BLACKHAWK NETWORK HOLDINGS, INC
Form 10-Q
October 17, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 7, 2013

OR

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

For the transition period from ______ to ______

Commission File Number: 001-35882

BLACKHAWK NETWORK HOLDINGS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

(925) 226-9990

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter time period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

As of October 9, 2013, there were 11,549,713 shares of the Registrant s Class A common stock outstanding and 40,426,352 shares of the Registrant s Class B common stock outstanding.

Table of Contents

Blackhawk Network Holdings, Inc.

FORM 10-Q

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	September 7, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 103,453	$ 172,665
Overnight cash advances to Parent	9,000	495,000
Settlement receivables, net ($18,011 and $75,124 from Parent)	167,945	510,853
Accounts receivable, net ($2,061 and $4,229 from Parent)	91,634	101,001
Deferred income taxes	10,499	10,499
Prepaid expenses and other current assets	57,674	53,968
Total current assets	440,205	1,343,986
Property, equipment and technology, net	71,384	66,998
Intangible assets, net	22,198	1,699
Goodwill	42,729	42,729
Restricted cash		8,968
Deferred income taxes	983	1,937
Other assets ($4,962 and $0 from Parent)	70,473	67,394
TOTAL ASSETS	$ 647,972	$ 1,533,711
LIABILITIES, REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY		
Current liabilities:		
Settlement payables ($2,213 and $4,952 to Parent)	$ 351,938	$ 1,231,429
Accounts payable and accrued liabilities ($484 and $23,839 to Parent)	108,575	154,542
Total current liabilities	460,513	1,385,971
Warrant and common stock liabilities		26,675
Deferred income taxes	9,959	266
Other liabilities ($0 and $3,072 to Parent)	15,986	23,152
Total liabilities	486,458	1,436,064

Commitments and contingencies (see Note 5)				
Redeemable equity				34,997
Stockholders equity:				
Preferred stock: $0.001 par value; 10,000 shares authorized; no shares issued				
Class A common stock: $0.001 par value; 125,000 and 0 shares authorized, respectively; 11,565 and 0 shares issued, respectively		11		
Class B common stock: $0.001 par value; 125,000 and 140,000 shares authorized, respectively; 40,854 and 51,681 shares issued, respectively		41		51
Additional paid-in capital		95,225		31,542
Treasury stock		(50)		
Accumulated other comprehensive income (loss)		(2,930)		298
Retained earnings		69,073		30,669
Total Blackhawk Network Holdings, Inc. equity		161,370		62,560
Non-controlling interest		144		90
Total stockholders equity		161,514		62,650
TOTAL LIABILITIES, REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY	$	647,972	$	1,533,711

See accompanying notes to condensed consolidated financial statements

1

Table of Contents

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except for per share amounts)

(Unaudited)

	12 Weeks Ended		36 Weeks Ended	
	September 7, 2013	September 8, 2012	September 7, 2013	September 8, 2012
OPERATING REVENUES:				
Commissions and fees	$ 158,270	$ 133,993	$ 479,564	$ 411,356
Program, interchange, marketing and other fees	25,352	16,039	78,617	53,862
Product sales	22,374	14,619	58,727	40,954
Total operating revenues	205,996	164,651	616,908	506,172
OPERATING EXPENSES:				
Distribution partner commissions	105,361	89,458	319,496	268,040
Processing and services	34,927	29,594	101,321	85,406
Sales and marketing	30,502	22,891	98,791	72,260
Costs of products sold	21,493	14,349	55,993	40,180
General and administrative	9,979	4,123	31,894	22,672
Total operating expenses	202,262	160,415	607,495	488,558
OPERATING INCOME	3,734	4,236	9,413	17,614
OTHER INCOME (EXPENSE):				
Interest income and other income, net	59	262	432	972
Interest expense		(1)		(11)
INCOME BEFORE INCOME TAX EXPENSE	3,793	4,497	9,845	18,575
INCOME TAX EXPENSE	1,544	1,494	3,972	6,876
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	2,249	3,003	5,873	11,699
Add: Loss attributable to non-controlling interest (net of tax)	106	88	319	121
NET INCOME ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.	$ 2,355	$ 3,091	$ 6,192	$ 11,820

EARNINGS PER SHARE CLASS A AND CLASS B:				
Basic	$ 0.05	$ 0.06	$ 0.12	$ 0.23
Diluted	$ 0.04	$ 0.06	$ 0.12	$ 0.23
Weighted average shares outstanding basic	51,615	50,058	50,811	50,055
Weighted average shares outstanding diluted	53,074	50,820	51,982	50,792

See accompanying notes to condensed consolidated financial statements

Table of Contents

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	12 Weeks Ended		36 Weeks Ended	
	September 7, 2013	**September 8, 2012**	**September 7, 2013**	**September 8, 2012**
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	$ 2,249	$ 3,003	$ 5,873	$ 11,699
Other comprehensive income (loss):				
Currency translation adjustments	(1,413)	1,440	(3,228)	1,326
COMPREHENSIVE INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	836	4,443	2,645	13,025
Add: Comprehensive loss attributable to non-controlling interest (net of tax)	106	88	319	121
COMPREHENSIVE INCOME ATTRIBUTABLE TO BLACKHAWK NETWORK HOLDINGS, INC.	$ 942	$ 4,531	$ 2,964	$ 13,146

