

BLACKHAWK NETWORK HOLDINGS, INC
Form 10-Q
July 26, 2017
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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 June 17, 2017

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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No ý

As of July 19, 2017, there were 56,655,000 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)

| | June 17, 2017 | December 31, 2016 | June 18, 2016 |
|---|--------------------|----------------------|--------------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$295,071 | \$ 1,008,125 | \$263,988 |
| Restricted cash | 67,322 | 10,793 | 2,500 |
| Settlement receivables, net | 401,758 | 641,691 | 340,925 |
| Accounts receivable, net | 262,616 | 262,672 | 226,929 |
| Other current assets | 180,925 | 131,375 | 103,061 |
| Total current assets | 1,207,692 | 2,054,656 | 937,403 |
| Property, equipment and technology, net | 174,314 | 172,381 | 165,246 |
| Intangible assets, net | 327,763 | 350,185 | 302,435 |
| Goodwill | 572,855 | 570,398 | 511,808 |
| Deferred income taxes | 361,584 | 362,302 | 349,286 |
| Other assets | 82,223 | 85,856 | 67,597 |
| TOTAL ASSETS | \$2,726,431 | \$ 3,595,778 | \$2,333,775 |

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)

| | June 17, 2017 | December 31, 2016 | June 18, 2016 |
|--|--------------------|----------------------|--------------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Settlement payables | \$622,653 | \$ 1,626,827 | \$607,463 |
| Consumer and customer deposits | 226,727 | 173,344 | 132,662 |
| Accounts payable and accrued operating expenses | 146,893 | 153,885 | 97,717 |
| Deferred revenue | 151,037 | 150,582 | 111,941 |
| Note payable, current portion | 9,890 | 9,856 | 156,091 |
| Notes payable to Safeway | 4,201 | 3,163 | 3,753 |
| Bank line of credit | — | — | 100,000 |
| Other current liabilities | 91,101 | 51,176 | 48,259 |
| Total current liabilities | 1,252,502 | 2,168,833 | 1,257,886 |
| Deferred income taxes | 28,877 | 27,887 | 20,168 |
| Note payable | 177,924 | 137,984 | 268,571 |
| Convertible notes payable | 434,855 | 429,026 | — |
| Other liabilities | 27,672 | 39,653 | 24,196 |
| Total liabilities | 1,921,830 | 2,803,383 | 1,570,821 |
| 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; 56,623, 55,667 and 56,289 shares outstanding, respectively | 56 | 56 | 56 |
| Additional paid-in capital | 626,693 | 608,568 | 581,712 |
| Accumulated other comprehensive loss | (34,893) | (48,877) | (32,065) |
| Retained earnings | 208,513 | 228,451 | 208,895 |
| Total Blackhawk Network Holdings, Inc. equity | 800,369 | 788,198 | 758,598 |
| Non-controlling interests | 4,232 | 4,197 | 4,356 |
| Total stockholders' equity | 804,601 | 792,395 | 762,954 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$2,726,431 | \$ 3,595,778 | \$2,333,775 |
| See accompanying notes to condensed consolidated financial statements | | | |

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(In thousands, except for per share amounts)

(Unaudited)

| | 12 weeks ended | | 24 weeks ended | |
|---|-------------------|--------------------|--------------------|--------------------|
| | June 17, 2017 | June 18, 2016 | June 17, 2017 | June 18, 2016 |
| OPERATING REVENUES: | | | | |
| Commissions and fees | \$282,633 | \$262,931 | \$537,839 | \$502,555 |
| Program and other fees | 107,914 | 67,419 | 208,824 | 142,861 |
| Marketing | 24,825 | 20,696 | 39,106 | 34,155 |
| Product sales | 47,774 | 40,160 | 84,613 | 78,097 |
| Total operating revenues | 463,146 | 391,206 | 870,382 | 757,668 |
| OPERATING EXPENSES: | | | | |
| Partner distribution expense | 201,525 | 191,231 | 381,001 | 363,386 |
| Processing and services | 107,680 | 76,875 | 209,952 | 150,816 |
| Sales and marketing | 77,722 | 60,511 | 140,507 | 113,849 |
| Costs of products sold | 44,541 | 38,309 | 80,734 | 74,041 |
| General and administrative | 25,563 | 22,557 | 54,588 | 46,054 |
| Transition and acquisition | 905 | 641 | 1,356 | 1,586 |
| Amortization of acquisition intangibles | 13,648 | 15,259 | 26,673 | 25,157 |
| Change in fair value of contingent consideration | (4,037) | 800 | (2,997) | 800 |
| Total operating expenses | 467,547 | 406,183 | 891,814 | 775,689 |
| OPERATING INCOME (LOSS) | (4,401) | (14,977) | (21,432) | (18,021) |
| OTHER INCOME (EXPENSE): | | | | |
| Interest income and other income (expense), net | 667 | 486 | 1,503 | 898 |
| Interest expense | (7,051) | (4,118) | (13,994) | (8,184) |
| INCOME (LOSS) BEFORE INCOME TAX EXPENSE (BENEFIT) | (10,785) | (18,609) | (33,923) | (25,307) |
| INCOME TAX EXPENSE (BENEFIT) | (4,591) | (7,290) | (14,366) | (10,527) |
| NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS | (6,194) | (11,319) | (19,557) | (14,780) |
| Loss (income) attributable to non-controlling interests, net of tax | (157) | (18) | (280) | (110) |
| NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC. | \$(6,351) | \$(11,337) | \$(19,837) | \$(14,890) |
| EARNINGS (LOSS) PER SHARE: | | | | |
| Basic | \$(0.11) | \$(0.20) | \$(0.35) | \$(0.27) |
| Diluted | \$(0.11) | \$(0.20) | \$(0.35) | \$(0.27) |
| Weighted average shares outstanding—basic | 56,448 | 56,134 | 56,176 | 55,944 |
| Weighted average shares outstanding—diluted | 56,448 | 56,134 | 56,176 | 55,944 |
| 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 | | 24 weeks ended | |
|--|------------------|------------------|------------------|------------------|
| | June 17, 2017 | June 18, 2016 | June 17, 2017 | June 18, 2016 |
| NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS | \$(6,194) | \$(11,319) | \$(19,557) | \$(14,780) |
| Other comprehensive income (loss): | | | | |
| Currency translation adjustments | 7,764 | 2,985 | 13,739 | 8,051 |
| COMPREHENSIVE INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS | 1,570 | (8,334) | (5,818) | (6,729) |
| Comprehensive loss (income) attributable to non-controlling interests, net of tax | 47 | 71 | (35) | (31) |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC. | \$1,617 | \$(8,263) | \$(5,853) | \$(6,760) |
| See accompanying notes to condensed consolidated financial statements | | | | |

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | 24 weeks ended | |
|--|------------------|------------------|
| | June 17, 2017 | June 18, 2016 |
| OPERATING ACTIVITIES: | | |
| Net income (loss) before allocation to non-controlling interests | \$(19,557) | \$(14,780) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation and amortization of property, equipment and technology | 25,020 | 21,684 |
| Amortization of intangibles | 29,160 | 27,459 |
| Amortization of deferred program and contract costs | 14,044 | 12,544 |
| Amortization of deferred financing costs and debt discount | 6,344 | 880 |
| Loss on property, equipment and technology disposal/write-down | 606 | 3,094 |
| Employee stock-based compensation expense | 16,451 | 16,572 |
| Change in fair value of contingent consideration | (2,997) | 800 |
| Other | (68) | (3,011) |
| Changes in operating assets and liabilities: | | |
| Settlement receivables | 252,160 | 293,441 |
| Settlement payables | (1,010,431) | (1,005,723) |
| Accounts receivable, current and long-term | (10,664) | 16,964 |
| Other current assets | 3,579 | 16,914 |
| Other assets | (5,357) | (2,544) |
| Consumer and customer deposits | 764 | 31,974 |
| Accounts payable and accrued operating expenses | 2,098 | (33,574) |
| Deferred revenue | 4,356 | 493 |
| Other current and long-term liabilities | 14,670 | (21,742) |
| Income taxes, net | (14,467) | (4,722) |
| Net cash (used in) provided by operating activities | (694,289) | (643,277) |
| INVESTING ACTIVITIES: | | |
| Expenditures for property, equipment and technology | (30,178) | (20,281) |
| Business acquisitions, net of cash acquired | (10,260) | (144,477) |
| Investment in unconsolidated entities | (5,601) | — |
| Change in restricted cash | (10,580) | 689 |
| Other | (4,487) | (2,500) |
| Net cash (used in) provided by investing activities | (61,106) | (166,569) |

