
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**

For the Quarterly Period Ended September 30, 2018.

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 001-37584

CPI Card Group Inc.

(Exact name of the registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

26-0344657

(I.R.S. employer identification no.)

10026 West San Juan Way

Littleton, CO

(Address of principal executive offices)

80127

(Zip Code)

(303) 973-9311

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

☐

Accelerated filer

☐

Non-accelerated filer

☒

Smaller reporting company

☒

Emerging growth company

☒

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Number of shares of Common Stock, \$0.001 par value, outstanding as of October 26, 2018: 11,160, 377

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Item 1. Financial Statement s

CPI Card Group Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Dollars in Thousands, Except Share and Per Share Amounts)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,818	\$ 23,205
Accounts receivable, net	51,373	32,531
Inventories	10,481	13,799
Prepaid expenses and other current assets	2,922	3,681
Income taxes receivable	6,736	8,208
Assets of discontinued operation	—	20,651
Total current assets	84,330	102,075
Plant, equipment and leasehold improvements, net	38,773	44,436
Intangible assets, net	36,601	40,093
Goodwill	47,150	47,150
Other assets	294	251
Total assets	<u>\$ 207,148</u>	<u>\$ 234,005</u>
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable	\$ 15,328	\$ 13,239
Accrued expenses	17,933	12,789
Income taxes payable	678	—
Deferred revenue and customer deposits	515	3,342
Liabilities of discontinued operation	—	5,669
Total current liabilities	34,454	35,039
Long-term debt	305,330	303,869
Deferred income taxes	6,540	12,168
Other long-term liabilities	3,163	2,503
Total liabilities	349,487	353,579
Commitments and contingencies (Note 13)		
Stockholders' deficit:		
Common stock; \$0.001 par value—100,000,000 shares authorized; 11,160,377 and 11,134,714 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	11	11
Capital deficiency	(112,422)	(113,081)
Accumulated loss	(28,686)	(1,366)
Accumulated other comprehensive loss	(1,242)	(5,138)
Total stockholders' deficit	(142,339)	(119,574)
Total liabilities and stockholders' deficit	<u>\$ 207,148</u>	<u>\$ 234,005</u>

See accompanying notes to condensed consolidated financial statements

CPI Card Group Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Loss
(Dollars in Thousands, Except Share and Per Share Amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales:				
Products	\$ 34,673	\$ 26,777	\$ 90,911	\$ 79,644
Services	36,314	34,220	96,387	86,611
Total net sales	70,987	60,997	187,298	166,255
Cost of sales:				
Products (exclusive of depreciation and amortization shown below)	23,796	18,617	59,076	53,724
Services (exclusive of depreciation and amortization shown below)	21,214	20,297	60,991	53,710
Depreciation and amortization	2,669	2,639	9,620	8,063
Total cost of sales	47,679	41,553	129,687	115,497
Gross profit	23,308	19,444	57,611	50,758
Operating expenses:				
Selling, general and administrative (exclusive of depreciation and amortization shown below)	17,033	14,541	48,119	43,801
Depreciation and amortization	1,588	1,533	4,513	4,779
Total operating expenses	18,621	16,074	52,632	48,580
Income from operations	4,687	3,370	4,979	2,178
Other expense, net:				
Interest, net	(6,151)	(5,304)	(17,243)	(15,532)
Foreign currency gain (loss)	16	348	(248)	520
Other income, net	8	5	15	11
Total other expense, net	(6,127)	(4,951)	(17,476)	(15,001)
Loss from continuing operations before income taxes	(1,440)	(1,581)	(12,497)	(12,823)
Income tax benefit	355	783	4,933	4,154
Net loss from continuing operations	(1,085)	(798)	(7,564)	(8,669)
Net (loss) income from discontinued operation, net of tax (see Note 3)	(5,030)	63	(22,551)	1,266
Net loss	<u>\$ (6,115)</u>	<u>\$ (735)</u>	<u>\$ (30,115)</u>	<u>\$ (7,403)</u>
Basic and diluted loss per share:				
Continuing operations	\$ (0.10)	\$ (0.07)	\$ (0.68)	\$ (0.78)
Discontinued operation	(0.45)	0.01	(2.02)	0.11
Net loss per share	<u>\$ (0.55)</u>	<u>\$ (0.06)</u>	<u>\$ (2.70)</u>	<u>\$ (0.67)</u>
Basic and diluted weighted-average shares outstanding	11,159,984	11,127,873	11,145,946	11,111,728
Dividends declared per common share	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 0.45</u>
Comprehensive loss:				
Net loss	\$ (6,115)	\$ (735)	\$ (30,115)	\$ (7,403)
Other comprehensive loss from discontinued operations	3,983	—	3,983	—
Currency translation adjustment	98	434	(87)	1,221
Total comprehensive loss	<u>\$ (2,034)</u>	<u>\$ (301)</u>	<u>\$ (26,219)</u>	<u>\$ (6,182)</u>

See accompanying notes to condensed consolidated financial statements

CPI Card Group Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Operating activities		
Net loss	\$ (30,115)	\$ (7,403)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss (income) from discontinued operation	22,551	(1,266)
Depreciation and amortization expense	14,133	12,842
Stock-based compensation expense	741	1,367
Amortization of debt issuance costs and debt discount	1,461	1,461
Deferred income taxes	(6,169)	(863)
Other, net	165	(209)
Changes in operating assets and liabilities:		
Accounts receivable	(13,016)	(10,309)
Inventories	(2,628)	1,498
Prepaid expenses and other assets	711	746
Income taxes	2,207	(4,470)
Accounts payable	2,108	2,460
Accrued expenses	4,725	(1,574)
Deferred revenue and customer deposits	230	1,188
Other liabilities	1,052	438
Cash used in operating activities - continuing operations	(1,844)	(4,094)
Cash used in operating activities - discontinued operation	(2,914)	(2,834)
Investing activities		
Acquisitions of plant, equipment and leasehold improvements	(5,028)	(6,289)
Cash used in investing activities - continuing operations	(5,028)	(6,289)
Cash used in investing activities - discontinued operation	(220)	(1,519)
Financing activities		
Payments on capital lease obligations	(388)	—
Dividends paid on common stock	—	(7,537)
Taxes withheld and paid on stock-based compensation awards	—	(341)
Cash used in financing activities	(388)	(7,878)
Effect of exchange rates on cash	7	474
Net decrease in cash and cash equivalents	(10,387)	(22,140)
Cash and cash equivalents, beginning of period	23,205	36,955
Cash and cash equivalents, end of period	\$ 12,818	\$ 14,815
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$ 14,703	\$ 13,719
Income taxes, net (refunds) payments	\$ (1,299)	\$ 1,437
Capital lease obligations incurred for certain machinery and equipment leases	\$ 821	\$ —
Accounts payable for acquisitions of plant, equipment and leasehold improvements	\$ 171	\$ 385

See accompanying notes to condensed consolidated financial statements

CPI Card Group Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Dollars in Thousands, Except Share and Per Share Amounts or as Otherwise Indicated)
(Unaudited)

1. Business Overview and Summary of Significant Accounting Policies

Business Overview

CPI Card Group Inc. (which, together with its subsidiaries, is referred to herein as “CPI” or the “Company”) is engaged in the design, production, data personalization, packaging and fulfillment of Financial Payment Cards, which the Company defines as credit cards, debit cards and prepaid debit cards issued on the networks of the Payment Card Brands (Visa, MasterCard, American Express, Discover and Interac (in Canada)) in the United States and Canada. The Company also is engaged in the design, production, data personalization, packaging and fulfillment of retail gift and loyalty cards (primarily in Canada).

As a producer and provider of services for Financial Payment Cards, each of the Company’s secure facilities must be certified by one or more of the Payment Card Brands and is therefore subject to specific requirements and conditions. Noncompliance with these requirements would prohibit the individual facilities of the Company from producing Financial Payment Cards for these entities’ payment card issuers.

During February 2018, the Company made the decision to consolidate three personalization operations in the United States into two facilities to better enable the Company to optimize operations and achieve market-leading quality and service with a cost-competitive business model. In conjunction with this decision, the Company accelerated the depreciation of certain related assets, which totaled \$266 for the three months ended September 30, 2018 and \$2,398 for the nine months ended September 30, 2018. The Company recorded severance charges of \$552 and recorded lease termination charges of \$432 in the nine months ended September 30, 2018. The charges were recorded in the U.S. Debit and Credit segment and primarily included in “Cost of sales” on the Condensed Consolidated Statement of Operations.

Basis of Presentation

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, these financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for the fair statement of the results of the interim periods presented. The Condensed Consolidated Balance Sheet as of December 31, 2017 is derived from the audited financial statements as of that date. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

On August 3, 2018, the Company completed the sale of its three facilities in the United Kingdom that produce retail cards, such as gift and loyalty cards, for customers in the United Kingdom and continental Europe, and provide personalization, packaging and fulfillment services. The facilities sold included Colchester, Liverpool and Derby locations. The transaction was structured as a sale of all of the outstanding shares of CPI Card Group – UK Limited, for total consideration of approximately \$4,500, to an affiliate of SEA Equity Limited, a private investment firm focused on investments in companies in the United Kingdom and Europe. The Company received net cash proceeds of \$315 after the repayment of liabilities associated with the United Kingdom facilities, excluding tax benefits related to the structure of the sale.

The Company has reported the U.K. Limited reporting segment as discontinued operations and restated the comparative financial information for all periods presented in conformity with GAAP. Unless otherwise indicated, information in these notes to the unaudited condensed consolidated financial statements relate to continuing operations. See Note 3 “Discontinued Operation” for further information.

On December 20, 2017, the Company effected a one-for-five reverse stock split of its common stock, whereby each lot of five shares of common stock issued and outstanding immediately prior to the reverse stock split was

converted into and became one share of common stock. Share and per share amounts reflect the one-for-five reverse stock split for all periods presented.

Use of Estimates

Management uses estimates and assumptions relating to the reporting of assets and liabilities in its preparation of the condensed consolidated financial statements. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, goodwill and intangible assets, valuation allowances for inventories and deferred tax assets, debt, discontinued operations, revenue recognized for period-end work in process and stock-based compensation expense. Actual results could differ from those estimates.

Machinery and Equipment Financing

The Company leases certain machinery and equipment under capital leases. The assets and liabilities under these capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. Once ready for their intended use, the assets are depreciated over the lower of their related lease term or their estimated productive lives.

Foreign Currency Translation

The change in the balance of "accumulated other comprehensive loss" on the balance sheet was comprised of the following:

	Foreign Currency Translation
Balance at December 31, 2017	(5,138)
Amount released to loss from discontinued operations	3,983
Change in foreign currency translation	(87)
Balance at September 30, 2018	(1,242)

Adoption of New Accounting Standard

As of January 1, 2018, the Company adopted Accounting Standards Update Codification ASC 606, *Revenue from Contracts with Customers*, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASC 606 also requires an entity to disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Company applied ASC 606 as of January 1, 2018 to all its contracts using the modified retrospective method and recognized the cumulative effect of adoption as an adjustment to the opening balance of "Accumulated loss" on the Condensed Consolidated Balance Sheet. Under the new guidance, the Company recognizes certain performance obligations over time as the goods are produced, since those products provide value to only a specified customer, have no alternative use and the Company has the right to payment for work completed on such items. This accelerates the timing of revenue recognition for these arrangements, as revenue is recognized as goods are produced rather than upon shipment or delivery of goods. In addition, as a result of adopting the new guidance, the Company has recorded decreases to deferred revenue, and work in process and finished goods inventories, and an increase to accounts receivable. These changes are reflected in the adoption adjustments table below. The comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods.

See Note 2 "Revenue" for revenue recognition timing and methodology under ASC 606.

