.07 ) | \$(0.26 )      | \$(0.02 )   |
| Pro forma EPS—Diluted  | \$(0.07 )      | \$(0.07 ) | \$(0.26 )      | \$(0.02 )   |

The pro forma financial information includes adjustments to reclassify acquisition-related costs from 2016 to 2015, to amortize technology and intangible assets starting at the beginning of 2015, and to reflect the impact on revenue resulting from the step-down in basis of consumer and customer deposits from its book value to its fair value as of the beginning of 2015.

We have not presented separate results of operations since closing for GiftCards because its integration with our existing operations makes it impractical to do so. In addition, results of operations for Extrameasures and NimbleCommerce are immaterial, both individually and in the aggregate.

## Subsequent Event

On October 6, 2016, we acquired the outstanding common stock of Grass Roots Group Holdings, Ltd. and its subsidiaries, a leading provider of employee and customer engagement solutions, for purchase consideration of £93.7 million, or \$119.1 million based on the exchange rate on the acquisition date. The acquisition broadens the global capabilities of our incentives and engagement business. We are in the process of gathering the information to allocate the purchase price and accordingly are unable to provide initial allocation estimates nor provide pro forma financial information.

## 2015 Acquisitions

During the 36 weeks ended September 10, 2016, we recorded a measurement period adjustment for Achievers, acquired in June 2015, which decreased deferred revenue by \$3.6 million, intangible assets by \$1.9 million, goodwill by \$1.2 million and deferred income tax assets by \$0.5 million. The measurement periods for Achievers and Didix are now closed.

## 3. Financing

## Credit Agreement

On January 25, 2016, we exercised our option to draw down an incremental \$100 million term loan under our Credit Agreement.

On July 27, 2016, in conjunction with the issuance of the Convertible Senior Notes, as described below, we entered into an amendment and restatement to our Credit Agreement (the Restated Credit Agreement). We repaid all amounts outstanding under our revolving line of credit and \$276 million of the \$426 million outstanding under our term loan such that \$150 million remained outstanding under our term loan. The Restated Credit Agreement provides for the extension of credit in an aggregate principal amount up to \$700 million, consisting of revolving loans up to \$400 million (the Revolving Credit Facility) and term loans up to \$300 million (the Term Loan Facility). The term loan has \$150 million outstanding with a delayed draw option for up to an additional \$150 million. The Restated Credit Agreement also includes an ability to increase aggregate commitments by up to an incremental \$300 million if certain criteria are met and lenders choose to participate. The Restated Credit Agreement extended the term of the Credit Agreement to July 2021 and made certain modifications to the financial and other covenants to add operating flexibility, including modification of the leverage covenant and removal of the net worth covenant and the dollar limitation on acquisitions.

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### Convertible Senior Notes

On July 27, 2016, we issued \$500 million aggregate principal amount of 1.50% Convertible Senior Notes due in January 2022 (the Notes), in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the Securities Act). The Notes have not been registered under the Securities Act, or applicable state securities laws or blue sky laws, and may not be offered or sold in the United States absent registration under the Securities Act and applicable state securities laws or available exemptions from the registration requirements.

The Notes are senior unsecured obligations and rank equally in right of payment with all of our future senior unsecured indebtedness and are junior to our existing and future secured indebtedness. The Notes pay interest in cash semi-annually (January and July) at a rate of 1.50% per annum.

On or after September 15, 2021, until the second scheduled trading day immediately preceding the maturity date, the Notes may be converted at the option of the holders. Holders may convert the Notes at their option prior to September 15, 2021 only under the following circumstances:

- 1) during any calendar quarter commencing after the calendar quarter ending on September 30, 2016 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- 2) during the five business day period after any five consecutive trading day period (the measurement period) in which the “trading price” per \$1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or
- 3) upon the occurrence of specified corporate events, including if there is a fundamental change.

Upon conversion, we will pay or deliver cash, shares of our own common stock or a combination, at our election. The conversion rate is initially 20.0673 shares of common stock per \$1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately \$49.83 per share of common stock), subject to certain adjustments. We may not redeem the Notes prior to the maturity date. At an event of default, holders may, upon satisfaction of certain conditions, accelerate the principal amount of the Notes plus accrued and unpaid interest. If we undergo a fundamental change, a holder may require us to repurchase for cash all or any portion of its Notes at a price equal to the principal amount of the Notes to be repurchased, plus accrued and unpaid interest.

We separately account for the liability and equity components of the Notes. The initial debt component of the Notes was valued at \$436.6 million based on the contractual cash flows discounted at an appropriate comparable market non-convertible debt borrowing rate at the date of issuance of 4.1%, with the equity component representing the residual amount of the proceeds which was recorded as a debt discount. We allocated the issuance costs pro-rata based on the relative initial carrying amounts of the debt and equity components, including the Note Hedges and Warrants transactions described below. As a result, \$1.8 million of the issuance costs were allocated to the equity component of the Notes and \$12.3 million of issuance costs were allocated to the liability component of the Notes and accounted for as a debt discount. We amortize the issuance costs allocated to the liability component as additional interest expense over the term of the Notes using the effective interest method. The effective interest rate of the Notes is 4.65% per annum (1.50% coupon rate plus 3.15% of non-cash accretion expense).

### Convertible Note Hedges and Warrants

Concurrent with the pricing of the Notes, we purchased call options for our own common stock to hedge the Notes (the Note Hedges) and sold call options for our own common stock (the Warrants). We structured the Note Hedges to reduce potential dilution to our common stock upon any conversion of Notes and/or offset any cash payments we are required to make in excess of the principal amount of converted Notes, as the case may be. However, the Warrants could separately have a dilutive effect to the extent that the market value per share of our common stock exceeds the strike price of the Warrants.

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The Note Hedges—On July 21 and 22, 2016, we purchased Note Hedges from certain counterparties for an aggregate price of approximately \$75.8 million. The Note Hedges are exercisable upon conversion of the Notes for cash, a number of shares of our common stock or a combination of cash and shares of our common stock generally based on the amount by which the market price per share of our common stock, as measured under the terms of the Note Hedges during the relevant valuation period, is greater than the strike price of the Note Hedges. The strike price of the Note Hedges initially corresponds to the conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes, subject to certain exceptions. Under the terms of the Note Hedges, we will receive cash, shares or a combination of cash and shares that offsets share dilution caused by conversion of the Notes.

Warrants—On July 21 and 22, 2016, we sold call options to the same counterparties for approximately \$47.0 million, which give the counterparties the right to buy from us up to approximately 10.0 million shares of our common stock, subject to adjustments, at an exercise price of \$61.20 per share, subject to adjustments, over a series of days commencing on April 18, 2022 and ending August 9, 2022. Upon each exercise of the Warrants, we will be obligated to deliver shares of our common stock having a value equal to the difference between the market price on the exercise date and the strike price of the Warrants.

The Note Hedges and Warrants are classified in stockholders' equity on our condensed consolidated balance sheets. We also recognized a \$5.2 million deferred tax asset with an offset to Additional paid-in capital for excess tax interest deductions relating to the Notes and Note Hedges.

Maturities of Long-Term Debt

As a result of the Amendment and the Notes, the following table presents the amounts due by year of maturity for our term loan and the Notes (in thousands):

|                      | As of<br>July 27,<br>2016 |
|----------------------|---------------------------|
| 2017                 | \$10,000                  |
| 2018                 | 7,500                     |
| 2019                 | 7,500                     |
| 2020                 | 15,000                    |
| 2021                 | 110,000                   |
| 2022                 | 500,000                   |
| Total long-term debt | \$650,000                 |

Share Repurchase

In conjunction with the issuance of the Notes, on July 27, 2016, we repurchased approximately 1.0 million shares of our common stock for \$34.8 million.

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## 4. Fair Value Measurements

We measure certain assets and liabilities at fair value on a recurring basis. The table below summarizes the fair values of these assets and liabilities as of September 10, 2016, January 2, 2016 and September 12, 2015 (in thousands):

| September 10, 2016        |           |         |           |            |
|---------------------------|-----------|---------|-----------|------------|
|                           | Level 1   | Level 2 | Level 3   | Total      |
| Assets                    |           |         |           |            |
| Cash and cash equivalents |           |         |           |            |
| Money market mutual funds | \$5,112   | \$      | —\$—      | \$5,112    |
| Liabilities               |           |         |           |            |
| Contingent consideration  | \$—       | \$      | —\$22,200 | \$22,200   |
| January 2, 2016           |           |         |           |            |
|                           | Level 1   | Level 2 | Level 3   | Total      |
| Assets                    |           |         |           |            |
| Cash and cash equivalents |           |         |           |            |
| Money market mutual funds | \$370,070 | \$      | —\$       | —\$370,070 |
| Liabilities               |           |         |           |            |
| Contingent consideration  | \$—       | \$      | —\$       | —\$—       |
| September 12, 2015        |           |         |           |            |
|                           | Level 1   | Level 2 | Level 3   | Total      |
| Assets                    |           |         |           |            |
| Cash and cash equivalents |           |         |           |            |
| Money market mutual funds | \$5,070   | \$      | —\$       | —\$5,070   |
| Liabilities               |           |         |           |            |
| Contingent consideration  | \$—       | \$      | —\$       | —\$—       |

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. Level 2 investments include commercial paper.

In the 36 weeks ended September 10, 2016, 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. Level 3 includes the estimated fair value of our contingent consideration liabilities.

Contingent Consideration—We estimate the fair value of the contingent consideration based on our estimates of the probability of achieving the relevant targets and discount rates reflecting the risk of meeting these targets.

Term loan —As of September 10, 2016, using Level 2 inputs, we estimate the fair value of our term loan to be approximately \$150.0 million.

Convertible notes payable—As of September 10, 2016, using Level 2 inputs, we estimate the fair value of our convertible notes payable to be approximately \$490.6 million.

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The changes in fair value of contingent consideration for the 36 weeks ended September 10, 2016 and September 12, 2015 are as follows (in thousands):

|  | 36 weeks ended        |                       |
|--|-----------------------|-----------------------|
|  | September 10,<br>2016 | September 12,<br>2015 |
| Contingent Consideration                         |                       |                       |
| Balance, beginning of period                     | \$—                   | \$ 7,567              |
| Issuance of contingent consideration             | 20,100                | —                     |
| Change in fair value of contingent consideration | 2,100                 | (7,567 )              |
| Balance, end of period                           | \$22,200              | \$ —                  |

We present the change in the fair value of contingent consideration in Change in fair value of contingent consideration and as a non-cash adjustment to net income in our condensed consolidated statements of cash flows. The decrease in fair value of contingent consideration related to our acquisition of CardLab for the 36 weeks ended September 12, 2015 resulted from the projected failure of financial targets to be met relating to the launch of incentive programs during the contingent earn-out measurement period. Such measurement period concluded during the 36 weeks ended September 10, 2016 with no amounts due. The issuance and increase in fair value of contingent consideration during the 36 weeks ended September 10, 2016 related to our acquisition of Extrameasures (see Note 2—Business Acquisitions). The increase in fair value reflects the passage of time and increases in our projections of the payment of portions of the earn-out. As of September 10, 2016, we estimated the fair value of the remaining contingent consideration based on our estimates of the amounts payable for and probability of achieving the relevant targets and a discount rate of 17%. A significant increase (decrease) in our estimates of the amounts payable for and probability of achieving the relevant targets or a significant decrease (increase) in the discount rate could materially increase (decrease) the estimated fair value of contingent consideration.