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)

| | 24 weeks ended | |
|--|------------------|------------------|
| | June 17, 2017 | June 18, 2016 |
| FINANCING ACTIVITIES: | | |
| Payments for acquisition liability | (5,503) | — |
| Repayment of debt assumed in business acquisitions | (300) | (8,964) |
| Proceeds from issuance of note payable | 50,000 | 100,000 |
| Repayment of note payable | (10,000) | (37,500) |
| Payments of financing costs | (619) | — |
| Borrowings under revolving bank line of credit | 1,198,597 | 1,502,675 |
| Repayments on revolving bank line of credit | (1,198,597) | (1,402,675) |
| Repayment on notes payable to Safeway | (254) | (376) |
| Proceeds from issuance of common stock from exercise of employee stock options and employee stock purchase plans | 10,371 | 3,452 |
| Other stock-based compensation related | (9,705) | (2,002) |
| Net cash (used in) provided by financing activities | 33,990 | 154,610 |
| Effect of exchange rate changes on cash and cash equivalents | 8,351 | 4,648 |
| Decrease in cash and cash equivalents | (713,054) | (650,588) |
| Cash and cash equivalents—beginning of period | 1,008,125 | 914,576 |
| Cash and cash equivalents—end of period | \$295,071 | \$263,988 |
| NONCASH FINANCING AND INVESTING ACTIVITIES: | | |
| Financing of business acquisition with contingent consideration | \$1,640 | \$20,100 |
| 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 consumers and businesses a broad selection of prepaid cards in physical and electronic forms, as well as complementary prepaid products, payment services and incentives solutions. We currently offer our products and/or solutions directly or through commercial relationships in the United States and 25 other countries and can deliver solutions in over 100 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 February 27, 2017 (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 30, 2017 or for any other interim period or other future year. Our condensed consolidated balance sheet as of December 31, 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

For our retail business, a significant portion of gift card sales occurs in late December 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 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. 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 is in either the first or second quarter. As a result, quarterly financial results are

not necessarily reflective of the results to be expected for the year or any other interim or future period. Seasonality also impacts our incentives businesses, but such impact is smaller in comparison to our retail business.

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Recently Issued or Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09 Revenue from Contracts with Customers (Topic 606), which along with amendments issued in 2015 and 2016, will replace nearly all current U.S. GAAP guidance on this topic with a comprehensive revenue measurement and recognition standard and expanded disclosure requirements. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This new guidance is to be applied retrospectively either to each reporting period presented (full retrospective method) or with the cumulative effect of initially applying the guidance at the date of initial application for reporting periods beginning after December 15, 2017. Early adoption is not permitted. We will adopt this standard using the full retrospective method in the first quarter of fiscal 2018, and we are currently evaluating the impact of this guidance on our condensed financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the existing two-step guidance for goodwill impairment testing by eliminating the second step resulting in a write-down to goodwill equal to the initial amount of impairment determined in step one. The ASU is to be applied prospectively for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed after January 1, 2017. We have early-adopted this standard in the first quarter of 2017, however, it has no impact on our financial statements unless we determine in the future that goodwill is impaired at one of our reporting units.

Significant Accounting Policies

Except for goodwill as stated above, 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.

2. Business Acquisitions

2017 Acquisition

During the first quarter of 2017, we completed an acquisition of a rebates and incentives business for total consideration of approximately \$18.0 million, which includes \$16.4 million cash on hand and approximately \$1.6 million related to contingent consideration, which is a cash payment of up to \$2.0 million based on the performance of the acquired business through December 31, 2017. In aggregate, \$6.1 million cash was acquired, and based on our initial estimate of the purchase price allocation, \$7.8 million was attributed to intangible assets, \$9.9 million was attributed to goodwill, and \$5.8 million was attributed to net tangible liabilities acquired.

For the intangible assets acquired, customer relationships have an average useful life of 7 years.

We expect to deduct goodwill and identifiable technology and intangible assets for tax purposes, a portion of which will commence upon settlement of contingent consideration and contingent liabilities.

We have not presented separate results of operations since closing or combined pro forma financial information of us and the acquisition since the beginning of fiscal 2016, as results of operations for the acquisition are immaterial.

2016 Acquisitions

During the second quarter of 2017, we recorded a measurement period adjustment for The Grass Roots Group Holdings Limited and its subsidiaries (collectively, “Grass Roots”), which increased the purchase price by \$0.8 million, increased accounts receivables by \$0.4 million, decreased consumer and customer deposits by \$1.8 million and decreased goodwill by \$1.4 million. We also recorded a measurement period adjustment for Spafinder Wellness, Inc. and its subsidiaries (collectively, “Spafinder”), which increased goodwill by \$0.3 million and decreased inventory by \$0.3 million. The measurement periods for IMShopping, Inc. and its subsidiary (collectively, “NimbleCommerce”) and 888extramoney.com LLC (“Extrameasures”) were closed in the first and second quarter of 2017, respectively.

The measurement period for our acquisitions of Grass Roots, Spafinder and Samba Days Experience Group Ltd. and certain of its subsidiaries remains open with respect to intangibles and deferred taxes.

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3. Financing

Credit Agreement

In March 2017, we repaid \$10.0 million of the term loan outstanding under our Credit Agreement, as amended and restated (the “Restated Credit Agreement”).

On April 20, 2017, we borrowed an additional \$50.0 million of term loan under the Restated Credit Agreement. The terms of the new term loan are substantially similar to the outstanding term loan.

On April 25, 2017, we entered into an amendment to the Restated Credit Agreement to extend the term loan commitments provided by the lenders under our Restated Credit Agreement to January 12, 2018 and made certain modifications to the financial and other covenants to add operating flexibility, including modification of the leverage covenant and increasing the dollar limitation on dividends, stock repurchases and other restricted payments under certain conditions.

The following table presents the amounts due by maturity date of our term loan and convertible notes as of June 17, 2017 (in thousands):

| | June 17, 2017 |
|------|------------------|
| 2018 | \$10,000 |
| 2019 | 10,000 |
| 2020 | 20,000 |
| 2021 | 150,000 |
| 2022 | 500,000 |

Total long-term debt \$690,000

As a result of the covenants in our Restated Credit Agreement which require us to maintain certain leverage ratios of total debt to adjusted EBITDA (as defined in the Restated Credit Agreement), and depending on our levels of adjusted EBITDA, we are limited in our ability to incur additional indebtedness either under the Restated Credit Agreement or through other debt facilities. These limitations also affect the amount of capital we can allocate to acquisitions, internal capital developments and capital returned to stockholders.

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 June 17, 2017, December 31, 2016 and June 18, 2016 (in thousands):

| | June 17, 2017 | | | |
|---------------------------|---------------|---------|-----------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Cash and cash equivalents | | | | |
| Money market mutual funds | \$4,092 | \$ | —\$— | \$4,092 |
| Liabilities | | | | |
| Contingent consideration | \$— | \$ | —\$16,892 | \$16,892 |

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December 31, 2016
Level 1 Level 2 Level 3 Total

| | | | |
|---------------------------|-----------|--------------|-----------|
| Assets | | | |
| Cash and cash equivalents | | | |
| Money market mutual funds | \$300,015 | \$ — | \$300,015 |
| Liabilities | | | |
| Contingent consideration | \$ — | \$ —\$23,752 | \$23,752 |

June 18, 2016
Level 1 Level 2 Level 3 Total

| | | | |
|---------------------------|----------|--------------|----------|
| Assets | | | |
| Cash and cash equivalents | | | |
| Money market mutual funds | \$11,100 | \$ — | \$11,100 |
| Liabilities | | | |
| Contingent consideration | \$ — | \$ —\$20,900 | \$20,900 |

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.

During the 24 weeks ended June 17, 2017, there were no transfers between levels.

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.

Term loan —As of June 17, 2017, using Level 2 inputs, we estimate the fair value of our term loan (classified as Note payable on the balance sheet) to be approximately \$190.0 million.

Convertible notes payable—As of June 17, 2017, using Level 2 inputs, we estimate the fair value of our convertible notes payable to be approximately \$541.9 million.

