

WINMARK CORP  
Form 10-Q  
October 25, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**For the quarterly period ended September 29, 2012**

**or**

**o 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: 000-22012**

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# WINMARK CORPORATION

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of incorporation or organization)

**41-1622691**

(I.R.S. Employer Identification No.)

**605 Highway 169 North, Suite 400, Minneapolis, MN 55441**

(Address of principal executive offices) (Zip Code)

**(763) 520-8500**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Common stock, no par value, 4,986,539 shares outstanding as of October 19, 2012.



Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

INDEX

	PAGE
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>
<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u>
	<u>CONSOLIDATED CONDENSED BALANCE SHEETS:</u>
	<u>September 29, 2012 and December 31, 2011</u> 3
	<u>CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS:</u>
	<u>Three Months Ended September 29, 2012 and September 24, 2011</u>
	<u>Nine Months Ended September 29, 2012 and September 24, 2011</u> 4
	<u>CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME:</u>
	<u>Three Months Ended September 29, 2012 and September 24, 2011</u>
	<u>Nine Months Ended September 29, 2012 and September 24, 2011</u> 5
	<u>CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS:</u>
	<u>Nine Months Ended September 29, 2012 and September 24, 2011</u> 6
	<u>NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS</u> 7 14
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 14 23
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 24
<u>Item 4.</u>	<u>Controls and Procedures</u> 24
<u>PART II.</u>	<u>OTHER INFORMATION</u>
<u>Item 1.</u>	<u>Legal Proceedings</u> 25
<u>Item 1A.</u>	<u>Risk Factors</u> 25
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 25
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u> 25
<u>Item 4.</u>	<u>Mine Safety Disclosures</u> 25

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<u>Item 5.</u>	<u>Other Information</u>	25
<u>Item 6.</u>	<u>Exhibits</u>	26
	<u>SIGNATURES</u>	27

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1: Financial Statements

**WINMARK CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**

(Unaudited)

	September 29, 2012	December 31, 2011
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 2,249,200	\$ 9,020,100
Marketable securities	90,400	1,043,800
Receivables, less allowance for doubtful accounts of \$18,100 and \$15,100	1,164,500	1,316,200
Net investment in leases - current	10,764,800	11,746,900
Income tax receivable	427,800	116,500
Inventories	85,300	68,500
Prepaid expenses	573,300	362,000
Total current assets	15,355,300	23,674,000
Net investment in leases - long-term	23,373,200	18,102,000
Long-term investments, less allowance for losses of \$1,543,800 and \$883,100	2,506,300	3,817,400
Property and equipment, net	1,229,700	1,474,800
Other assets	677,500	677,500
	\$ 43,142,000	\$ 47,745,700
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current Liabilities:		
Line of credit	\$ 10,700,000	\$
Accounts payable	1,511,300	1,460,300
Accrued liabilities	2,443,900	1,346,000
Discounted lease rentals	570,100	20,800
Rents received in advance	206,600	274,700
Deferred revenue	1,583,400	1,212,400
Deferred income taxes	3,447,600	3,464,800
Total current liabilities	20,462,900	7,779,000
Long-Term Liabilities:		
Discounted lease rentals	658,600	
Rents received in advance	135,100	269,400
Deferred revenue	923,800	844,300
Other liabilities	1,289,700	1,389,200
Deferred income taxes	2,586,500	2,355,100
Total long-term liabilities	5,593,700	4,858,000

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Shareholders' Equity:

Common stock, no par, 10,000,000 shares authorized, 4,993,927 and 4,987,643 shares issued and outstanding			629,800
Accumulated other comprehensive (loss) income	(1,200)		17,000
Retained earnings	17,086,600		34,461,900
Total shareholders' equity	17,085,400		35,108,700
	\$ 43,142,000	\$	47,745,700

The accompanying notes are an integral part of these financial statements.