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## 5. Consolidated Financial Statement Details

The following tables represent the components of Other current assets, Other assets, Other current liabilities and Other liabilities as of September 10, 2016, January 2, 2016 and September 12, 2015 consisted of the following (in thousands):

|  | September 10,<br>2016 | January 2,<br>2016 | September 12,<br>2015 |
|--|-----------------------|--------------------|-----------------------|
| Other current assets:                  |                       |                    |                       |
| Inventory                              | \$ 35,634             | \$ 36,528          | \$ 47,272             |
| Deferred expenses                      | 12,099                | 18,182             | 10,854                |
| Income tax receivables                 | 38,427                | 14,831             | 20,632                |
| Other                                  | 37,759                | 33,778             | 29,192                |
| Total other current assets             | \$ 123,919            | \$ 103,319         | \$ 107,950            |
| Other assets:                          |                       |                    |                       |
| Deferred program and contract costs    | \$ 44,388             | \$ 50,717          | \$ 52,428             |
| Other receivables                      | 1,390                 | 2,281              | 4,734                 |
| Income taxes receivable                | —                     | 6,155              | 6,368                 |
| Deferred financing costs               | 2,871                 | 2,100              | 2,002                 |
| Other                                  | 20,390                | 20,511             | 12,762                |
| Total other assets                     | \$ 69,039             | \$ 81,764          | \$ 78,294             |
| Other current liabilities:             |                       |                    |                       |
| Payroll and related liabilities        | \$ 25,425             | \$ 34,530          | \$ 23,103             |
| Income taxes payable                   | 3,158                 | 3,216              | 2,122                 |
| Acquisition liability                  | 11,250                | —                  | 607                   |
| Other payables and accrued liabilities | 8,797                 | 19,596             | 17,488                |
| Total other current liabilities        | \$ 48,630             | \$ 57,342          | \$ 43,320             |
| Other liabilities:                     |                       |                    |                       |
| Acquisition liability                  | \$ 10,950             | \$ —               | \$ —                  |
| Payable to content provider            | —                     | —                  | 825                   |
| Income taxes payable                   | 6,213                 | 4,249              | 2,418                 |
| Deferred income and other liabilities  | 8,266                 | 10,451             | 1,624                 |
| Total other liabilities                | \$ 25,429             | \$ 14,700          | \$ 4,867              |

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## 6. Goodwill

We have assigned goodwill to our US Retail, International Retail and Incentives & Rewards segments. To date, we have not recorded any impairment charges against or disposed of any reporting units with goodwill. During the first quarter of 2016, as a result of changes in reporting financial results to our Chief Operating Decision Maker, we concluded that we should split our historical e-Commerce operating segment, which we had reported in Incentives & Rewards reportable segment, into two operating segments: e-Commerce Retail, which we now report in US Retail reportable segment, and e-Commerce Incentives, which we continue to report in Incentives & Rewards reportable segment. Accordingly, we allocated the goodwill from the historical e-Commerce segment between these two segments based on their relative fair values. We allocated the goodwill from our acquisition of GiftCards between these two segments. A summary of changes in goodwill during the 36 weeks ended September 10, 2016 is as follows (in thousands):

|  | September 10, 2016 |                         |                            |           |
|--|--------------------|-------------------------|----------------------------|-----------|
|  | US<br>Retail       | International<br>Retail | Incentives<br>&<br>Rewards | Total     |
| Balance, beginning of period             | \$42,729           | \$ 49,156               | \$310,604                  | \$402,489 |
| Re-allocation of e-Commerce goodwill     | 2,671              | —                       | (2,671 )                   | —         |
| Acquisition of GiftCards                 | 34,427             | —                       | 33,279                     | 67,706    |
| Acquisition of NimbleCommerce            | 10,365             | —                       | —                          | 10,365    |
| Acquisition of Extrameasures             | —                  | —                       | 27,160                     | 27,160    |
| Measurement period adjustment            | —                  | —                       | (1,234 )                   | (1,234 )  |
| Foreign currency translation adjustments | —                  | 1,639                   | 482                        | 2,121     |
| Balance, end of period                   | \$90,192           | \$ 50,795               | \$367,620                  | \$508,607 |

## 7. Stockholders' Equity and Stock Based Compensation

## Stockholders' Equity

During the 36 weeks ended September 10, 2016, the issuance of our Convertible Senior Notes, the purchase of the Note Hedges, the sale of the Warrants (see Note 3—Financing) and our adoption of ASU 2016-04 and 2016-09 on a modified retrospective basis had a significant impact on Additional paid-in capital and Retained earnings.

Accordingly, we present in the tables below a reconciliation of such balances from January 2, 2016 to September 10, 2016.

The following table presents the changes within Additional paid-in capital during the 36 weeks ended September 10, 2016 (in thousands except average price per share):

|  |           |
|--|-----------|
| BALANCE—January 2, 2016  | \$561,939 |
| Cumulative adjustment upon modified retrospective adoption of ASU 2016-09 (see Note 1—The Company and Significant Accounting Policies) | 650       |
| Employee-related stock-based activity  | 28,940    |
| Equity component of convertible notes issuance (see Note 3—Financing)  | 63,434    |
| Equity component of convertible notes issuance costs (see Note 3—Financing)  | (1,792 )  |
| Purchase of convertible notes hedges (see Note 3—Financing)  | (75,750 ) |
| Proceeds from sale of warrants (see Note 3—Financing)  | 47,000    |
| Deferred tax assets recognized for convertible notes (see Note 3—Financing)  | 5,161     |
| Repurchase of common stock (996 shares at an average price of \$34.98 per share)   | (34,843 ) |
| BALANCE— September 10, 2016  | \$594,739 |



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The following table presents the changes within Retained earnings during the 36 weeks ended September 10, 2016 (in thousands):

|  |           |
|--|-----------|
| BALANCE—January 2, 2016  | \$207,973 |
| Cumulative adjustment upon modified retrospective adoption of ASU 2016-04 and 2016-09 (see Note 1—The Company and Significant Accounting Policies) | 15,854    |
| Net loss   | (19,992 ) |
| Dividends paid   | (44 )     |
| BALANCE— September 10, 2016  | \$203,791 |

## Stock Based Compensation

During the 36 weeks ended September 10, 2016, our Board of Directors granted 1,129,019 restricted stock units, 172,300 performance stock units and 584,350 stock options at a weighted-average exercise price of \$37.90 per share. The following table presents total stock-based compensation expense according to the income statement line in our condensed consolidated statements of income (loss) for the 12 and 36 weeks ended September 10, 2016 and September 12, 2015 (in thousands):

|  | 12 weeks ended     |                    | 36 weeks ended     |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 10, 2016 | September 12, 2015 | September 10, 2016 | September 12, 2015 |
| Processing and services                | \$1,364            | \$ 1,530           | \$4,259            | \$ 4,366           |
| Sales and marketing                    | 2,759              | 2,038              | 8,600              | 5,523              |
| Cost of products sold                  | 31                 | 13                 | 89                 | 25                 |
| General and administrative             | 4,139              | 3,536              | 11,917             | 9,942              |
| Total stock-based compensation expense | \$8,293            | \$ 7,117           | \$24,865           | \$ 19,856          |

## 8. Income Taxes

Our effective tax rates were 62.3% and 47.7% for the 12 weeks ended September 10, 2016 and September 12, 2015, respectively, and 48.8% and 53.0% for the 36 weeks ended September 10, 2016 and September 12, 2015, respectively. The effective rate for the 12 weeks ended September 10, 2016 was higher due to a discrete tax benefit for a tax return to provision true-up, resulting in an increase to the effective tax rate due to pre-tax loss, and permanent tax adjustments from deemed foreign income and nondeductible acquisition expenses. The effective rate for the 36 weeks ended September 10, 2016 was lower due to a net reduction in 2015 in the value of our deferred tax assets from changes in certain state tax apportionment laws (which resulted in an increase to the effective tax rate for the 36 weeks ended September 12, 2015), partially offset by a discrete tax benefit for a tax return to provision true-up and excess tax benefits for employee stock based compensation, both increasing the effective tax rate due to pre-tax loss.

## 9. Commitments and Contingencies

## Contingencies

From time to time, we enter into contracts containing provisions that 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 providers, retail distribution partners and issuing banks, we are 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, we have paid immaterial amounts pursuant to these indemnification provisions.

We are subject to audits related to various indirect taxes, including, but not limited to, sales and use taxes, value-added tax, and goods and services tax, in various foreign and state jurisdictions. We evaluate our exposure related to these audits and potential audits and do not believe that it is probable that any audit would hold us liable for any material amounts due.

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### Legal Matters

There are various claims and lawsuits arising in the normal course of business pending against us, including the matters described below, some of which seek damages and other relief which, if granted, may require future cash expenditures. Management does not believe that it is probable that the resolution of these matters would result in any liability that would materially affect our results of operations or financial condition.

On March 30, 2015, Greg Haney in his capacity as Seller Representative for CardLab, Inc. filed a lawsuit against us in the Delaware Chancery Court (CardLab, Inc. v. Blackhawk Network Holdings, Inc., Case No. 10851). The complaint generally alleges that we failed to disclose material information relating to a potential earn-out payment in connection with our acquisition of CardLab, Inc. in 2014. We believe that the suit is without merit, and are vigorously defending ourselves against these claims. On June 8, 2015, we filed a motion to dismiss the complaint. On June 22, 2015, the plaintiff filed an amended complaint. On July 7, 2015, we filed a motion to dismiss the case in its entirety. On February 26, 2016, the Court granted the motion to dismiss in part, dismissing two claims of the amended complaint. On March 25, 2016 we filed our answer denying the remaining claims and a counterclaim for attorneys' fees pursuant to the merger agreement between the parties. On June 22, 2016, the plaintiff filed a motion to dismiss our counterclaim for indemnification. On July 22, 2016, we filed an amended counterclaim in response. The litigation is in the early stage of discovery. We believe the likelihood of loss is remote.

In addition, we transact business in non-U.S. markets and may, from time to time, be subject to disputes and tax audits by foreign tax authorities related to indirect taxes typically on commissions or fees we receive from non-resident content providers. As a result of an indemnification that we received, our exposure has decreased from \$12 million as reported in our Annual Report to approximately \$5 million, primarily in a single jurisdiction. In that jurisdiction, we have lost an appeal over a dispute related to a specific period. Even if we were to be assessed for other periods, which we currently estimate could be up to approximately \$5 million, we believe it is more likely than not that we will prevail upon appeal.

### 10. Segment Reporting

Our three reportable segments are US Retail, International Retail and Incentives & Rewards. During the first quarter of 2016, as a result of changes in reporting financial results to our Chief Operating Decision Maker (CODM), we concluded that we should split our historical e-Commerce segment, which we had reported in Incentives & Rewards, into two segments: e-Commerce Retail, which we report in US Retail, and e-Commerce Incentives, which we report in Incentives & Rewards. We have not retroactively adjusted 2015 segment information as the results of the e-Commerce Retail segment were immaterial.

We do not assess performance based on assets and do not provide information on the assets of our reportable segments to our CODM. The key metrics used by our CODM to assess segment performance include Operating revenues, Operating revenues, net of Partner distribution expense and segment profit.

We exclude from the determination of segment profit and report in Corporate and Unallocated: i) certain US operations, account management and marketing personnel who primarily support our US Retail segment (as these costs are not included in segment profit reviewed by the CODM), ii) the substantial majority of our technology personnel and related depreciation and amortization of technology and related hardware which support our US Retail and International Retail segments, iii) US accounting, finance, legal, human resources and other administrative functions which may support all segments and iv) noncash charges including amortization of acquisition intangibles, stock-based compensation and change in fair value of contingent consideration, as we do not include these costs in segment profit reviewed by our CODM. Segment profit for our International Retail segment includes all sales and marketing personnel and the substantial majority of operations, legal, accounting, finance and other administrative personnel in such international regions, and segment profit for our Incentives & Rewards segment includes all sales, marketing, technology, operations, legal, certain accounting, finance and other administrative personnel supporting that segment, as well as substantially all depreciation and amortization specifically related to that segment.

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The following tables present the key metrics used by our CODM for the evaluation of segment performance, including certain significant noncash charges (consisting of certain depreciation and amortization of property, equipment and technology and distribution partner stock-based compensation expense) which have been deducted from the segment profit amounts shown below, and reconciliations of these amounts to our consolidated financial statements (in thousands):

|   | 12 weeks ended<br>September 10, 2016 |                         |                            |                                 |              |
|---|--------------------------------------|-------------------------|----------------------------|---------------------------------|--------------|
|   | US Retail                            | International<br>Retail | Incentives<br>&<br>Rewards | Corporate<br>and<br>Unallocated | Consolidated |
| Total operating revenues                                | \$ 197,081                           | \$ 100,069              | \$ 64,410                  | \$ —                            | \$ 361,560   |
| Partner distribution expense                            | 103,601                              | 69,841                  | 4,921                      | —                               | 178,363      |
| Operating revenues, net of Partner distribution expense | 93,480                               | 30,228                  | 59,489                     | —                               | 183,197      |
| Other operating expenses                                | 58,192                               | 25,158                  | 50,779                     | 59,161                          | 193,290      |
| Segment profit (loss) / Operating income (loss)         | \$ 35,288                            | \$ 5,070                | \$ 8,710                   | \$ (59,161 )                    | (10,093 )    |
| Other income (expense)                                  |                                      |                         |                            |                                 | (3,324 )     |
| Loss before income tax expense                          |                                      |                         |                            |                                 | \$ (13,417 ) |
| Non-cash charges  | \$ 1,570                             | \$ 772                  | \$ 7,562                   | 26,715                          |              |
|   | 12 weeks ended<br>September 12, 2015 |                         |                            |                                 |              |
|   | US Retail                            | International<br>Retail | Incentives<br>&<br>Rewards | Corporate<br>and<br>Unallocated | Consolidated |
| Total operating revenues                                | \$ 214,941                           | \$ 83,671               | \$ 54,053                  | \$ —                            | \$ 352,665   |
| Partner distribution expense                            | 101,890                              | 56,972                  | 2,990                      | —                               | 161,852      |
| Operating revenues, net of Partner distribution expense | 113,051                              | 26,699                  | 51,063                     | —                               | 190,813      |
| Other operating expenses                                | 69,877                               | 22,751                  | 46,674                     | 53,761                          | 193,063      |
| Segment profit (loss) / Operating income (loss)         | \$ 43,174                            | \$ 3,948                | \$ 4,389                   | \$ (53,761 )                    | (2,250 )     |
| Other income (expense)                                  |                                      |                         |                            |                                 | (4,652 )     |
| Income before income tax expense                        |                                      |                         |                            |                                 | \$ (6,902 )  |
| Non-cash charges  | \$ 1,270                             | \$ 431                  | \$ 6,233                   | 22,934                          |              |