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. The changes in fair value of contingent consideration for the 24 weeks ended June 17, 2017 and June 18, 2016 are as follows (in thousands):

| | | |
|--|----------------|---------------|
| | 24 weeks ended | |
| | June 17, 2017 | June 18, 2016 |
| Balance, beginning of period | \$23,752 | \$ — |
| Addition from acquisition (see Note 2—Business Acquisitions) | 1,640 | 20,100 |
| Change in fair value of contingent consideration | (2,997) | 800 |
| Settlement | (5,503) | — |
| Balance, end of period | \$16,892 | \$20,900 |

We present the change in the fair value of contingent consideration in Change in fair value of contingent consideration and as a noncash adjustment to net income in our condensed consolidated statements of cash flows. 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.

The issuance and increase in fair value of contingent consideration during 2016 was related to our acquisition of Extrameasures. During the 24 weeks ended June 17, 2017, we paid out \$5.5 million for achieving relevant targets during the first earn-out year, and 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%.

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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 June 17, 2017, December 31, 2016 and June 18, 2016 consisted of the following (in thousands):

| | June 17, 2017 | December 31, 2016 | June 18, 2016 |
|--|------------------|----------------------|------------------|
| Other current assets: | | | |
| Inventory | \$42,616 | \$ 43,950 | \$34,154 |
| Deferred expenses | 18,931 | 22,148 | 12,656 |
| Income tax receivables | 30,134 | 13,599 | 25,639 |
| Other | 48,874 | 51,678 | 30,612 |
| Assets held for sale | 40,370 | — | — |
| Total other current assets | \$180,925 | \$ 131,375 | \$103,061 |
| Other assets: | | | |
| Deferred program and contract costs | \$39,097 | \$ 48,066 | \$43,527 |
| Other receivables | 1,622 | 2,713 | 2,810 |
| Income taxes receivable | 2,270 | 2,358 | — |
| Deferred financing costs | 2,756 | 2,688 | 1,675 |
| Other | 36,478 | 30,031 | 19,585 |
| Total other assets | \$82,223 | \$ 85,856 | \$67,597 |
| Other current liabilities: | | | |
| Payroll and related liabilities | \$28,309 | \$ 24,944 | \$24,336 |
| Income taxes payable | 5,000 | 4,199 | 2,333 |
| Acquisition liability | 7,352 | 6,672 | 10,850 |
| Other payables and accrued liabilities | 11,582 | 15,361 | 10,740 |
| Liabilities held for sale | 38,858 | — | — |
| Total other current liabilities | \$91,101 | \$ 51,176 | \$48,259 |
| Other liabilities: | | | |
| Acquisition liability | \$9,540 | \$ 17,080 | \$10,050 |
| Income taxes payable | 7,130 | 6,957 | 6,186 |
| Deferred income and other liabilities | 11,002 | 15,616 | 7,960 |
| Total other liabilities | \$27,672 | \$ 39,653 | \$24,196 |

Assets held for sale

During the first quarter of 2017, management approved a plan to sell all assets and liabilities related to Grass Roots' Meetings & Events ("M&E") business. It is probable that such sale will occur within one year. As a result, beginning from the time the plan was approved, each of the relevant asset and liability balances will be accounted for as held for sale and measured at the lower of its carrying value or fair value less cost to sell. Based on the purchase price allocation performed in the fourth quarter of 2016, we believe that the carrying value of all the relevant assets and liabilities does not exceed fair value less cost to sell.

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The following table presents the aggregate carrying amounts of the major classes of assets and liabilities related to the M&E business as of June 17, 2017 (in thousands):

| | |
|---|------------------|
| | June 17, 2017 |
| Accounts receivable, net | \$16,174 |
| Other current assets | 4,657 |
| Property, equipment and technology, net | 927 |
| Intangible assets, net | 5,607 |
| Goodwill | 11,924 |
| Deferred income taxes | 1,081 |
| Total assets held for sale | \$40,370 |
| Settlement payables | \$7,838 |
| Consumer and customer deposits | 1,754 |
| Accounts payable and accrued operating expenses | 8,454 |
| Deferred revenue | 4,695 |
| Other current liabilities | 16,004 |
| Deferred income taxes | 113 |
| Total liabilities held for sale | \$38,858 |

During the first two quarters of 2017, the M&E business recorded pre-tax income of \$0.6 million during the period it was accounted for as an asset held for sale.

6. Goodwill

We have assigned goodwill to our U.S. Retail, Incentives & Rewards and International segments. To date, we have not recorded any impairment charges against or disposed of any reporting units with goodwill. During the first quarter of 2017, as a result of changes in reporting financial results to our Chief Operating Decision Maker (“CODM”), we concluded that we would report the international incentives businesses within the International reportable segment. Accordingly, we re-allocated a portion of the goodwill from the historical Incentives & Rewards segment to the International segment based on their relative fair values. As we continue to develop our e-commerce strategy, we also re-allocated a portion of the e-commerce goodwill from U.S. Retail to Incentives & Rewards to align with the way our business is managed. A summary of changes in goodwill during the 24 weeks ended June 17, 2017 is as follows (in thousands):

| | June 17, 2017 | | | |
|---|----------------|----------------------------|---------------|-----------|
| | U.S. Retail | Incentives & Rewards | International | Total |
| Balance, beginning of period | \$99,685 | \$366,508 | \$ 104,205 | \$570,398 |
| Re-allocation of goodwill to International | — | (7,152) | 7,152 | — |
| Re-allocation of e-commerce goodwill | (10,505) | 10,505 | — | — |
| Acquisition (see Note 2—Business Acquisitions) | — | 9,919 | — | 9,919 |
| Measurement period of adjustments for 2016 acquisitions | 338 | — | (1,384) | (1,046) |
| Asset held for sale (see Note 5—Consolidated Financial Statement Details) | — | — | (11,924) | (11,924) |
| Foreign currency translation adjustments | — | 386 | 5,122 | 5,508 |
| Balance, end of period | \$89,518 | \$380,166 | \$ 103,171 | \$572,855 |

7. Stock-Based Compensation

During the 24 weeks ended June 17, 2017, our Board of Directors granted 992,669 restricted stock units and 200,700 performance stock units.

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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 24 weeks ended June 17, 2017 and June 18, 2016 (in thousands):

| | 12 weeks ended | | 24 weeks ended | |
|--|----------------|---------------|----------------|---------------|
| | June 17, 2017 | June 18, 2016 | June 17, 2017 | June 18, 2016 |
| Processing and services | \$1,798 | \$1,522 | \$3,500 | \$2,964 |
| Sales and marketing | 2,884 | 3,027 | 5,696 | 5,841 |
| Cost of products sold | 4 | 42 | 21 | 58 |
| General and administrative | 3,364 | 3,981 | 7,234 | 7,709 |
| Total stock-based compensation expense | \$8,050 | \$8,572 | \$16,451 | \$16,572 |

8. Income Taxes

Our effective tax rates were 42.6% and 39.2% for the 12 weeks ended June 17, 2017 and June 18, 2016, respectively, and 42.3% and 41.6% for the 24 weeks ended June 17, 2017 and June 18, 2016, respectively. The effective rate for the 12 weeks and 24 weeks ended June 17, 2017 was higher primarily due to excess tax benefits of employee stock-based compensation.

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.

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. On August 5, 2016, the plaintiff filed a reply. On May 11, 2017, the parties updated the Court regarding the status of the case. 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. After the application of third party indemnities, our present exposure is approximately \$4.9 million, primarily in a single jurisdiction. If we were to be assessed for this exposure, we believe it is probable that we will prevail.

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10. Segment Reporting

Our three reportable segments are U.S. Retail, Incentives & Rewards and International. During the first quarter of 2017, as a result of changes in reporting financial results to our CODM, we concluded that we would report the international incentives businesses within the International reportable segment. We also determined that it would be appropriate to allocate all costs that have been previously reported within Corporate and Unallocated: i) account management and marketing personnel, ii) the substantial majority of our technology personnel and related depreciation and amortization of technology and related hardware, iii) accounting, finance, legal, human resources and other administrative functions and iv) noncash charges including amortization of acquisition intangibles, stock-based compensation and change in fair value of contingent consideration, to the respective reportable segments.

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.