See accompanying notes to condensed consolidated financial statements

3

Table of Contents

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	36 Weeks Ended	
	September 7, 2013	**September 8, 2012**
OPERATING ACTIVITIES:		
Net income before allocation to non-controlling interest	$ 5,873	$ 11,699
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	16,963	12,882
Program development cost amortization	13,259	11,150
Change in allowance for doubtful accounts and sales adjustments	333	(415)
Employee stock-based compensation expense	5,279	3,467
Distribution partner mark-to-market expense	6,961	1,928
Change in fair value of contingent consideration	(1,255)	(3,636)
Excess tax benefit from stock-based awards	(588)	
Other	80	262
Changes in operating assets and liabilities:		
Settlement receivables	339,710	113,670
Settlement payables	(877,287)	(669,008)
Accounts receivable, current and long-term	16,421	12,648
Prepaid expenses and other current assets	(4,624)	(5,566)
Other assets	(19,894)	(10,559)
Accounts payable and accrued liabilities	(22,029)	(31,871)
Other liabilities	165	739
Income taxes, net	(16,956)	(18,611)
Net cash used in operating activities	(537,589)	(571,221)
INVESTING ACTIVITIES:		
Change in overnight cash advances to Parent	486,000	470,750
Expenditures for property, equipment and technology and intangible assets	(21,349)	(15,097)
Change in restricted cash	8,968	
Other	(250)	(160)
Net cash provided by investing activities	473,369	455,493
FINANCING ACTIVITIES:		
Dividends paid	(135)	
Payments for acquisition liability	(2,281)	

Payments for initial public offering costs	(4,694)	
Reimbursement for initial public offering costs	5,540	
Proceeds from exercise of stock options	359	100
Excess tax benefit from stock-based awards	588	
Payments for surrendered stock-based awards for taxes	(890)	(374)
Repurchase of redeemable common stock	(171)	(937)
Contribution from non-controlling interest	324	199
Net cash used in financing activities	(1,360)	(1,012)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(3,632)	1,405
DECREASE IN CASH AND CASH EQUIVALENTS	(69,212)	(115,335)
CASH AND CASH EQUIVALENTS Beginning of year	172,665	153,674
CASH AND CASH EQUIVALENTS End of period	$ 103,453	$ 38,339
NON-CASH FINANCING AND INVESTING ACTIVITIES		
Reclassification of warrant and common stock liabilities to additional paid-in capital upon initial public offering	$ 27,121	$
Reclassification of redeemable equity to stockholders equity upon initial public offering	$ 36,171	$
Intangible assets recognized for the issuance of fully vested warrants	$ 22,183	$

See accompanying notes to condensed consolidated financial statements

Table of Contents

BLACKHAWK NETWORK HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENT OF REDEEMABLE EQUITY AND STOCKHOLDERS EQUITY

(In thousands)

(Unaudited)

	Redeemable Equity	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Total Blackhawk Network Holdings, Inc. Equity	Non-Controlling Interest	Tota Stock-ho Equit
LANCE December 2012	$ 34,997		$	51,681	$ 51	$ 31,542	$	$ 298	$ 30,669	$ 62,560	$ 90	$ 62,6
nprehensive me								(3,228)	6,192	2,964	(319)	2,6
k-based loyee npensation ense						5,279				5,279		5,2
rcise of options	66			45		293				293		2
ender of k-based equity rds for taxes	(465)	23		(23)		(375)	(50)			(425)		(4
ess tax benefit n stock-based rds, net						588				588		5
urchase of emable common k	(171)											
ance of restricted k awards		42		228								
ance of common k upon vesting of icted stock units				16								
k-to-market stment on mon stock and rants issued to ibution partners						6,366				6,366		6,3
ance of fully ed warrants to ibution partners						22,332				22,332		22,3

assification of rant and common k liabilities upon al public offering					1	27,120				27,121		27,1
rcise of warrant				407								
tribution from ority interest											373	3
dends paid									(135)	(135)		(1
ustment to emable equity	1,744								(1,744)	(1,744)		(1,7
assification of emable equity n initial public ring	(36,171)					2,080			34,091	36,171		36,1
version of Class ommon stock to s A common k upon initial ic offering		11,500	11	(11,500)	(11)							
LANCE September 013	$	11,565	$ 11	40,854	$ 41	$ 95,225	$ (50)	$ (2,930)	$ 69,073	$ 161,370	$ 144	$ 161,5

See accompanying notes to the condensed consolidated financial statements

5

Table of Contents

BLACKHAWK NETWORK HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Significant Accounting Policies

The Company

Blackhawk Network Holdings, Inc., together with its subsidiaries (Blackhawk or the Company), is a majority-owned subsidiary of Safeway Inc. (Safeway or Parent). As of September 7, 2013, Safeway owned approximately 72.8% of Blackhawk s outstanding common stock. Blackhawk is a prepaid payments network utilizing proprietary technology to offer a broad range of gift cards, other prepaid products and payment services. The Company s payment network supports its three primary constituents: consumers who purchase the products and services the Company offers, content providers who offer branded products that are redeemable for goods and services, and distribution partners who sell those products. The Company s product offerings include gift cards, prepaid telecom products and prepaid financial services products, including general purpose reloadable (GPR) cards and the Company s reload network (collectively prepaid products). The Company offers gift cards from leading consumer brands (known as closed loop) as well as branded gift cards from leading payment network card associations such as American Express, MasterCard and Visa (known as open loop) and prepaid telecom products offered by prepaid wireless telecom brands. The Company also distributes GPR cards, including Green Dot and NetSpend branded cards, as well as PayPower, the Company s proprietary GPR card. The Company operates a proprietary reload network named REloadit, which allows consumers to reload funds onto their previously purchased GPR cards. The Company distributes products across multiple high-traffic channels such as grocery, convenience, specialty and online retailers (referred to as distribution partners) in the Americas, Europe, Australia and Asia.

