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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 10, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-35882

BLACKHAWK NETWORK HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

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

(925) 226-9990
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of October 12, 2016, there were 55,377,000 shares of the Registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

See accompanying notes to condensed consolidated financial statements

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

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

See accompanying notes to condensed consolidated financial statements

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

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

See accompanying notes to condensed consolidated financial statements

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

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

See accompanying notes to condensed consolidated financial statements

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

	36 weeks ended	
	September 10, 2016	September 12, 2015
OPERATING ACTIVITIES:		
Net income (loss) before allocation to non-controlling interests	$(19,840)	$ 3,932
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization of property, equipment and technology	33,096	27,765
Amortization of intangibles	38,988	21,634
Amortization of deferred program and contract costs	18,805	20,032
Employee stock-based compensation expense	24,865	19,856
Change in fair value of contingent consideration	2,100	(7,567)
Deferred income taxes	—	13,371
Other	5,780	5,496
Changes in operating assets and liabilities:		
Settlement receivables	359,398	274,941
Settlement payables	(1,091,151)	(906,181)
Accounts receivable, current and long-term	44,585	(3,573)
Other current assets	3,940	(20,562)
Other assets	(9,299)	(9,996)
Consumer and customer deposits	13,963	(31,140)
Accounts payable and accrued operating expenses	(28,775)	(9,695)
Deferred revenue	2,703	(8,105)
Other current and long-term liabilities	(24,912)	4,385
Income taxes, net	(13,883)	(15,492)
Net cash used in operating activities	(639,637)	(620,899)
INVESTING ACTIVITIES:		
Expenditures for property, equipment and technology	(33,522)	(37,310)
Business acquisitions, net of cash acquired	(144,284)	(78,394)
Investment in unconsolidated entities	(3,901)	—
Change in restricted cash	689	(38,043)
Other	4,000	(561)
Net cash used in investing activities	(177,018)	(154,308)

See accompanying notes to condensed consolidated financial statements

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

	36 weeks ended	
	September 10, 2016	September 12, 2015
FINANCING ACTIVITIES:		
Payments for acquisition liability	—	(1,811)
Repayment of debt assumed in business acquisitions	(8,964)	—
Proceeds from issuance of note payable	250,000	—
Repayment of note payable	(463,750)	(11,250)
Payments of financing costs	(15,926)	(724)
Borrowings under revolving bank line of credit	1,959,749	1,536,083
Repayments on revolving bank line of credit	(1,959,749)	(1,436,083)
Proceeds from convertible debt	500,000	—
Payments for bond hedges	(75,750)	—
Proceeds from warrants	47,000	—
Repayment on notes payable to Safeway	(890)	(6,320)
Proceeds from issuance of common stock from exercise of employee stock options and employee stock purchase plans	4,491	8,055
Other stock-based compensation related	(2,135)	(675)
Repurchase of common stock	(34,845)	—
Other	(155)	(1,494)
Net cash provided by financing activities	199,076	85,781
Effect of exchange rate changes on cash and cash equivalents	3,352	(7,467)
Decrease in cash and cash equivalents	(614,227)	(696,893)
Cash and cash equivalents—beginning of period	914,576	911,615
Cash and cash equivalents—end of period	$300,349	$ 214,722
NONCASH FINANCING AND INVESTING ACTIVITIES		
Net deferred tax assets recognized for tax basis step-up with offset to Additional paid-in capital	$—	$ 366,306
Note payable to Safeway contributed to Additional paid-in capital	$—	$ 8,229
Financing of business acquisition with contingent consideration	$20,100	$ —
Intangible assets recognized for warrants issued	$—	$ 3,147

See accompanying notes to condensed consolidated financial statements

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BLACKHAWK NETWORK HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. The Company and Significant Accounting Policies
The Company
Blackhawk Network Holdings, Inc., together with its subsidiaries (we, us, our, the Company), is a leading prepaid payment network utilizing proprietary technology to offer a broad range of prepaid gift, telecom and debit cards, in physical and electronic forms, as well as related prepaid products and payment services in the United States and 23 other countries. Our product offerings include single-use gift cards; loyalty, incentive and reward products and services; prepaid telecom products and prepaid financial services products, including general purpose reloadable (GPR) cards, and our reload network (collectively, prepaid products). We offer gift cards from leading consumer brands (known as closed loop) as well as branded gift and incentive cards from leading payment network card associations such as American Express, Discover, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom carriers. We also distribute GPR cards and operate a proprietary reload network named Reloadit, which allows consumers to reload funds onto their previously purchased GPR cards. We distribute these prepaid products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as retail distribution partners) in the Americas, Europe, Africa, Australia and Asia and provide these prepaid products and related services to business clients for their loyalty, incentive and reward programs.
Basis of Presentation
The accompanying condensed consolidated financial statements of Blackhawk Network Holdings, Inc. are unaudited. We have prepared our unaudited interim condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. We have condensed or omitted certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP pursuant to such rules and regulations. Accordingly, our interim condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K, filed with the SEC on March 2, 2016 (the Annual Report). We have prepared our condensed consolidated financial statements on the same basis as our annual audited consolidated financial statements and, in the opinion of management, have reflected all adjustments, which include only normal recurring adjustments, necessary to present fairly our financial position and results of operations for the interim periods presented. Our results for the interim periods are not necessarily reflective of the results to be expected for the year ending December 31, 2016 or for any other interim period or other future year. Our condensed consolidated balance sheet as of January 2, 2016, included herein was derived from our audited consolidated financial statements as of that date but does not include all disclosures required by GAAP for annual financial statements, including notes to the financial statements.
Seasonality
A significant portion of gift card sales occurs in late December of each year during the holiday selling season. As a result, we earn a significant portion of revenues, net income and cash inflows during the fourth fiscal quarter of each year and remit the majority of the cash, less commissions, to our content providers in January of the following year. The timing of our fiscal year-end, December holiday sales and the related January cash settlement with content providers significantly increases our Cash and cash equivalents, Settlement receivables and Settlement payables balances at the end of each fiscal year relative to normal daily balances. The cash settlement with our content providers in January accounts for the majority of the use of cash from operating activities in our condensed consolidated statements of cash flows during our first three fiscal quarters. Additionally, our operating income may fluctuate significantly during our first three fiscal quarters due to lower revenues and timing of certain expenses during such fiscal periods. As a result, quarterly financial results are not necessarily reflective of the results to be expected for the year, any other interim period or other future year.
Recently Issued or Adopted Accounting Pronouncements