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 condensed consolidated financial statements (in thousands):

| | 12 weeks ended June 17, 2017 | | | |
|---|---------------------------------|----------------------------|---------------|--------------|
| | U.S. Retail | Incentives & Rewards | International | Consolidated |
| Total operating revenues | \$237,705 | \$80,702 | \$144,739 | \$463,146 |
| Partner distribution expense | 124,763 | 6,650 | 70,112 | 201,525 |
| Operating revenues, net of Partner distribution expense | 112,942 | 74,052 | 74,627 | 261,621 |
| Other operating expenses | 111,697 | 76,325 | 78,000 | 266,022 |
| Segment profit (loss) / Operating income (loss) | \$1,245 | \$(2,273) | \$(3,373) | \$(4,401) |
| Other income (expense) | | | | (6,384) |
| Income (loss) before income tax expense | | | | \$(10,785) |
| Noncash charges | \$13,660 | \$11,869 | \$8,696 | |
| | 12 weeks ended June 18, 2016 | | | |
| | U.S. Retail | Incentives & Rewards | International | Consolidated |
| Total operating revenues | \$237,608 | \$61,119 | \$92,479 | \$391,206 |
| Partner distribution expense | 120,795 | 5,218 | 65,218 | 191,231 |
| Operating revenues, net of Partner distribution expense | 116,813 | 55,901 | 27,261 | 199,975 |
| Other operating expenses | 112,701 | 68,678 | 33,573 | 214,952 |
| Segment profit (loss) / Operating income (loss) | \$4,112 | \$(12,777) | \$(6,312) | \$(14,977) |
| Other income (expense) | | | | (3,632) |
| Income (loss) before income tax expense | | | | \$(18,609) |
| Noncash charges | \$13,727 | \$22,041 | \$5,595 | |

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| | 24 weeks ended June 17, 2017 | | | |
|---|---------------------------------|----------------------------|---------------|--------------|
| | U.S. Retail | Incentives & Rewards | International | Consolidated |
| Total operating revenues | \$445,343 | \$143,927 | \$281,112 | \$870,382 |
| Partner distribution expense | 226,476 | 10,736 | 143,789 | 381,001 |
| Operating revenues, net of Partner distribution expense | 218,867 | 133,191 | 137,323 | 489,381 |
| Other operating expenses | 220,610 | 142,748 | 147,455 | 510,813 |
| Segment profit (loss) / Operating income (loss) | \$(1,743) | \$(9,557) | \$(10,132) | \$(21,432) |
| Other income (expense) | | | | (12,491) |
| Income (loss) before income tax expense | | | | \$(33,923) |
| Noncash charges | \$27,277 | \$27,699 | \$16,524 | |
| | 24 weeks ended June 18, 2016 | | | |
| | U.S. Retail | Incentives & Rewards | International | Consolidated |
| Total operating revenues | \$453,104 | \$120,773 | \$183,791 | \$757,668 |
| Partner distribution expense | 226,354 | 8,049 | 128,983 | 363,386 |
| Operating revenues, net of Partner distribution expense | 226,750 | 112,724 | 54,808 | 394,282 |
| Other operating expenses | 214,444 | 130,141 | 67,718 | 412,303 |
| Segment profit (loss) / Operating income (loss) | \$12,306 | \$(17,417) | \$(12,910) | \$(18,021) |
| Other income (expense) | | | | (7,286) |
| Income (loss) before income tax expense | | | | \$(25,307) |
| Noncash charges | \$25,243 | \$38,301 | \$9,865 | |

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11. Earnings Per Share

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

| | 12 weeks ended | | | |
|--|----------------|------------|---------------|------------|
| | June 17, 2017 | | June 18, 2016 | |
| | Basic | Diluted | Basic | Diluted |
| Net income (loss) attributable to Blackhawk Network Holdings, Inc. | \$(6,351) | \$(6,351) | \$(11,337) | \$(11,337) |
| Distributed and undistributed earnings allocated to participating securities | — | — | — | — |
| Net income (loss) attributable to common stockholders | \$(6,351) | \$(6,351) | \$(11,337) | \$(11,337) |
| Weighted-average common shares outstanding | 56,448 | 56,448 | 56,134 | 56,134 |
| Common share equivalents | | — | | — |
| Weighted-average shares outstanding | | 56,448 | | 56,134 |
| Earnings (loss) per share | \$(0.11) | \$(0.11) | \$(0.20) | \$(0.20) |
| | 24 weeks ended | | | |
| | June 17, 2017 | | June 18, 2016 | |
| | Basic | Diluted | Basic | Diluted |
| Net income (loss) attributable to Blackhawk Network Holdings, Inc. | \$(19,837) | \$(19,837) | \$(14,890) | \$(14,890) |
| Distributed and undistributed earnings allocated to participating securities | — | — | (15) | (15) |
| Net income (loss) attributable to common stockholders | \$(19,837) | \$(19,837) | \$(14,905) | \$(14,905) |
| Weighted-average common shares outstanding | 56,176 | 56,176 | 55,944 | 55,944 |
| Common share equivalents | | — | | — |
| Weighted-average shares outstanding | | 56,176 | | 55,944 |
| Earnings (loss) per share | \$(0.35) | \$(0.35) | \$(0.27) | \$(0.27) |

The weighted-average common shares outstanding for diluted EPS for the 12 weeks ended June 17, 2017 and June 18, 2016, excluded approximately 5,046,000 and 5,694,000, respectively, and for the 24 weeks ended June 17, 2017 and June 18, 2016, excluded approximately 5,177,000 and 5,407,000, respectively, of total potential common stock outstanding because the effect would have been anti-dilutive.

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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 (the "SEC"), on February 27, 2017 (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," "forecasts," "can," "could," "may," "anticipates," "estimates," "pursues," "seeks," "should," "targets," "will," "would," "outlook," "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, fail to maintain existing relationships with our distribution partners or fail to attract new distribution partners to our network or if the financial performance of our distribution partners' businesses 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,
- 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 comply with Europay, MasterCard and Visa ("EMV") requirements,
- 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 anti-money laundering rules and regulations, and
- other risks and uncertainties described in our reports and filings with the SEC, 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 SEC.

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

For our retail business, a significant portion of gift card sales occurs in late December 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 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. 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 is in either the first or second quarter. As a result, quarterly financial results are not necessarily reflective of the results to be expected for the year or any other interim or future period. Seasonality also impacts our incentives businesses, but such impact is smaller in comparison to our retail business.

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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 24 weeks ended June 17, 2017 and June 18, 2016:

| | 12 weeks ended | | 24 weeks ended | |
|--|--|------------------|------------------|------------------|
| | June 17, 2017 | June 18, 2016 | June 17, 2017 | June 18, 2016 |
| | (in thousands, except percentages and per share amounts) | | | |
| Prepaid and processing revenues | \$390,547 | \$330,350 | \$746,663 | \$645,416 |
| Partner distribution expense as a % of prepaid and processing revenues | 51.6 | % 57.9 | % 51.0 | % 56.3 |
| Prepaid and processing revenues: | | | | |
| Commissions and fees | \$282,633 | \$262,931 | \$537,839 | \$502,555 |
| Program and other fees | 107,914 | 67,419 | 208,824 | 142,861 |
| Prepaid and processing revenues | \$390,547 | \$330,350 | \$746,663 | \$645,416 |
| Total operating revenues | \$463,146 | \$391,206 | \$870,382 | \$757,668 |
| Revenue adjustment from purchase accounting (2) | 1,505 | 4,439 | 3,489 | 8,209 |
| Marketing revenue and other pass-through revenue | (27,653) | (20,696) | (44,633) | (34,155) |
| Partner distribution expense | (201,525) | (191,231) | (381,001) | (363,386) |
| Adjusted operating revenues (1) | \$235,473 | \$183,718 | \$448,237 | \$368,336 |

- 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.
- (2)

Prepaid and Processing Revenues—Represents the total amount of Commissions and fees and Program and other fees recognized during the period. Our prepaid product revenues vary among our various product offerings: content provider commissions from closed loop gift and prepaid telecom cards; 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 from open loop gift cards and incentive and reward products and services; for our employee engagement businesses, 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.

Partner Distribution Expense as a Percentage of Prepaid and Processing Revenues—Represents partner distribution expense divided by Prepaid and processing revenues during the period. Partner Distribution Expense 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 sales 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

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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 and other pass-through revenues which have offsetting marketing expenses included in Sales and marketing expense and to remove the impact of 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 and other pass-through revenue, which has offsetting 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.

Transaction Dollar Volume—For our incentives and rewards businesses, transaction dollar volume generally do not correlate with the amount of revenues recognized in the same period. Due to the growth of our incentives businesses worldwide, we no longer monitor this metric at the reportable segment level for Incentives & Rewards and International.