Initial Public Offering

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

Basis of Presentation

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

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

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

Significant Accounting Policies

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

Use of Estimates

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

Seasonality

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

Treasury Stock

Prior to the Offering, the Company recognized the repurchase of common stock related to employee equity awards as a settlement of *Redeemable equity* (see *Note 2 Fair Value Measurements*). After the Offering, the Company uses the cost method when it purchases its own common stock as treasury shares and presents treasury stock as a reduction of *Stockholders equity*. As of September 7, 2013, treasury shares totaled approximately 439,000 shares.

Stock-Based Employee Compensation

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

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

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

Reclassification

In the accompanying condensed consolidated statements of cash flows, the Company has reclassified the working capital change related to long-term receivables from previously reported amounts in Other assets to Accounts receivables, current and long-term, as well as certain amounts related to employee equity awards within financing activities to conform to current presentation.

2. Fair Value Measurements

The Company measures certain assets, liabilities and equity instruments at fair value on a recurring basis. The table below summarizes the fair value of these assets, liabilities and equity instruments as of September 7, 2013 and December 29, 2012 (in thousands):

		September 7, 2013			
		Level 1	**Level 2**	**Level 3**	**Total**
Assets					
Cash and cash equivalents	Money market mutual funds	$ 28,000	$	$	$ 28,000
Liabilities					
Contingent consideration		$	$	$ 13,485	$ 13,485

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

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

Level 2 Inputs other than quoted prices included in Level 1 that are either directly or indirectly observable. The Company did not classify any amounts within Level 2 as of September 7, 2013 or December 29, 2012.

In the 36 weeks ended September 7, 2013, there were no transfers between Level 1 and Level 2.

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

Contingent Consideration The Company estimates the fair value of contingent consideration by using a discounted cash flows methodology. As of September 7, 2013, the Company used a discount rate of 7.0%, reflecting the time value of money, the Company s credit risk, the uncertainty in the cash flows and the Company s estimated probability of achieving the relevant financial and operational milestones. A significant decrease (increase) in the Company s credit standing, an increase (decrease) in the uncertainty in the cash flows or a decrease (increase) in the Company s estimate of the probability of achieving the relevant financial and operational milestones could materially decrease (increase) the fair value of contingent consideration. The Company presents contingent consideration in *Accounts payable and accrued liabilities* and *Other liabilities* in the accompanying condensed consolidated balance sheets.

Table of Contents

The change in fair value of contingent consideration classified as Level 3 for the 12 and 36 weeks ended September 7, 2013 and the 12 and 36 weeks ended September 8, 2012 is as follows (in thousands):

	September 7, 2013		September 8, 2012	
	12 Weeks Ended	36 Weeks Ended	12 Weeks Ended	36 Weeks Ended
Contingent Consideration				
Balance Beginning of period	$ 17,149	$ 18,947	$ 23,430	$ 23,329
Decrease in fair value of contingent consideration	(352)	(1,255)	(3,737)	(3,636)
Settlements	(3,312)	(4,207)		
Balance End of period	$ 13,485	$ 13,485	$ 19,693	$ 19,693

The Company records the change in the fair value of the business acquisition liability in *General and administrative* expense and presents such change as a non-cash adjustment to net income in the accompanying condensed consolidated statements of cash flows. The change in fair value reflects the changes in the passage of time, expected timing of the contingent payments and the Company s estimate of the probability of achieving the applicable financial and operational milestones. Settlements reflect the resolution of the contingency based on achievement of financial and operational milestones, and $3.3 million was payable as of September 7, 2013. During the 36 weeks ended September 7, 2013, the Company paid settlements totaling $2.3 million, of which $1.4 million resulted from fiscal 2012 financial and operational performance and presents such payments as a financing outflow at the acquisition-date fair value in the accompanying condensed consolidated statements of cash flows.

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

The change in fair value of *Redeemable equity* classified as Level 3 for the 36 weeks ended September 7, 2013 is as follows (in thousands):

	2013
Redeemable Equity	
Balance as of December 29, 2012	$ 34,997
Additions	1,810
Settlements	(36,807)
Balance as of September 7, 2013	$

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

3. Capital Stock

Classes of Common Stock and Shares Authorized and Issued

After the Offering, the Company s common stock consists of Class A common stock and Class B common stock. Authorized Class A common stock consists of 125 million shares of $0.001 par value per share common stock. Class A common stock issued as of September 7, 2013 was approximately 11,565,000 shares, of which 11,550,000 shares were outstanding. Authorized Class B common stock consists of 125 million shares of $0.001 par value per share common stock. Class B common stock issued as of September 7, 2013 was approximately 40,854,000 shares, and Class B common stock outstanding was approximately 40,429,000 shares. The Company also has 10 million shares of authorized preferred stock with no shares outstanding as of September 7 2013.

Reverse Split

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

Shares Issued in Conjunction with Initial Public Offering

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

Equity Awards Issued to Distribution Partners

As a result of the Offering, the put and call rights with respect to 1,069,665 shares of Class B common stock issued to a distribution partner and a warrant to purchase 750,000 shares of Class B common stock issued to another distribution partner were terminated. The termination of the call rights eliminated the performance conditions of these equity instruments, and, accordingly, the Company expensed the remaining unamortized fair value of $6.0 million at the time of the Offering, determined as the excess of the Offering price of $23.00 per share over the put price of the common stock of $18.90 per share or the exercise price of the warrant of $10.52 per share, less amounts previously expensed, with an offsetting increase to *Additional paid-in capital*. Further, the Company reclassified *Warrant and common stock liabilities* related to these put rights of $27.1 million to *Additional paid-in capital*. The Offering also terminated the restriction on the cash that the Company had received for purchase of the Class B common stock issued to the distribution partner, and therefore the Company reclassified *Restricted cash* of $9.0 million to *Cash and cash equivalents*.