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|   | 36 weeks ended<br>September 10, 2016 |                         |                            |                                 |              |
|---|--------------------------------------|-------------------------|----------------------------|---------------------------------|--------------|
|   | US Retail                            | International<br>Retail | Incentives<br>&<br>Rewards | Corporate<br>and<br>Unallocated | Consolidated |
| Total operating revenues                                | \$652,359                            | \$ 279,311              | \$ 187,558                 | \$—                             | \$ 1,119,228 |
| Partner distribution expense                            | 330,283                              | 198,703                 | 12,763                     | —                               | 541,749      |
| Operating revenues, net of Partner distribution expense | 322,076                              | 80,608                  | 174,795                    | —                               | 577,479      |
| Other operating expenses                                | 202,384                              | 69,134                  | 154,796                    | 179,279                         | 605,593      |
| Segment profit (loss) / Operating income (loss)         | \$ 119,692                           | \$ 11,474               | \$ 19,999                  | \$(179,279 )                    | (28,114 )    |
| Other income (expense)                                  |                                      |                         |                            |                                 | (10,610 )    |
| Loss before income tax expense                          |                                      |                         |                            |                                 | \$(38,724 )  |
| Non-cash charges  | \$4,976                              | \$ 3,441                | \$ 20,932                  | 80,680                          |              |
|   | 36 weeks ended<br>September 12, 2015 |                         |                            |                                 |              |
|   | US Retail                            | International<br>Retail | Incentives<br>&<br>Rewards | Corporate<br>and<br>Unallocated | Consolidated |
| Total operating revenues                                | \$659,984                            | \$ 251,249              | \$ 133,411                 | \$—                             | \$ 1,044,644 |
| Partner distribution expense                            | 313,628                              | 169,578                 | 10,987                     | —                               | 494,193      |
| Operating revenues, net of Partner distribution expense | 346,356                              | 81,671                  | 122,424                    | —                               | 550,451      |
| Other operating expenses                                | 209,856                              | 73,665                  | 110,462                    | 137,597                         | 531,580      |
| Segment profit (loss) / Operating income (loss)         | \$ 136,500                           | \$ 8,006                | \$ 11,962                  | \$(137,597 )                    | 18,871       |
| Other income (expense)                                  |                                      |                         |                            |                                 | (10,504 )    |
| Income before income tax expense                        |                                      |                         |                            |                                 | \$8,367      |
| Non-cash charges  | \$3,741                              | \$ 860                  | \$ 11,488                  | 51,423                          |              |

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## 11. Earnings Per Share

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        |            |                       |           |
|--|-----------------------|------------|-----------------------|-----------|
|  | September 10,<br>2016 |            | September 12,<br>2015 |           |
|  | Basic                 | Diluted    | Basic                 | Diluted   |
| Net income (loss) attributable to Blackhawk Network Holdings, Inc.           | \$(5,102)             | \$(5,102)  | \$(3,615)             | \$(3,615) |
| Distributed and undistributed earnings allocated to participating securities | —                     | —          | —                     | —         |
| Net income (loss) attributable to common stockholders                        | \$(5,102)             | \$(5,102)  | \$(3,615)             | \$(3,615) |
| Weighted-average common shares outstanding                                   | 55,668                | 55,668     | 54,467                | 54,467    |
| Common share equivalents   |                       | —          |                       | —         |
| Weighted-average shares outstanding  |                       | 55,668     |                       | 54,467    |
| Earnings (loss) per share  | \$(0.09 )             | \$(0.09 )  | \$(0.07 )             | \$(0.07 ) |
|  | 36 weeks ended        |            |                       |           |
|  | September 10, 2016    |            | September 12,<br>2015 |           |
|  | Basic                 | Diluted    | Basic                 | Diluted   |
| Net income (loss) attributable to Blackhawk Network Holdings, Inc.           | \$(19,992)            | \$(19,992) | \$3,995               | \$3,995   |
| Distributed and undistributed earnings allocated to participating securities | (15 )                 | (15 )      | (46 )                 | (46 )     |
| Net income (loss) attributable to common stockholders                        | \$(20,007)            | \$(20,007) | \$3,949               | \$3,949   |
| Weighted-average common shares outstanding                                   | 55,851                | 55,851     | 53,941                | 53,941    |
| Common share equivalents   |                       | —          |                       | 2,053     |
| Weighted-average shares outstanding  |                       | 55,851     |                       | 55,994    |
| Earnings (loss) per share  | \$(0.36 )             | \$(0.36 )  | \$0.07                | \$0.07    |

The weighted-average common shares outstanding for diluted EPS excluded approximately 4,416,000 and 5,020,000 potential common shares outstanding for the 12 weeks ended September 10, 2016 and September 12, 2015 and 4,329,000 for the 36 weeks ended September 10, 2016 due to the net loss attributable to common shareholders. Also excluded were approximately 1,850,000 and 576,000 potential common stock outstanding for the 12 weeks ended September 10, 2016 and September 12, 2015, respectively, and 1,642,000 and 555,000 for the 36 weeks ended September 10, 2016 and September 12, 2015, respectively, because the effect would have reduced weighted-average shares outstanding. Potential common stock outstanding results in fewer common share equivalents as a result of the treasury stock method.

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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 (the Quarterly Report) and our Annual Report filed on Form 10-K filed with the Securities and Exchange Commission on March 2, 2016 (the Annual Report). This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. You should review the "Risk Factors" of our Annual Report and "Special Note regarding Forward-Looking Statements" section and the "Risk Factors" section of this Quarterly Report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

## Special Note regarding Forward Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are indicated by words or phrases such as "guidance," "believes," "expects," "intends," "can," "could," "may," "anticipates," "estimates," "plans," "projects," "should," "targets," "will," "would" "continuing," "ongoing," and similar words or phrases and the negative of such words and phrases. Forward-looking statements are based on our current plans and expectations and involve risks and uncertainties which are, in many instances, beyond our control, and which could cause actual results to differ materially from those included in or contemplated or implied by the forward-looking statements. Such risks and uncertainties include the following:

- our ability to grow adjusted operating revenues as anticipated,
  - our ability to grow at historic rates or at all,
  - the consequences should we lose one or more of our top distribution partners or fail to attract new distribution partners to our network or if the financial performance of our distribution partners' businesses decline,
  - our reliance on our content providers, the demand for their products and our exclusivity arrangements with them,
  - our reliance on relationships with card issuing banks,
  - the consequences to our future growth if our distribution partners fail to actively and effectively promote our products and services,
  - the ability of our distribution partners to implement EMV compliance within their expected timeline and lift the measures they may have taken prior to such compliance to limit or control their exposure to liability for fraud losses,
  - the timing and manner that our distribution partners remove the limits or controls implemented by them during the period before they achieve EMV compliance,
  - changes in consumer behavior away from our distribution partners or our products resulting from limits or controls implemented by our distribution partners during their transition to EMV compliance,
  - our ability to successfully integrate our acquisitions,
  - our ability to generate adequate taxable income to enable us to fully utilize our deferred income tax assets,
  - changes in applicable tax law that preclude us from fully utilizing our deferred income tax assets,
  - the requirement that we comply with applicable laws and regulations, including increasingly stringent money-laundering rules and regulations, and
  - other risks and uncertainties described in our reports and filings with the Securities and Exchange Commission, including the risks and uncertainties set forth in Item 1A under the heading Risk Factors in our Annual Report, this Quarterly Report and other subsequent periodic reports we file with the Securities and Exchange Commission.
- Furthermore, such forward-looking statements speak only as of the date of this Quarterly 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.

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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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## Key Operating Statistics

The following table sets forth key operating statistics that directly affect our financial performance, a reconciliation of Commissions and fees and Program and other fees to Prepaid and processing revenues and a reconciliation of Total operating revenues to Adjusted operating revenues for the 12 and 36 weeks ended September 10, 2016 and September 12, 2015:

|  | 12 weeks ended   |                    | 36 weeks ended     |                    |   |
|--|--|--------------------|--------------------|--------------------|---|
|  | September 10, 2016                                       | September 12, 2015 | September 10, 2016 | September 12, 2015 |   |
|  | (in thousands, except percentages and per share amounts) |                    |                    |                    |   |
| Transaction dollar volume  | \$3,212,272  | \$3,167,719        | \$9,770,803        | \$9,660,243        |   |
| Prepaid and processing revenues  | \$312,995  | \$292,908          | \$958,411          | \$881,281          |   |
| Prepaid and processing revenues as a % of transaction dollar volume    | 9.7  | % 9.2              | % 9.8              | % 9.1              | % |
| Partner distribution expense as a % of prepaid and processing revenues | 57.0   | % 55.3             | % 56.5             | % 56.1             | % |
| Adjusted operating revenues (1)  | \$168,920  | \$177,108          | \$537,256          | \$493,945          |   |
| Prepaid and processing revenues:                                       |  |                    |                    |                    |   |
| Commissions and fees   | \$248,138  | \$231,492          | \$750,693          | \$709,339          |   |
| Program and other fees   | 64,857   | 61,416             | 207,718            | 171,942            |   |
| Prepaid and processing revenues  | \$312,995  | \$292,908          | \$958,411          | \$881,281          |   |
| Adjusted operating revenues:   |  |                    |                    |                    |   |
| Total operating revenues   | \$361,560  | \$352,665          | \$1,119,228        | \$1,044,644        |   |
| Revenue adjustment from purchase accounting (2)                        | 3,666  | 2,606              | 11,875             | 2,606              |   |
| Marketing revenue  | (17,943 )  | (16,311 )          | (52,098 )          | (59,112 )          |   |
| Partner distribution expense   | (178,363 )   | (161,852 )         | (541,749 )         | (494,193 )         |   |
| Adjusted operating revenues  | \$168,920  | \$177,108          | \$537,256          | \$493,945          |   |

Our Adjusted operating revenues 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, operating revenues, operating income, operating margin, cash flows, or other measures of the financial performance prepared in accordance with GAAP.

(1) Impact on revenues recognized resulting from the step down in basis of deferred revenue from its carrying value to fair value in a business combination at the acquisition date.

Transaction Dollar Volume—Represents the total dollar amount of value loaded onto any of our prepaid products, rebates processed during the period and gross billings to Achievers' business clients. The dollar amount and volume of card sales and rebates processed directly affect the amount of our revenues and direct costs. We measure and monitor Transaction dollar volume by retail distribution partner channel, content provider program and business client program.

Prepaid and Processing Revenues as a Percentage of Transaction Dollar Volume—Represents the total amount of Commissions and fees and Program and other fees recognized during the period as a percentage of Transaction dollar volume for the same period. Our prepaid product revenues vary among our various product offerings: closed loop gift and prepaid telecom cards generate the highest rates due to the content provider commissions; open loop gift cards and incentive and reward products and services also generate high rates due to program management fees, interchange and other fees included in Program and other fees in addition to the consumer and client purchase fees included in Commissions and fees; financial services products generate the lowest rates due to higher average transaction values; for Achievers, the gross billings are recorded as deferred revenue and recognized as the products are delivered or services are rendered, and we only include the portion of revenue related to software in Program and other fees in this



metric, as we present revenue from the redemption of employee rewards in Product sales. This metric helps us understand and manage overall margins from our product offerings.

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Partner Distribution Expense as a Percentage of Prepaid and Processing Revenues—Represents partner distribution expense divided by Prepaid and processing revenues (as defined above under Prepaid and processing revenues as a percentage of transaction dollar volume) during the period. This metric represents the expense recognized for the portion of content provider commissions and purchase or load fees shared with our retail distribution partners (known as distribution partner commissions), as well as other compensation we pay our retail business partners and certain business clients, including certain program development payments to our retail distribution partners, compensation for the distribution of our open loop products and expense recognized for equity awards issued to certain retail distribution partners. We present this expense as a percentage of prepaid and processing revenues to present the overall portion of our revenues from the sale of our prepaid products and services that we share with our retail distribution partners and business clients. The substantial majority of this expense is distribution partner commissions which are based on a percentage of the gross content provider commissions and consumer purchase fees. These percentages are individually negotiated with our retail distribution partners and are independent of the commission rates negotiated between us and our content providers. Partner distribution expense percentage is affected by changes in the proportion of Transaction dollar volume i) among our various products (as we share significantly lower amounts of revenues included in Program and other fees generated by our open loop gift, open loop incentive and financial services products), ii) among our various regions (as commission share percentages differ from region to region, particularly those with sub-distributor relationships) and iii) among retail distribution partners (as the commission share percentage is individually negotiated with each retail distribution partner).