Transaction dollar volume remains a key operating statistic for our U.S. Retail segment as discussed in our Results of Operations.

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Results of Operations

Comparison of the 12 and 24 Weeks ended June 17, 2017 and June 18, 2016

The fiscal periods presented in the accompanying tables below and throughout this Results of Operations section consist of the 12-week and 24-week periods ended June 17, 2017 and June 18, 2016 (the second quarter of 2017 and second quarter of 2016, respectively).

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 second quarter of 2017 and second quarter of 2016.

| | 12 weeks ended June 17, 2017 | % of Total Operating Revenues | | 12 weeks ended June 18, 2016 | % of Total Operating Revenues | |
|---|---------------------------------------|-------------------------------------|--|---------------------------------------|-------------------------------------|--|
| | (in thousands, except percentages) | | | | | |
| OPERATING REVENUES: | | | | | | |
| Commissions and fees | \$282,633 | 61.0 % | | \$262,931 | 67.2 % | |
| Program and other fees | 107,914 | 23.3 % | | 67,419 | 17.2 % | |
| Marketing | 24,825 | 5.4 % | | 20,696 | 5.3 % | |
| Product sales | 47,774 | 10.3 % | | 40,160 | 10.3 % | |
| Total operating revenues | 463,146 | 100.0 % | | 391,206 | 100.0 % | |
| OPERATING EXPENSES: | | | | | | |
| Partner distribution expense | 201,525 | 43.5 % | | 191,231 | 48.9 % | |
| Processing and services | 107,680 | 23.3 % | | 76,875 | 19.6 % | |
| Sales and marketing | 77,722 | 16.8 % | | 60,511 | 15.5 % | |
| Costs of products sold | 44,541 | 9.6 % | | 38,309 | 9.8 % | |
| General and administrative | 25,563 | 5.5 % | | 22,557 | 5.7 % | |
| Transition and acquisition | 905 | 0.2 % | | 641 | 0.2 % | |
| Amortization of acquisition intangibles | 13,648 | 3.0 % | | 15,259 | 3.9 % | |
| Change in fair value of contingent consideration | (4,037) | (0.9)% | | 800 | 0.2 % | |
| Total operating expenses | 467,547 | 101.0 % | | 406,183 | 103.8 % | |
| OPERATING INCOME (LOSS) | (4,401) | (1.0)% | | (14,977) | (3.8)% | |
| OTHER INCOME (EXPENSE): | | | | | | |
| Interest income and other income (expense), net | 667 | 0.2 % | | 486 | 0.1 % | |
| Interest expense | (7,051) | (1.5)% | | (4,118) | (1.1)% | |
| INCOME (LOSS) BEFORE INCOME TAX EXPENSE (BENEFIT) | (10,785) | (2.3)% | | (18,609) | (4.8)% | |
| INCOME TAX EXPENSE (BENEFIT) | (4,591) | (1.0)% | | (7,290) | (1.9)% | |
| NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS | (6,194) | (1.3)% | | (11,319) | (2.9)% | |
| Loss (income) attributable to non-controlling interests, net of tax | (157) | (0.1)% | | (18) | — % | |
| NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC. | \$(6,351) | (1.4)% | | \$(11,337) | (2.9)% | |

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| | 24 weeks ended June 17, 2017 | % of Total Operating Revenues | | 24 weeks ended June 18, 2016 | % of Total Operating Revenues | |
|---|---------------------------------------|-------------------------------------|--|---------------------------------------|-------------------------------------|--|
| (in thousands, except percentages) | | | | | | |
| OPERATING REVENUES: | | | | | | |
| Commissions and fees | \$537,839 | 61.8 % | | \$502,555 | 66.3 % | |
| Program and other fees | 208,824 | 24.0 % | | 142,861 | 18.9 % | |
| Marketing | 39,106 | 4.5 % | | 34,155 | 4.5 % | |
| Product sales | 84,613 | 9.7 % | | 78,097 | 10.3 % | |
| Total operating revenues | 870,382 | 100.0 % | | 757,668 | 100.0 % | |
| OPERATING EXPENSES: | | | | | | |
| Partner distribution expense | 381,001 | 43.8 % | | 363,386 | 47.9 % | |
| Processing and services | 209,952 | 24.1 % | | 150,816 | 19.9 % | |
| Sales and marketing | 140,507 | 16.1 % | | 113,849 | 15.0 % | |
| Costs of products sold | 80,734 | 9.3 % | | 74,041 | 9.8 % | |
| General and administrative | 54,588 | 6.3 % | | 46,054 | 6.1 % | |
| Transition and acquisition | 1,356 | 0.1 % | | 1,586 | 0.2 % | |
| Amortization of acquisition intangibles | 26,673 | 3.1 % | | 25,157 | 3.3 % | |
| Change in fair value of contingent consideration | (2,997) | (0.3)% | | 800 | 0.1 % | |
| Total operating expenses | 891,814 | 102.5 % | | 775,689 | 102.3 % | |
| OPERATING INCOME (LOSS) | (21,432) | (2.5)% | | (18,021) | (2.4)% | |
| OTHER INCOME (EXPENSE): | | | | | | |
| Interest income and other income (expense), net | 1,503 | 0.2 % | | 898 | 0.1 % | |
| Interest expense | (13,994) | (1.6)% | | (8,184) | (1.1)% | |
| INCOME (LOSS) BEFORE INCOME TAX EXPENSE | (33,923) | (3.9)% | | (25,307) | (3.3)% | |
| INCOME TAX EXPENSE (BENEFIT) | (14,366) | (1.7)% | | (10,527) | (1.4)% | |
| NET INCOME (LOSS) BEFORE ALLOCATION TO NON-CONTROLLING INTERESTS | (19,557) | (2.2)% | | (14,780) | (2.0)% | |
| Loss (income) attributable to non-controlling interests, net of tax | (280) | (0.1)% | | (110) | — % | |
| NET INCOME (LOSS) ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC. | \$(19,837) | (2.3)% | | \$(14,890) | (2.0)% | |

We identify our reportable segments based on how we manage our operations and how our Chief Operating Decision Maker (“CODM”) reviews financial information. Our reportable segments are described below:

• U.S. Retail - sale of prepaid cards to consumers in the U.S. through our physical retail distribution partners as well as through our various online distribution channels.

• Incentives & Rewards - our incentives businesses in the U.S., which provide software, services and prepaid products to business clients for their loyalty, incentive and reward programs, our e-commerce incentives business, as well as our Achievers business in Canada.

• International - our retail and incentives businesses outside of the United States, except for our Achievers business in Canada, which is reported in the Incentives & Rewards segment.

Further information regarding our reportable segments can be found in Note 10—Segment Reporting.

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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 24-week periods ended June 17, 2017 and June 18, 2016.

| | 12 weeks ended | | | |
|---|------------------------------------|------------------|-----------|--------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OPERATING REVENUES: | | | | |
| Commissions and fees | \$282,633 | \$262,931 | \$19,702 | 7.5 % |
| Program and other fees | 107,914 | 67,419 | 40,495 | 60.1 % |
| Marketing | 24,825 | 20,696 | 4,129 | 20.0 % |
| Product sales | 47,774 | 40,160 | 7,614 | 19.0 % |
| Total operating revenues | \$463,146 | \$391,206 | \$71,940 | 18.4 % |
| Partner distribution expense | 201,525 | 191,231 | 10,294 | 5.4 % |
| Operating revenues, net of Partner distribution expense | \$261,621 | \$199,975 | \$61,646 | 30.8 % |
| | 24 weeks ended | | | |
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OPERATING REVENUES: | | | | |
| Commissions and fees | \$537,839 | \$502,555 | \$35,284 | 7.0 % |
| Program and other fees | 208,824 | 142,861 | 65,963 | 46.2 % |
| Marketing | 39,106 | 34,155 | 4,951 | 14.5 % |
| Product sales | 84,613 | 78,097 | 6,516 | 8.3 % |
| Total operating revenues | \$870,382 | \$757,668 | \$112,714 | 14.9 % |
| Partner distribution expense | 381,001 | 363,386 | 17,615 | 4.8 % |
| Operating revenues, net of Partner distribution expense | \$489,381 | \$394,282 | \$95,099 | 24.1 % |

U.S. 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 U.S. Retail segment for the 12-week and 24-week periods ended June 17, 2017 and June 18, 2016.