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

Equity Awards to Blackhawk Employees

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

During the 36 weeks ended September 7, 2013, the Board granted 864,250 stock options at a weighted-average exercise price of $20.14 per share and 270,250 shares of restricted stock.

4. Income Taxes

The Company s effective tax rates were 40.7% and 33.2% for the 12 weeks ended September 7, 2013 and September 8, 2012, respectively, and were 40.3% and 37.0% for the 36 weeks ended September 7, 2013 and September 8, 2012, respectively. The effective rates for the 12 and 36 weeks ended September 7, 2013 were higher primarily due to lower amounts of non-taxable benefits for the decrease in the estimated fair value of the Cardpool contingent consideration liability, an operating loss in one of the Company s foreign subsidiaries for which it did not recognize an income tax benefit and higher amounts of non-deductible expenses resulting from mark-to-market on redeemable common stock, partially offset by an increased benefit for foreign rate differential and other net individually immaterial items.

In February 2013, the Company received a ruling from the Internal Revenue Service (IRS) that permits the current deduction of a content provider fee that was previously amortized for the Company s tax provision. As a result, the Company reclassified $8.1 million of deferred tax assets to income tax receivable from Parent and reduced its unrecognized tax benefit position by $4.4 million. The Company will collect the resulting net receivable of $3.7 million from Safeway when Safeway settles such amounts with the IRS. The gross unrecognized benefit at September 7, 2013 was $2.7 million.

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

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

5. Commitments and Contingencies

Legal Matters

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

Commitments

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

6. Related-Party Transactions

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

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

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

	12 Weeks Ended		36 Weeks Ended	
	September 7, 2013	**September 8, 2012**	**September 7, 2013**	**September 8, 2012**
OPERATING REVENUES:				
Commissions and fees	$ 376	$ 468	$ 1,493	$ 1,671
Program, interchange, marketing and other fees	321	278	1,053	1,011
Product sales	1,669	1,468	3,552	3,159
Total operating revenues	2,366	2,214	6,098	5,841
OPERATING EXPENSES:				
Distribution partner commissions	9,887	7,843	30,973	24,425
Processing and services	(1,105)	(160)	(1,453)	(443)
Sales and marketing	27	98	90	282
Costs of products sold				
General and administrative	611	631	1,949	1,928
Total operating expenses	9,420	8,412	31,559	26,192
OTHER INCOME (EXPENSE):				
Interest income and other income, net	25	143	201	580
Interest expense				(10)

11

Table of Contents

7. Earnings Per Share

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

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

Class A and Class B common stock have equal rights to dividends as declared by the Board. As a result, basic and diluted EPS are equivalent for Class A and Class B common stock for the 12 and 36 weeks ended September 7, 2013. For the 12 and 36 weeks ended September 8, 2012, Blackhawk s common stock consisted solely of Class B common stock.

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

	12 Weeks Ended September 7, 2013		12 Weeks Ended September 8, 2012	
	Basic	Diluted	Basic	Diluted
Net income attributable to Blackhawk Network Holdings, Inc.	$ 2,355	$ 2,355	$ 3,091	$ 3,091
Distributed and undistributed earnings allocated to participating securities	(14)	(14)	(76)	(75)
Net income attributable to common stockholders	$ 2,341	$ 2,341	$ 3,015	$ 3,016
Weighted-average common shares outstanding	51,615	51,615	50,058	50,058
Common share equivalents		1,459		762
Weighted-average shares outstanding		53,074		50,820
Earnings per share Class A and Class B	$ 0.05	$ 0.04	$ 0.06	$ 0.06

	36 Weeks Ended September 7, 2013		36 Weeks Ended September 8, 2012	
	Basic	Diluted	Basic	Diluted
Net income attributable to Blackhawk Network Holdings, Inc.	$ 6,192	$ 6,192	$ 11,820	$ 11,820

Distributed and undistributed earnings allocated to participating securities	(176)	(174)	(294)	(294)
Net income attributable to common stockholders	$ 6,016	$ 6,018	$ 11,526	$ 11,526
Weighted-average common shares outstanding	50,811	50,811	50,055	50,055
Common share equivalents		1,171		737
Weighted-average shares outstanding		51,982		50,792
Earnings per share Class A and Class B	$ 0.12	$ 0.12	$ 0.23	$ 0.23

For the 12 and 36 weeks ended September 7, 2013, distributed and undistributed earnings allocated to participating securities included approximately $0 and $74,000, respectively, of payments for the dividend declared by the Board on December 14, 2012 to holders of nonvested stock that vested during such periods.

Diluted weighted-average shares outstanding exclude approximately 35,000 and 364,000 common share equivalents for the 12 weeks ended September 7, 2013 and September 8, 2012, respectively, and 160,000 and 318,000 common share equivalents for the 36 weeks ended September 7, 2013 and September 8, 2012, respectively, because their effect would have been anti-dilutive.

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

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

Forward Looking Information

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

Company Overview

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

Quarterly Results of Operations and Seasonality

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

Description of Our Revenues

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Description of Our Expenses

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

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

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

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

General and Administrative General and administrative expenses include compensation and benefits for administrative staff, corporate facilities costs, telecommunications costs and professional service fees, as well as the change in the estimated fair value of the Cardpool contingent consideration liability.