The cumulative effects of the adjustments made to the Company's January 1, 2018 Condensed Consolidated Balance Sheet upon adoption of ASC 606 were as follows:

	December 31, 2017	Adoption Adjustments	January 1, 2018
Assets:			
Accounts receivable, net	\$ 32,531	\$ 5,991	\$ 38,522
Inventories	13,799	(5,929)	7,870
Assets of discontinued operation	20,651	(357)	20,294
Liabilities:			
Deferred revenue and customer deposits	3,342	(3,063)	279
Liabilities of discontinued operation	5,669	(535)	5,134
Deferred income taxes	12,168	479	12,647
Stockholders' deficit:			
Accumulated (loss) earnings	(1,366)	2,824	1,458

In accordance with ASC 606, the impact on the Company's Condensed Consolidated Balance Sheet and Statement of Operations and Comprehensive Loss was as follows:

	As Reported September 30, 2018	Adjustments	Balances Without Adoption of ASC 606
Balance Sheet			
Assets:			
Accounts receivable, net	\$ 51,373	\$ (7,726)	\$ 43,647
Inventories	10,481	8,735	19,216
Liabilities:			
Deferred revenue and customer deposits	515	2,258	2,773
Deferred income taxes	6,540	(479)	6,061
Stockholders' deficit:			
Accumulated loss	(28,686)	(770)	(29,456)

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As Reported September 30, 2018	Adjustments	Balances Without Adoption of ASU 2014- 09	As Reported September 30, 2018	Adjustments	Balances Without Adoption of ASC 606
Statement of Operations and Comprehensive Loss						
Net sales:						
Products	\$ 34,673	\$ (2,219)	\$ 32,454	\$ 90,911	\$ (2,874)	\$ 88,037
Services	36,314	1,517	37,831	96,387	1,152	97,539
Cost of sales:						
Products (exclusive of depreciation and amortization)	23,796	(2,139)	21,657	59,076	(3,056)	56,020
Services (exclusive of depreciation and amortization)	21,214	789	22,003	60,991	720	61,711
Gross profit	23,308	648	23,956	57,611	614	58,225
Income tax benefit (expense)	355	(136)	219	4,933	(129)	4,804
Net loss from continuing operations	(1,085)	512	(573)	(7,564)	485	(7,079)
Net loss from discontinued operation, net of tax	(5,030)	176	(4,854)	(22,551)	157	(22,394)

During 2017, the Company early adopted ASU 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* (“ASU 2017-04”) in conjunction with its annual impairment testing effective October 1, 2017. In accordance with ASU 2017-04, an entity is required to perform its goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount of the reporting unit exceeds its fair value.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (the “FASB”) issued ASU 2016-02, *Leases* (“ASU 2016-02”), which provides guidance for accounting for leases. The new guidance requires companies to recognize the assets and liabilities for the rights and obligations created by leased assets. ASU 2016-02 is effective for annual and interim periods beginning after December 15, 2018 (the Company’s fiscal year 2019) with early adoption permitted. The new guidance requires the recognition and measurement of leases at the beginning of the earliest comparative period presented in the financial statements. The guidance required a modified retrospective approach, with an option to apply the transition provisions of the new guidance at the adoption date without adjusting the comparative periods presented. In July 2018, the FASB issued additional accounting standard updates clarifying certain provisions, as well as providing for a second transition method allowing entities to initially apply the standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings. The Company is considering the method of transition upon adoption of this guidance. The Company is in the process of assessing the impact of ASU 2016-02 on its results of operations, financial position and consolidated financial statements.

2. Revenue

The Company disaggregates its revenue by major source as follows:

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Products	Services	Total	Products	Services	Total
U.S. Debit and Credit	\$ 34,176	\$ 13,826	\$ 48,002	\$ 88,340	\$ 40,652	\$ 128,992
U.S. Prepaid Debit	—	21,190	21,190	—	52,128	52,128
Other	549	1,371	1,920	3,549	4,050	7,599
Intersegment eliminations	(52)	(73)	(125)	(978)	(443)	(1,421)
Total	\$ 34,673	\$ 36,314	\$ 70,987	\$ 90,911	\$ 96,387	\$ 187,298

For periods after January 1, 2018, the Company accounts for its revenue as follows:

Products Revenue

“Products” revenue is recognized when obligations under the terms of a contract with a customer are satisfied. In most instances, this occurs over time as cards are manufactured for specific customers and have no alternative use and the Company has an enforceable right to payment for work performed. For work performed but not completed and unbilled, the Company estimates revenue by taking actual costs incurred and applying historical margins for similar types of contracts. Items included in “Products” revenue are manufactured Financial Payment Cards, including in contact-EMV, Dual-Interface EMV®, contactless and magnetic stripe cards, private label credit cards and retail gift cards. Card@Once® printers and consumables are also included in “Products” revenue, and their associated revenues are recognized at the time of shipping.

Services Revenue

Revenue is recognized for “Services” as the services are performed. Items included in “Services” revenue include the personalization and fulfillment of Financial Payment Cards, providing tamper-evident secure packaging and fulfillment services to Prepaid Debit Card program managers and software as a service personalization of instant issuance debit cards. For work performed but not completed and unbilled, the Company estimates revenue by taking actual costs incurred and applying historical margins for similar types of contracts.

Customer Contracts

The Company often enters into Master Services Agreements (“MSAs”) with its customers. Generally, enforceable rights and obligations for goods and services occur only when a customer places a purchase order or statement of work to obtain goods or services under an MSA. The contract term as defined by ASU 2014-09 is the length of time it takes to deliver the goods or services promised under the purchase order or statement of work. As such, the Company's contracts are generally short term in nature.

3. Discontinued Operation

On August 3, 2018, the Company completed the sale of its United Kingdom facilities that comprised the U.K. Limited reporting segment. The Company did not retain significant continuing involvement with the discontinued operation subsequent to the disposal. In connection with the sale, the Company performed a goodwill impairment test and recorded a charge of \$6,366 in the second quarter of 2018. The impairment was a result of continued market softness in the U.K. Limited segment, resulting in lower sales and margins and an expected sales price below the carrying value of the segment. The Company also recorded an impairment charge of \$1,249 to customer relationship intangible assets related to the U.K. Limited segment in the second quarter of 2018.

The Company recorded a \$7,248 loss on sale of U.K Limited for the nine months ended September 30, 2018. In connection with the substantial liquidation of the foreign entity, the Company released the related cumulative translation adjustment from accumulated other comprehensive loss into loss from discontinued operations. This adjustment was \$3,983 and is included in other expense (income), net in the schedule below.

As of December 31, 2017, the carrying amounts of the major classes of assets and liabilities of the discontinued operation were as follows:

	<u>December 31, 2017</u>
Assets:	
Accounts receivable	\$ 5,006
Inventories	2,438
Other assets	506
Plant, equipment and leasehold improvements	4,864
Intangible assets	1,379
Goodwill	6,458
Total assets of discontinued operation	<u>20,651</u>
Liabilities:	
Accounts payable	3,307
Other current liabilities	1,866
Other long-term liabilities	496
Total liabilities of discontinued operation	<u>\$ 5,669</u>

The major line items constituting the (loss) income of the discontinued operation for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total net sales	\$ 1,943	\$ 7,047	\$ 10,741	\$ 23,644
Total cost of sales	1,721	5,514	10,221	18,045
Selling, general and administrative	1,238	1,406	4,303	4,122
Impairments	-	—	7,615	
Other expense (income), net	4,009	35	4,038	(50)
Pretax (loss) income from discontinued operation	(5,025)	92	(15,436)	1,527
Pretax loss on sale of discontinued operation	(5)	—	(7,248)	—
Total pretax (loss) income on discontinued operation	(5,030)	92	(22,684)	1,527
Income tax benefit (expense)	-	(29)	133	(261)
Net (loss) income from discontinued operation	<u>\$ (5,030)</u>	<u>\$ 63</u>	<u>\$ (22,551)</u>	<u>\$ 1,266</u>

4. Accounts Receivable

Accounts receivable consisted of the following:

	September 30, 2018	December 31, 2017
Trade accounts receivable	\$ 43,862	\$ 32,579
Unbilled accounts receivable	7,747	—
	<u>51,609</u>	<u>32,579</u>
Less allowance for doubtful accounts	(236)	(48)
	<u>\$ 51,373</u>	<u>\$ 32,531</u>

5. Inventories

Inventories are summarized below:

	September 30, 2018	December 31, 2017
Raw materials	\$ 8,453	\$ 5,718
Work-in-process	—	5,107
Finished goods	2,028	2,974
	<u>\$ 10,481</u>	<u>\$ 13,799</u>

6. Plant, Equipment and Leasehold Improvements

Plant, equipment and leasehold improvements consisted of the following:

	September 30, 2018	December 31, 2017
Machinery and equipment	\$ 59,589	\$ 58,595
Machinery and equipment under capital leases	821	—
Furniture, fixtures and computer equipment	6,936	6,288
Leasehold improvements	19,372	19,601
Construction in progress	3,320	1,512
	<u>90,038</u>	<u>85,996</u>
Less accumulated depreciation	(51,265)	(41,560)
	<u>\$ 38,773</u>	<u>\$ 44,436</u>

Depreciation of plant, equipment and leasehold improvements, including depreciation of assets under capital leases, was \$3,093 and \$3,000 for the three months ended September 30, 2018 and 2017, respectively, and \$10,641 and \$9,327 for the nine months ended September 30, 2018 and 2017, respectively.

7. Goodwill and Other Intangible Assets

The Company reports all of its goodwill in its U.S. Debit and Credit segment at September 30, 2018 and December 31, 2017.

Intangible assets consist of customer relationships, technology and software, non-compete agreements and trademarks. Intangible amortization expense was \$1,164 and \$1,172 for the three months ended September 30, 2018 and 2017, respectively, and \$3,492 and \$3,515 for the nine months ended September 30, 2018 and 2017, respectively.

At September 30, 2018 and December 31, 2017, intangible assets, excluding goodwill, were comprised of the following:

	Average Life (Years)		September 30, 2018			December 31, 2017		
			Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Customer relationships	12 to 20		\$ 55,454	\$ (24,768)	\$ 30,686	\$ 55,454	\$ (22,311)	\$ 33,143
Technology and software	7 to 10		7,101	(3,793)	3,308	7,101	(3,095)	4,006
Trademarks	7.5 to 10		3,330	(779)	2,551	3,330	(487)	2,843
Non-compete agreements	5 to 8		491	(435)	56	491	(390)	101
Intangible assets subject to amortization			<u>\$ 66,376</u>	<u>\$ (29,775)</u>	<u>\$ 36,601</u>	<u>\$ 66,376</u>	<u>\$ (26,283)</u>	<u>\$ 40,093</u>

The estimated future aggregate amortization expense for the identified amortizable intangibles noted above as of September 30, 2018 was as follows:

2018 (remaining 3 months)	\$ 1,164
2019	4,635
2020	4,595
2021	4,352
2022	3,867
Thereafter	17,988
	<u>\$ 36,601</u>

8. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). In determining fair value, the Company utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1—Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2—Observable inputs other than Level 1 prices, such as quoted prices in active markets for similar assets and liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term for the assets or liabilities.
- Level 3—Valuations based on unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

The Company's financial assets and liabilities that are not required to be remeasured at fair value in the Condensed Consolidated Balance Sheets were as follows:

	Carrying Value as of September 30, 2018	Fair Value as of September 30, 2018	Fair Value Measurement at September 30, 2018 (Using Fair Value Hierarchy)		
			Level 1	Level 2	Level 3
Liabilities:					
First Lien Term Loan	\$ 312,500	\$ 196,875	\$ —	\$ 196,875	\$ —

	Carrying Value as of December 31, 2017	Fair Value as of December 31, 2017	Fair Value Measurement at December 31, 2017 (Using Fair Value Hierarchy)		
			Level 1	Level 2	Level 3
Liabilities:					
First Lien Term Loan	\$ 312,500	\$ 228,125	\$ —	\$ 228,125	\$ —

The aggregate fair value of the Company's First Lien Term Loan, as defined in Note 9 "Long-Term Debt and Credit Facility," was based on bank quotes.

The carrying amounts for cash and cash equivalents, accounts receivable and accounts payable each approximate fair value.

Nonrecurring fair value measurements include the Company's goodwill and intangible asset impairments recognized during the second quarter of 2018 as determined based on unobservable Level 3 inputs. Refer to Note 3 "Discontinued Operation."

9. Long-Term Debt and Credit Facility

At September 30, 2018 and December 31, 2017, long-term debt and credit facilities consisted of the following:

	Interest Rate ⁽¹⁾	September 30, 2018	December 31, 2017
First Lien Term Loan ⁽¹⁾	7.02 %	\$ 312,500	\$ 312,500
Unamortized discount		(2,616)	(3,122)
Unamortized deferred financing costs		(4,554)	(5,509)
Long-term debt		<u>\$ 305,330</u>	<u>\$ 303,869</u>

(1) Interest rate at September 30, 2018. Interest rate at December 31, 2017 was 5.96%.

First Lien Credit Facility

On August 17, 2015, the Company entered into a first lien credit facility (the "First Lien Credit Facility") with a syndicate of lenders providing for a \$435,000 first lien term loan (the "First Lien Term Loan") and a \$40,000 revolving credit facility (the "Revolving Credit Facility"). The First Lien Term Loan and the Revolving Credit Facility have maturity dates of August 17, 2022 and August 17, 2020, respectively.

The First Lien Credit Facility is secured by a first-priority security interest in substantially all of the Company's assets constituting equipment, inventory, receivables, cash and other tangible and intangible property.

Interest rates under the First Lien Credit Facility are based, at the Company's election, on a Eurodollar rate, subject to an interest rate floor of 1.0%, plus a margin of 4.50%, or a base rate plus a margin of 3.50%.

The First Lien Credit Facility contains customary nonfinancial covenants, including among other things, restrictions on indebtedness, issuance of liens, investments, dividends, redemptions and other distributions to equity holders, asset sales, certain mergers or consolidations, sales, transfers, leases or dispositions of substantially all of the Company's assets and affiliate transactions. The First Lien Credit Facility also contains a requirement that, as of the last

day of any fiscal quarter, if the amount the Company has drawn under the Revolving Credit Facility is greater than 50% of the aggregate principal amount of all commitments of the lenders thereunder, the Company maintain a first lien net leverage ratio not in excess of 7.0 times trailing twelve month Adjusted EBITDA, as defined in the agreement. As of September 30, 2018, the Company was in compliance with all covenants under the First Lien Credit Facility.