Adjusted Operating Revenues—We regard Adjusted operating revenues as a useful measure of operational and financial performance of the business. Adjusted operating revenues are prepared and presented to offset the distribution commissions paid and other compensation to our distribution partners and business clients, to remove marketing revenues which have offsetting marketing expenses included in Sales and marketing expense and to remove the impact that the step down in basis of deferred revenue from its book value to its fair value in purchase accounting. Our Adjusted operating revenues 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. You are encouraged to evaluate our adjustments and the reasons we consider them appropriate.

We believe Adjusted operating revenues is useful to evaluate our operating performance for the following reasons:

- adjusting our operating revenues for distribution commissions paid and other compensation to our retail distribution partners and business clients is useful to understanding our operating margin;
- adjusting our operating revenues for marketing revenue, which has offsetting marketing expense, is useful for understanding our operating margin;

in a business combination, a company records an adjustment to reduce the carrying value of deferred revenue to its fair value and reduces the company's revenues from what it would have recorded otherwise, and as such we do not believe is indicative of our core operating performance.

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## Results of Operations

Comparison of the 12 and 36 Weeks Ended September 10, 2016 and September 12, 2015.

The fiscal periods presented in the accompanying tables below and throughout this Results of Operations section consist of the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015 (the 12 weeks ended September 10, 2016 is referred to as the second quarter of 2016, the 36 weeks ended September 10, 2016 is referred to as the first 36 weeks of 2016, the 12 weeks ended September 12, 2015 is referred to as the second quarter of 2015, and the 36 weeks ended September 12, 2015 is referred to as the first 36 weeks of 2015).

The following tables set forth the revenue and expense amounts as a percentage of total operating revenues by the line items in our condensed consolidated statements of income (loss) for the 12-week and 36-week period ended September 10, 2016 and September 12, 2015.

|   | 12 Weeks<br>Ended<br>September<br>10, 2016 | % of Total<br>Operating<br>Revenues |  | 12 Weeks<br>Ended<br>September<br>12, 2015 | % of Total<br>Operating<br>Revenues |  |
|---|--|-------------------------------------|--|--|-------------------------------------|--|
|   | (in thousands, except percentages)         |                                     |  |  |                                     |  |
| <b>OPERATING REVENUES:</b>  |  |                                     |  |  |                                     |  |
| Commissions and fees  | \$248,138                                  | 68.6 %                              |  | \$231,492                                  | 65.6 %                              |  |
| Program and other fees  | 64,857                                     | 17.9 %                              |  | 61,416                                     | 17.4 %                              |  |
| Marketing   | 17,943                                     | 5.0 %                               |  | 16,311                                     | 4.6 %                               |  |
| Product sales   | 30,622                                     | 8.5 %                               |  | 43,446                                     | 12.3 %                              |  |
| Total operating revenues  | 361,560                                    | 100.0 %                             |  | 352,665                                    | 100.0 %                             |  |
| <b>OPERATING EXPENSES:</b>  |  |                                     |  |  |                                     |  |
| Partner distribution expense  | 178,363                                    | 49.2 %                              |  | 161,852                                    | 45.9 %                              |  |
| Processing and services   | 75,090                                     | 20.8 %                              |  | 68,246                                     | 19.4 %                              |  |
| Sales and marketing   | 52,327                                     | 14.5 %                              |  | 49,954                                     | 14.2 %                              |  |
| Costs of products sold  | 29,122                                     | 8.1 %                               |  | 40,577                                     | 11.5 %                              |  |
| General and administrative  | 22,501                                     | 6.2 %                               |  | 22,136                                     | 6.3 %                               |  |
| Transition and acquisition  | 2,574                                      | 0.7 %                               |  | 5,275                                      | 1.5 %                               |  |
| Amortization of acquisition intangibles                                       | 10,376                                     | 2.9 %                               |  | 6,875                                      | 1.9 %                               |  |
| Change in fair value of contingent consideration                              | 1,300                                      | 0.4 %                               |  | —  | — %                                 |  |
| Total operating expenses  | 371,653                                    | 102.8 %                             |  | 354,915                                    | 100.6 %                             |  |
| <b>OPERATING INCOME (LOSS)</b>  | (10,093 )                                  | (2.8 )%                             |  | (2,250 )                                   | (0.6 )%                             |  |
| <b>OTHER INCOME (EXPENSE):</b>  |  |                                     |  |  |                                     |  |
| Interest income and other income (expense), net                               | 2,360                                      | 0.7 %                               |  | (1,421 )                                   | (0.4 )%                             |  |
| Interest expense  | (5,684 )                                   | (1.6 )%                             |  | (3,231 )                                   | (0.9 )%                             |  |
| <b>INCOME (LOSS) BEFORE INCOME TAX EXPENSE</b>                                | (13,417 )                                  | (3.7 )%                             |  | (6,902 )                                   | (2.0 )%                             |  |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>   | (8,357 )                                   | (2.3 )%                             |  | (3,290 )                                   | (0.9 )%                             |  |
| <b>NET INCOME (LOSS) BEFORE ALLOCATION TO<br/>NON-CONTROLLING INTERESTS</b>   | (5,060 )                                   | (1.4 )%                             |  | (3,612 )                                   | (1.0 )%                             |  |
| Loss (income) attributable to non-controlling interests, net of tax           | (42 )                                      | — %                                 |  | (3 )                                       | — %                                 |  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK<br/>NETWORK HOLDINGS, INC.</b> | <b>\$(5,102 )</b>                          | <b>(1.4 )%</b>                      |  | <b>\$(3,615 )</b>                          | <b>(1.0 )%</b>                      |  |

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|   | 36 Weeks<br>Ended<br>September<br>10, 2016 | % of Total<br>Operating<br>Revenues |          | 36 Weeks<br>Ended<br>September<br>12, 2015 | % of Total<br>Operating<br>Revenues |          |
|---|--|-------------------------------------|----------|--|-------------------------------------|----------|
| (in thousands, except percentages)  |  |                                     |          |  |                                     |          |
| <b>OPERATING REVENUES:</b>  |  |                                     |          |  |                                     |          |
| Commissions and fees  | \$750,693                                  | 67.1                                | %        | \$709,339                                  | 67.9                                | %        |
| Program and other fees  | 207,718                                    | 18.6                                | %        | 171,942                                    | 16.4                                | %        |
| Marketing   | 52,098                                     | 4.7                                 | %        | 59,112                                     | 5.7                                 | %        |
| Product sales   | 108,719                                    | 9.7                                 | %        | 104,251                                    | 10.0                                | %        |
| Total operating revenues  | 1,119,228                                  | 100.1                               | %        | 1,044,644                                  | 100.0                               | %        |
| <b>OPERATING EXPENSES:</b>  |  |                                     |          |  |                                     |          |
| Partner distribution expense  | 541,749                                    | 48.3                                | %        | 494,193                                    | 47.3                                | %        |
| Processing and services   | 224,331                                    | 20.0                                | %        | 198,272                                    | 19.0                                | %        |
| Sales and marketing   | 166,176                                    | 14.8                                | %        | 156,653                                    | 15.0                                | %        |
| Costs of products sold  | 103,163                                    | 9.2                                 | %        | 97,593                                     | 9.3                                 | %        |
| General and administrative  | 70,130                                     | 6.3                                 | %        | 62,186                                     | 6.0                                 | %        |
| Transition and acquisition  | 4,160                                      | 0.4                                 | %        | 6,091                                      | 0.6                                 | %        |
| Amortization of acquisition intangibles                                       | 35,533                                     | 3.2                                 | %        | 18,352                                     | 1.8                                 | %        |
| Change in fair value of contingent consideration                              | 2,100                                      | 0.2                                 | %        | (7,567)                                    | (0.7)                               | %        |
| Total operating expenses  | 1,147,342                                  | 102.4                               | %        | 1,025,773                                  | 98.3                                | %        |
| <b>OPERATING INCOME (LOSS)</b>  | <b>(28,114)</b>                            | <b>(2.5)</b>                        | <b>%</b> | <b>18,871</b>                              | <b>1.8</b>                          | <b>%</b> |
| <b>OTHER INCOME (EXPENSE):</b>  |  |                                     |          |  |                                     |          |
| Interest income and other income (expense), net                               | 3,258                                      | 0.3                                 | %        | (1,938)                                    | (0.2)                               | %        |
| Interest expense  | (13,868)                                   | (1.2)                               | %        | (8,566)                                    | (0.8)                               | %        |
| <b>INCOME (LOSS) BEFORE INCOME TAX EXPENSE</b>                                | <b>(38,724)</b>                            | <b>(3.5)</b>                        | <b>%</b> | <b>8,367</b>                               | <b>0.8</b>                          | <b>%</b> |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>   | <b>(18,884)</b>                            | <b>(1.7)</b>                        | <b>%</b> | <b>4,435</b>                               | <b>0.4</b>                          | <b>%</b> |
| <b>NET INCOME (LOSS) BEFORE ALLOCATION TO<br/>NON-CONTROLLING INTERESTS</b>   | <b>(19,840)</b>                            | <b>(1.8)</b>                        | <b>%</b> | <b>3,932</b>                               | <b>0.4</b>                          | <b>%</b> |
| Loss (income) attributable to non-controlling interests, net of tax           | (152)                                      | —                                   | %        | 63   | —                                   | %        |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK<br/>NETWORK HOLDINGS, INC.</b> | <b>\$(19,992)</b>                          | <b>(1.8)</b>                        | <b>%</b> | <b>\$3,995</b>                             | <b>0.4</b>                          | <b>%</b> |

Although our Chief Operating Decision Maker (CODM) reviews information regarding segment profit for our three reportable segments of US Retail, International Retail and Incentives & Rewards, segment profit for US Retail excludes certain sales, marketing and operations personnel costs used by that segment in generating revenues, whereas such costs are included in segment profit for International Retail and Rewards & Incentives. Additionally, US Retail and International Retail utilize shared costs for technology personnel and related depreciation and amortization of developed technology and related hardware, which we do not include in the determination of segment profit, but we do include such costs in the determination of segment profit for Incentives & Rewards (see Note 10—Segment Reporting for additional information). Accordingly, in the following detailed discussions of our operating results, we discuss Total operating revenues, Partner distribution expense and Operating revenues, net of Partner distribution expense for our three reportable segments and discuss our remaining operating expenses at the consolidated level.

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Operating Revenues, Partner Distribution Expense and Operating Revenues, net of Partner Distribution Expense  
The following tables set forth our consolidated Total operating revenues, Partner distribution expense and Operating revenues, net of Partner distribution expense for the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015.

|   | 12 weeks ended                     |                    | Change     |         |
|---|------------------------------------|--------------------|------------|---------|
|   | September 10, 2016                 | September 12, 2015 |            |         |
|   | (in thousands, except percentages) |                    |            |         |
| <b>OPERATING REVENUES:</b>                              |                                    |                    |            |         |
| Commissions and fees                                    | \$248,138                          | \$ 231,492         | \$16,646   | 7.2 %   |
| Program and other fees                                  | 64,857                             | 61,416             | 3,441      | 5.6 %   |
| Marketing   | 17,943                             | 16,311             | 1,632      | 10.0 %  |
| Product sales   | 30,622                             | 43,446             | (12,824 )  | (29.5)% |
| Total operating revenues                                | \$361,560                          | \$ 352,665         | \$8,895    | 2.5 %   |
| Partner distribution expense                            | 178,363                            | 161,852            | 16,511     | 10.2 %  |
| Operating revenues, net of Partner distribution expense | \$183,197                          | \$ 190,813         | \$(7,616 ) | (4.0 )% |

|   | 36 weeks ended                     |                    | Change   |         |
|---|------------------------------------|--------------------|----------|---------|
|   | September 10, 2016                 | September 12, 2015 |          |         |
|   | (in thousands, except percentages) |                    |          |         |
| <b>OPERATING REVENUES:</b>                              |                                    |                    |          |         |
| Commissions and fees                                    | \$750,693                          | \$ 709,339         | \$41,354 | 5.8 %   |
| Program and other fees                                  | 207,718                            | 171,942            | 35,776   | 20.8 %  |
| Marketing   | 52,098                             | 59,112             | (7,014 ) | (11.9)% |
| Product sales   | 108,719                            | 104,251            | 4,468    | 4.3 %   |
| Total operating revenues                                | \$1,119,228                        | \$ 1,044,644       | \$74,584 | 7.1 %   |
| Partner distribution expense                            | 541,749                            | 494,193            | 47,556   | 9.6 %   |
| Operating revenues, net of Partner distribution expense | \$577,479                          | \$ 550,451         | \$27,028 | 4.9 %   |