Key Operating Statistics

The following table sets forth key operating statistics that directly affect our financial performance for the 12 and 36 weeks ended September 7, 2013 and September 8, 2012:

	12 Weeks Ended		36 Weeks Ended	
	September 7, 2013	September 8, 2012	September 7, 2013	September 8, 2012
	(in thousands, except percentages, average load transaction value and per share amounts)			
Load value	$ 1,727,753	$ 1,462,201	$ 5,256,978	$ 4,505,128
Commissions and fees as a % of load value	9.2%	9.2%	9.1%	9.1%
Distribution partner commissions paid as a % of commissions and fees	66.6%	66.8%	66.6%	65.2%
Number of load transactions	40,929	35,792	124,375	111,969
Average load transaction value	$ 42.21	$ 40.85	$ 42.27	$ 40.24
Adjusted operating revenues(1)	$ 100,635	$ 75,193	$ 297,412	$ 238,132
Adjusted EBITDA(1)	$ 11,477	$ 7,228	$ 37,361	$ 32,255
Adjusted EBITDA margin(1)	11.4%	9.6%	12.6%	13.5%
Adjusted net income(1)	$ 4,005	$ 1,709	$ 14,703	$ 13,059
Adjusted earnings per share Basic(1)	$ 0.08	$ 0.03	$ 0.28	$ 0.25
Adjusted earnings per share Diluted(1)	$ 0.08	$ 0.03	$ 0.28	$ 0.25

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

Table of Contents

Reconciliation of Non-GAAP Measures:

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

	12 Weeks Ended		**36 Weeks Ended**	
	September 7, 2013	**September 8, 2012**	**September 7, 2013**	**September 8, 2012**
	(in thousands, except percentages and per share amounts)			
Adjusted operating revenues:				
Total operating revenues	$ 205,996	$ 164,651	$ 616,908	$ 506,172
Distribution partner commissions	(105,361)	(89,458)	(319,496)	(268,040)
Adjusted operating revenues	$ 100,635	$ 75,193	$ 297,412	$ 238,132
Adjusted EBITDA:				
Net income before allocation to non-controlling interest	$ 2,249	$ 3,003	$ 5,873	$ 11,699
Interest income and other income, net	(59)	(262)	(432)	(972)
Interest expense		1		11
Income tax expense	1,544	1,494	3,972	6,876
Depreciation and amortization	6,312	4,813	16,963	12,882
EBITDA	10,046	9,049	26,376	30,496
Adjustments to EBITDA:				
Employee stock-based compensation	1,817	1,280	5,279	3,467
Distribution partner mark-to-market expense(a)	(34)	636	6,961	1,928
Change in fair value of contingent consideration(b)	(352)	(3,737)	(1,255)	(3,636)
Adjusted EBITDA	$ 11,477	$ 7,228	$ 37,361	$ 32,255
Adjusted EBITDA margin:				
Total operating revenues	$ 205,996	$ 164,651	$ 616,908	$ 506,172
Operating income	$ 3,734	$ 4,236	$ 9,413	$ 17,614
Operating margin	1.8%	2.6%	1.5%	3.5%
Adjusted operating revenues	$ 100,635	$ 75,193	$ 297,412	$ 238,132
Adjusted EBITDA	$ 11,477	$ 7,228	$ 37,361	$ 32,255
Adjusted EBITDA margin	11.4%	9.6%	12.6%	13.5%
Adjusted net income:				
Net income before allocation to non-controlling interest	$ 2,249	$ 3,003	$ 5,873	$ 11,699
Employee stock-based compensation	1,817	1,280	5,279	3,467

Distribution partner mark-to-market expense(a)		(34)		636		6,961		1,928
Change in fair value of contingent consideration(b)		(352)		(3,737)		(1,255)		(3,636)
Amortization of intangibles(c)		1,206		181		2,284		544
Total pretax adjustments		2,637		(1,640)		13,269		2,303
Tax expense on adjustments(d)		(987)		258		(4,758)		(1,064)
Adjusted net income before allocation to non-controlling interest		3,899		1,621		14,384		12,938
Add: Loss attributable to non-controlling interest (net of tax)		106		88		319		121
Adjusted net income attributable to Blackhawk Network Holdings, Inc.	$	4,005	$	1,709	$	14,703	$	13,059

Table of Contents

	12 Weeks Ended		36 Weeks Ended	
	September 7, 2013	September 8, 2012	September 7, 2013	September 8, 2012
	(in thousands, except percentages and per share amounts)			
Adjusted diluted earnings per share:				
Net income attributable to Blackhawk Network Holdings, Inc.	$ 2,355	$ 3,091	$ 6,192	$ 11,820
Distributed and undistributed income allocated to participating securities	(14)	(75)	(174)	(294)
Net income attributable to common shareholders	$ 2,341	$ 3,016	$ 6,018	$ 11,526
Diluted weighted-average shares outstanding	53,074	50,820	51,982	50,792
Diluted earnings per share	$ 0.04	$ 0.06	$ 0.12	$ 0.23
Adjusted net income attributable to Blackhawk Network Holdings, Inc.	$ 4,005	$ 1,709	$ 14,703	$ 13,059
Adjusted distributed and undistributed income allocated to participating securities	(24)	(41)	(312)	(321)
Adjusted net income attributable to common shareholders	$ 3,981	$ 1,668	$ 14,391	$ 12,738
Diluted weighted average shares outstanding	53,074	50,820	51,982	50,792
Adjusted diluted earnings per share	$ 0.08	$ 0.03	$ 0.28	$ 0.25

(a) Distribution partner equity instruments are generally marked to market at each reporting date to fair value until the instrument is settled or expired.
(b) Adjustments to reflect a contingent business acquisition liability at its estimated fair value.
(c) Non-cash expense resulting from the amortization of intangible assets.
(d) Assumes our statutory tax rate adjusted for certain amounts that are not deductible for tax purposes.

19

Table of Contents

Results of Operations

Comparison of the 12 Weeks Ended September 7, 2013 and September 8, 2012

The following table sets forth the revenue and expense amounts as a percentage of total operating revenues by the line items in our condensed consolidated statements of income for the 12 weeks ended September 7, 2013 and September 8, 2012.