The First Lien Credit Facility also requires prepayment in advance of the maturity date upon the occurrence of certain customary events, including based on an annual excess cash flow calculation, pursuant to the terms of the agreement, with any required payments to be made after the issuance of the Company's annual financial statements. As of September 30, 2018, the Company did not expect to have a required excess cash flow payment related to 2018.

At September 30, 2018, the Company did not have any outstanding amounts under the Revolving Credit Facility and has \$19,950 available for borrowing. Additional amounts may be available for borrowing under the term of the Revolving Credit Facility, up to the full \$40,000, to the extent the Company's net leverage ratio does not exceed 7.0 times Adjusted EBITDA, as defined in the agreement. The Company has one outstanding letter of credit for \$50 relating to the security deposit on a real property lease agreement. The Company pays a fee on outstanding letters of credit at the applicable margin, which was 4.50% as of September 30, 2018 and December 31, 2017, in addition to a fronting fee of 0.125% per annum. In addition, the Company is required to pay an unused commitment fee ranging from 0.375% per annum to 0.50% per annum of the average unused portion of the revolving commitments. The unused commitment fee is determined on the basis of a grid that results in a lower unused commitment fee as the Company's total net leverage ratio declines. The Company recorded accrued interest of \$5,058 and \$4,296 within "Accrued expenses" on the Condensed Consolidated Balance Sheets at September 30, 2018 and December 31, 2017, respectively.

Deferred Financing Costs

Certain costs incurred with borrowings or the establishment or modification of credit facilities are reflected as a reduction to the long-term debt balance. These costs are amortized as an adjustment to interest expense over the life of the borrowing using the effective-interest rate method.

10. Income Taxes – Continuing Operations

During the three months ended September 30, 2018, the Company recognized an income tax benefit of \$355 on a pre-tax loss of \$1,440, representing an effective income tax rate of 24.7%, compared to an income tax benefit of \$783 on a pre-tax loss of \$1,581, representing an effective tax rate of 49.5% during the three months ended September 30, 2017. During the nine months ended September 30, 2018, the Company recognized an income tax benefit of \$4,933 on a pre-tax loss of \$12,497, representing an effective income tax rate of 39.5%, compared to an income tax benefit of \$4,154 on a pre-tax loss of \$12,823, representing an effective tax rate of 32.4% during the nine months ended September 30, 2017. On December 22, 2017, the U.S. government enacted comprehensive tax reform legislation (the "Tax Act"). In conjunction with the Tax Act, the U.S. federal tax rate reduced from 35.0% in 2017 to 21.0% in 2018.

The effective tax rate differs from the federal U.S. statutory rate primarily due to the impact of a tax benefit of \$3,465 recorded in connection with the U.K. Limited sale in 2018. Partially offsetting the increased tax benefit was the establishment of a partial valuation allowance on certain U.S. deferred tax assets due to the limitation on the deductibility of business interest expense, and an unrecognized tax benefit of \$729 related to state income tax matters, which is recorded as a long term payable in the Condensed Consolidated Balance Sheet.

The Company received a proposed determination regarding a previously unrecognized tax benefit related to state income tax matters. Based on this proposal, during the first quarter of 2018, the Company reclassified the \$678 balance to "Income taxes payable," in the Condensed Consolidated Balance Sheet, as the Company expects to pay the balance within the next 12 months.

2017 Tax Reform

The Tax Act includes significant changes to taxation of business entities. These changes include, among others, (i) a permanent reduction to the corporate income tax rate, (ii) a partial limitation on the deductibility of business interest expense, (iii) elimination of deduction for income attributable to domestic production activities and (iv) a partial shift of the U.S. taxation of multinational corporations from a tax on worldwide income to a territorial system (along with a transitional rule that taxes certain historic foreign accumulated earnings and certain rules that aim to prevent erosion of U.S. income tax base). In conjunction with the Tax Act's reduction of the U.S. federal tax rate from 35.0% to 21.0%, the Company accrued a \$7,057 tax benefit during the year ended December 31, 2017 related to the net change in deferred tax liabilities.

Due to the complexities involved in accounting for the recently enacted Tax Act, the U.S. Securities and Exchange Commission's Staff Accounting Bulletin ("SAB") 118 requires that the Company include in its financial statements the reasonable estimate of the impact of the Tax Act on earnings to the extent such reasonable estimate has been determined. The Company has determined there is no tax liability on foreign unremitted earnings due to a net earnings and profits ("E&P") deficit on accumulated post-1986 deferred foreign income. Therefore, as of September 30, 2018, the Company has not accrued any amount of tax expense for the Tax Act's one-time transition tax on the foreign subsidiaries' accumulated, unremitted earnings going back to 1986.

11. Stockholders' Deficit

During the nine months ended September 30, 2017, the Company paid dividends of \$7,537, representing \$0.45 per share. During August 2017, the Company discontinued its quarterly dividend of \$0.225 per share.

12. Loss per Share

Basic and diluted loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period.

The following table sets forth the computation of basic and diluted loss per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net loss from continuing operations	\$ (1,085)	\$ (798)	\$ (7,564)	\$ (8,669)
Net (loss) income from discontinued operation	(5,030)	63	(22,551)	1,266
Net loss	<u>\$ (6,115)</u>	<u>\$ (735)</u>	<u>\$ (30,115)</u>	<u>\$ (7,403)</u>
Denominator:				
Basic and diluted weighted-average common shares outstanding	11,159,984	11,127,873	11,145,946	11,111,728
Basic and diluted loss per share:				
Continuing operations	\$ (0.10)	\$ (0.07)	\$ (0.68)	\$ (0.78)
Discontinued operation	(0.45)	0.01	(2.02)	0.11
Net loss per share	<u>\$ (0.55)</u>	<u>\$ (0.06)</u>	<u>\$ (2.70)</u>	<u>\$ (0.67)</u>

The Company reported a net loss for the three and nine months ended September 30, 2018 and 2017. Accordingly, the potentially dilutive effect of 666,101 and 953,042 stock options and 68,811 and 52,664 restricted stock units were excluded from the computation of diluted earnings per share as of September 30, 2018 and 2017, respectively, as their inclusion would be anti-dilutive.

13. Commitments and Contingencies

Commitments

The Company incurred rent expense under non-cancellable operating leases of \$887 and \$896 for the three months ended September 30, 2018 and 2017, respectively, and \$2,663 and \$2,666 for the nine months ended September 30, 2018 and 2017, respectively. During the first quarter of 2018, the Company leased certain machinery and equipment under capital lease obligations, which consisted of the following at September 30, 2018:

	September 30, 2018
Machinery and equipment	\$ 711
Less current portion of capital lease obligations	(147)
Total long-term capital lease obligations	\$ 564

In its Condensed Consolidated Balance Sheet at September 30, 2018, the Company has recorded the current portion of capital lease obligations in “Accrued expenses” and the long-term capital lease obligations in “Other long-term liabilities”.

Contingencies

In accordance with applicable accounting guidance, the Company establishes an accrued liability when loss contingencies are both probable and estimable. In such cases, there may be an exposure to loss in excess of any amounts accrued. As a matter develops, the Company, in conjunction with any outside counsel handling the matter, evaluates on an ongoing basis whether such matter presents a loss contingency that is probable and estimable. Once the loss contingency is deemed to be both probable and estimable, the Company will establish an accrued liability and record a corresponding amount of litigation-related expense. The Company expenses professional fees associated with litigation claims and assessments as incurred.

In Re CPI Card Group Inc. Securities Litigation, Case No. 1:16-CV-04531 (S.D.N.Y.) (the “Class Action”)

On June 15, 2016, two purported CPI stockholders filed putative class action lawsuits captioned Vance, et al. v. CPI Card Group Inc., et al. and Chipman, et al. v. CPI Card Group Inc. in the United States District Court for the Southern District of New York (the “Court”) against CPI, certain of its former officers and current and former directors, along with the sponsors of and the financial institutions who served as underwriters for CPI’s October 2015 initial public offering (“IPO”). The complaints, purportedly brought on behalf of all purchasers of CPI common stock pursuant to the October 8, 2015 Registration Statement filed in connection with the IPO, assert claims under §§11 and 15 of the Securities Act of 1933, as amended (the “Securities Act”) and seek, among other things, damages and costs. In particular, the complaints allege that the Registration Statement contained false or misleading statements or omissions regarding CPI’s customers’ (i) purchases of Europay, MasterCard and VISA chip cards (collectively, “EMV® cards”) during the first half of fiscal year 2015 and resulting EMV® card inventory levels; and (ii) capacity to purchase additional EMV® cards in the fourth quarter of fiscal year 2015, and the remainder of the fiscal year ended December 31, 2015. The complaints allege that these actions artificially inflated the price of CPI common stock issued pursuant to the IPO.

On August 30, 2016, the Court consolidated the Vance and Chipman actions and appointed lead plaintiff and lead counsel pursuant to the Private Securities Litigation Reform Act. On October 17, 2016, lead plaintiff filed a consolidated amended complaint, asserting the same claims for violations of §§11 and 15 of the Securities Act. The amended complaint is based principally on the same theories as the original complaints, but adds allegations that the Registration Statement contained inadequate risk disclosures and failed to disclose (i) small and mid-size issuers’ slower-than-anticipated conversion to EMV® technology and (ii) increased pricing pressure and competition CPI faced in the EMV® market.

On November 16, 2016, the Company filed a motion to dismiss the amended complaint, which was denied by the Court on October 30, 2017. On January 12, 2018, the Company filed an answer to the amended complaint. On March 23, 2018, lead plaintiff filed his motion for class certification. On June 11, 2018, the Company filed an opposition to lead plaintiff’s motion for class certification.

On July 31, 2018, the parties notified the Court that they had reached an agreement in principle to settle the Class Action. On September 21, 2018, the parties executed a stipulation and agreement of settlement (“Stipulation”) and lead plaintiff filed with the Court his unopposed motion for authorization to notify the settlement class of the proposed settlement. On October 1, 2018, the Court provisionally denied lead plaintiff’s motion without prejudice to renew subject to certain revisions to the proposed form of class notice. On October 15, 2018, lead plaintiff filed a renewed unopposed motion for authorization to notify the class of the proposed settlement and to schedule a hearing, with an amended proposed form of notice. On October 22, 2018, the Court granted lead plaintiff’s renewed motion and approved amended form of notice to the class of the proposed settlement. The Court scheduled the settlement hearing for February 5, 2019.

The Company had a liability recorded as of September 30, 2018, which is not material to the financial statements, and reflects the Company’s estimate of the probable loss pursuant to an allocation of the total agreed settlement amount. There was no liability recorded as of December 31, 2017.

Heckermann v. Montross et al., Case No. 1:17-CV-01673 (D. Del.) (the “Derivative Suit”)

On November 20, 2017, a purported CPI stockholder filed a stockholder derivative complaint in the United States District Court for the District of Delaware (the “Court”) against certain of CPI’s former officers and current and former directors, along with the sponsors of the IPO. CPI is also named as a nominal defendant. The derivative complaint asserts claims under §§10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 and seeks, among other things, injunctive relief, damages and costs. It alleges false or misleading statements and omissions in the Registration Statement filed by CPI in connection with its IPO and subsequent public filings and statements. The derivative complaint also asserts claims for purported breaches of fiduciary duties, unjust enrichment, mismanagement and waste of corporate assets.

On March 28, 2018, the Court entered the parties’ stipulated order staying the Derivative Suit pending final determination of the Class Action.

The Company believes these claims are without merit and is defending the Derivative Suit vigorously. Given the current stage of these matters, the range of any potential loss is not probable or estimable and no liability has been recorded as of September 30, 2018 or December 31, 2017.

In addition to the matters described above, the Company is subject to routine legal proceedings in the ordinary course of business. The Company believes that the ultimate resolution of these matters will not have a material adverse effect on its business, financial condition or results of operations.

14. Stock-Based Compensation

CPI Card Group Inc. Omnibus Incentive Plan

On December 20, 2017, the Company effected a one-for-five reverse stock split of its common stock, whereby each lot of five shares of common stock issued and outstanding immediately prior to the reverse stock split was converted into and became one share of common stock. Share and per share amounts below reflect the one-for-five reverse stock split for all periods presented.

During October 2015, the Company adopted the CPI Card Group Inc. Omnibus Incentive Plan (the “Omnibus Plan”) pursuant to which cash and equity based incentives may be granted to participating employees, advisors and directors. The Company had reserved 800,000 shares of common stock for issuance under the Omnibus Plan. Effective September 25, 2017, the Omnibus Plan was amended and restated, providing for an increase in the number of shares of common stock authorized for issuance thereunder by 400,000. The increase was made effective in the fourth quarter of 2017 by stockholder approval in accordance with applicable law, after which the Company had reserved 1,200,000 shares of common stock for issuance. As of September 30, 2018, there were 131,498 shares available for grant under the Omnibus Plan.

During the nine months ended September 30, 2018, the Company granted awards of non-qualified stock options for 159,755 shares of common stock. All stock option grants have a 10-year term and will generally vest ratably over a three-year period beginning on the first anniversary of the grant date.