**US Retail Segment**

The following tables set forth our Total operating revenues, Partner distribution expense and Operating revenues, net of Partner distribution expense and related key operating statistics for our US Retail segment for the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015.

|   | 12 weeks ended                     |                    | Change      |         |
|---|------------------------------------|--------------------|-------------|---------|
|   | September 10, 2016                 | September 12, 2015 |             |         |
|   | (in thousands, except percentages) |                    |             |         |
| Total operating revenues  | \$197,081                          | \$214,941          | \$(17,860 ) | (8.3 )% |
| Partner distribution expense  | 103,601                            | 101,890            | 1,711       | 1.7 %   |
| Operating revenues, net of Partner distribution expense                         | \$93,480                           | \$ 113,051         | \$(19,571 ) | (17.3)% |
| Transaction dollar volume   | \$1,844,666                        | \$2,040,745        | \$(196,079) | (9.6 )% |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 9.2 %                              | 8.5 %              | 0.7 %       | 8.2 %   |
| Partner distribution expense as a percentage of prepaid and processing revenues | 61.1 %                             | 58.6 %             | 2.5 %       | 4.3 %   |

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|   | 36 weeks ended                     |                    |             |         |
|---|------------------------------------|--------------------|-------------|---------|
|   | September 10, 2016                 | September 12, 2015 | Change      |         |
|   | (in thousands, except percentages) |                    |             |         |
| Total operating revenues  | \$652,359                          | \$659,984          | \$(7,625 )  | (1.2)%  |
| Partner distribution expense  | 330,283                            | 313,628            | 16,655      | 5.3 %   |
| Operating revenues, net of Partner distribution expense                         | \$322,076                          | \$346,356          | \$(24,280 ) | (7.0)%  |
| Transaction dollar volume   | \$5,904,531                        | \$6,310,610        | \$(406,079) | (6.4)%  |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 9.3                                | % 8.6              | % 0.7       | % 8.1 % |
| Partner distribution expense as a percentage of prepaid and processing revenues | 60.4                               | % 57.9             | % 2.5       | % 4.3 % |

Our Operating revenues, net of partner distribution expense decreased for the third quarter and first 36 weeks of 2016 due to a decrease in Transaction dollar volume and an increase in Partner distribution expense as a percentage of prepaid and processing revenue, partially offset by an increase in Prepaid and processing revenue as a percentage of transaction dollar volume:

Transaction dollar volume—On October 1, 2015, the payment card industry shifted liability for certain debit and credit card transactions to retailers who do not accept EMV chip technology transactions. As a result, some of our non-EMV compliant retail distribution partners have taken restrictive measures around the sale of gift cards, in particular higher denomination open loop gift cards and some closed loop gift cards. These measures include establishing lower limits on credit card purchases of gift cards and removing higher denomination products from displays in impacted markets to mitigate their liability for fraudulent credit card activity in their stores, which decreased our transaction dollar volume. Although EMV implementation at these retail distribution partners is not under our control, based on our most current information provided by such non-EMV compliant retail distribution partners, we expect that our top U.S. distribution partners for our open loop gift products will have completed their EMV implementations in the vast majority of their store locations by the end of October 2016. We expect that the distributions partners would continue to remove the limits and controls implemented by them before they were EMV compliant and finish restoring our products to their displays during our fourth quarter. We expect the negative impact of restricted sales of high-denomination open loop gift cards to continue while they take these steps and message to their customers that such products are once again available for purchase using credit cards. Additionally, we discontinued certain low-margin financial services programs, including certain co-branded GPR products, which also decreased transaction dollar volume. These decreases were partially offset by higher sales of other prepaid products through our retail distribution partner network as well as an increase in sales through our online distribution channels, partially as a result of our acquisition of GiftCards in the first quarter of 2016.

Prepaid and processing revenues as a percentage of transaction dollar volume—Increased for the third quarter and first 36 weeks of 2016 due to the discontinuation of certain low-margin financial services programs.

Additionally, the prepaid and processing revenue rate for open loop gift increased due to i) a higher commissions and fees rate and ii) revenue from interchange and deferred revenue from sales in prior periods that were proportionately higher. The higher commission and fees rate resulted from shift in mix from higher denomination cards to lower denomination cards as a result of the restrictions at non-EMV compliant distribution partners. The increase in the prepaid and processing revenue rate for open loop gift cards was partially offset by a lower program management fees rate that will continue to decrease as a result of a contract amendment with one of our issuing banks based on changing redemption patterns for open loop gift products. The prepaid and processing revenue rate for closed loop gift decreased slightly for the third quarter and first 36 weeks of 2016. Our adoption of ASU 2016-04 in the first 36 weeks of 2016 also did not have a material impact on our prepaid and processing revenue rate for the third quarter and first 36 weeks of 2016 (see Note 1—Recently Issued or Adopted Accounting Pronouncements in the notes to our condensed consolidated financial statements).

Partner distribution expense as a percentage of prepaid and processing revenues—Increased for the third quarter and first 36 weeks of 2016 due to i) an increase in the proportion of sales through retail distribution partners with higher commission share rates and ii) partially offset by a decrease in the proportion of open loop gift products sold as we share a smaller portion of our total revenues with our retail distribution partners for our program-managed Visa gift products. These impacts were partially offset by an increase in sales through our online distribution channels since we do not incur such expense for sales through our proprietary websites.

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Our Operating revenues and Operating revenues, net of Partner distribution expense were also impacted by an increase of \$2.7 million in marketing revenue for first 36 weeks of 2016, with minimal impact for the third quarter of 2016, and decreases of \$13.6 million and \$14.5 million in sales from Cardpool for the third quarter and first 36 weeks of 2016, respectively, due to the reduced number of retail kiosk for acquisition of its inventory.

In the second quarter of 2016, we entered into an agreement with NetSpend, whose GPR card products we already distribute, to exit our U.S program-managed GPR business under the PayPower brand, to assign the PayPower programs with our issuing bank to NetSpend and to provide the fixture space previously provided to PayPower to NetSpend. As a result of these agreements, we recognized a \$4 million gain as a reduction in General and administrative expense which was substantially offset by the write-off of certain GPR technology assets. Additionally, we have agreed to provide NetSpend with certain transition services worth approximately \$6 million, which we will recognize as revenue or a reduction of expense over the service period during 2016. During the third quarter and first 36 weeks of 2016, we recognized \$1.3 million and \$1.7 million in revenue, respectively, and \$1.4 million and \$2.2 million as a reduction in expense, respectively. We do not expect our exit from the program management of GPR cards to have a significant impact on our results of operations.

**International Retail**

The following tables set forth our Total operating revenues, Partner distribution expense and Operating revenues, net of Partner distribution expense and related key operating statistics for our International Retail segment for the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015.

|   | 12 weeks ended                     |                       |             |            |
|---|------------------------------------|-----------------------|-------------|------------|
|   | September 10,<br>2016              | September 12,<br>2015 | Change      |            |
|   | (in thousands, except percentages) |                       |             |            |
| Total operating revenues  | \$ 100,069                         | \$ 83,671             | \$ 16,398   | 19.6 %     |
| Partner distribution expense  | 69,841                             | 56,972                | 12,869      | 22.6 %     |
| Operating revenues, net of Partner distribution expense                         | \$ 30,228                          | \$ 26,699             | \$ 3,529    | 13.2 %     |
| Transaction dollar volume   | \$ 826,746                         | \$ 661,890            | \$ 164,856  | 24.9 %     |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 10.8                               | % 11.2                | % (0.4      | )% (3.6 )% |
| Partner distribution expense as a percentage of prepaid and processing revenues | 78.4                               | % 77.2                | % 1.2       | % 1.6 %    |
|   | 36 weeks ended                     |                       |             |            |
|   | September 10,<br>2016              | September 12,<br>2015 | Change      |            |
|   | (in thousands, except percentages) |                       |             |            |
| Total operating revenues  | \$ 279,311                         | \$ 251,249            | \$ 28,062   | 11.2 %     |
| Partner distribution expense  | 198,703                            | 169,578               | 29,125      | 17.2 %     |
| Operating revenues, net of Partner distribution expense                         | \$ 80,608                          | \$ 81,671             | \$ (1,063 ) | (1.3 )%    |
| Transaction dollar volume   | \$ 2,325,476                       | \$ 1,966,692          | \$ 358,784  | 18.2 %     |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 10.9                               | % 11.0                | % (0.1      | )% (0.9 )% |
| Partner distribution expense as a percentage of prepaid and processing revenues | 78.3                               | % 78.0                | % 0.3       | % 0.4 %    |

Our Operating revenues, net of Partner distribution expense had a significant impact from pass-through marketing revenues (for which we have offsetting expense in Sales and marketing), which increased \$1.7 million for the third quarter 2016 but decreased \$9.2 million for the first 36 weeks of 2016. Excluding marketing revenue, Operating revenues, net of Partner distribution expense increased by \$1.8 million, or 9.9%, for the third quarter of 2016 and \$8.1 million, or 15.8%, for the first 36 weeks of 2016, primarily due to the increase in our Transaction dollar volume, partially offset by a decrease in Prepaid and processing revenue as a percentage of transaction dollar volume and an increase in Partner distribution expense as a percentage of prepaid and processing revenue.





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Transaction dollar volume—Increased for both the third quarter and first 36 weeks of 2016 primarily due to increases in sales in Canada and Europe, primarily Germany and our acquisition of Didix in the fourth quarter of 2015, and through our sub-distributor relationships in Japan and South Korea, partially offset by decreases in Australia.

Transaction dollar volume for the first 36 weeks of 2016 also decreased in Mexico and our sub-distributor relationship in South Africa but increased and remained flat for the third quarter of 2016 for these countries, respectively. On a constant currency basis, transaction dollar volume increased 17.1% and 16.1% for the third quarter and first 36 weeks of 2016, respectively.

Prepaid and processing revenues as a percentage of transaction dollar volume—As a result of our adoption of ASU 2016-04, we recognized \$1.4 and \$4.0 million of breakage revenue in the third quarter and first 36 weeks of 2016, respectively. Excluding this benefit, the prepaid and processing revenue rates were 10.6% and 10.7% for the third quarter and first 36 weeks of 2016, respectively. The prepaid and processing revenue rate decreased due to an increase in the proportion of products sold in Germany which generates a lower prepaid and processing revenue rate.

Partner distribution expense as a percentage of prepaid and processing revenues—The adoption of ASU 2016-04 decreased the partner distribution expense rate for both third quarter and first 36 weeks of 2016, since certain cards for which we record breakage revenue are higher margin products. Excluding this benefit, the partner distribution expense rate increased to 79.7% and 79.6% for the third quarter and first 36 weeks of 2016, respectively, due to an increase in the proportion of sales through sub-distributor relationships, primarily Japan (which have higher commission share arrangements but for which we incur minimal other operating expenses), partially offset by increase in proportion of sales in Germany where we have lower commission sharing arrangements.

Changes in product sales had minimal impacts on Operating revenues and Operating revenues, net of Partner distribution expense.

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## Incentives &amp; Rewards

The following tables set forth our Total operating revenues, Partner distribution expense and Operating revenues, net of Partner distribution expense and related key operating statistics for our Incentives & Rewards segment for the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015.

|   | 12 weeks ended                     |                       |            |           |
|---|------------------------------------|-----------------------|------------|-----------|
|   | September 10,<br>2016              | September 12,<br>2015 | Change     |           |
|   | (in thousands, except percentages) |                       |            |           |
| Total operating revenues  | \$64,410                           | \$ 54,053             | \$ 10,357  | 19.2 %    |
| Partner distribution expense  | 4,921                              | 2,990                 | 1,931      | 64.6 %    |
| Operating revenues net of Partner distribution expense                          | \$59,489                           | \$ 51,063             | \$ 8,426   | 16.5 %    |
| Transaction dollar volume   | \$540,860                          | \$ 465,084            | \$ 75,776  | 16.3 %    |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 10.1                               | % 9.7                 | % 0.4      | % 4.1 %   |
| Partner distribution expense as a percentage of prepaid and processing revenues | 9.0                                | % 6.6                 | % 2.4      | % 36.4 %  |
|   | 36 weeks ended                     |                       |            |           |
|   | September 10,<br>2016              | September 12,<br>2015 | Change     |           |
|   | (in thousands, except percentages) |                       |            |           |
| Total operating revenues  | \$187,558                          | \$ 133,411            | \$ 54,147  | 40.6 %    |
| Partner distribution expense  | 12,763                             | 10,987                | 1,776      | 16.2 %    |
| Operating revenues net of Partner distribution expense                          | \$ 174,795                         | \$ 122,424            | \$ 52,371  | 42.8 %    |
| Transaction dollar volume   | \$1,540,796                        | \$ 1,382,941          | \$ 157,855 | 11.4 %    |
| Prepaid and processing revenues as a percentage of transaction dollar volume    | 10.3                               | % 8.8                 | % 1.5      | % 17.0 %  |
| Partner distribution expense as a percentage of prepaid and processing revenues | 8.1                                | % 9.0                 | % (0.9)    | % (10.0)% |

Our Operating revenues, net of Partner distribution expense increased for the third quarter and first 36 weeks of 2016 primarily due to increases in Prepaid and processing revenue as a percentage of transaction dollar volume and an increase in Transaction dollar volume. The change in Partner distribution expense as a percentage of prepaid and processing revenue had a negative impact for the third quarter of 2016 and a positive impact for the first 36 weeks of 2016:

Transaction dollar volume—Increased for the third quarter and first 36 weeks of 2016 due to our acquisition and growth of Achievers in the third quarter of 2015 and increases in e-Commerce sales, primarily due to our acquisition of GiftCards in the first quarter of 2016 and Extrameasures in the second quarter of 2016, partially offset by the loss of certain business clients which had lower margin programs.