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

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

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

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

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

Significant Accounting Policies

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

Breakage Revenue

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

Stock-based Compensation

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

Reclassification

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

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

2. Business Acquisitions

2016 Acquisitions

Omni Prepaid

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

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

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

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

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

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

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

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

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

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

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Other 2016 Acquisitions

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

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

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

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

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

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

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

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

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

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

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Pro Forma Financial Information

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

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

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

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

Subsequent Event

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

2015 Acquisitions

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

3. Financing

Credit Agreement

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

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

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Convertible Senior Notes

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

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

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

1) during any calendar quarter commencing after the calendar quarter ending on September 30, 2016 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

2) during the five business day period after any five consecutive trading day period (the measurement period) in which the “trading price” per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or

3) upon the occurrence of specified corporate events, including if there is a fundamental change.

Upon conversion, we will pay or deliver cash, shares of our own common stock or a combination, at our election. The conversion rate is initially 20.0673 shares of common stock per $1,000 principal amount of the Notes (equivalent to an initial conversion price of approximately $49.83 per share of common stock), subject to certain adjustments.

We may not redeem the Notes prior to the maturity date. At an event of default, holders may, upon satisfaction of certain conditions, accelerate the principal amount of the Notes plus accrued and unpaid interest. If we undergo a fundamental change, a holder may require us to repurchase for cash all or any portion of its Notes at a price equal to the principal amount of the Notes to be repurchased, plus accrued and unpaid interest.

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

Convertible Note Hedges and Warrants

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

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

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

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

Maturities of Long-Term Debt

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

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

Share Repurchase

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

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4. Fair Value Measurements

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

	September 10, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents				
Money market mutual funds	$5,112	$—	$—	$5,112
Liabilities				
Contingent consideration	$—	$—	$22,200	$22,200

	January 2, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents				
Money market mutual funds	$370,070	$—	$—	$370,070
Liabilities				
Contingent consideration	$—	$—	$—	$—

	September 12, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents				
Money market mutual funds	$5,070	$—	$—	$5,070
Liabilities				
Contingent consideration	$—	$—	$—	$—

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

Level 2— Inputs other than quoted prices included in Level 1 that are either directly or indirectly observable. Level 2 investments include commercial paper.

In the 36 weeks ended September 10, 2016, there were no transfers between Level 1 and Level 2.

Level 3— Unobservable inputs in which little or no market activity exists, therefore requiring an entity to develop its own assumptions about the inputs that market participants would use in pricing. Level 3 includes the estimated fair value of our contingent consideration liabilities.

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

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

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

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

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

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

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5. Consolidated Financial Statement Details

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

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

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6. Goodwill

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

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

7. Stockholders' Equity and Stock Based Compensation

Stockholders' Equity

During the 36 weeks ended September 10, 2016, the issuance of our Convertible Senior Notes, the purchase of the Note Hedges, the sale of the Warrants (see Note 3—Financing) and our adoption of ASU 2016-04 and 2016-09 on a modified retrospective basis had a significant impact on Additional paid-in capital and Retained earnings. Accordingly, we present in the tables below a reconciliation of such balances from January 2, 2016 to September 10, 2016.

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

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

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

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

Stock Based Compensation

During the 36 weeks ended September 10, 2016, our Board of Directors granted 1,129,019 restricted stock units, 172,300 performance stock units and 584,350 stock options at a weighted-average exercise price of $37.90 per share.