| | 12 weeks ended | | | |
|--|------------------------------------|---------------|-----------|-----------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$237,705 | \$237,608 | \$97 | — % |
| Partner distribution expense | 124,763 | 120,795 | 3,968 | 3.3 % |
| Operating revenues, net of Partner distribution expense | \$112,942 | \$116,813 | \$(3,871) | (3.3)% |
| Transaction dollar volume (1) | \$2,263,834 | \$2,088,959 | \$174,875 | 8.4 % |
| Prepaid and processing revenues | \$205,032 | \$194,140 | \$10,892 | 5.6 % |
| Prepaid and processing revenues as a percentage of transaction dollar volume (2) | 9.1 | % 9.3 | % (0.2) |)% (2.2)% |
| Partner distribution expense as a percentage of prepaid and processing revenues | 60.9 | % 62.2 | % (1.3) |)% (2.1)% |

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| | 24 weeks ended | | | |
|--|------------------------------------|---------------|-----------|-----------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$445,343 | \$453,104 | \$(7,761) | (1.7)% |
| Partner distribution expense | 226,476 | 226,354 | 122 | 0.1 % |
| Operating revenues, net of Partner distribution expense | \$218,867 | \$226,750 | \$(7,883) | (3.5)% |
| Transaction dollar volume (1) | \$4,061,555 | \$4,005,505 | \$56,050 | 1.4 % |
| Prepaid and processing revenues | \$383,402 | \$375,194 | \$8,208 | 2.2 % |
| Prepaid and processing revenues as a percentage of transaction dollar volume (2) | 9.4 | % 9.4 | % — | % — % |
| Partner distribution expense as a percentage of prepaid and processing revenues | 59.1 | % 60.3 | % (1.2) |)% (2.0)% |

(1) Transaction dollar volume represents the total dollar amount of value loaded onto any of our prepaid products. 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 and content provider program.

(2) 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 also generate high rates due to program management fees, interchange and other fees included in Program and other fees in addition to the consumer purchase fees included in Commissions and fees; financial services products generate the lowest rates due to higher average transaction values. This metric helps us understand and manage overall margins from our product offerings.

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. During 2016, our non-EMV compliant distribution partners placed restrictions on the sale of open loop gift cards and some closed loop gift cards until they completed their EMV implementation. By the end of 2016, most of our distribution partner store locations were EMV compliant and had lifted those restrictions. In 2017, the negative impact of restricted sales has gradually decreased, and by the second quarter of 2017, sales volumes at our distribution partner store locations have recovered to expected levels, which are reflected in higher transaction dollar volume in the second quarter and first 24 weeks of 2017. In addition, sales from our online distribution channels have increased in the second quarter and first 24 weeks of 2017. These increases were partially offset by the discontinuation of certain low-margin financial services programs, including certain co-branded GPR products, which decreased transaction dollar volume.

Prepaid and processing revenues as a percentage of transaction dollar volume—Decreased for the second quarter of 2017 due to a lower prepaid and processing revenue rate for open loop gift cards, which resulted from a shift in mix from lower denomination cards to higher denomination cards due to the reduction of the impact from EMV restrictions. Prepaid and processing revenues as a percentage of transaction dollar volume was also impacted by lower program management fees due to lower contractual rates with our primary issuing bank. Prepaid and processing revenues as a percentage of transaction dollar volume for the first 24 weeks of 2017 did not change compared to the same period in 2016 primarily due to the increased sales of higher-margin products, offset by a lower prepaid and processing revenue rate for open loop gift cards and increased sales of lower-margin closed gift products.

Partner distribution expense as a percentage of prepaid and processing revenues—Decreased due to increased sales of products for which we incur lower partner distribution expense, as well as an increase in sales through our online distribution channels where we do not incur such expense for sales through our proprietary websites.

Our Operating revenues, net of Partner distribution expense were also impacted by a decrease of \$11.4 million and \$16.3 million for the second quarter and first 24 weeks of 2017, respectively, in sales from Cardpool. In our Annual Report for the year ended December 31, 2016, we reported that the Cardpool reporting unit had an elevated risk of goodwill impairment due to its exposure to lowered expectations of sales volume related to the card exchange

business and lower operating margins. As of December 31, 2016, the fair value of the Cardpool reporting unit exceeded its carrying value by \$3.4 million, or 6.9%. During the second quarter of 2017, Cardpool's operating results were lower than expected due to certain technology

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implementation issues which we believe have since been resolved. We re-evaluated our forecast for Cardpool and lowered its forecasted revenue growth for the remainder of 2017 and 2018 as a result of changes in expectations regarding our sales pipeline. We reviewed our goodwill impairment assessment for Cardpool as of June 17, 2017 and determined that, while the excess has decreased by approximately \$2.0 million, fair value still exceeded its carrying value. We continue to monitor the operating results and cash flows of our reporting units on a quarterly basis for indicators of goodwill impairment.

Incentives & 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 24-week periods ended June 17, 2017 and June 18, 2016.

| | 12 weeks ended | | | |
|---|------------------------------------|------------------|----------|-------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$80,702 | \$61,119 | \$19,583 | 32.0% |
| Partner distribution expense | 6,650 | 5,218 | 1,432 | 27.4% |
| Operating revenues, net of Partner distribution expense | \$74,052 | \$55,901 | \$18,151 | 32.5% |
| Prepaid and processing revenues | \$54,979 | \$51,388 | \$3,591 | 7.0% |
| Partner distribution expense as a percentage of prepaid and processing revenues | 12.1% | 10.2% | 1.9% | 18.6% |
| | 24 weeks ended | | | |
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$143,927 | \$120,773 | \$23,154 | 19.2% |
| Partner distribution expense | 10,736 | 8,049 | 2,687 | 33.4% |
| Operating revenues, net of Partner distribution expense | \$133,191 | \$112,724 | \$20,467 | 18.2% |
| Prepaid and processing revenues | \$104,235 | \$101,857 | \$2,378 | 2.3% |
| Partner distribution expense as a percentage of prepaid and processing revenues | 10.3% | 7.9% | 2.4% | 30.4% |

Prepaid and processing revenues—In the second quarter of 2017, we entered into a contractual amendment with one of our issuing banks to standardize fees across different products. The amendment resulted in a one-time benefit of \$0.9 million in the second quarter of 2017. Excluding this benefit, prepaid and processing revenues increased by \$2.7 million for the second quarter of 2017 primarily driven by the growth in our employee engagement business. Prepaid and processing revenues grew \$2.4 million for the first 24 weeks of 2017, primarily due to \$4.9 million increase in the employee engagement business, \$1.1 million increase due to growth in our rebate and incentive processing business, \$0.9 million increase related to the contractual amendment entered into during the second quarter of 2017, offset by a one-time benefit of \$4.3 million in the first 24 weeks of 2016 as a result of a contractual amendment with one of our issuing banks.

- Partner distribution expense as a percentage of prepaid and processing revenue—Increased due to higher proportion of sales 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 second quarter and first 24 weeks of 2017 due to an increase in product sales of \$16.0 million and \$20.8 million for the second quarter and first 24 weeks of 2017, respectively, due to the growth in our incentives loyalty programs.

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International

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 segment for the 12-week and 24-week periods ended June 17, 2017 and June 18, 2016.

| | 12 weeks ended | | | |
|---|------------------------------------|------------------|----------|----------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$144,739 | \$92,479 | \$52,260 | 56.5 % |
| Partner distribution expense | 70,112 | 65,218 | 4,894 | 7.5 % |
| Operating revenues, net of Partner distribution expense | \$74,627 | \$27,261 | \$47,366 | 173.8 % |
| Prepaid and processing revenues | \$130,536 | \$84,822 | \$45,714 | 53.9 % |
| Partner distribution expense as a percentage of prepaid and processing revenues | 53.7 | % 76.9 | % (23.2) |)(30.2)% |
| | 24 weeks ended | | | |
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| Total operating revenues | \$281,112 | \$183,791 | \$97,321 | 53.0 % |
| Partner distribution expense | 143,789 | 128,983 | 14,806 | 11.5 % |
| Operating revenues, net of Partner distribution expense | \$137,323 | \$54,808 | \$82,515 | 150.6 % |
| Prepaid and processing revenues | \$259,027 | \$168,365 | \$90,662 | 53.8 % |
| Partner distribution expense as a percentage of prepaid and processing revenues | 55.5 | % 76.6 | % (21.1) |)(27.5)% |

Prepaid and processing revenues—Our acquisition of The Grass Roots Group Holdings Limited and its subsidiaries (collectively, “Grass Roots”) in the fourth quarter of 2016 accounted for a \$37.4 million and \$67.6 million increase to our prepaid and processing revenues for the second quarter and the first 24 weeks of 2017, respectively, of which \$20.3 million for the second quarter and \$35.4 million for the first 24 weeks of 2017 related to the Meetings & Events business (see Note 5—Consolidated Financial Statement Details—Assets held for sale). Prepaid and processing revenues also increased \$8.3 million and \$23.1 million for the second quarter and first 24 weeks of 2017, respectively, due to increased sales volume in all regions, primarily Germany, Mexico and from our sub-distributor relationships, primarily in Japan.