Prepaid and processing revenues as a percentage of transaction dollar volume—In the first quarter of 2016, we entered into a contractual amendment with one of our issuing banks to settle our right to receive future fees for cards issued under a legacy contract. The amendment resulted in a one-time benefit of \$4.3 million which we recognized in Program and other fees. Excluding this benefit, our prepaid and processing revenue rate was 10.0% for the first 36 weeks of 2016, and our prepaid and processing revenue rate increased for both third quarter and first 36 weeks of 2016 due to our acquisition of Achievers, which generates a higher prepaid and processing revenue rate from its software revenue and the loss of certain business clients which had lower margin programs.

Partner distribution expense as a percentage of prepaid and processing revenue—Changes in the partner distribution expense rate reflect changes in transaction volume sold through business clients for which we recognize net pricing discounts as an expense.

Our Operating revenues and Operating revenues net of Partner distribution expense also increased for the third quarter and first 36 weeks of 2016 due to increases in product sales of \$1.1 million and \$18.7 million, respectively, primarily from our acquisition of Achievers.

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## Operating Expenses

The following tables set forth our consolidated operating expenses for the 12-week and 36-week periods ended September 10, 2016 and September 12, 2015.

|  | 12 weeks ended                     |                    | Change    |         |
|--|------------------------------------|--------------------|-----------|---------|
|  | September 10, 2016                 | September 12, 2015 |           |         |
|  | (in thousands, except percentages) |                    |           |         |
| <b>OPERATING EXPENSES:</b>                       |                                    |                    |           |         |
| Partner distribution expense                     | 178,363                            | 161,852            | 16,511    | 10.2 %  |
| Processing and services                          | 75,090                             | 68,246             | 6,844     | 10.0 %  |
| Sales and marketing                              | 52,327                             | 49,954             | 2,373     | 4.8 %   |
| Costs of products sold                           | 29,122                             | 40,577             | (11,455 ) | (28.2)% |
| General and administrative                       | 22,501                             | 22,136             | 365       | 1.6 %   |
| Transition and acquisition                       | 2,574                              | 5,275              | (2,701 )  | (51.2)% |
| Amortization of acquisition intangibles          | 10,376                             | 6,875              | 3,501     | 50.9 %  |
| Change in fair value of contingent consideration | 1,300                              | —                  | 1,300     | N/M     |
| Total operating expenses                         | \$371,653                          | \$ 354,915         | \$ 16,738 | 4.7 %   |

|  | 36 weeks ended                     |                    | Change     |         |
|--|------------------------------------|--------------------|------------|---------|
|  | September 10, 2016                 | September 12, 2015 |            |         |
|  | (in thousands, except percentages) |                    |            |         |
| <b>OPERATING EXPENSES:</b>                       |                                    |                    |            |         |
| Partner distribution expense                     | 541,749                            | 494,193            | 47,556     | 9.6 %   |
| Processing and services                          | 224,331                            | 198,272            | 26,059     | 13.1 %  |
| Sales and marketing                              | 166,176                            | 156,653            | 9,523      | 6.1 %   |
| Costs of products sold                           | 103,163                            | 97,593             | 5,570      | 5.7 %   |
| General and administrative                       | 70,130                             | 62,186             | 7,944      | 12.8 %  |
| Transition and acquisition                       | 4,160                              | 6,091              | (1,931 )   | (31.7)% |
| Amortization of acquisition intangibles          | 35,533                             | 18,352             | 17,181     | 93.6 %  |
| Change in fair value of contingent consideration | 2,100                              | (7,567 )           | 9,667      | N/M     |
| Total operating expenses                         | \$1,147,342                        | \$ 1,025,773       | \$ 121,569 | 11.9 %  |

Partner distribution expense—Please see our discussion of Operating revenues, net of Partner distribution expense and Partner distribution expense as a percentage of prepaid and processing revenues for our reportable segments above.

**Processing and Services**

Processing and services expenses increased for both third quarter and first 36 weeks of 2016 due to increases in Prepaid and processing revenues of 6.9% and 8.8% for the third quarter and first 36 weeks of 2016, respectively, or 6.3% and 7.7%, respectively, when excluding the revenue benefits from contract amendments and breakage recognized for the adoption of ASU 2016-04. Excluding such benefits, Processing and services expenses as a percentage of Prepaid and processing revenues increased to 24.1% from 23.3% and to 23.6% from 22.5% for the third quarter and first 36 weeks of 2016, respectively, primarily due to increases in employee compensation and depreciation and amortization expenses, reflecting our continued expected growth with the short-term negative impact on revenues derived from our non-EMV compliant retail distribution partners.

The increases of \$6.8 million for the third quarter (\$26.1 million for the first 36 weeks of 2016) reflect:

\$1.6 million increase for technology and operations personnel costs (\$12.8 million for the first 36 weeks of 2016), including employee and contractor compensation, benefits and travel related costs;

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\$3.7 million increase for our technology infrastructure (\$7.9 million for the first 36 weeks of 2016), including depreciation of capitalized software and related hardware, data center lease, hosting and connectivity, activation transaction processing and other equipment costs;

\$1.3 million increase for our program management services (\$3.3 million for the first 36 weeks of 2016), including card production, redemption transaction processing and customer care primarily for our Visa gift and open loop incentive cards, reflecting the increase in open loop cards sold in our Incentives & Rewards segment, partially offset by the decrease in the US Retail segment due to restrictions at our non-EMV compliant retail distribution partners;

\$1.2 million increase in other net costs (\$3.7 million for the first 36 weeks of 2016);

\$0.5 million decrease in costs for maintaining our distribution network (\$1.6 million for the first 36 weeks of 2016), including fulfillment and merchandising expenses.

### Sales and Marketing

The changes in Sales and marketing expenses reflect increases in personnel costs, including employee compensation, benefits and travel related costs, as well as changes in program marketing and development expenses, which increased for the third quarter of 2016 but decreased for the first 36 weeks of 2016. Personnel costs increased by \$0.5 million and \$11.9 million for the third quarter and first 36 weeks of 2016, respectively, primarily from our acquisition of Achievers in the third quarter of 2015 and increases of \$0.7 million and \$3.1 million, respectively, in stock-based compensation. Program marketing and development expenses increased by \$1.9 million for the third quarter, reflecting the increase of \$1.6 million in marketing revenue, and such expenses decreased by \$4.3 million for the first 36 weeks of 2016, reflecting a decrease of \$7.0 million in marketing revenue (including \$9.2 million in our International Retail segment). Sales and marketing expenses also reflect increases in other costs of \$1.0 million and \$3.5 million for the third quarter of 2016 and first 36 weeks of 2016, respectively, partially offset by the reduction in expense from transition services provided to NetSpend of \$0.9 million and \$1.6 million, respectively.

### Costs of Products Sold

Costs of products sold decreased for the third quarter of 2016 due to the decrease in Product sales, primarily due to a decrease in sales from Cardpool, partially offset by an increase in sales for Achievers. Costs of products sold increased for the first 36 weeks of 2016 due to an increase in sales for Achievers, partially offset by a decrease in sales from Cardpool. Gross margin decreased for both third quarter and first 36 weeks of 2016 due to a decrease in the gross margin for Cardpool, partially offset by our acquisition of Achievers in the third quarter of 2015, which generates higher gross margins.

### General and Administrative

General and administrative expenses increased primarily due to increases of \$1.2 million and \$5.8 million for the third quarter and first 36 weeks of 2016, respectively, in personnel costs, including employee compensation, benefits and travel related costs. Other costs decreased \$0.3 million for the third quarter of 2016 and increased \$3.5 million for the first 36 weeks of 2016. The increases in other costs includes increases of \$1.0 million and \$3.4 million in rent expense, reflecting our new lease agreement for our corporate offices and our acquisition of Achievers. These expenses were partially offset by \$0.5 million and \$1.4 million for the third quarter and first 36 weeks of 2016, respectively, for the services and the gain on our U.S GPR business to NetSpend, net of related write-offs of GPR technology assets.

### Transition and Acquisition

Transition and acquisition expense for 2016 reflects our on-going acquisition activity, including our acquisitions of GiftCards and NimbleCommerce in the first quarter of 2016, Extrameasures in the second quarter of 2016 and Grass Roots in the fourth quarter. Transition and acquisition expense for 2015 reflects our acquisitions of Achievers in the third quarter of 2015 and Didix early in fourth quarter of 2015.

### Amortization of Acquisition Intangibles

Amortization expense increased for both the third quarter and first 36 weeks of 2016 due to continued acquisition activity, including Achievers and Didix in the third quarter of 2015, GiftCards and NimbleCommerce in the first quarter of 2016 and Extrameasures in the second quarter of 2016.



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## Change in Fair Value of Contingent Consideration

The decrease in the estimated fair value of contingent consideration for the first 36 weeks of 2015 relates to our CardLab contingent consideration liability, reflecting the projected failure of financial targets to be met relating to the launch of incentive programs during the contingent earn-out measurement period. The increase in the estimated fair value of contingent consideration for the third quarter and first 36 weeks of 2016 reflects the accretion of the discount on estimated earnout and improvements on our projections of the earnout.

## Other Income (Expense) and Income Tax Expense (Benefit)

The following tables set forth our consolidated other income (expense), and income tax expense (benefit) and effective tax rates for 12-week and 36-week periods ended September 10, 2016 and September 12, 2015

|   | 12 weeks ended                     |                    |                  |                |
|---|------------------------------------|--------------------|------------------|----------------|
|   | September 10, 2016                 | September 12, 2015 | Change           |                |
|   | (in thousands, except percentages) |                    |                  |                |
| <b>OTHER INCOME (EXPENSE):</b>                  |                                    |                    |                  |                |
| Interest income and other income (expense), net | \$2,360                            | \$ (1,421 )        | \$3,781          | (266.1)%       |
| Interest expense                                | (5,684 )                           | (3,231 )           | (2,453 )         | 75.9 %         |
| Total other income (expense)                    | \$(3,324)                          | \$(4,652 )         | \$1,328          | (28.5 )%       |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>             | <b>\$(8,357)</b>                   | <b>\$(3,290 )</b>  | <b>\$(5,067)</b> | <b>154.0 %</b> |
| <b>EFFECTIVE TAX RATE</b>                       | <b>62.3 %</b>                      | <b>47.7 %</b>      | <b>14.6 %</b>    |                |

|   | 36 weeks ended                     |                    |                   |                 |
|---|------------------------------------|--------------------|-------------------|-----------------|
|   | September 10, 2016                 | September 12, 2015 | Change            |                 |
|   | (in thousands, except percentages) |                    |                   |                 |
| <b>OTHER INCOME (EXPENSE):</b>                  |                                    |                    |                   |                 |
| Interest income and other income (expense), net | \$3,258                            | \$ (1,938 )        | \$5,196           | (268.1)%        |
| Interest expense                                | (13,868 )                          | (8,566 )           | (5,302 )          | 61.9 %          |
| Total other income (expense)                    | \$(10,610)                         | \$(10,504 )        | \$(106 )          | 1.0 %           |
| <b>INCOME TAX EXPENSE (BENEFIT)</b>             | <b>\$(18,884)</b>                  | <b>\$4,435</b>     | <b>\$(23,319)</b> | <b>(525.8)%</b> |
| <b>EFFECTIVE TAX RATE</b>                       | <b>48.8 %</b>                      | <b>53.0 %</b>      | <b>(4.2 )%</b>    |                 |

## Other Income (Expense)

Interest income and other income (expense), net increased for both the third quarter and first 36 weeks of 2016 primarily due to a \$1.9 million from the gain on the sale of our member interest in Visa Europe and foreign exchange gains on intercompany transactions in 2016, as compared to losses in 2015.