The following table presents total stock-based compensation expense according to the income statement line in our condensed consolidated statements of income (loss) for the 12 and 36 weeks ended September 10, 2016 and September 12, 2015 (in thousands):

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

8. Income Taxes

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

9. Commitments and Contingencies

Contingencies

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

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

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Legal Matters

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

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

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

10. Segment Reporting

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

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

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

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

	12 weeks ended September 10, 2016				
	US Retail	International Retail	Incentives & Rewards	Corporate and Unallocated	Consolidated
Total operating revenues	$197,081	$ 100,069	$ 64,410	$ —	$ 361,560
Partner distribution expense	103,601	69,841	4,921	—	178,363
Operating revenues, net of Partner distribution expense	93,480	30,228	59,489	—	183,197
Other operating expenses	58,192	25,158	50,779	59,161	193,290
Segment profit (loss) / Operating income (loss)	$35,288	$ 5,070	$ 8,710	$ (59,161)	(10,093)
Other income (expense)					(3,324)
Loss before income tax expense					$ (13,417)
Non-cash charges	$1,570	$ 772	$ 7,562	26,715	

	12 weeks ended September 12, 2015				
	US Retail	International Retail	Incentives & Rewards	Corporate and Unallocated	Consolidated
Total operating revenues	$214,941	$ 83,671	$ 54,053	$ —	$ 352,665
Partner distribution expense	101,890	56,972	2,990	—	161,852
Operating revenues, net of Partner distribution expense	113,051	26,699	51,063	—	190,813
Other operating expenses	69,877	22,751	46,674	53,761	193,063
Segment profit (loss) / Operating income (loss)	$43,174	$ 3,948	$ 4,389	$ (53,761)	(2,250)
Other income (expense)					(4,652)
Income before income tax expense					$ (6,902)
Non-cash charges	$1,270	$ 431	$ 6,233	22,934	

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	36 weeks ended September 10, 2016				
	US Retail	International Retail	Incentives & Rewards	Corporate and Unallocated	Consolidated
Total operating revenues	$652,359	$ 279,311	$187,558	$—	$1,119,228
Partner distribution expense	330,283	198,703	12,763	—	541,749
Operating revenues, net of Partner distribution expense	322,076	80,608	174,795	—	577,479
Other operating expenses	202,384	69,134	154,796	179,279	605,593
Segment profit (loss) / Operating income (loss)	$119,692	$ 11,474	$19,999	$(179,279)	(28,114)
Other income (expense)					(10,610)
Loss before income tax expense					$(38,724)
Non-cash charges	$4,976	$ 3,441	$20,932	80,680	

	36 weeks ended September 12, 2015				
	US Retail	International Retail	Incentives & Rewards	Corporate and Unallocated	Consolidated
Total operating revenues	$659,984	$ 251,249	$133,411	$—	$1,044,644
Partner distribution expense	313,628	169,578	10,987	—	494,193
Operating revenues, net of Partner distribution expense	346,356	81,671	122,424	—	550,451
Other operating expenses	209,856	73,665	110,462	137,597	531,580
Segment profit (loss) / Operating income (loss)	$136,500	$ 8,006	$11,962	$(137,597)	18,871
Other income (expense)					(10,504)
Income before income tax expense					$8,367
Non-cash charges	$3,741	$ 860	$11,488	51,423	

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11. Earnings Per Share

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

	12 weeks ended			
	September 10, 2016		September 12, 2015	
	Basic	Diluted	Basic	Diluted
Net income (loss) attributable to Blackhawk Network Holdings, Inc.	$(5,102)	$(5,102)	$(3,615)	$(3,615)
Distributed and undistributed earnings allocated to participating securities	—	—	—	—
Net income (loss) attributable to common stockholders	$(5,102)	$(5,102)	$(3,615)	$(3,615)
Weighted-average common shares outstanding	55,668	55,668	54,467	54,467
Common share equivalents		—		—
Weighted-average shares outstanding		55,668		54,467
Earnings (loss) per share	$(0.09)	$(0.09)	$(0.07)	$(0.07)

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

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

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

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

Special Note regarding Forward Looking Statements

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

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

Furthermore, such forward-looking statements speak only as of the date of this Quarterly Report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

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Quarterly Results of Operations and Seasonality

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

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Key Operating Statistics

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

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

(1) 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.

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

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

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

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

Adjusted Operating Revenues—We regard Adjusted operating revenues as a useful measure of operational and financial performance of the business. Adjusted operating revenues are prepared and presented to offset the distribution commissions paid and other compensation to our distribution partners and business clients, to remove marketing revenues which have offsetting marketing expenses included in Sales and marketing expense and to remove the impact that the step down in basis of deferred revenue from its book value to its fair value in purchase accounting. Our Adjusted operating revenues may not be comparable to similarly titled measures of other organizations because other organizations may not calculate these measures in the same manner as we do. You are encouraged to evaluate our adjustments and the reasons we consider them appropriate.

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

- adjusting our operating revenues for distribution commissions paid and other compensation to our retail distribution partners and business clients is useful to understanding our operating margin;
- adjusting our operating revenues for marketing revenue, which has offsetting marketing expense, is useful for understanding our operating margin;
- in a business combination, a company records an adjustment to reduce the carrying value of deferred revenue to its fair value and reduces the company’s revenues from what it would have recorded otherwise, and as such we do not believe is indicative of our core operating performance.

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Results of Operations

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

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

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

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

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