Partner distribution expense as a percentage of prepaid and processing revenues—Decreased mainly due to our acquisition of Grass Roots, which did not incur any partner distribution expense. Excluding Grass Roots, our partner distribution expense as a percentage of prepaid and processing revenue decreased from 76.9% to 75.1% for the second quarter and from 76.6% to 75.0% for the first 24 weeks of 2017. The decrease for both the second quarter and first 24 weeks of 2017 is due to higher sales of products which have minimal partner distribution expense along with a decrease in proportion of sales through our sub-distributor relationships, primarily in Japan (which have higher commission share arrangements but for which we incur minimal other operating expenses).

Operating revenues and Operating revenues, net of Partner distribution expense were also impacted by an increase in marketing revenue of \$4.9 million and \$6.5 million, for the second quarter and first 24 weeks of 2017, respectively, mainly due to activity in Japan.

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Operating Expenses

The following tables set forth our consolidated operating expenses for the 12-week and 24-week periods ended June 17, 2017 and June 18, 2016.

| | 12 weeks ended | | | |
|--|------------------------------------|------------------|----------|---------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OPERATING EXPENSES: | | | | |
| Partner distribution expense | \$201,525 | \$191,231 | \$10,294 | 5.4 % |
| Processing and services | 107,680 | 76,875 | 30,805 | 40.1 % |
| Sales and marketing | 77,722 | 60,511 | 17,211 | 28.4 % |
| Costs of products sold | 44,541 | 38,309 | 6,232 | 16.3 % |
| General and administrative | 25,563 | 22,557 | 3,006 | 13.3 % |
| Transition and acquisition | 905 | 641 | 264 | 41.2 % |
| Amortization of acquisition intangibles | 13,648 | 15,259 | (1,611) | (10.6)% |
| Change in fair value of contingent consideration | (4,037) | 800 | (4,837) | N/M |
| Total operating expenses | \$467,547 | \$406,183 | \$61,364 | 15.1 % |

| | 24 weeks ended | | | |
|--|------------------------------------|------------------|-----------|---------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OPERATING EXPENSES: | | | | |
| Partner distribution expense | \$381,001 | \$363,386 | \$17,615 | 4.8 % |
| Processing and services | 209,952 | 150,816 | 59,136 | 39.2 % |
| Sales and marketing | 140,507 | 113,849 | 26,658 | 23.4 % |
| Costs of products sold | 80,734 | 74,041 | 6,693 | 9.0 % |
| General and administrative | 54,588 | 46,054 | 8,534 | 18.5 % |
| Transition and acquisition | 1,356 | 1,586 | (230) | (14.5)% |
| Amortization of acquisition intangibles | 26,673 | 25,157 | 1,516 | 6.0 % |
| Change in fair value of contingent consideration | (2,997) | 800 | (3,797) | N/M |
| Total operating expenses | \$891,814 | \$775,689 | \$116,125 | 15.0 % |

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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 as a percentage of Prepaid and processing revenues increased from 23.3% to 27.6% for the second quarter and from 23.4% to 28.1% for the first 24 weeks of 2017 primarily due to our acquisition of Grass Roots in the fourth quarter of 2016. Processing and services expenses increased by \$30.8 million for the second quarter (\$59.1 million for the first 24 weeks) of 2017 primarily due to costs related to Grass Roots in the amount of \$23.7 million for the second quarter (\$43.4 million for the first 24 weeks) of 2017, of which \$16.7 million for the second quarter (\$29.3 million for the first 24 weeks) of 2017 was related to the Meetings & Events business (see Note 5—Consolidated Financial Statement Details—Assets held for sale). Excluding Grass Roots, Processing and services expenses were impacted by \$2.3 million increase for the second quarter (\$5.7 million for the first 24 weeks) of 2017 for technology and infrastructure, including depreciation of capitalized software, activation transaction processing and other equipment; \$2.3 million increase for the second quarter (\$2.7 million for the first 24 weeks) of 2017 for technology and operations personnel including employee and contractor compensation, benefits and travel related costs; \$1.3 million increase for the second quarter (\$3.1 million for the first 24 weeks) of 2017 for program management and maintaining our distribution network including launch costs for Target Corporation as a new distribution partner; and \$1.2 million increase for the second quarter (\$4.3 million for the first 24 weeks) of 2017 for merchant services and other costs.

Sales and Marketing

Sales and marketing expenses increased by \$17.2 million and \$26.7 million for the second quarter and first 24 weeks of 2017, respectively. Grass Roots contributed \$7.9 million and \$13.6 million of the increase in those respective periods. Excluding Grass Roots, the increase in Sales and marketing expenses is primarily due to \$8.3 million and \$13.8 million in higher program marketing expenses, including costs related to our Visa 5% cash back program.

Costs of Products Sold

Costs of products sold increased by \$17.4 million and \$19.8 million in product costs related to our incentives business and card services for the second quarter and first 24 weeks of 2017, respectively, reflecting the increase in product sales in our incentives business. The increase is partially offset by decreases in Cardpool costs of \$9.0 million and \$12.9 million for the second quarter and first 24 weeks of 2017, respectively, reflecting lower sales from Cardpool. Gross margin increased for the second quarter of 2017 primarily due to increases in the gross margin for both our card services and incentives and loyalty programs, but gross margin decreased for the first 24 weeks of 2017 due to the negative impact from Cardpool.

General and Administrative

General and administrative expenses increased primarily due to increases of \$1.1 million for the second quarter and \$6.1 million the first 24 weeks of 2017 related to higher personnel costs, including employee compensation, benefits and travel related costs, as a result of increased headcount from acquisitions. General and administrative expenses also increased \$1.0 million for the second quarter and \$1.6 million for the first 24 weeks of 2017 due to higher rent expense, professional services and other costs. In addition, in the second quarter of 2016, we had a one-time gain of \$0.8 million from the sale of our U.S. GPR business under the PayPower brand, net of related write-offs of GPR technology assets.

Transition and Acquisition

Transition and acquisition expenses include legal, tax, audit and valuation professional services related to acquisitions, severance resulting from integration of acquisitions and certain employment compensation payments that we recognize in our post combination financial statements. In the second quarter and first 24 weeks of 2017, we incurred such expenses related to our acquisition made in the first quarter of 2017 as well as on-going acquisition activity.

Amortization of Acquisition Intangibles

Amortization expense increased in the second quarter and the first 24 weeks of 2017 due to the addition of intangibles from our various acquisitions in 2016.

Change in Fair Value of Contingent Consideration

The change in the fair value of contingent consideration relates to our Extrameasures acquisition in 2016. Changes in contingent liabilities result from changes in time value of money and changes in expectations related to the meeting of financial targets.

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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 24-week periods ended June 17, 2017 and June 18, 2016:

| | 12 weeks ended | | | |
|---|------------------------------------|------------------|----------------|----------------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OTHER INCOME (EXPENSE): | | | | |
| Interest income and other income (expense), net | \$667 | \$486 | \$181 | 37.2 % |
| Interest expense | (7,051) | (4,118) | (2,933) | 71.2 % |
| Total other income (expense) | \$(6,384) | \$(3,632) | \$(2,752) | 75.8 % |
| INCOME TAX EXPENSE (BENEFIT) | \$(4,591) | \$(7,290) | \$2,699 | (37.0)% |
| EFFECTIVE TAX RATE | 42.6 % | 39.2 % | 3.4 % | |

| | 24 weeks ended | | | |
|---|------------------------------------|-------------------|------------------|---------------|
| | June 17, 2017 | June 18, 2016 | Change | |
| | (in thousands, except percentages) | | | |
| OTHER INCOME (EXPENSE): | | | | |
| Interest income and other income (expense), net | \$1,503 | \$898 | \$605 | 67.4 % |
| Interest expense | (13,994) | (8,184) | (5,810) | 71.0 % |
| Total other income (expense) | \$(12,491) | \$(7,286) | \$(5,205) | 71.4 % |
| INCOME TAX EXPENSE (BENEFIT) | \$(14,366) | \$(10,527) | \$(3,839) | 36.5 % |
| EFFECTIVE TAX RATE | 42.3 % | 41.6 % | 0.7 % | |

Other Income (Expense)

Interest income and other income (expense), net increased for the second quarter and the first 24 weeks of 2017 primarily due to higher interest received for investments as well as lower foreign exchange losses compared to the second quarter and the first 24 weeks of 2016.