The following is a summary of the activity in outstanding stock options under the Omnibus Plan:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)
Outstanding as of December 31, 2017	937,310	\$ 17.11	
Granted	159,755	2.74	
Forfeited	(161,181)	14.21	
Outstanding as of September 30, 2018	935,884	\$ 15.16	8.62
Options vested and exercisable as of September 30, 2018	276,383	18.09	8.40
Options vested and expected to vest as of September 30, 2018	933,834	15.19	8.62

The following is a summary of the activity in non-vested stock options under the Omnibus Plan:

	Number	Weighted-Average Grant-Date Fair Value
Non-vested as of December 31, 2017	876,903	\$ 4.08
Granted	159,755	1.20
Forfeited	(148,972)	3.47
Vested	(228,185)	2.76
Non-vested as of September 30, 2018	659,501	\$ 3.98

Unvested options as of September 30, 2018 will vest as follows:

2018	50,879
2019	302,695
2020	251,654
2021	54,273
Total unvested options as of September 30, 2018	659,501

The fair value of the stock option awards granted during the nine months ended September 30, 2018 was determined at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended September 30, 2018
Expected term in years ⁽¹⁾	6.0
Volatility ⁽²⁾	48.0 %
Risk-free interest rate ⁽³⁾	2.7 %
Dividend yield ⁽⁴⁾	— %

- (1) The Company estimated the expected term based on the average of the weighted-average vesting period and the contractual term of the stock option awards by utilizing the “simplified method”, as the Company does not have sufficient available historical data to estimate the expected term of these stock option awards.
- (2) During the first nine months of 2018, the Company considered the volatility of its own common stock in determining the fair value of stock option awards, in addition to a peer group average historical volatility over the

expected option term. The peer group was based on financial technology companies that completed an initial public offering of common stock within the last 10 years.

- (3) The risk-free interest rate was determined by using the United States Treasury rate for the period that coincided with the expected option term.
- (4) The Company discontinued its quarterly dividend program during August 2017.

The weighted-average grant-date fair value of options granted was as follows:

	Three Months Ended September 30,	
	2018	2017
Weighted-average grant-date fair value of options granted	\$ 1.20	\$ 4.31

The following table summarizes the changes in the number of outstanding restricted stock units for the nine-month period ended September 30, 2018:

	Units	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Amortization Period (in Years)
Outstanding as of December 31, 2017	49,677	\$ 16.20	
Granted	75,188	2.66	
Vested	(25,928)	10.63	
Forfeited	(30,126)	9.85	
Outstanding as of September 30, 2018	68,811	\$ 6.28	1.14

During the nine months ended September 30, 2018, the Company granted awards of restricted stock units for 75,188 shares of common stock. The restricted stock units contain conditions associated with continued employment or service and generally vest one year from the date of grant. On the vesting dates, shares of common stock will be issued to the award recipients.

Unvested restricted stock units as of September 30, 2018 will vest as follows:

2018	—
2019	57,563
2020	11,005
2021	243
Total unvested restricted stock units as of September 30, 2018	68,811

The following table summarizes the changes in the number of outstanding cash performance units for the nine-month period ended September 30, 2018:

	Units
Outstanding as of December 31, 2017	822,915
Granted	—
Vested	(274,854)
Forfeited	(115,907)
Outstanding as of September 30, 2018	432,154

There were no awards of cash performance units during the nine months ended September 30, 2018. These awards will settle in cash in three annual payments on the first, second and third anniversaries of the date of grant. The cash performance units are based on the performance of the Company's stock, measured based on the Company's stock price at each of the first, second and third anniversaries of the grant date compared to the Company's stock price on the date of grant. During the first nine months of 2018, the first tranche of the cash performance units vested. Accordingly, the Company made a cash payment of \$137 to the award recipients.

The Company recognizes compensation expense on a straight-line basis for each annual performance period. The cash performance units are accounted for as a liability and remeasured to fair value at the end of each reporting period. As of September 30, 2018, the Company recognized a liability of \$83 in “Accrued expenses” and \$56 in “Other long-term liabilities” in the Condensed Consolidated Balance Sheet for unsettled cash performance units.

Compensation expense for the Omnibus Plan for the three months ended September 30, 2018 and 2017 was \$(42) and \$507, respectively, and \$741 and \$1,738 for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, the total unrecognized compensation expense related to unvested options, restricted stock units and cash performance unit awards under the Omnibus Plan was \$1,246, which the Company expects to recognize over an estimated weighted-average period of 1.4 years.

CPI Holdings I, Inc. Amended and Restated 2007 Stock Option Plan

In 2007, the Company’s Board of Directors adopted the CPI Holdings I, Inc. Amended and Restated 2007 Stock Option Plan (the “Option Plan”). Under the provisions of the Option Plan, stock options may be granted to employees, directors and consultants at an exercise price greater than or equal to (and not less than) the fair market value of a share on the date the option is granted.

As a result of the Company’s adoption of the Omnibus Plan, as further described above, no further awards will be made under the Option Plan. The outstanding stock options under the Option Plan are non-qualified, have a 10-year life and are fully vested as of September 30, 2018.

During the nine months ended September 30, 2018, there was no activity under the Option Plan. As such, total shares outstanding and exercisable were 6,600 shares with a weighted-average exercise price of \$0.002 per share and a weighted-average remaining contract term of 4.7 years at September 30, 2018.

Compensation expense and unrecorded compensation expense related to options previously granted under the Option Plan, for the three and nine months ended September 30, 2018 and 2017, were de minimis.

Other Stock-Based Compensation Awards

During June 2015, the Company issued 38,332 restricted shares of common stock to certain executives of the Company at a weighted-average grant-date fair value of \$47.40. There were no outstanding unvested restricted shares of common stock as of September 30, 2018. There was no compensation expense recorded for these awards during the three or nine months ended September 30, 2018. During the first quarter of 2017, the executive holding the restricted shares changed employment status to a consultant and the Company remeasured the awards and reduced stock-based compensation expense by \$143. There was no compensation expense recorded for these awards during the three months ended September 30, 2017. Compensation expense recorded for these awards for the nine months ended September 30, 2017 was \$(371).

15. Segment Reporting

The Company has identified reportable segments as those consolidated subsidiaries that represent 10% or more of its revenue, EBITDA (as defined below) or total assets, or when the Company believes information about the segment would be useful to the readers of the financial statements. The Company’s chief operating decision maker is its Chief Executive Officer who is charged with management of the Company and is responsible for the evaluation of operating performance and decision making about the allocation of resources to operating segments based on measures, such as revenue and EBITDA.

EBITDA is the primary measure used by the Company’s chief operating decision maker to evaluate segment operating performance. As the Company uses the term, EBITDA is defined as income before interest expense, income taxes, depreciation and amortization. The Company’s chief operating decision maker believes EBITDA is a meaningful measure and is superior to available GAAP measures as it represents a transparent view of the Company’s operating performance that is unaffected by fluctuations in property, equipment and leasehold improvement additions. The Company’s chief operating decision maker uses EBITDA to perform periodic reviews and comparison of operating trends and identify strategies to improve the allocation of resources amongst segments.

On August 3, 2018, the Company completed the sale of the U.K. Limited segment. See Note 3 “Discontinued Operation” for further information. The Company has restated all historical periods presented within these financial statements and has not included U.K. Limited as a reportable segment.

During the first quarter of 2018, the Company reorganized its United States business operations and realigned its United States reporting segments to correspond with the manner with which the Company’s chief operating decision maker evaluates operating performance and makes decisions as to the allocation of resources. As a result of this realignment, the Company’s CPI on Demand business operations have been moved from the U.S. Prepaid Debit segment into the U.S. Debit and Credit reporting segment, consistent with the other related personalization operations. Segment information for previous periods has been restated to conform with this realignment and current period presentation. The restatement of the segment information for the three and nine-month periods ended September 30, 2017 was not material.

As of September 30, 2018, the Company’s reportable segments were as follows:

- U.S. Debit and Credit,
- U.S. Prepaid Debit, and
- Other.

The Other category includes the Company’s corporate headquarters and a less significant operating segment that derives its revenue from the production of Financial Payment Cards and retail gift cards in Canada.

Performance Measures of Reportable Segments

Revenue and EBITDA of the Company’s reportable segments for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Revenue			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
U.S. Debit and Credit	\$ 48,002	\$ 40,055	\$ 128,992	\$ 122,174
U.S. Prepaid Debit	21,190	19,144	52,128	40,901
Other	1,920	2,661	7,599	8,390
Intersegment eliminations	(125)	(863)	(1,421)	(5,210)
Total	\$ 70,987	\$ 60,997	\$ 187,298	\$ 166,255

	EBITDA			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
U.S. Debit and Credit	\$ 9,136	\$ 6,528	\$ 24,788	\$ 21,873
U.S. Prepaid Debit	8,831	7,607	18,337	13,255
Other	(8,999)	(6,240)	(24,246)	(19,577)
Total	\$ 8,968	\$ 7,895	\$ 18,879	\$ 15,551

The following table provides a reconciliation of total segment EBITDA from continuing operations to net loss for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total segment EBITDA from continuing operations	\$ 8,968	\$ 7,895	\$ 18,879	\$ 15,551
Interest, net	(6,151)	(5,304)	(17,243)	(15,532)
Income tax benefit	355	783	4,933	4,154
Depreciation and amortization	(4,257)	(4,172)	(14,133)	(12,842)
Net loss from continuing operations	\$ (1,085)	\$ (798)	\$ (7,564)	\$ (8,669)

Balance Sheet Data of Reportable Segments

Total assets of the Company's reportable segments at September 30, 2018 and December 31, 2017 were as follows:

	<u>September 30, 2018</u>	<u>December 31, 2017</u>
U.S. Debit and Credit	\$ 153,905	\$ 164,397
U.S. Prepaid Debit	38,375	33,130
Other	14,868	15,827
Total assets - reportable segments	207,148	213,354
Assets of discontinued operation	—	20,651
Total assets	<u>\$ 207,148</u>	<u>\$ 234,005</u>

Plant, Equipment and Leasehold Improvement Additions of Geographic Locations

Plant, equipment and leasehold improvement additions of the Company's geographical locations for the three and nine months ended September 30, 2018 and 2017 were as follows:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
U.S.	\$ 1,652	\$ 1,081	\$ 5,425	\$ 6,131
Canada	—	38	46	161
Total plant, equipment and leasehold improvement additions	<u>\$ 1,652</u>	<u>\$ 1,119</u>	<u>\$ 5,471</u>	<u>\$ 6,292</u>

Net Sales to Geographic Locations

Subsequent to the sale of the Company's U.K segment and reclassification to discontinued operations, the majority of the Company's sales are to customers in the United States of America.

Long-Lived Assets of Geographic Segments

Long-lived assets of the Company's geographic segments at September 30, 2018 and December 31, 2017 were as follows:

	<u>September 30, 2018</u>	<u>December 31, 2017</u>
U.S.	\$ 121,778	\$ 130,768
Canada	746	911
Total long-lived assets	<u>\$ 122,524</u>	<u>\$ 131,679</u>

Net Sales by Products and Services

Net sales from products and services sold by the Company for the three and nine months ended September 30, 2018 and 2017 were as follows:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Products net sales ^(a)	\$ 34,673	\$ 26,777	\$ 90,911	\$ 79,644
Services net sales ^(b)	36,314	34,220	96,387	86,611
Total net sales	<u>\$ 70,987</u>	<u>\$ 60,997</u>	<u>\$ 187,298</u>	<u>\$ 166,255</u>

- (a) "Products" net sales include the design and production of Financial Payment Cards in contact-EMV ® , Dual-Interface EMV, metal, contactless and magnetic stripe card formats. The Company also generates "Products" revenue from the sale of Card@Once ® instant issuance systems, private label credit cards and retail gift cards.

- (b) “Services” net sales include revenue from the personalization and fulfillment of Financial Payment Cards, providing tamper-evident security packaging and fulfillment services to Prepaid Debit Card program managers and software as a service personalization of instant issuance debit cards. The Company also generates “Services” revenue from personalizing retail gift cards (primarily in Canada) and from click-fees generated from the Company’s patented card design software, known as MYCA, which provides customers and cardholders the ability to design cards on the internet and customize cards with individualized digital images.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operation s

References to the “Company,” “our,” “us” or “we” refer to CPI Card Group Inc. and its subsidiaries. For an understanding of the significant factors that influenced our results, the following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and related notes appearing elsewhere in this report. This management’s discussion and analysis should also be read in conjunction with the management’s discussion and analysis and consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission (“SEC”).