	12 Weeks Ended September 7, 2013	% of Total Operating Revenues	12 Weeks Ended September 8, 2012	% of Total Operating Revenues
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 158,270	76.8%	$ 133,993	81.4%
Program, interchange, marketing and other fees	25,352	12.3%	16,039	9.7%
Product sales	22,374	10.9%	14,619	8.9%
Total operating revenues	205,996	100.0%	164,651	100.0%
OPERATING EXPENSES:				
Distribution partner commissions	105,361	51.1%	89,458	54.3%
Processing and services	34,927	17.0%	29,594	18.0%
Sales and marketing	30,502	14.8%	22,891	13.9%
Costs of products sold	21,493	10.4%	14,349	8.7%
General and administrative	9,979	4.8%	4,123	2.5%
Total operating expenses	202,262	98.2%	160,415	97.4%
OPERATING INCOME	3,734	1.8%	4,236	2.6%
OTHER INCOME (EXPENSE):				
Interest income and other income, net	59	0.0%	262	0.2%
Interest expense		%	(1)	%
INCOME BEFORE INCOME TAX EXPENSE	3,793	1.8%	4,497	2.7%
INCOME TAX EXPENSE	1,544	0.7%	1,494	0.9%
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	2,249	1.1%	3,003	1.8%
Add: Loss attributable to non-controlling interest (net of tax)	106	0.1%	88	0.1%
NET INCOME ATTRIBUTABLE TO BLACKHAWK	$ 2,355	1.1%	$ 3,091	1.9%

Operating Revenues

The following table sets forth our consolidated operating revenues for the 12 weeks ended September 7, 2013 and September 8, 2012.

	12 Weeks Ended			
	September 7, 2013	September 8, 2012	Change	
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 158,270	$ 133,993	$ 24,277	18.1%
Program, interchange, marketing and other fees	25,352	16,039	9,313	58.1%
Product sales	22,374	14,619	7,755	53.0%
Total operating revenues	$ 205,996	$ 164,651	$ 41,345	25.1%

Commissions and Fees

Commissions and fees revenue increased 18.1%, or $24.3 million, to $158.3 million for the 12 weeks ended September 7, 2013 from $134.0 million for the 12 weeks ended September 8, 2012. This increase was primarily due to an 18.2%, or $265.6 million, increase in Load value. Commissions and fees as a percentage of load value remained consistent at 9.2% for the 12 weeks ended September 7, 2013 and the 12 weeks ended September 8, 2012. The increase in Load value was primarily due to a 14.4% increase in the Number of load transactions and a 3.3% increase in the Average load transaction value. The increase in Number of load transactions reflects increased average per-store productivity for most distribution partners and the addition of new distribution partners worldwide, partially offset by the discontinuation of our wholesale telecom business. Commissions and fees as a percentage of load value was flat due to the mix of prepaid products sold and an increase in the portion of our products sold internationally, which generally have higher Commissions and fees as a percentage of load value, offset by an increase in direct deposit loads onto our PayPower GPR card, for which we do not earn *Commissions and fees* revenue.

Table of Contents

Program, Interchange, Marketing and Other Fees

Program, interchange, marketing and other fees increased 58.1%, or $9.3 million, to $25.4 million for the 12 weeks ended September 7, 2013 from $16.0 million for the 12 weeks ended September 8, 2012. This increase was driven primarily by a 203.5%, or $6.9 million, increase in marketing revenue and a 30.9%, or $2.2 million, increase in program management fees related to our Visa gift cards.

Product Sales

Product sales increased 53.0%, or $7.8 million, to $22.4 million for the 12 weeks ended September 7, 2013 from $14.6 million for the 12 weeks ended September 8, 2012. This increase was due to a 41.6%, or $4.1 million, increase in sales from Cardpool, a 101.7%, or $2.0 million, increase in telecom handset sales and a 58.3%, or $1.7 million, increase in card production sales.

Operating Expenses

The following table sets forth our consolidated operating expenses for the 12 weeks ended September 7, 2013 and September 8, 2012.

	12 Weeks Ended		Change	
	September 7, 2013	September 8, 2012		
	(in thousands, except percentages)			
OPERATING EXPENSES:				
Distribution partner commissions	$ 105,361	$ 89,458	$ 15,903	17.8%
Processing and services	34,927	29,594	5,333	18.0%
Sales and marketing	30,502	22,891	7,611	33.2%
Costs of products sold	21,493	14,349	7,144	49.8%
General and administrative	9,979	4,123	5,856	142.0%
Total operating expenses	$ 202,262	$ 160,415	$ 41,847	26.1%

Distribution Partner Commissions

Distribution partner commissions expense increased 17.8%, or $15.9 million, to $105.4 million for the 12 weeks ended September 7, 2013 from $89.5 million for the 12 weeks ended September 8, 2012, primarily due to an 18.1%, or $24.3 million, increase in *Commissions and fees* revenue. In addition, Distribution partner commissions expense as a percentage of commissions and fees revenue decreased 0.2 percentage points to 66.6% for the 12 weeks ended September 7, 2013 from 66.8% in the 12 weeks ended September 8, 2012 primarily due to a $2.3 million expense as a result of a retroactive contract amendment with a distribution partner in June 2012, partially offset by increased commissions paid to Safeway as a result of amendments to our distribution partner agreements with Safeway (see *Note 6 Related-Party Transactions* in the notes to our condensed consolidated financial statements) and an increase in the portion of our products sold internationally, which generally have higher average Distribution partner commissions paid as a percentage of load value. The amendments with Safeway increased the amount of *Distribution partner commissions* expense for the 12 weeks ended September 7, 2013 by $1.2 million, or 0.8% of *Commissions and fees* revenue, as compared to what the expense would have been without the amendments.