Table of Contents

## WINMARK CORPORATION AND SUBSIDIARIES

## CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
<b>REVENUE:</b>				
Royalties	\$ 9,178,400	\$ 8,046,400	\$ 25,160,800	\$ 21,918,500
Leasing income	4,312,700	2,369,300	9,989,800	12,584,500
Merchandise sales	716,600	664,300	2,083,200	1,998,700
Franchise fees	411,000	516,200	966,000	836,200
Other	180,400	177,300	625,100	765,300
Total revenue	14,799,100	11,773,500	38,824,900	38,103,200
<b>COST OF MERCHANDISE SOLD</b>	684,400	631,400	1,982,200	1,908,500
<b>LEASING EXPENSE</b>	770,700	290,400	1,336,200	4,149,300
<b>PROVISION FOR CREDIT LOSSES</b>	(1,700)	(13,100)	(69,600)	8,200
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	4,882,200	4,219,100	15,239,900	14,095,400
Income from operations	8,463,500	6,645,700	20,336,200	17,941,800
<b>LOSS FROM EQUITY INVESTMENTS</b>	(372,300)	(224,700)	(650,400)	(444,600)
<b>IMPAIRMENT OF INVESTMENT IN NOTES</b>	(660,700)	(293,200)	(660,700)	(546,100)
<b>INTEREST EXPENSE</b>	(110,200)	(26,200)	(302,300)	(84,200)
<b>INTEREST AND OTHER INCOME (EXPENSE)</b>	14,300	(9,000)	50,600	22,100
Income before income taxes	7,334,600	6,092,600	18,773,400	16,889,000
<b>PROVISION FOR INCOME TAXES</b>	(3,075,100)	(2,609,100)	(7,593,500)	(6,979,000)
<b>NET INCOME</b>	\$ 4,259,500	\$ 3,483,500	\$ 11,179,900	\$ 9,910,000
<b>EARNINGS PER SHARE BASIC</b>	\$ .85	\$ .70	\$ 2.22	\$ 1.99
<b>EARNINGS PER SHARE DILUTED</b>	\$ .82	\$ .66	\$ 2.13	\$ 1.89
<b>WEIGHTED AVERAGE SHARES OUTSTANDING BASIC</b>	5,013,822	4,970,046	5,041,023	4,980,160
<b>WEIGHTED AVERAGE SHARES OUTSTANDING DILUTED</b>	5,222,719	5,263,343	5,257,057	5,239,424

The accompanying notes are an integral part of these financial statements.



Table of Contents

## WINMARK CORPORATION AND SUBSIDIARIES

## CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
NET INCOME	\$ 4,259,500	\$ 3,483,500	\$ 11,179,900	\$ 9,910,000
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX:				
Unrealized net gains (losses) on marketable securities:				
Unrealized holding net gains (losses) arising during period	(5,600)	(118,600)	(2,000)	(119,600)
Reclassification adjustment for net gains included in net income			(28,000)	
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX	(5,600)	(118,600)	(30,000)	(119,600)
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME:				
Unrealized net gains/losses on marketable securities:				
Unrealized holding net gains/losses arising during period	2,200	46,600	800	47,000
Reclassification adjustment for net gains included in net income			11,000	
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME	2,200	46,600	11,800	47,000
OTHER COMPREHENSIVE GAIN (LOSS), NET OF TAX	(3,400)	(72,000)	(18,200)	(72,600)
COMPREHENSIVE INCOME	\$ 4,256,100	\$ 3,411,500	\$ 11,161,700	\$ 9,837,400

The accompanying notes are an integral part of these financial statements.

Table of Contents

## WINMARK CORPORATION AND SUBSIDIARIES

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended	
	September 29, 2012	September 24, 2011
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 11,179,900	\$ 9,910,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	326,600	361,600
Provision for credit losses	(69,600)	8,200
Compensation expense related to stock options	683,000	552,800
Deferred income taxes	214,200	
Loss (gain) on sale of marketable securities	(34,600)	600
Loss from equity investments	650,400	444,600
Impairment of investment in notes	660,700	546,100
Deferred initial direct costs	(484,100)	(269,000)
Amortization of deferred initial direct costs	421,800	440,800
Tax benefits on exercised stock options	(353,300)	(137,600)
Change in operating assets and liabilities:		
Receivables	151,700	303,500
Income tax receivable / payable	53,800	2,742,600
Inventories	(16,800)	17,900
Prepaid expenses	(211,300)	(126,300)
Accounts payable	51,000	415,000
Accrued and other liabilities	998,400	51,500
Rents received in advance and security deposits	(100)	25,800
Other assets		(14,500)
Deferred revenue	450,500	152,700
Net cash provided by operating activities	14,672,200	15,426,300
<b>INVESTING ACTIVITIES:</b>		
Purchase of long term investments		(1,000,000)
Proceeds from sale of marketable securities	1,424,700	161,300
Purchase of marketable securities	(466,700)	(451,500)
Purchase of property and equipment	(81,500)	(138,200)
Purchase of equipment for lease contracts	(17,372,400)	(15,578,600)
Principal collections on lease receivables	12,802,200	15,069,800
Net cash used for investing activities	(3,693,700)	(1,937,200)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from borrowings on line of credit	20,300,000	3,000,000
Payments on line of credit	(9,600,000)	(11,800,000)
Repurchases of common stock	(4,893,600)	(3,527,200)
Proceeds from exercises of stock options	594,900	738,300
Dividends paid	(25,922,600)	(398,400)
Proceeds from discounted lease rentals	1,418,600	
Tax benefits on exercised stock options	353,300	137,600
Net cash used for financing activities	(17,749,400)	(11,849,700)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(6,770,900)</b>	<b>1,639,400</b>