Cautionary Statement Regarding Forward-Looking Information

Certain statements and information in this Form 10-Q may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended (the “1933 Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “1934 Act”). The words “believe,” “estimate,” “project,” “expect,” “anticipate,” “plan,” “intend,” “foresee,” “should,” “would,” “could” or other similar expressions are intended to identify forward-looking statements, which are generally not historical in nature. These forward-looking statements are based on our current expectations and beliefs concerning future developments and their potential effect on us, and other information currently available. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. We are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated. These risks and uncertainties include, but are not limited to: our substantial indebtedness, including inability to make debt service payments or refinance such indebtedness; the restrictive terms of our credit facility and covenants of future agreements governing indebtedness; our limited ability to raise capital in the future; system security risks, data protection breaches and cyber-attacks; interruptions in our operations, including our IT systems; defects in our software; failure to identify and attract new customers or to retain our existing customers; problems in production quality and process; failure to meet our customers’ demands in a timely manner; a loss of market share or a decline in profitability resulting from competition; developing technologies that make our existing technology solutions and products less relevant or a failure to introduce new products and services in a timely manner; disruptions relating to the development and execution of our strategy, or a failure to realize the anticipated benefits of such strategy; our inability to sell, exit, reconfigure or consolidate businesses or facilities that no longer meet with our strategy; our inability to develop, introduce and commercialize new products; our inability to adequately protect our trade secrets and intellectual property rights from misappropriation or infringement; our dependence on the timely supply of materials, products and specialized equipment from third-party suppliers; a competitive disadvantage resulting from chip operating systems developed by our competitors; price erosion in the financial payment card industry; failure to accurately predict demand for our products and services; quarterly variation in our operating results; the effect of legal and regulatory proceedings; infringement of our intellectual property rights, or claims that our technology is infringing on third-party intellectual property; our inability to realize the full value of our long-lived assets; the impact of U.S. tax reform legislation; our failure to operate our business in accordance with data privacy laws, the PCI Security Standards Council (“PCI”) security standards or other industry standards, such as Payment Card Brand certification standards; costs relating to product defects; a decline in U.S. and global market and economic conditions; potential imposition of tariffs and/or trade restrictions on goods imported into the United States; our dependence on licensing arrangements; inability to renew leases for our facilities or renew leases at existing terms; dependence on our senior leadership team; inability to recruit, retain and develop qualified personnel; the continued viability of the Payment Card Brands; non-compliance with, and changes in, laws in the United States and in foreign jurisdictions in which we operate and sell our products; failure to maintain our listing on the NASDAQ or TSX and other risks and other risk factors or uncertainties identified from time to time in our filings with the SEC. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct. Reference is made to a more complete discussion of forward-looking statements and applicable risks contained under the captions “Cautionary Statement Regarding Forward-Looking Information” and “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 13, 2018. CPI Card Group Inc. undertakes no obligation to update or revise any of its forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are engaged in the design, production, data personalization, packaging and fulfillment of Financial Payment Cards, which we define as credit cards, debit cards and prepaid debit cards issued on the networks of the Payment Card Brands (Visa, MasterCard, American Express, Discover and Interac (in Canada)) in the United States and Canada. We also are engaged in the design, production, data personalization, packaging and fulfillment of retail gift and loyalty cards (primarily in Canada).

As a producer and provider of services for Financial Payment Cards, each of our secure facilities must be certified by one or more of the Payment Card Brands and is therefore subject to specific requirements and conditions. Noncompliance with these requirements would prohibit the individual facilities from producing Financial Payment Cards for these entities' payment card issuers.

On August 3, 2018, we completed the sale of the U.K. Limited segment. The historical financial position, results of operations and cash flows for the U.K. segment have been restated for all periods to conform with discontinued operations presentation. Unless otherwise indicated, information in Management's Discussion and Analysis of Financial Condition and Results of Operations relates to continuing operations.

Furthermore, the operations and cash flows were removed from the Company's condensed consolidated operating results. In connection with the substantial liquidation of the Company's U.K. Limited segment in the third quarter of 2018, we released the related foreign currency cumulative translation adjustment of \$4.0 million from accumulated other comprehensive loss into loss from discontinued operations.

The major line items constituting the (loss) income of the discontinued operation for the three and nine months ended September 30, 2018 and 2017 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total net sales	\$ 1,943	\$ 7,047	\$ 10,741	\$ 23,644
Total cost of sales	1,721	5,514	10,221	18,045
Selling, general and administrative	1,238	1,406	4,303	4,122
Impairments	-	—	7,615	
Other expense (income), net	4,009	35	4,038	(50)
Pretax (loss) income from discontinued operation	(5,025)	92	(15,436)	1,527
Pretax loss on sale of discontinued operation	(5)	—	(7,248)	—
Total pretax (loss) income on discontinued operation	(5,030)	92	(22,684)	1,527
Income tax benefit (expense)	-	(29)	133	(261)
Net (loss) income from discontinued operation	<u>\$ (5,030)</u>	<u>\$ 63</u>	<u>\$ (22,551)</u>	<u>\$ 1,266</u>

U.K. Limited incurred a pre-tax loss from operations of \$5.2 million and \$15.6 million for the three and nine months ended September 30, 2018, respectively, due to the softness in our U.K. Limited retail sector and a decline in sales relating to certain customers. Additionally, we recorded the following charges during the nine months ended September 30, 2018: impairment charges of \$7.6 million associated with goodwill and customer relationship intangible assets, a loss of \$4.0 million in connection with the release of foreign currency cumulative translation adjustments, and a \$7.2 million loss on the discontinued operation classification.

During February 2018, we made the decision to consolidate three personalization operations in the United States into two facilities to better enable us to optimize operations and achieve market-leading quality and service with a cost-competitive business model. In conjunction with this decision, we accelerated the depreciation of certain related assets, which totaled \$0.3 million for the three months ended September 30, 2018 and \$2.4 million for the nine months

ended September 30, 2018. We also recorded severance charges of \$0.6 million and a lease termination charge of \$0.4 million in the nine months ended September 30, 2018. The charges were recorded in our U.S. Debit and Credit segment.

Results of Continuing Operations

The following table presents the components of our condensed consolidated statements of continuing operations for each of the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(dollars in thousands)			
Net sales:				
Products	\$ 34,673	\$ 26,777	\$ 90,911	\$ 79,644
Services	36,314	34,220	96,387	86,611
Total net sales	70,987	60,997	187,298	166,255
Cost of sales	47,679	41,553	129,687	115,497
Gross profit	23,308	19,444	57,611	50,758
Operating expenses	18,621	16,074	52,632	48,580
Income from operations	4,687	3,370	4,979	2,178
Other expense, net:				
Interest, net	(6,151)	(5,304)	(17,243)	(15,532)
Foreign exchange (loss) gain	16	348	(248)	520
Other income, net	8	5	15	11
Loss from continuing operations before taxes	(1,440)	(1,581)	(12,497)	(12,823)
Income tax benefit	355	783	4,933	4,154
Net loss from continuing operations	\$ (1,085)	\$ (798)	\$ (7,564)	\$ (8,669)

Segment Discussion

During the first quarter of 2018, we reorganized our United States business operations and realigned our United States reporting segments to correspond with the manner with which our chief operating decision maker evaluates operating performance and makes decisions as to the allocation of resources. As a result of this realignment, the CPI on Demand business operations have been moved from the U.S. Prepaid Debit segment into the U.S. Debit and Credit reporting segment, consistent with the other related personalization operations. Segment information for previous periods has been restated to conform with this realignment and current year presentation. The restatement of the segment information for the three- and nine-month periods ended September 30, 2017 was not material.

Three Months Ended September 30, 2018 Compared With Three Months Ended September 30, 2017

Net Sales

	Three Months Ended September 30,			
	2018	2017	\$ Change	% Change
	(dollars in thousands)			
Net sales by segment:				
U.S. Debit and Credit	\$ 48,002	\$ 40,055	\$ 7,947	19.8 %
U.S. Prepaid Debit	21,190	19,144	2,046	10.7 %
Other	1,920	2,661	(741)	(27.8)%
Eliminations	(125)	(863)	738	* %
Total	\$ 70,987	\$ 60,997	\$ 9,990	16.4 %

* Not meaningful

Net sales for the three months ended September 30, 2018 increased \$10.0 million, or 16.4%, to \$71.0 million compared to \$61.0 million for the three months ended September 30, 2017.

U.S. Debit and Credit:

Net sales for U.S. Debit and Credit for the three months ended September 30, 2018 increased \$7.9 million, or 19.8%, to \$48.0 million compared to \$40.1 million for the three months ended September 30, 2017. The increase in net sales was primarily due to an increase of \$5.7 million in revenue from our emerging products and solutions, including dual-interface EMV®, metal cards, and Card@Once® revenues. The remaining increase is attributable to higher Non-EMV and other sales, and card personalization and fulfillment revenues.

For the three months ended September 30, 2018, excluding dual-interface EMV, we sold 22.1 million EMV cards at an ASP of \$0.77, compared to 19.5 million EMV cards at an ASP of \$0.86 for the three months ended September 30, 2017. The decrease in ASP during the three months ended September 30, 2018 compared to 2017 was due to lower pricing across our customer base and our customer mix.

U.S. Prepaid Debit:

Net sales for U.S. Prepaid Debit for the three months ended September 30, 2018 increased \$2.0 million, or 10.7%, to \$21.2 million compared to \$19.1 million for the three months ended September 30, 2017. The increase was the result of additional sales volumes from our existing customer base.

Other:

Other net sales were \$1.9 million for the three months ended September 30, 2018 compared to \$2.7 million for the three months ended September 30, 2017. The decrease is a result of lower volumes with certain customers.

Gross Profit and Gross Profit Margin

	Three Months Ended September 30,					
	% of 2018		% of 2017		Net Sales	
	2018	Net Sales	2017	Net Sales	\$ Change	% Change
(dollars in thousands)						
Gross profit by segment:						
U.S. Debit and Credit	\$13,551	28.2 %	\$ 10,637	26.6 %	\$ 2,914	27.4 %
U.S. Prepaid Debit	9,439	44.5 %	7,862	41.1 %	1,577	20.1 %
Other	318	16.6 %	945	35.5 %	(627)	* %
Total	<u>\$23,308</u>	32.8 %	<u>\$ 19,444</u>	31.9 %	<u>\$ 3,864</u>	19.9 %

* Not meaningful; see Other category description in Note 15.

Gross profit for the three months ended September 30, 2018 increased \$3.9 million, or 19.9%, to \$23.3 million compared to \$19.4 million for the three months ended September 30, 2017. Gross profit margin for the three months ended September 30, 2018 increased to 32.8% compared to 31.9% for the three months ended September 30, 2017.

U.S. Debit and Credit:

Gross profit for U.S. Debit and Credit for the three months ended September 30, 2018 increased \$2.9 million, or 27.4%, to \$13.6 million compared to \$10.6 million during the three months ended September 30, 2017. The increase in gross profit for U.S. Debit and Credit was driven primarily by a more profitable sales mix from our emerging products and solutions, and the increase in net sales. Gross profit margin for U.S. Debit and Credit for the three months ended September 30, 2018 increased to 28.2% compared to 26.6% for the same period in the prior year due to sales mix and higher overhead cost absorption attributed to increased sales.

U.S. Prepaid Debit:

Gross profit for U.S. Prepaid Debit during the three months ended September 30, 2018 increased 20.1% to \$9.4 million compared to \$7.9 million for the three months ended September 30, 2017. Gross profit margin for U.S. Prepaid Debit for the three months ended September 30, 2018 increased to 44.5% compared to 41.1% for the three months ended September 30, 2017. The increase in gross profit and margin was attributed primarily to higher sales volumes and improved cost efficiencies.

Other:

Other gross profit was \$0.3 million for the three months ended September 30, 2018 compared to \$0.9 million for the three months ended September 30, 2017. The decrease is a result of lower sales volumes with certain customers and unfavorable overhead cost absorption.

Operating Expenses

	Three Months Ended September 30,			
	2018	2017	\$ Change	% Change
(dollars in thousands)				
Operating expenses by segment:				
U.S. Debit and Credit	\$ 7,060	\$ 6,444	\$ 616	9.6 %
U.S. Prepaid Debit	1,050	760	290	38.2 %
Other	10,511	8,870	1,641	18.5 %
Total	<u>\$ 18,621</u>	<u>\$ 16,074</u>	<u>\$ 2,547</u>	15.8 %

Operating expenses for the three months ended September 30, 2018 increased \$2.5 million, or 15.8%, to \$18.6 million compared to \$16.1 million for the three months ended September 30, 2017.

U.S. Debit and Credit:

U.S. Debit and Credit operating expenses increased to \$7.1 million in the three months ended September 30, 2018 compared to \$6.4 million in the three months ended September 30, 2017, due to increased employee performance incentive compensation.

U.S. Prepaid Debit:

U.S. Prepaid Debit operating expenses increased \$0.3 million, or 38.2%, due to increased employee performance incentive compensation.

Other:

Other operating expenses during the three months ended September 30, 2018 increased \$1.6 million compared to the three months ended September 30, 2017, primarily from increased employee performance incentive compensation.