Processing and Services

Processing and services expenses increased 18.0%, or $5.3 million, to $34.9 million for the 12 weeks ended September 7, 2013 from $29.6 million for the 12 weeks ended September 8, 2012. The increase is primarily due to a 14.4% increase in the Number of load transactions for the 12 weeks ended September 7, 2013 from the 12 weeks ended September 8, 2012. The $5.3 million increase includes increases of $1.4 million in merchandising costs, $1.0 million in supply chain costs, $1.0 million in in-store fixture amortization and other fixture costs, $0.9 million in depreciation, equipment and data center lease expenses related to capitalized software projects and related hardware and a $1.0 million net increase in other costs, with no increase in net employee and contractor compensation, benefits and travel related costs for our technology and operations personnel. Processing and services expenses decreased as a percentage of total operating revenue to 17.0% in the 12 weeks ended September 7, 2013 from 18.0% in the 12 weeks ended September 8, 2012 due to improved leverage of our technology infrastructure.

Table of Contents

Sales and Marketing

Sales and marketing expenses increased 33.2%, or $7.6 million, to $30.5 million for the 12 weeks ended September 7, 2013 from $22.9 million for the 12 weeks ended September 8, 2012, primarily due to a $7.5 million increase in program marketing and development expenses, which substantially resulted from the $6.9 million increase in marketing revenue in *Program, interchange, marketing and other fees*. This increase also reflects a $0.2 million increase in mark-to-market and amortization expense related to equity instruments held by distribution partners and a $0.2 million increase in employee compensation, benefits and travel related costs, partially offset by a $0.3 million decrease in other costs.

Costs of Products Sold

Costs of products sold increased 49.8%, or $7.1 million, to $21.5 million for the 12 weeks ended September 7, 2013 from $14.3 million for the 12 weeks ended September 8, 2012. Cardpool accounted for $3.8 million of the increase. In addition, telecom handset costs increased by $1.9 million, and card production costs increased by $1.4 million. Costs of products sold decreased to 96.1% of *Product sales* in the 12 weeks ended September 7, 2013 from 98.2% in the 12 weeks ended September 8, 2012 primarily due to an increase in gross margin percentages for Cardpool and card production sales, partially offset by a decrease in gross margin percentage for telecom handset sales.

General and Administrative

General and administrative expenses increased 142.0%, or $5.9 million, to $10.0 million for the 12 weeks ended September 7, 2013 from $4.1 million for the 12 weeks ended September 8, 2012, primarily due to a $3.4 million reduction in the amount of the non-cash credit adjustment related to the change in the estimated fair value of the Cardpool contingent consideration liability. Excluding these credit adjustments in both years, General and administrative expenses increased 31.4%, or $2.5 million, to $10.3 million for the 12 weeks ended September 7, 2013 from $7.9 million for the 12 weeks ended September 8, 2012, primarily due to a $1.0 million increase in professional services, a $0.8 million increase in employee compensation, benefits and travel related costs and a $0.7 million net increase in other costs.

Other Income (Expense) and Income Tax Expense

The following table sets forth our consolidated other income (expense), income tax expense and effective tax rates for the 12 weeks ended September 7, 2013 and September 8, 2012.

	12 Weeks Ended September 7, 2013	12 Weeks Ended September 8, 2012	Change	
	(in thousands, except percentages)			
OTHER INCOME (EXPENSE):				
Interest income and other income, net	$ 59	$ 262	$ (203)	-77.5%
Interest expense		(1)	1	-100.0%
Total other income (expense)	$ 59	$ 261	$ (202)	-77.4%
INCOME TAX EXPENSE	$ 1,544	$ 1,494	$ 50	3.3%
EFFECTIVE TAX RATE	40.7%	33.2%	7.5%	

Other Income (Expense)

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

Income Tax Expense

Prior to the Initial Public Offering (the Offering see *Note 4 Income Taxes* in the notes to our condensed consolidated financial statements), income tax expense, deferred income taxes and income taxes receivable and payable are calculated assuming that we file a hypothetical stand-alone income tax return for both federal and state purposes. After the Offering, income tax expense, deferred income taxes and income taxes receivable and payable are calculated on a stand-alone basis except for a hypothetical stand-alone income tax return for certain states where we will continue to be included in Safeway s consolidated tax return. We have historically been included in Safeway s consolidated group for U.S. federal income tax purposes and in certain consolidated, combined or unitary groups for state and local income tax purposes. We are also party to a Tax Sharing Agreement with Safeway, or the TSA. Prior to our Offering, the TSA was generally designed to approximate the tax liability that for (i) U.S. federal income tax purposes, would be incurred if we filed our own federal consolidated income tax return separate from the Safeway consolidated group and (ii) state and local income tax purposes, would represent our proportionate share of the tax liability shown due on any state or local combined, consolidated or unitary state or local income tax return filed by Safeway in which we or any of our subsidiaries were included. As a result of our Offering, we will no longer be included in Safeway s federal tax return and certain state and local tax

Table of Contents

returns, and will begin to file tax returns and settle amounts due directly with such tax authorities. We will settle amounts due to or from Safeway related to fiscal periods prior to our Offering pursuant to the terms of the TSA and will continue to be included with Safeway in certain state and local tax returns and settle such amounts pursuant to the TSA. We do not expect that the change in tax status or settlement terms will materially affect our consolidated financial statements.