Interest expense increased for both the third quarter and first 36 weeks of 2016 due to a higher applicable margin under our Credit Agreement and higher amounts of outstanding debt in 2016 resulting from increases in our term loan and higher use of our revolving line of credit, as well as the issuance of our convertible notes payable in the third quarter of 2016.

## Income Tax Expense (Benefit)

Our effective tax rates were 62.3% and 47.7% for the 12 weeks ended September 10, 2016 and September 12, 2015, respectively, and 48.8% and 53.0% for the 36 weeks ended September 10, 2016 and September 12, 2015, respectively. The effective rate for the 12 weeks ended September 10, 2016 was higher due to a discrete tax benefit for a tax return to provision true-up, resulting in an increase to the effective tax rate due to pre-tax loss, and permanent tax adjustments from deemed foreign income and nondeductible acquisition expenses. The effective rate for the 36 weeks ended September 10, 2016 was lower due to a net reduction in 2015 in the value of our deferred tax assets from changes in certain state tax apportionment laws (which resulted in an increase to the effective tax rate for the 36 weeks ended September 12, 2015), partially offset by a discrete tax benefit for a tax return to provision true-up and excess tax benefits for employee stock based compensation, both increasing the effective tax rate due to pre-tax loss.





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## Liquidity and Capital Resources

The following table sets forth the major sources and uses of cash for the 36 weeks ended September 10, 2016 and September 12, 2015.

|  | 36 weeks ended        |                       |
|--|-----------------------|-----------------------|
|  | September 10,<br>2016 | September 12,<br>2015 |
|  | (in thousands)        |                       |
| Net cash used in operating activities                        | \$(639,637)           | \$(620,899 )          |
| Net cash used in investing activities                        | (177,018 )            | (154,308 )            |
| Net cash provided by financing activities                    | 199,076               | 85,781                |
| Effect of exchange rate changes on cash and cash equivalents | 3,352                 | (7,467 )              |
| Net decrease in cash and cash equivalents                    | \$(614,227)           | \$(696,893 )          |

## Cash Flows from Operating Activities

Our use of cash during both 36 weeks ended September 10, 2016 and September 12, 2015 primarily reflects the timing of cash settlement of Settlement receivables, Settlement payables and Consumer and customer deposits which are significantly impacted by the portion of gift card sales that occur in late December. Excluding the impact of these settlement related items, net cash provided by operating activities increased by \$36.7 million to a source of cash of \$78.2 million for the 36 weeks ended September 10, 2016 from a source of cash of \$41.5 million for the 36 weeks ended September 12, 2015. This cash reduction reflects:

pre-tax income, adjusted for noncash reconciling items (excluding deferred income taxes), decreased \$10.7 million, or 11.2%, to \$84.9 million from \$95.6 million, reflecting higher operating expenses relative to our increase in operating revenues due to the impact on revenue derived at non-EMV compliant retail distribution partners;

offset by a decrease of \$11.4 million in our income tax payments to \$5.0 million in net refunds for the 36 weeks ended September 10, 2016 from \$6.4 million payment for the 36 weeks ended September 12, 2015, which include refunds of \$0.9 million and \$6.3 million for the 36 weeks ended September 10, 2016 and the 36 weeks ended September 12, 2015, respectively, for overpayments for Spin-Off taxes to certain states which we repaid to Safeway and present such repayment in financing activities. Excluding these refunds, our net income tax payments decreased by \$16.8 million from a net refund of \$4.1 million for the 36 weeks ended September 10, 2016 from a net payment of \$12.7 million 36 weeks ended September 12, 2015, due to settlement of income tax receivables from Safeway related to periods before our initial public offering and our use of net operating loss carryforwards.

use of cash for non-settlement related operating assets and liabilities totaled \$11.8 million and \$47.5 million, for the 36 weeks ended September 10, 2016 and September 12, 2015, respectively, reflecting a significantly greater use of cash from accounts receivable for the 36 weeks ended September 12, 2015.

## Cash Flows from Investing Activities

The net cash used in investing activities for 36 weeks ended September 10, 2016 totaled \$177.0 million, which primarily included \$144.3 million for our acquisitions of GiftCards, NimbleCommerce and Extrameasures, and \$33.5 million for expenditures for property, equipment and technology. The net cash used in investing activities for the 36 weeks ended September 12, 2015 included \$116.4 million related to our acquisitions of Achievers and Didix (as we had remitted the cash consideration of \$38.0 million to the exchange agent prior to the end of the third quarter of 2015 but did not close until early fourth quarter) and expenditures for property, equipment and technology of \$37.3 million.

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Cash Flows from Financing Activities

In January 2016, we exercised our option to draw down an additional \$100 million under our term loan, which we used to finance our acquisition of GiftCards. In March 2016, we made our scheduled term loan repayment of \$37.5 million. In July 2016, we entered into an amendment and restatement to our Credit Agreement (the Restated Credit Agreement). We repaid all amounts outstanding under our revolving line of credit and \$276 million of the \$426 million outstanding under our term loan such that \$150 million remained outstanding. Additionally, we issued \$500 million of aggregate principal amount of 1.50% Convertible Senior Notes due in January 2022. Concurrently with the pricing of the Notes, we purchased call options for our own common stock to hedge the Notes for \$75.8 million, sold call options for our own common stock for \$47.0 million and repurchased \$34.8 million of our common stock. Collectively, these activities, net of debt issuance costs, provided us with \$206.7 million during the 36 weeks ended September 10, 2016. Significant additional cash flows from financing activities during the 36 weeks ended September 10, 2016 include repayments \$9.0 million for debt assumed from business acquisitions and net proceeds of \$2.4 million from employee stock-related activities. For additional information on the terms of these agreements, including the total capacity of our Restated Credit Agreement, repayment terms of Restated Credit Agreement and significant terms of our Convertible Senior Notes, purchased call options and sold call options, see Note 3—Financing. The net cash provided by financing activities for the 36 weeks ended September 12, 2015 totaled \$85.8 million, including a \$100.0 million net increase in our revolving line of credit, \$11.3 million scheduled repayment of our term loan and repayments of \$6.3 million on our notes payable to Safeway related to Spin-Off tax refunds, as described in cash flows from operating activities.

Off-Balance Sheet Arrangements

None.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to our market risk position from the information provided under “Part II, Item 7A. Quantitative and Qualitative Disclosures About Market Risk,” in our Annual Report filed on Form 10-K filed with the Securities and Exchange Commission on March 2, 2016.

**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 September 10, 2016. 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 September 10, 2016, 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 Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the fiscal quarter ended September 10, 2016 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 the degree of compliance with policies or procedures may deteriorate. 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 currently do not believe that it is probable that the resolution of any of these matters would result in any liability that would have a material adverse effect on our results of operations or financial condition.

On March 30, 2015, Greg Haney in his capacity as Seller Representative for CardLab, Inc. filed a lawsuit against us in the Delaware Chancery Court (CardLab, Inc. v. Blackhawk Network Holdings, Inc., Case No. 10851). The complaint generally alleges that we failed to disclose material information relating to a potential earn-out payment in connection with our acquisition of CardLab, Inc. in 2014. We believe that the suit is without merit, and we are vigorously defending ourselves against these claims. On June 8, 2015, we filed a motion to dismiss the complaint. On June 22, 2015, the plaintiff filed an amended complaint. On July 7, 2015, we filed a motion to dismiss the case in its entirety. On February 26, 2016, the Court granted the motion to dismiss in part, dismissing two claims of the amended complaint. On March 25, 2016, we filed our answer denying the remaining claims and a counterclaim for attorneys' fees pursuant to the merger agreement contemplating the acquisition of CardLab, Inc. between the parties. On June 22, 2016, the plaintiff filed a motion to dismiss our counterclaim for indemnification. On July 22, 2016, we filed an amended counterclaim in response. The litigation is in the early stage of discovery.

In addition, we transact business in non-U.S. markets and may, from time to time, be subject to disputes and tax audits by foreign tax authorities related to indirect or other value added taxes typically on commissions or fees received from non-residents content providers.

ITEM 1A. RISK FACTORS

Our business faces significant risks, some of which are set forth below to enable readers to assess, and be appropriately apprised of, many of the risks and uncertainties applicable to the forward-looking statements made in this Quarterly Report on Form 10-Q. You should carefully consider these risk factors as each of these risks could adversely affect our business, operating results, cash flows and financial condition. If any of the events or circumstances described in the following risks actually occurs, our business may suffer, the trading price of our common stock and our 2022 Notes could decline and our financial condition or results of operations could be harmed. Given these risks and uncertainties, you are cautioned not to place undue reliance on forward-looking statements. These risks should be read in conjunction with the other information set forth in this Quarterly Report on Form 10-Q. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we currently believe to be immaterial, may also adversely affect our business. Risks facing our business have not changed substantively from those discussed in our Annual Report on Form 10-K for the year ended January 2, 2016, except those set forth below.

Our retail distribution partners' noncompliance or delays in complying with industry security standards related to credit and debit cards could negatively impact sales of our products, results of operations and financial condition.

Technological changes continue to significantly impact the financial services and payment services industries, such as continuing development of technologies in the areas of smart cards, radio frequency and proximity payment devices, electronic wallets and mobile commerce, among others. The payment networks' rules and regulations are generally subject to change, and they may modify their rules and regulations from time to time. Our retail distribution partners' inability to react timely to changes in the rules and regulations or their interruption or application, may result in substantial disruption to our business and negatively impact our results of operations.

For examples, payment processors Europay, MasterCard and Visa, or EMV, set a deadline of October 2015 for retailers to install and implement in their point-of-sale systems new terminals that would accept credit and debit cards that have an embedded chip on them. The chip is used in the transaction checkout instead of the magnetic strip and has information about the card holder and a unique transaction identification number that can only be used once. This

chip-on-card technology prohibits fraudulent duplication of credit and debit cards and helps eliminate one of the primary sources of fraud at point of sale.

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There are significant risks in delayed application of the EMV chip card standards to our retail distribution partners, which may have adverse implications for our business. Namely, if a retailer did not achieve EMV-compliance by October 2015, all liability for payment fraud losses incurred by such retailer shifted from the banks issuing the credit and debit cards to the EMV-non-compliant retailers. In response, some of our EMV-non-compliant retail distribution partners have taken measures in their stores to limit their exposure to liability for fraud losses by limiting or controlling the sales of higher denomination gift cards. While we have been assisting retailers in implementing alternative fraud prevention practices such as identity verification and credit card authentication, the actions taken by retailers to limit their liability for fraud losses during a transition to EMV compliance have had a material adverse impact on our results of operations and financial condition. In addition, consumers may have changed their shopping behavior away from our distribution partners or our products resulting from limits or controls implemented by our distribution partners during their transition to EMV compliance. We cannot guarantee the timing and manner that our distribution partners remove the limits or controls implemented by them during the period before they achieve EMV compliance. Either of these factors could have an adverse impact on our results of operations and financial condition. Our credit and security agreements with Wells Fargo Bank, National Association, and other financial institutions contain certain restrictions that limit our flexibility in operating our business and, in the event of a default, could have a material adverse impact on our business and results of operations.

On July 27, 2016, we entered into an Amended and Restated Credit Agreement (the Restated Credit Agreement) with the lenders party thereto and Wells Fargo Bank, National Association as administrative agent (the Administrative Agent). The Restated Credit Agreement amends and restates our Credit Agreement dated as of March 28, 2014 with the Administrative Agent and the financial institutions party thereto as lenders. The Restated Credit Agreement provides for the extension of credit in an aggregate principal amount of up to \$700 million, consisting of revolving loans in an aggregate principal amount not to exceed \$400 million (the Revolving Credit Facility) and term loans in an aggregate principal amount not to exceed \$300 million (the Term Loan Facility). We have the ability from time to time to increase the commitments under the Revolving Credit Facility and/or the Term Loan Facility (subject to compliance with specified conditions), with the aggregate amount of all such Revolving Credit Facility and/or Term Loan Facility increases not to exceed an incremental \$300 million. The Revolving Credit Facility and the Term Loan Facility are scheduled to mature on July 27, 2021. The Restated Credit Agreement and other related agreements contain customary restrictions on us and our subsidiaries. Subject to a number of important exceptions, these limitations include covenants that limit or restrict us and our subsidiaries from:

- incurring additional indebtedness or modifying subordinated indebtedness;
- granting liens on or with respect to any of our property;
- making investments;
- consolidating or merging with, or acquiring, another business;
- selling or otherwise disposing of our assets;
- paying dividends and making other distributions to our stockholders;
- entering into certain transactions with our affiliates;
- redeeming our stock;
- amending our charter documents;
- changing the nature of our business;
- entering into sale-leaseback agreements; and
- disposing of our interests in certain subsidiaries.