Income from Operations and Operating Margin

	Three Months Ended September 30,					
	% of		% of		\$ Change	% Change
	2018		2017			
	Net Sales	2018	Net Sales	2017		
(dollars in thousands)						
Income from operations by segment:						
U.S. Debit and Credit	\$ 6,491	13.5 %	\$ 4,192	10.5 %	\$ 2,299	54.8 %
U.S. Prepaid Debit	8,389	39.6 %	7,103	37.1 %	1,286	18.1 %
Other	(10,193)	* %	(7,925)	* %	(2,268)	28.6 %
Total	\$ 4,687	6.6 %	\$ 3,370	5.5 %	\$ 1,317	39.1 %

* Not meaningful

Income from operations for the three months ended September 30, 2018 was \$4.7 million compared to income from operations of \$3.4 million for the three months ended September 30, 2017. The Company's operating profit margin for the three months ended September 30, 2018 increased to 6.6% compared to an operating profit margin of 5.5% for the three months ended September 30, 2017.

U.S. Debit and Credit:

Income from operations for U.S. Debit and Credit for the three months ended September 30, 2018 increased \$2.3 million, or 13.5%, to \$6.5 million compared to \$4.2 million for the three months ended September 30, 2017 due primarily to more profitable sales mix from our emerging products and solutions, higher overhead cost absorption attributed to increased sales partially offset by higher operating expenses. Operating margins for the three months ended September 30, 2018 increased to 13.5% compared to 10.5% for the three months ended September 30, 2017.

U.S. Prepaid Debit:

Income from operations for U.S. Prepaid Debit for the three months ended September 30, 2018 increased to \$8.4 million compared to \$7.1 million for the three months ended September 30, 2017 primarily due to increased sales volumes and improved operating efficiencies. U.S. Prepaid Debit operating income margin for the three months ended September 30, 2018 increased to 39.6% from 37.1% for the same period in 2017.

Other :

The loss from operations in Other was \$10.2 million for the three months ended September 30, 2018 compared to a loss from operations of \$7.9 million for the same time period of 2017. The change in the loss from operations was attributable to a decline in gross profit from lower sales volumes with certain customers, combined with higher operating expenses in the third quarter of 2018.

Interest, net :

Interest expense for the three months ended September 30, 2018 increased to \$6.2 million compared to \$5.3 million for the three months ended September 30, 2017. The additional interest expense resulted from a higher average interest rate on the First Lien Term Loan during the three months ended September 30, 2018 compared to the three months ended September 30, 2017.

Income tax benefit:

During the three months ended September 30, 2018, there was an income tax benefit of \$0.4 million on pre-tax loss of \$1.4 million, compared with an income tax benefit of \$0.8 million on pre-tax loss of \$1.6 million for the three months ended September 30, 2017. In conjunction with the Tax Act, the U.S. federal tax rate reduced from 35.0% in 2017 to 21.0% in 2018. The effective tax rate differs from the federal U.S. statutory rate due to the impact of a partial valuation allowance on certain U.S. deferred tax assets, and an uncertain tax position reserve recorded in the U.S.

Net loss from continuing operations:

During the three months ended September 30, 2018, net loss was \$1.1 million, compared to a net loss of \$0.8 million during the three months ended September 30, 2017. The change was primarily due to more profitable sales mix, higher sales volumes and improved resulting gross margin, offset by lower EMV pricing, and higher operating expenses and interest expense as described above.

Nine Months Ended September 30, 2018 Compared With Nine Months Ended September 30, 2017

Net Sales

	Nine Months Ended September 30,			
	2018	2017	\$ Change	% Change
	(dollars in thousands)			
Net sales by segment:				
U.S. Debit and Credit	\$ 128,992	\$ 122,174	\$ 6,818	5.6 %
U.S. Prepaid Debit	52,128	40,901	11,227	27.4 %
Other	7,599	8,391	(792)	(9.4)%
Eliminations	(1,421)	(5,211)	3,790	* %
Total	\$ 187,298	\$ 166,255	\$ 21,043	12.7 %

* Not meaningful

Net sales for the nine months ended September 30, 2018 increased \$21.0 million, or 12.7%, to \$187.3 million compared to \$166.3 million for the nine months ended September 30, 2017.

U.S. Debit and Credit:

Net sales for U.S. Debit and Credit for the nine months ended September 30, 2018 increased \$6.8 million, or 5.6%, to \$129.0 million compared to \$122.2 million for the nine months ended September 30, 2017. The increase in net sales was primarily due to \$10.8 million higher revenues from our emerging products and solutions, including metal cards, Card@Once®, and dual interface EMV®. The increase was partially offset by a decline in EMV and non-EMV sales.

For the nine months ended September 30, 2018, excluding dual-interface EMV, we sold 57.7 million EMV cards at an ASP of \$0.78 compared to 56.6 million EMV cards at an ASP of \$0.85 for the nine months ended September 30, 2017. The decrease in ASP during the nine months ended September 30, 2018 compared to 2017 was due to lower pricing across our customer base and our customer mix.

U.S. Prepaid Debit:

Net sales for U.S. Prepaid Debit for the nine months ended September 30, 2018 increased \$11.2 million, or 27.4%, to \$52.1 million compared to \$40.9 million for the nine months ended September 30, 2017. The increase was the result of additional sales volumes predominately from new portfolio wins with existing customers.

Other:

Other net sales declined from \$8.4 million in the nine months ended September 30, 2017, to \$7.6 million for corresponding period in 2018 as a result of lower volumes with certain customers.

Gross Profit and Gross Profit Margin

	Nine Months Ended September 30,					
	% of 2018		% of 2017			
	2018	Net Sales	2017	Net Sales	\$ Change	% Change
(dollars in thousands)						
Gross profit by segment:						
U.S. Debit and Credit	\$35,891	27.8 %	\$ 34,235	28.0 %	\$ 1,656	4.8 %
U.S. Prepaid Debit	20,111	38.6 %	14,417	35.2 %	5,694	39.5 %
Other	1,609	21.2 %	2,106	25.1 %	(497)	* %
Total	\$57,611	30.8 %	\$ 50,758	30.5 %	\$ 6,853	13.5 %

* Not meaningful

Gross profit for the nine months ended September 30, 2018 increased \$6.9 million, or 13.5%, to \$57.6 million compared to \$50.8 million for the nine months ended September 30, 2017. Gross profit margin for the nine months ended September 30, 2018 increased to 30.8% compared to 30.5% for the nine months ended September 30, 2017.

U.S. Debit and Credit:

Gross profit for U.S. Debit and Credit for the nine months ended September 30, 2018 increased \$1.7 million, or 4.8%, to \$35.9 million compared to \$34.2 million during the nine months ended September 30, 2017. The increase in gross profit for U.S. Debit and Credit was driven by more profitable sales mix, partially offset by the acceleration of depreciation expense and restructuring charges relating to the consolidation of our personalization operations. Gross profit margin for U.S. Debit and Credit for the nine months ended September 30, 2018 decreased to 27.8% compared to 28.0% for the same period in the prior year due to the consolidation of our personalization operations.

U.S. Prepaid Debit:

Gross profit for U.S. Prepaid Debit during the nine months ended September 30, 2018 increased 39.5% to \$20.1 million compared to \$14.4 million for the nine months ended September 30, 2017. Gross profit margin for U.S. Prepaid

Debit for the nine months ended September 30, 2018 increased to 38.6% compared to 35.2% for the nine months ended September 30, 2017. The increase in gross profit and margin was attributed primarily to higher sales volumes, favorable overhead cost absorption, and cost efficiencies.

Other:

Other gross profit was \$1.6 million for the nine months ended September 30, 2018 compared to \$2.1 million for the nine months ended September 30, 2017. The decrease is a result of lower sales volumes with certain customers and unfavorable overhead cost absorption.

Operating Expenses

	Nine Months Ended September 30,			
	2018	2017	\$ Change	% Change
	(dollars in thousands)			
Operating expenses by segment:				
U.S. Debit and Credit	\$ 20,241	\$ 19,470	\$ 771	4.0 %
U.S. Prepaid Debit	3,179	2,822	357	12.7 %
Other	29,212	26,288	2,924	11.1 %
Total	\$ 52,632	\$ 48,580	\$ 4,052	8.3 %

Operating expenses for the nine months ended September 30, 2018 increased \$4.1 million, or 8.3%, to \$52.6 million compared to \$48.6 million for the nine months ended September 30, 2017.

U.S. Debit and Credit:

U.S. Debit and Credit operating expenses increased to \$20.2 million in the nine months ended September 30, 2018 compared to \$19.5 million in the nine months ended September 30, 2017 primarily due to charges relating to the consolidation of our personalization operations and increased employee performance incentive compensation.

U.S. Prepaid Debit:

U.S. Prepaid Debit operating expenses increased \$0.4 million primarily due to increased employee performance incentive compensation.

Other:

Other operating expenses during the nine months ended September 30, 2018 increased \$2.9 million compared to the nine months ended September 30, 2017. The net increase primarily resulted from higher employee performance incentive compensation of \$2.6 million and increased consulting and other administrative costs of \$1.7 million, partially offset by a decrease in legal costs of \$1.4 million.

Income from Operations and Operating Margin

	Nine Months Ended September 30,					
		% of		% of		
	2018	2018	2017	2017	\$ Change	%
		Net		Net		Change
		Sales		Sales		
	(dollars in thousands)					
Income (loss) from operations by segment:						
U.S. Debit and Credit	\$ 15,650	12.1 %	\$ 14,766	12.1 %	\$ 884	6.0 %
U.S. Prepaid Debit	16,932	32.5 %	11,595	28.3 %	5,337	46.0 %
Other	(27,603)	* %	(24,183)	* %	(3,420)	14.1 %
Total	\$ 4,979	2.7 %	\$ 2,178	1.3 %	\$ 2,801	128.6 %

* Not meaningful

Income from operations for the nine months ended September 30, 2018 was \$5.0 million compared to \$2.2 million for the nine months ended September 30, 2017. The Company's operating profit margin for the nine months ended September 30, 2018 increased to 2.7% compared to 1.3% for the nine months ended September 30, 2017.

U.S. Debit and Credit:

Income from operations for U.S. Debit and Credit for the nine months ended September 30, 2018 increased \$0.9 million, or 6.0%, to \$15.7 million compared to \$14.8 million for the nine months ended September 30, 2017 due primarily to higher sales volume and more profitable sales mix, partially offset by charges relating to the consolidation of our personalization operations. Operating margins for the nine months ended September 30, 2018 were flat at 12.1% for the nine months ended September 30, 2018 compared to the prior year comparable period.

U.S. Prepaid Debit:

Income from operations for U.S. Prepaid Debit for the nine months ended September 30, 2018 increased 46.0% to \$16.9 million compared to \$11.6 million for the nine months ended September 30, 2017 due to increased sales volumes and higher overhead cost absorption attributed to increased sales. U.S. Prepaid Debit operating income margin for the nine months ended September 30, 2018 increased to 32.5% from 28.3% for the same period in 2017.

Other :

The loss from operations in Other was \$27.6 million for the nine months ended September 30, 2018 compared to a loss from operations of \$24.2 million for the same time period of 2017. The operating loss was attributable to higher operating expenses in the first nine months of 2018, in addition to lower gross profit from reduced sales volumes.

Interest, net :

Interest expense for the nine months ended September 30, 2018 increased to \$17.2 million compared to \$15.5 million for the nine months ended September 30, 2017. The additional interest expense resulted from a higher average interest rate on the First Lien Term Loan during the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017.

Income tax benefit:

During the nine months ended September 30, 2018, there was an income tax benefit of \$4.9 million on pre-tax loss of \$12.5 million, compared with an income tax benefit of \$4.2 million on pre-tax loss of \$12.8 million for the nine months ended September 30, 2017. In conjunction with the Tax Act, the U.S. federal tax rate reduced from 35.0% in 2017 to 21.0% in 2018. The effective tax rate differs from the federal U.S. statutory rate primarily due to the impact of a tax benefit recorded during the nine months ended September 30, 2018 in connection with the U.K. Limited sale. Partially offsetting the increased tax benefit was the establishment of a partial valuation allowance on certain U.S. deferred tax assets and an uncertain tax position reserve.

Net loss from continuing operations:

During the nine months ended September 30, 2018, net loss was \$7.6 million, compared to a net loss of \$8.7 million during the nine months ended September 30, 2017. The change was due to higher sales and profit, partially offset by higher operating expenses and interest expense.

Liquidity and Capital Resources

At September 30, 2018, we had \$12.8 million of cash and cash equivalents. Of this amount, \$1.2 million was held in accounts outside of the United States.

Our ability to make investments in and grow our business, service our debt and improve our debt leverage ratios, while maintaining strong liquidity, will depend upon our ability to generate excess operating cash flows through our operating subsidiaries. Although we can provide no assurances, we believe that our cash flows from operations, combined with our current cash levels and available borrowing capacity, will be adequate to fund debt service

requirements and provide cash, as required, to support our ongoing operations, capital expenditures, lease obligations and working capital needs.

At September 30, 2018, there was \$312.5 million outstanding under the First Lien Term Loan, and we had a \$40.0 million Revolving Credit Facility, of which \$20.0 million is available for borrowing. Additional amounts may be available for borrowing during the term of the Revolving Credit Facility, up to the full \$40.0 million, to the extent our net leverage ratio does not exceed 7.0 times Adjusted EBITDA, as defined in the agreement. The First Lien Term Loan and Revolving Credit Facility mature on August 17, 2022 and August 17, 2020, respectively.