Interest expense includes interest charged under our Restated Credit Agreement and convertible notes (see Note 3—Financing in the notes to our condensed financial statements), the amortization of deferred financing costs and the discount on our term loan and convertible notes. In the second quarter of 2017, interest expense for our credit facility and convertible notes increased by \$0.2 million and amortization expense increased by \$2.7 million. For the first 24 weeks of 2017, interest expense for our credit facility and convertible notes increased by \$0.4 million and amortization expense increased by \$5.5 million. The increase in interest expense for our credit facility was primarily due to overall higher level of borrowings, as driven by our acquisition activity; the increase in amortization expense was driven by the increase in deferred financing costs and debt discounts when we issued the convertible notes during the third quarter of 2016.

Income Tax Expense (Benefit)

Our effective tax rates were 42.6% and 39.2% for the 12 weeks ended June 17, 2017 and June 18, 2016, respectively, and 42.3% and 41.6% for the 24 weeks ended June 17, 2017 and June 18, 2016, respectively. The effective rate for the 12 weeks and 24 weeks ended June 17, 2017 was higher primarily due to excess tax benefits of employee stock-based compensation.

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Liquidity and Capital Resources

The following table sets forth the major sources and uses of cash for the 24 weeks ended June 17, 2017 and June 18, 2016.

| | 24 weeks ended | |
|--|------------------|------------------|
| | June 17, 2017 | June 18, 2016 |
| | (in thousands) | |
| Net cash (used in) provided by operating activities | \$(694,289) | \$(643,277) |
| Net cash (used in) provided by investing activities | (61,106) | (166,569) |
| Net cash (used in) provided by financing activities | 33,990 | 154,610 |
| Effect of exchange rate changes on cash and cash equivalents | 8,351 | 4,648 |
| Decrease in cash and cash equivalents | \$(713,054) | \$(650,588) |

Cash Flows from Operating Activities

Our use of cash during both 24 weeks ended June 17, 2017 and June 18, 2016 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 during the 24 weeks ended June 17, 2017 increased by \$26.2 million compared to the 24 weeks ended June 18, 2016. This increase in cash primarily reflects: an increase of \$32.2 million cash provided by non-settlement related operating assets and liabilities for the 24 weeks ended June 17, 2017 compared to the 24 weeks ended June 18, 2016, due to an increase in our operating liabilities; partially offset by a decrease of \$6.7 million cash provided by income tax related receivables and payables for the 24 weeks ended June 17, 2017 compared to the 24 weeks ended June 18, 2016, due to a non-recurring income tax refund of \$7.5 million received in the 24 weeks ended June 18, 2016.

Cash Flows from Investing Activities

The net cash used in investing activities for the 24 weeks ended June 17, 2017 totaled \$61.1 million, which primarily included \$30.2 million for expenditures for property, equipment and technology, \$10.6 million for a restricted cash deposit, \$10.3 million for the acquisition of a company in the rebates and incentives business and \$5.6 million investment in equity ventures. The net cash used in investing activities for the 24 weeks ended June 18, 2016 totaled \$166.6 million, which primarily included \$144.5 million for our acquisitions of GiftCards, NimbleCommerce and Extrameasures and \$20.3 million for expenditures for property, equipment and technology.

Cash Flows from Financing Activities

The net cash provided by financing activities for the 24 weeks ended June 17, 2017 totaled \$34.0 million, primarily driven by an additional \$50.0 million draw down on our term loan under our Restated Credit Agreement, as amended (see Note 3—Financing in the notes to our condensed consolidated financial statements), and \$10.4 million net proceeds from employee stock-related activities, partially offset by our term loan repayment of \$10.0 million, \$9.7 million related to the exercise and settlement of employee stock awards and \$5.5 million payment of contingent consideration related to the Extrameasures acquisition.

The net cash provided by financing activities for the 24 weeks ended June 18, 2016 totaled \$154.6 million, primarily driven by the \$100.0 million draw down on our term loan and net increase of \$100.0 million in our bank line of credit. These were offset by repayments of \$37.5 million for our term loan and \$9.0 million for debt assumed in our acquisitions of GiftCards and NimbleCommerce.

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 February 27, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 17, 2017. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of June 17, 2017, 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 June 17, 2017 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. On August 5, 2016, the plaintiff filed a reply. On May 11, 2017, the parties updated the Court regarding the status of the case.

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 is subject to many risks and uncertainties, which may materially and adversely affect our business, prospects, financial condition and results of operations. These risk factors are disclosed in "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended on December 31, 2016. There have been no material changes to our risk factors since our Annual Report on Form 10-K.

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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 June 17, 2017:

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share (2) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------------------------|--|--|--|---|
| March 26, 2017 to April 22, 2017 | 8,916 | \$ 38.70 | — | \$ — |
| April 23, 2017 to May 20, 2017 | — | \$ — | — | \$ — |
| May 21, 2017 to June 17, 2017 | — | \$ — | — | \$ — |
| Total | 8,916 | \$ 38.70 | — | \$ — |

This table does not include shares of common stock that we withheld in order to satisfy minimum tax withholding requirements in connection with the vesting of restricted stock units or exercise of options or stock appreciation rights. The numbers represent 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.

(2) Average price paid per share of common stock does not include brokerage commissions.

In October 2016, the Company’s Board of Directors approved a stock repurchase program that authorizes the Company to purchase up to \$100 million of the Company’s outstanding common stock over a period of up to two (2) years. Under the repurchase program, purchases of shares of common stock may be made from time to time in the open market, or in privately negotiated transactions, or as otherwise may be determined by the authorized officers of the Company, in compliance with applicable state and federal securities laws. The timing and amounts of any purchases are based on market conditions and other factors including price, regulatory requirements, and capital availability. The stock repurchase program does not obligate the company to acquire any specific number of shares in any period. As of June 17, 2017, the Company had not made any purchases under the 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: July 26, 2017

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INDEX TO EXHIBITS

| Exhibit No | Description of Exhibit | Incorporated by Reference | | | Filing Date | Filed Herewith |
|------------|---|---------------------------|-----------|------------|----------------|----------------|
| | | Form | File No. | Exhibit(s) | | |
| 3.1 | <u>Third Amended and Restated Certificate of Incorporation of Blackhawk Network Holdings, Inc.</u> | 8-K | 001-35882 | 3.1 | June 9, 2017 | |
| 3.2 | <u>Amended and Restated Bylaws of Blackhawk Network Holdings, Inc.</u> | 8-K | 001-35882 | 3.2 | June 9, 2017 | |
| 10.1 | <u>First Amendment to Credit Agreement dated as of April 25, 2017, by and among Blackhawk Network Holdings, Inc., as borrower, the financial institutions signatory thereto, as lenders, and Wells Fargo Bank, National Association, as administrative agent.</u> | 8-K | 001-35882 | 10.1 | April 27, 2017 | |
| 10.2+ | <u>Separation Agreement, effective as of May 8, 2017, by and between Blackhawk Network, Inc. and Jerry Ulrich.</u> | 8-K | 001-35882 | 10.1 | May 22, 2017 | |
| 10.3+ | <u>Second Amendment to Blackhawk Network Holdings, Inc. 2013 Equity Incentive Award Plan.</u> | DEF 14A | 001-35882 | Annex A | April 20, 2017 | |
| 10.4 | <u>Second Amendment to Lease Agreement, effective as of April 21, 2017, by and between 6200 Stoneridge Mall Road Investors LLC and Blackhawk Network, Inc.</u> | | | | | X |
| 31.1 | <u>Certification Required Under Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.</u> | | | | | X |
| 31.2 | <u>Certification Required Under Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.</u> | | | | | X |
| 32.1* | <u>Certification Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section §1350.</u> | | | | | 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 |

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⁺ Indicates a management contract or compensatory plan.

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.