Our effective tax rate in the 12 weeks ended September 7, 2013 was 40.7%, compared to 33.2% in the 12 weeks ended September 8, 2012. Approximately 7% of the higher effective tax rate was attributable to lower amounts of non-taxable benefits resulting from the decrease in the estimated fair value of the Cardpool contingent consideration liability. The remainder of the increase was attributable to an operating loss in one of our foreign subsidiaries for which we did not recognize an income tax benefit and higher amounts of non-deductible expenses resulting from mark-to-market expense on redeemable common stock, partially offset by an increased benefit for foreign rate differential and other net individually immaterial items.

Comparison of the 36 Weeks Ended September 7, 2013 and September 8, 2012

The following table sets forth the revenue and expense amounts as a percentage of total operating revenues by the line items in our condensed consolidated statements of income for the 36 weeks ended September 7, 2013 and September 8, 2012.

	36 Weeks Ended September 7, 2013	% of Total Operating Revenues	36 Weeks Ended September 8, 2012	% of Total Operating Revenues
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 479,564	77.7%	$ 411,356	81.3%
Program, interchange, marketing and other fees	78,617	12.7%	53,862	10.6%
Product sales	58,727	9.5%	40,954	8.1%
Total operating revenues	616,908	100.0%	506,172	100.0%
OPERATING EXPENSES:				
Distribution partner commissions	319,496	51.8%	268,040	53.0%
Processing and services	101,321	16.4%	85,406	16.9%
Sales and marketing	98,791	16.0%	72,260	14.3%
Costs of products sold	55,993	9.1%	40,180	7.9%
General and administrative	31,894	5.2%	22,672	4.5%
Total operating expenses	607,495	98.5%	488,558	96.5%
OPERATING INCOME	9,413	1.5%	17,614	3.5%
OTHER INCOME (EXPENSE):				
Interest income and other income, net	432	0.1%	972	0.2%
Interest expense		%	(11)	%

INCOME BEFORE INCOME TAX EXPENSE	9,845	1.6%	18,575	3.7%
INCOME TAX EXPENSE	3,972	0.6%	6,876	1.4%
NET INCOME BEFORE ALLOCATION TO NON-CONTROLLING INTEREST	5,873	1.0%	11,699	2.3%
Add: Loss attributable to non-controlling interest (net of tax)	319	0.1%	121	%
NET INCOME ATTRIBUTABLE TO BLACKHAWK	$ 6,192	1.0%	$ 11,820	2.3%

Table of Contents

Operating Revenues

The following table sets forth our consolidated operating revenues for the 36 weeks ended September 7, 2013 and September 8, 2012.

	36 Weeks Ended			
	September 7, 2013	September 8, 2012	Change	
	(in thousands, except percentages)			
OPERATING REVENUES:				
Commissions and fees	$ 479,564	$ 411,356	$ 68,208	16.6%
Program, interchange, marketing and other fees	78,617	53,862	24,755	46.0%
Product sales	58,727	40,954	17,773	43.4%
Total operating revenues	$ 616,908	$ 506,172	$ 110,736	21.9%

Commissions and Fees

Commissions and fees revenue increased 16.6%, or $68.2 million, to $479.6 million for the 36 weeks ended September 7, 2013 from $411.4 million for the 36 weeks ended September 8, 2012. This increase was primarily due to a 16.7%, or $751.9 million, increase in Load value. Commissions and fees as a percentage of load value remained consistent at 9.1% for the 36 weeks ended September 7, 2013 and the 36 weeks ended September 8, 2012. The increase in Load value was primarily due to a 11.1% increase in the Number of load transactions and a 5.0% increase in the Average load transaction value. The increase in Number of load transactions reflects improved store productivity at most of our distribution partners and the addition of new distribution partners, partially offset by a discontinuation of certain low-margin promotional programs and the discontinuation of our wholesale telecom business. The increase in Average load transaction value was primarily driven by tax refunds and other direct deposits loaded onto our PayPower GPR cards. Commissions and fees as a percentage of load value was flat due to the mix of prepaid products sold and an increase in the portion of our products sold internationally, which generally have higher Commissions and fees as a percentage of load value, offset by tax refunds and other direct deposits loaded onto our PayPower GPR cards, for which we do not earn *Commissions and fees* revenue.

Program, Interchange, Marketing and Other Fees

Program, interchange, marketing and other fees increased 46.0%, or $24.8 million, to $78.6 million for the 36 weeks ended September 7, 2013 from $53.9 million for the 36 weeks ended September 8, 2012. This increase was driven primarily by a 70.8%, or $10.7 million, increase in marketing revenue, a 29.5%, or $6.7 million, increase in program management fees related to our Visa gift cards, a $3.4 million increase in other fees on certain Visa gift cards sold internationally, for which we had minimal revenues for the 36 weeks ended September 8, 2012, and a 42.9%, or $2.2 million, increase in net interchange fees.

Product Sales

Product sales increased 43.4%, or $17.8 million, to $58.7 million for the 36 weeks ended September 7, 2013 from $41.0 million for the 36 weeks ended September 8, 2012. This increase was due to a 42.1%, or $11.4 million, increase in sales from Cardpool, a 59.4%, or $4.6 million, increase in card production sales, and a 28.7%, or $1.7 million, increase in telecom handset sales.

Operating Expenses

The following table sets forth our consolidated operating expenses for the 36 weeks ended September 7, 2013 and September 8, 2012.

	36 Weeks Ended			
	September 7, 2013	September 8, 2012	Change	
	(in thousands, except percentages)			
OPERATING EXPENSES:				
Distribution partner commissions	$ 319,496	$ 268,040	$ 51,456	19.2%
Processing and services	101,321	85,406	15,915	18.6%
Sales and marketing	98,791	72,260	26,531	36.7%
Costs of products sold	55,993	40,180	15,813	39.4%
General and administrative	31,894	22,672	9,222	40.7%
Total operating expenses	$ 607,495	$		