Interest rates under the First Lien Term Loan, at the Company's election, are based on either a Eurodollar rate, subject to an interest rate floor of 1.0%, plus a margin of 4.5%, or a base rate plus a margin of 3.5%. As of September 30, 2018, the interest rate on our First Lien Term Loan was 7.02%.

The First Lien Credit Facility contains customary covenants, including among other things, certain restrictions or limitations on indebtedness, issuance of liens, investments, dividends, redemptions and other distributions to equity holders, asset sales, certain mergers or consolidations, sales, transfers, leases or dispositions of substantially all of our assets and affiliate transactions. As of September 30, 2018, we were in compliance with all covenants under the First Lien Credit Facility. We may also be required to make repayments on the First Lien Term Loan in advance of the maturity date based on a calculation of excess cash flows, as defined in the agreement, with any required payments to be made after the issuance of the Company's annual financial statements. As of September 30, 2018, we did not expect to have a required excess cash flow payment related to 2018.

Operating Activities – Continuing Operations

Cash used in operating activities – continuing operations for the nine months ended September 30, 2018 was \$1.8 million compared to a usage of \$4.1 million during the nine months ended September 30, 2017. The year over year fluctuation was due primarily to working capital cash flow increases, including income taxes and accrued expenses, partially offset by a cash flow decrease from inventory. Cash inflows from tax refunds of \$1.3 million were received during the nine months ended September 30, 2018.

Investing Activities – Continuing Operations

Cash used in investing activities – continuing operations for the nine months ended September 30, 2018 of \$5.0 million was lower than the comparative \$6.3 million during the nine months ended September 30, 2017. Cash used in investing activities – continuing operations during both periods was related to capital expenditures. In the current year period, capital leases were executed for the acquisition of certain machinery and equipment totaling \$0.8 million. The Company received net cash proceeds of \$0.3 million for the sale of CPI U.K. Limited and included the proceeds within cash used in investing activities- discontinued operations.

Financing Activities

During the nine months ended September 30, 2018, cash used in financing activities was \$0.4 million and related to principal payments on capital lease obligations.

Cash used in financing activities during the nine months ended September 30, 2017 was \$7.9 million and primarily related to dividend payments of \$7.5 million. The Company discontinued its quarterly dividend program during August 2017.

Contractual Obligations

During the nine months ended September 30, 2018, there were no material changes in our contractual obligations from those reported in our Annual Report on Form 10-K for the year ended December 31, 2017.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements at September 30, 2018.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts and disclosures in the financial statements and accompanying notes. Actual results could differ from those estimates. Our Critical Accounting Policies and Estimates disclosed in our Annual Report on Form 10-K filed for the year ended December 31, 2017, for which there were no material changes as of September 30, 2018, included:

- Impairment Assessments of Goodwill and Long-Lived Assets,
- Inventory Valuation,
- Stock-Based Compensation and
- Income Taxes.

As of January 1, 2018, we adopted ASU 2014-09, *Revenue from Contracts with Customers*, as amended, which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires an entity to disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. We adopted ASU 2014-09 as of January 1, 2018, to all of our contracts using the modified retrospective method and recognized the cumulative effect of application as an adjustment to the opening balance of “Accumulated loss” on the Condensed Consolidated Balance Sheet. The comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods.

For periods after January 1, 2018, we account for our revenues as follows:

Products Revenue

“Products” revenue is recognized when obligations under the terms of a contract with a customer are satisfied. In most instances, this occurs over time as cards are manufactured for specific customers and have no alternative use and the Company has an enforceable right to payment for work performed. For work performed but not completed and billed, we estimate revenue by taking actual costs incurred and applying historical margins for similar types of contracts. Items included in “Products” revenue are manufactured Financial Payment Cards, including in contact-EMV®, Dual-Interface EMV®, contactless and magnetic stripe cards, private label credit cards and retail gift cards. Card@Once® printers and consumables are also included in “Products” revenue, and their associated revenues are recognized at the time of shipping.

Services Revenue

Revenue is recognized for “Services” as the services are performed. Items included in “Services” revenue include the personalization and fulfillment of Financial Payment Cards, providing tamper-evident secure packaging and fulfillment services to Prepaid Debit Card program managers and software as a service personalization of instant issuance debit cards. For work performed but not completed and billed, we estimate revenue by taking actual costs incurred and applying historical margins for similar types of contracts.

Customer Contracts

The Company often enters into Master Services Agreements (“MSAs”) with its customers. Generally, enforceable rights and obligations for goods and services occur only when a customer places a purchase order or statement of work to obtain goods or services under an MSA. The contract term as defined by ASU 2014-09 is the length of time it takes to deliver the goods or services promised under the purchase order or statement of work. As such, the Company's contracts are generally short term in nature.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2018, there have been no material changes in market risk for key input prices, labor and benefits costs or interest rate risk from those included in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) that are designed to assure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2018.

Changes in Internal Control Over Financial Reporting

Beginning January 1, 2018, we implemented ASU 2014-09, *Revenue from Contracts with Customers*. We developed new accounting policies based on the revenue recognition standard, and implemented changes to our processes related to revenue recognition and the related control activities. Other than as it relates to ASU 2014-09, there has been no change in the Company's internal control over financial reporting during 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures will prevent all errors and fraud. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management's override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II – Other Information

Item 1. Legal Proceedings

In Re CPI Card Group Inc. Securities Litigation, Case No. 1:16-CV-04531 (S.D.N.Y.) (the "Class Action")

On June 15, 2016, two purported CPI stockholders filed putative class action lawsuits captioned *Vance, et al. v. CPI Card Group Inc., et al.* and *Chipman, et al. v. CPI Card Group Inc.* in the United States District Court for the Southern District of New York (the "Court") against CPI, certain of its former officers and current and former directors, along with the sponsors of and the financial institutions who served as underwriters for CPI's October 2015 initial public offering ("IPO"). The complaints, purportedly brought on behalf of all purchasers of CPI common stock pursuant to the October 8, 2015 Registration Statement filed in connection with the IPO, assert claims under §§11 and 15 of the Securities Act of 1933, as amended (the "Securities Act") and seek, among other things, damages and costs. In particular, the complaints allege that the Registration Statement contained false or misleading statements or omissions regarding CPI's customers' (i) purchases of Europay, MasterCard and VISA chip cards (collectively, "EMV® cards")

during the first half of fiscal year 2015 and resulting EMV® card inventory levels; and (ii) capacity to purchase additional EMV® cards in the fourth quarter of fiscal year 2015, and the remainder of the fiscal year ended December 31, 2015. The complaints allege that these actions artificially inflated the price of CPI common stock issued pursuant to the IPO.

On August 30, 2016, the Court consolidated the Vance and Chipman actions and appointed lead plaintiff and lead counsel pursuant to the Private Securities Litigation Reform Act. On October 17, 2016, lead plaintiff filed a consolidated amended complaint, asserting the same claims for violations of §§11 and 15 of the Securities Act. The amended complaint is based principally on the same theories as the original complaints, but adds allegations that the Registration Statement contained inadequate risk disclosures and failed to disclose (i) small and mid-size issuers' slower-than-anticipated conversion to EMV® technology and (ii) increased pricing pressure and competition CPI faced in the EMV® market.

On November 16, 2016, the Company filed a motion to dismiss the amended complaint, which was denied by the Court on October 30, 2017. On January 12, 2018, the Company filed an answer to the amended complaint. On March 23, 2018, lead plaintiff filed his motion for class certification. On June 11, 2018, the Company filed an opposition to lead plaintiff's motion for class certification.

On July 31, 2018, the parties notified the Court that they had reached an agreement in principle to settle the Class Action. On September 21, 2018, the parties executed a stipulation and agreement of settlement ("Stipulation") and lead plaintiff filed with the Court his unopposed motion for authorization to notify the settlement class of the proposed settlement. On October 1, 2018, the Court provisionally denied lead plaintiff's motion without prejudice to renew subject to certain revisions to the proposed form of class notice. On October 15, 2018, lead plaintiff filed a renewed unopposed motion for authorization to notify the class of the proposed settlement and to schedule a hearing, with an amended proposed form of notice. On October 22, 2018, the Court granted lead plaintiff's renewed motion and approved the amended form of notice to the class of the proposed settlement. The Court scheduled the settlement hearing for February 5, 2019.

Heckermann v. Montross et al., Case No. 1:17-CV-01673 (D. Del.) (the "Derivative Suit")

On November 20, 2017, a purported CPI stockholder filed a stockholder derivative complaint in the United States District Court for the District of Delaware (the "Court") against certain of CPI's former officers and current and former directors, along with the sponsors of the IPO. CPI is also named as a nominal defendant. The derivative complaint asserts claims under §§10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 and seeks, among other things, injunctive relief, damages and costs. It alleges false or misleading statements and omissions in the Registration Statement filed by CPI in connection with its IPO and subsequent public filings and statements. The derivative complaint also asserts claims for purported breaches of fiduciary duties, unjust enrichment, mismanagement and waste of corporate assets.

On March 28, 2018, the Court entered the parties' stipulated order staying the Derivative Suit pending final determination of the Class Action.

The Company believes these claims are without merit and is defending the Derivative Suit vigorously.

CPI Card Group Inc. v. Multi Packaging Solutions, Inc., et al. (2 cases)

First case. On October 11, 2016, the Company filed a patent infringement suit against Multi Packaging Solutions, Inc. ("MPS") in the United States District Court for the District of Colorado. The complaint asserts that MPS ultrasecure gift card packages sold to at least one customer infringe a Company patent on ultrasecure gift card packages. MPS answered the complaint and counterclaimed for invalidity and noninfringement. The Company's preliminary injunction request was denied without prejudice after MPS represented that it had voluntarily ceased using the accused technology and would notify CPI before it re-starts. MPS's early motion for summary judgment was denied in August 2017 and its motion to dismiss on jurisdictional grounds was denied in July 2018. The Company's subsidiary CPI Card Group-Minnesota, Inc., has been added to the case as plaintiff. The Company's patent will expire in 2028.

In June 2017, MPS filed an Inter Partes Review ("IPR") petition with the United States Patent & Trademark Office's Patent Trial & Appeal Board ("PTAB"). The PTAB instituted the IPR on January 9, 2018. The IPR is now fully

briefed. A hearing has occurred in October 2018, and the Company anticipates a decision by the PTAB by January 2019. The patent infringement suit is stayed pending the outcome of the IPR.

The Company intends to vigorously assert its intellectual property rights in connection with this litigation and the IPR.

Second case. During the summer of 2017, the Company commenced a lawsuit in the District of Minnesota against a former employee, MPS, and two MPS employees (collectively, the Defendants). The former employee was a sales executive who left the Company in 2017 to join MPS. In the lawsuit, the Company alleges that the Defendants misappropriated the Company's trade secrets and confidential information, that the former employee violated his employment agreements with the Company, and that Defendants committed various related business torts. After some early discovery, the Company moved for a preliminary injunction, which the Court granted in December, 2017. The company received a second preliminary injunction in August 2018. The litigation is ongoing.

In addition to the matters described above, the Company is subject to routine legal proceedings in the ordinary course of business. The Company believes that the ultimate resolution of these matters will not have a material adverse effect on our business, financial condition or results of operations.

Item 1A. Risk Factor s

The risk factors disclosed in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 set forth information relating to various risks and uncertainties that could materially adversely affect our business, financial condition and operating results. Such risk factors continue to be relevant to an understanding of our business, financial condition and operating results. As of the date of this Quarterly Report on Form 10-Q, there have been no material changes with respect to such risk factors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities

None.

Item 5. Other Information

None.

Item 6. Exhibit s

Exhibit Number	Exhibit Description
10.1	First Amendment to Credit Agreement dated December 31, 2016, between CPI Card Group and The Bank of Nova Scotia
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

SIGNATURE S

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

CPI CARD GROUP INC.

/s/ John Lowe

John Lowe

Chief Financial Officer

November 7, 2018

FIRST AMENDMENT TO CREDIT AGREEMENT

This FIRST AMENDMENT TO FIRST LIEN CREDIT AGREEMENT dated as of December 31, 2016 (this “Amendment”), is entered into among CPI ACQUISITION, INC. , a Delaware corporation (“Borrower”), CPI CARD GROUP INC. , a Delaware corporation (“Holdings”), the other Loan Parties, and THE BANK OF NOVA SCOTIA (“Scotiabank”), as administrative agent for the lenders (in such capacity, “Administrative Agent”).

W I T N E S S E T H :

WHEREAS, pursuant to the First Lien Credit Agreement, dated as of August 17, 2015 (as amended, restated, supplemented or otherwise modified from time to time, the “Credit Agreement”), among Borrower, Holdings, the financial institutions from time to time party thereto (each individually, a “Lender”, and collectively, the “Lenders”), and Administrative Agent, among others, the Lenders have made Loans and other extensions of credit to Borrower which remain outstanding;

WHEREAS, Borrower has requested that Administrative Agent amend the Credit Agreement as described herein pursuant to clause (B) to the proviso to Section 9.02(b) of the Credit Agreement; and

WHEREAS, Administrative Agent is willing to make the amendments to the Credit Agreement provided herein, but only on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the premises and for other good and valuable consideration the receipt and sufficiency of which is hereby acknowledged, the parties hereto hereby agree as follows:

ARTICLE I
DEFINITIONS

Section 1.1 **Defined Terms**. Unless otherwise defined herein, capitalized terms used herein have the meanings assigned in the Credit Agreement and the other Loan Documents, and the following term shall have the following meaning:

“Effective Date” shall have the meaning assigned to that term in Article III of this Amendment.