Our obligations under the Restated Credit Agreement are secured by security interests in all of our present and future personal property and those of certain current and future subsidiaries (other than our regulated assets). In addition, the Restated Credit Agreement contains financial covenants that require us to maintain specified financial ratios and satisfy certain financial condition tests. This may require that we take action to reduce our debt or to act in a manner contrary to our business objectives.

The breach of any of these covenants would result in a default under the Restated Credit Agreement. Any default, if not waived, could result in our lenders terminating commitments to make loans or extend other credit to us. In the

event of a default, the lenders also could accelerate and declare all or any obligations immediately due, and could take possession of or liquidate collateral. If any of these events occur, we may be unable to refinance the Restated Credit Agreement on favorable terms, if at all, which could have a material adverse effect on our business, results of operations and financial condition. In addition, the termination of the Restated Credit Agreement may adversely affect our ability to maintain our relationships with our content providers or adversely affect our cash flows.



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Our debt could adversely impact our operating income and growth prospects and make us vulnerable to adverse economic and industry conditions.

Our indebtedness could make it more challenging for us to obtain additional financing to fund our business strategy, acquisitions, debt service requirements, capital expenditures and working capital. It could also increase our vulnerability to interest rate changes and general adverse economic and industry conditions. This could limit our flexibility in planning for or reacting to changes in our business and our markets and place us at a competitive disadvantage relative to our competitors that have less debt.

Future economic and credit market conditions may limit our access to additional capital, at a time when the Restated Credit Agreement would otherwise permit additional financing, or may preclude our ability to refinance our existing indebtedness. If our lenders suffer from declining financial conditions, their ability to fund their commitments may be adversely affected, in which case we could be required yet unable to obtain replacement financing on similar or acceptable terms, if at all. A deterioration in the credit markets generally could further affect our ability to access sufficient financing or capital. Such limitations could have a material adverse impact on our operations and thus on our operating income, growth prospects and financial condition.

Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

On July 21, 2016, we completed an offering of \$500 million principal amount of our 2022 Notes. The 2022 Notes bear interest at a rate of 1.5% per year, payable semiannually in arrears on January 15 and July 15 of each year, beginning on January 15, 2017, and mature on January 15, 2022. In addition, on July 27, 2016, we entered into the Restated Credit Agreement for a \$700.0 million credit facility, to replace our prior credit facility. Please see the Risk Factor titled “Our credit and security agreements with Wells Fargo Bank, National Association, and other financial institutions contain certain restrictions that limit our flexibility in operating our business and, in the event of a default, could have a material adverse impact on our business and results of operations” for additional information. Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the notes and our Restated Credit Agreement, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. Despite our current debt levels, we may still incur substantially more debt or take other actions which would intensify the risks discussed above.

Despite our current consolidated debt levels, we and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We will not be restricted under the terms of the indenture governing the 2022 Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the 2022 Notes that could have the effect of diminishing our ability to make payments on the notes when due. Our new credit facility restricts our ability to incur additional indebtedness, including secured indebtedness, but if the facility matures or is repaid, we may not be subject to such restrictions under the terms of any subsequent indebtedness.

We may not have the ability to raise the funds necessary to settle conversions of the 2022 Notes or to repurchase the 2022 Notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the 2022 Notes.

Holder of our 2022 Notes have the right to require us to repurchase their notes upon the occurrence of a fundamental change at a fundamental change repurchase price equal to 100% of the principal amount of our notes to be repurchased, plus accrued and unpaid interest, if any. In addition, upon conversion of the notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the notes being converted. However, we

may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of notes surrendered or notes being converted. In addition, our ability to repurchase the notes or to pay cash upon conversions of the notes may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to repurchase notes at a time when the repurchase is required by

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the indenture or to pay any cash payable on future conversions of the notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the 2022 Notes or make cash payments upon conversions of the 2022 Notes.

The conditional conversion feature of the 2022 Notes, if triggered, may adversely affect our financial condition and operating results.

If the conditional conversion feature of the 2022 Notes is triggered, holders of the notes will be entitled to convert them at any time during specified periods at their option. If one or more holders elect to convert their notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the 2022 Notes, could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the notes. In addition, under certain circumstances, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

The convertible note hedge and warrant transactions related to our 2022 Notes may affect the value of our common stock.

In connection with the 2022 Notes offering, we entered into convertible note hedge transactions with affiliates of the initial purchasers of the 2022 Notes, which we refer to as the "option counterparties." The convertible note hedge transactions are expected generally to reduce the potential dilution upon conversion of the 2022 Notes and/or offset any cash payments we are required to make in excess of the principal amount of converted notes, as the case may be. We also entered into warrant transactions with the option counterparties. The warrant transactions could separately have a dilutive effect on our common stock to the extent that the market price per share of our common stock exceeds the applicable strike price of the warrants.

We are subject to counterparty risk with respect to the convertible note hedge transactions.

We are subject to the risk that the option counterparties may default under the convertible note hedge transactions.

Our exposure to the credit risk of the option counterparties will not be secured by any collateral. In the past, economic conditions have resulted in the actual or perceived failure or financial difficulties of a number of financial institutions. If the option counterparties become subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a

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claim equal to our exposure at that time under our transactions with such counterparties. Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in the market price and in the volatility of our common stock. In addition, upon a default by the option counterparties, we may suffer adverse tax consequences and more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

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

## Issuer Purchases of Equity Securities

The following table summarizes purchases of our ordinary shares made by or on behalf of us or any of our “affiliated purchasers” as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended, during each fiscal period during the 12 weeks ended September 10, 2016:

| Period                                | Total Number of Shares Purchased (1) | Average Price Paid per Share (4) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(5) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------------|--------------------------------------|----------------------------------|---|--|
| June 19, 2016 to July 16, 2016        | 45                                   | (2) \$ 33.29                     | —   | \$ —   |
| July 17, 2016 to August 13, 2016      | 996,400                              | (3) \$ 34.97                     | —   | \$ —   |
| August 14, 2016 to September 10, 2016 | —                                    | \$ —                             | —   | \$ —   |
| Total                                 | 996,445                              | \$ —                             | —   | \$ —   |

This table does not include shares of Common Stock that we withheld in order to satisfy minimum tax withholding (1) requirements in connection with the vesting of restricted stock units or exercise of options or stock appreciation rights.

(2) The number represents the shares of Common Stock that we withheld in order to satisfy minimum tax withholding requirements in connection with the vesting of restricted stock awards.

In conjunction with the issuance of the 2022 Notes, following a press release announcement of July 20, 2016, we (3) repurchased shares of our common stock for \$34.8 million (out of an approved amount of \$35 million) at a price per share of \$34.97 on July 27, 2016. There will be no further repurchases in connection with this transaction.

(4) Average price paid per share of Common Stock does not include brokerage commissions.

(5) The Company does not currently have a share repurchase program.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION.

Not applicable.

## ITEM 6. EXHIBITS

A list of exhibits filed with this report or incorporated herein by reference is found in the Index to Exhibits immediately following the signature page of this report and is incorporated into this Item 6 by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Blackhawk Network Holdings, Inc.

/s/ Jerry Ulrich

Jerry Ulrich

Chief Financial Officer and Chief Administrative Officer

(Principal Financial Officer and Duly Authorized Signatory)

Date: October 18, 2016

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## INDEX TO EXHIBITS

| Exhibit No | Description of Exhibit  | Incorporated by Reference |           |            | Filing Date   | Filed Herewith |
|------------|---|---------------------------|-----------|------------|---------------|----------------|
|            |   | Form                      | File No.  | Exhibit(s) |               |                |
| 4.1        | Indenture related to the 1.50% Convertible Senior Notes due 2022, dated as of July 27, 2016, among Blackhawk Network Holdings, Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee | 8-K                       | 001-35882 | 4.1        | July 28, 2016 |                |
| 4.2        | Form of 1.50% Convertible Senior Note due 2022 (included with Exhibit 4.1)  | 8-K                       | 001-35882 | 4.2        | July 28, 2016 |                |
| 10.1       | Letter Agreement, dated July 21, 2016, between the Company and Wells Fargo Bank, National Association, regarding Note Hedge Transaction   | 8-K                       | 001-35882 | 10.1       | July 28, 2016 |                |
| 10.2       | Letter Agreement, dated July 21, 2016, between the Company and Bank of America, N.A., regarding Note Hedge Transaction  | 8-K                       | 001-35882 | 10.2       | July 28, 2016 |                |
| 10.3       | Letter Agreement, dated July 21, 2016, between the Company and Bank of Montreal, regarding Note Hedge Transaction   | 8-K                       | 001-35882 | 10.3       | July 28, 2016 |                |
| 10.4       | Letter Agreement, dated July 21, 2016, between the Company and Wells Fargo Bank, National Association, regarding Warrant Transaction  | 8-K                       | 001-35882 | 10.4       | July 28, 2016 |                |
| 10.5       | Letter Agreement, dated July 21, 2016, between the Company and Bank of America, N.A., regarding Warrant Transaction   | 8-K                       | 001-35882 | 10.5       | July 28, 2016 |                |
| 10.6       | Letter Agreement, dated July 21, 2016, between the Company and Bank of Montreal, regarding Warrant Transaction  | 8-K                       | 001-35882 | 10.6       | July 28, 2016 |                |
| 10.7       | Letter Agreement, dated July 22, 2016, between the Company and Wells Fargo Bank, National Association, regarding Note Hedge Transaction   | 8-K                       | 001-35882 | 10.7       | July 28, 2016 |                |
| 10.8       | Letter Agreement, dated July 22, 2016, between the Company and Bank of America, N.A., regarding Note Hedge Transaction  | 8-K                       | 001-35882 | 10.8       | July 28, 2016 |                |
| 10.9       | Letter Agreement, dated July 22, 2016, between the Company and Bank of Montreal, regarding Note Hedge Transaction   | 8-K                       | 001-35882 | 10.9       | July 28, 2016 |                |
| 10.10      | Letter Agreement, dated July 22, 2016, between the Company and Wells Fargo Bank, National Association, regarding Warrant Transaction  | 8-K                       | 001-35882 | 10.10      | July 28, 2016 |                |
| 10.11      | Letter Agreement, dated July 22, 2016, between the Company and Bank of America, N.A., regarding Warrant Transaction   | 8-K                       | 001-35882 | 10.11      | July 28, 2016 |                |
| 10.12      | Letter Agreement, dated July 22, 2016, between the Company and Bank of Montreal, regarding Warrant Transaction  | 8-K                       | 001-35882 | 10.12      | July 28, 2016 |                |





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| Exhibit No | Description of Exhibit   | Incorporated by Reference |           |            | Filing Date    | Filed Herewith |
|------------|--|---------------------------|-----------|------------|----------------|----------------|
|            |  | Form                      | File No.  | Exhibit(s) |                |                |
| 10.13      | Amended and Restated Credit Agreement dated as of July 27, 2016, by and among the Company and the lenders identified on the signature pages thereto, including Wells Fargo Bank, National Association, as both lender and administrative agent | 8-K                       | 001-35882 | 10.1       | August 1, 2016 |                |
| 10.14      | Reaffirmation Agreement dated as of July 27, 2016, executed by the Company and certain of its subsidiaries in favor of Wells Fargo Bank, National Association, as administrative agent   | 8-K                       | 001-35882 | 10.2       | August 1, 2016 |                |
| 10.15      | First Amendment to Lease Agreement, effective as of September 22, 2016, between Blackhawk Network, Inc. and 6200 Stoneridge Mall Road Investors LLC  |                           |           |            |                | X              |
| 10.16      | Separation Agreement, dated as of October 17, 2016, by and between Blackhawk Network, Inc. and Christopher Crum  |                           |           |            |                | X              |
| 31.1       | Certification Required Under Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended  |                           |           |            |                | X              |
| 31.2       | Certification Required Under Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended  |                           |           |            |                | X              |
| 32.1*      | Certification Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section §1350  |                           |           |            |                | X              |
| 101.INS    | XBRL Instance Document   |                           |           |            |                | X              |
| 101.SCH    | XBRL Taxonomy Extension Schema   |                           |           |            |                | X              |
| 101.CAL    | XBRL Taxonomy Extension Calculation Linkbase   |                           |           |            |                | X              |
| 101.DEF    | XBRL Taxonomy Extension Definition Linkbase  |                           |           |            |                | X              |
| 101.LAB    | XBRL Taxonomy Extension Label Linkbase   |                           |           |            |                | X              |
| 101.PRE    | XBRL Taxonomy Extension Presentation Linkbase  |                           |           |            |                | X              |

The certification attached as Exhibit 32.1 to this Quarterly Report is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Quarterly Report), irrespective of any general incorporation language contained in such filing.