ARTICLE II
AMENDMENTS

Section 2.1 **Amendment to Section 1.01: Defined Terms**. Section 1.01 of the Credit Agreement shall be amended on the Effective Date by amending and restating the definition of “Available Amount” as follows:

“Available Amount” means, at any time (a) the sum at such time of (i) \$15,000,000, plus without duplication (ii) Cumulative Excess Cash Flow for each fiscal year of Holdings in respect of which financial statements have been delivered under Section 5.01(a), plus (iii) the Net Proceeds from any sale or issuance of any Equity Interests (other than Disqualified Equity Interests and Cure Amounts) by Holdings or from any capital

contributions in respect of Equity Interests (other than Disqualified Equity Interests and Cure Amounts) of Holdings, in each case to the extent such Net Proceeds are directly contributed to, and received by, the Borrower, plus (iv) the Net Proceeds of any Disposition of Investments made pursuant to Section 6.04(h) or (t) in reliance on the Available Amount, plus (v) to the extent not otherwise included, the aggregate amount of cash dividends, distributions, interest, fees, premiums, returns of capital, repayments of principal, income or profit returned to the Borrower or any Restricted Subsidiary in respect of Investments made pursuant to Section 6.04(h) or (t) in reliance on the Available Amount (up to the amount of the Investment), plus (vi) amounts declined by any Lender and retained by the Borrower pursuant to Section 2.11(f), plus (vii) the fair market value of all Qualified Equity Interests of the Borrower issued upon conversion or exchange of Indebtedness or Disqualified Equity Interests of the Borrower or any of its Restricted Subsidiaries after the Closing Date, together with the fair market value of any assets constituting Permitted Investments received upon such conversion or exchange minus (b) the sum at such time of (i) all prepayments required to be made under Section 2.11(d) (without giving effect to the first proviso in such Section) in respect of Excess Cash Flow, (ii) Restricted Payments previously made under Section 6.07(a)(ix) in reliance on the Available Amount, (iii) prepayments of Indebtedness previously made under Section 6.07(b)(v) in reliance on the Available Amount and (iv) Investments previously made under Section 6.04(h) and (t) in reliance on the Available Amount.

ARTICLE III CONDITIONS PRECEDENT

Section 3.1 **Conditions Precedent**. This Amendment shall not become effective unless and until each of the conditions precedent set forth below has been satisfied or the satisfaction thereof shall have been waived in writing by Administrative Agent (the date of satisfaction or waiver of such conditions being referred to as the “Effective Date”):

- (a) Receipt by Administrative Agent of counterparts of this Amendment, duly executed and delivered by Administrative Agent, Borrower, Holdings and each other Loan Party;
- (b) The ten (10) Business Day notification period required by Section 9.02(g) of the Credit Agreement shall have expired without the receipt by the Administrative Agent of a written objection to this Amendment by the Required Lenders.
- (c) Borrower shall have paid the invoiced costs and expenses required to be paid pursuant to subsection 9.03 of the Credit Agreement.

Administrative Agent shall notify Borrower in writing upon the occurrence of the Effective Date.

ARTICLE IV RATIFICATION

Section 4.1 **Ratification**. Each Loan Party hereby (i) ratifies and reaffirms all of its payment and performance obligations, contingent or otherwise, and each grant of security interests and Liens in favor of Administrative Agent or the Lenders, as the case may be, under each Loan Document to which it is a party, (ii) agrees and acknowledges that the Liens in favor of Administrative Agent and the Lenders under each Loan Document constitute valid, and to the extent required by the Loan Documents, first priority Liens on all of the Collateral and such Liens are not subject to avoidance, disallowance or subordination pursuant to any Requirement of Law, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting the enforcement of creditors' rights generally or by general equitable principles (whether enforcement is sought by proceedings in equity or at law), (iii) agrees and acknowledges the First Lien Obligations constitute legal, valid and binding obligations of the Loan Parties, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or limiting creditors' rights generally and by general equitable principles (whether enforcement is sought by proceedings in equity or at law), and that as of the Effective Date, (a) no offsets, defenses or counterclaims to the First Lien Obligations or any other causes of action with respect to the First Lien Obligations or the Loan Documents exist and (b) no portion of the First Lien Obligations is subject to avoidance, disallowance, reduction or subordination pursuant to any Requirement of Law, (iv) agrees that such ratification and reaffirmation is not a condition to the continued effectiveness of the Loan Documents, and (v) agrees that neither such ratification and reaffirmation, nor Administrative Agent's nor any Lender's solicitation of such ratification and reaffirmation, constitutes a course of dealing giving rise to any obligation or condition requiring a similar or any other ratification or reaffirmation from each party to the Credit Agreement with respect to any subsequent modifications, consent or waiver with respect to the Credit Agreement or other Loan Documents. Each Loan Party acknowledges and agrees that any of the Loan Documents to which it is a party or otherwise bound shall continue in full force and effect and that all of its obligations thereunder shall be valid and enforceable, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or limiting creditors' rights generally or by general equitable principles (whether enforcement is sought by proceedings in equity or at law), and shall not be impaired or limited by the execution or effectiveness of this Amendment. The Credit Agreement and each other Loan Document are in all respects hereby ratified and confirmed and neither the execution, delivery nor effectiveness of this Amendment shall operate as a waiver of any Default or Event of Default (whether or not known to Administrative Agent or any Lender), or any right, power or remedy of Administrative Agent or any Lender of any provision contained in the Credit Agreement or any other Loan Document, whether as a result of any Default, Event of Default or otherwise. This Amendment shall constitute a "Loan Document" for purposes of the Credit Agreement.

ARTICLE V INTERPRETATION

Section 5.1 **Continuing Effect of the Credit Agreement and the Other Loan Documents**. Borrower, Holdings, the other Loan Parties, and Administrative Agent hereby acknowledge and agree that the Credit Agreement and each other Loan Document shall continue to be and remain unchanged and in full force and effect in accordance with its terms, except as expressly provided herein. Nothing herein shall be deemed to entitle Borrower, Holdings, or the other Loan Parties to a consent to, or a waiver, amendment, modification or other change of, any of the terms, conditions, obligations, covenants or agreements contained in the Credit Agreement or the other Loan Documents in similar or different circumstances.

Section 5.2 **Defaults or Events of Default**. Nothing contained in this Amendment shall be construed or interpreted or is intended as a waiver of or limitation on any rights, powers, privileges or

remedies that Administrative Agent or the Lenders have or may have under the Credit Agreement or any other Loan Document on account of any Default or Event of Default.

ARTICLE VI MISCELLANEOUS

Section 6.1 **Representations and Warranties**. Each of the Loan Parties hereby represents and warrants as of the date hereof (and, if the date hereof is not the Effective Date, as of the Effective Date) that, (a) no Default or Event of Default has occurred and is continuing, (b) all representations and warranties of the Loan Parties contained in the Loan Documents are true and correct in all material respects with the same effect as if made on and as of such date(s), except to the extent such representations and warranties specifically relate to an earlier date, in which case, such representations and warranties were true and correct in all material respects on and as of such earlier date (and except to the extent such representations and warranties are already qualified by materiality in which case such representations and warranties were true and correct in all respects with the same effect as if made on and as of such date(s)), (c) the execution, delivery and performance by such Loan Party of this Amendment, and the performance of each Loan Document by each Loan Party that is a party thereto, (i) are within such Loan Party's corporate/limited liability company powers, (ii) have been duly authorized by all necessary corporate/limited liability company action, of such Loan Party, (iii) require no Governmental Approvals, except for Governmental Approvals (x) as have been obtained or will be obtained on or before the Effective Date, (y) the absence of which would not reasonably be expected to have a Material Adverse Effect, or (z) in connection with filings with respect to the Collateral, (iv) do not violate any provision of any law or any governmental rule or regulation applicable to Holdings, Borrower or any of its Subsidiaries, the Organizational Documents of Holdings, Borrower or any of its Subsidiaries or any order, judgment or decree of any court or other Governmental Authority binding on Holdings, Borrower or any of its Subsidiaries, except for any violation that would not reasonably be expected to result in a Material Adverse Effect, (v) do not conflict with, result in a breach of or constitute (with due notice or lapse of time or both) a default under any contractual obligation of Holdings, Borrower or any of its Subsidiaries, except for any conflict, breach or default that would not reasonably be expected to result in a Material Adverse Effect, (vi) will not result in or require the creation or imposition of any Lien upon any of the properties or assets of Holdings, Borrower or any of its Subsidiaries (other than any Liens created under any of the Loan Documents in favor of Administrative Agent on behalf of the Lenders and other Liens permitted by the Credit Agreement), (vii) require any approval of stockholders or any approval or consent of any Person under any material contractual obligation of Holdings, Borrower or any of its Subsidiaries, except for such approvals or consents (x) which have been obtained or will be obtained on or before the Effective Date or (y) the absence of which would not reasonably be expected to have a Material Adverse Effect, (d) this Amendment has been duly executed and delivered by each Loan Party, and (e) this Amendment, the Credit Agreement and each of the other Loan Documents constitutes a legally valid and binding obligation of such Loan Party enforceable against such Loan Party in accordance with their respective terms, except as such enforceability may be limited by the effect of any applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or limiting creditors' rights generally or by equitable principles.

Section 6.2 **Counterparts**. This Amendment may be executed by the parties hereto in any number of separate counterparts, and all of said counterparts taken together shall be deemed to constitute one and the same instrument. This Amendment may be transmitted and/or signed by telefacsimile and by signatures delivered in 'PDF' format by electronic mail. The effectiveness of any such documents and signatures shall, subject to any Requirement of Law, have the same force and effect as an original copy with manual signatures and shall be binding on all Loan Parties, Agents and the Lenders.

Section 6.3. **GOVERNING LAW.** THIS AMENDMENT SHALL BE CONSTRUED IN ACCORDANCE WITH AND GOVERNED BY THE LAWS OF THE STATE OF NEW YORK.

Section 6.4 **Consent of Other Loan Parties.** Each other Loan Party hereby (a) consents to this Amendment and the transactions contemplated hereby and (b) acknowledges and agrees that the guarantees (and all security therefor) contained in the Credit Agreement and the other Loan Documents previously executed by it are, and shall remain, in full force and effect after giving effect to this Amendment and all other prior modifications to the Credit Agreement, if any.

Section 6.5 **Fees and Expenses.** Borrower acknowledges that under subsection 9.03 of the Credit Agreement Borrower is obligated to pay, and Borrower confirms that it shall pay promptly, all reasonable and documented out-of-pocket costs and expenses incurred by Administrative Agent in connection with the negotiation, preparation and execution of this Amendment, including all reasonable fees, charges and disbursements of Latham & Watkins LLP in connection therewith.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed and delivered by their proper and duly authorized officers as of the date first above written.

CPI ACQUISITION, INC.

By: /s/ David Brush
Name: David Brush
Title: Chief Financial Officer

CPI CARD GROUP INC.

By: /s/ David Brush
Name: David Brush
Title: Chief Financial Officer

CPI CARD GROUP-INDIANA, INC.

By: /s/ David Brush
Name: David Brush
Title: Chief Financial Officer

CPI HOLDING CO.

By: /s/ David Brush
Name: David Brush
Title: Chief Financial Officer

CPI CARD GROUP-COLORADO, INC.

By: /s/ David Brush
Name: David Brush
Title: Chief Financial Officer

Signature Page to First Amendment

CPI CARD GROUP-MINNESOTA, INC.

By: /s/ David Brush

Name: David Brush

Title: Chief Financial Officer

CPI CARD GROUP-NEVADA, INC.

By: /s/ David Brush

Name: David Brush

Title: Chief Financial Officer

EFT SOURCE, INC.

By: /s/ David Brush

Name: David Brush

Title: Chief Financial Officer

Signature Page to First Amendment

THE BANK OF NOVA SCOTIA,
As Administrative Agent

By: /s/ Clement Yu
Name: Clement Yu
Title: Director

By:
Name:
Title: Analyst

Signature Page to First Amendment

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Scott Scheirman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CPI Card Group Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal controls over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2018

/s/ Scott Scheirman

Scott Scheirman
President and Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, John Lowe, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CPI Card Group Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal controls over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2018

/s/ John Lowe

John Lowe

Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of CPI Card Group Inc. (the “Company”) for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Scott Scheirman, President and Chief Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Scott Scheirman

Scott Scheirman

President and Chief Executive Officer

Date: November 7, 2018

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of CPI Card Group Inc. (the “Company”) for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, John Lowe, Chief Financial Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John Lowe

John Lowe

Chief Financial Officer

Date: November 7, 2018