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Cash and cash equivalents, beginning of period		9,020,100		2,257,100
Cash and cash equivalents, end of period	\$	2,249,200	\$	3,896,500

SUPPLEMENTAL DISCLOSURES:

Cash paid for interest	\$	266,400	\$	142,600
Cash paid for income taxes	\$	7,325,500	\$	4,085,000

The accompanying notes are an integral part of these financial statements.

Table of Contents

**WINMARK CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**1. Management's Interim Financial Statement Representation:**

The accompanying consolidated condensed financial statements have been prepared by Winmark Corporation and subsidiaries (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has a 52/53 week year which ends on the last Saturday in December. The information in the consolidated condensed financial statements includes normal recurring adjustments and reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of such financial statements. The consolidated condensed financial statements and notes are presented in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-Q, and therefore do not contain certain information included in the Company's annual consolidated financial statements and notes. This report should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's latest Annual Report on Form 10-K.

Revenues and operating results for the nine months ended September 29, 2012 are not necessarily indicative of the results to be expected for the full year.

*Reclassifications*

Certain reclassifications of previously reported amounts have been made to conform to the current year presentation. Such reclassifications did not impact net income or shareholders' equity as previously reported.

**2. Organization and Business:**

The Company offers licenses to operate franchises using the service marks Plato's Closet®, Play It Again Sports®, Once Upon A Child® and Music Go Round®. The Company also operates both middle market and small-ticket equipment leasing businesses under the Winmark Capital® and Wirth Business Credit® marks.

**3. Fair Value Measurements:**

The Company defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company uses three levels of inputs to measure fair value:

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- Level 1 quoted prices in active markets for identical assets and liabilities.
- Level 2 observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3 unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The Company's marketable securities were valued based on Level 1 inputs using quoted prices.

Due to their nature, the carrying value of cash equivalents, receivables, payables and debt obligations approximates fair value.

Table of Contents**4. Investments:*****Marketable Securities***

The following is a summary of marketable securities classified as available-for-sale securities:

	September 29, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Equity securities	\$ 92,400	\$ 90,400	\$ 1,015,800	\$ 1,043,800

The Company's unrealized gains and losses for marketable securities classified as available-for-sale securities in accumulated other comprehensive income are as follows:

	September 29, 2012	December 31, 2011
Unrealized gains	\$ 32,900	\$ 32,900
Unrealized losses	(2,000)	(4,900)
Net unrealized gains (losses)	\$ (2,000)	\$ 28,000

The Company's realized gains and losses recognized on sales of available-for-sale marketable securities are as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
Realized gains	\$ 4,600	\$ 4,600	\$ 46,900	\$ 46,900
Realized losses			(12,300)	(600)
Net realized gains (losses)	\$ 4,600	\$ 4,600	\$ 34,600	\$ (600)

Amounts reclassified out of accumulated other comprehensive income into earnings is determined by using the average cost of the security when sold.

***Long-Term Investments***

The Company has an investment in Tomsten, Inc. ( Tomsten ), the parent company of Archiver's retail chain. The Company has invested a total of \$8.5 million in the purchase of common stock of Tomsten. The Company's investment currently represents 22.0% of the outstanding common stock of Tomsten. As of September 29, 2012, \$0.3 million of the Company's investment, with a current carrying value of \$1.8 million, is attributable to goodwill. The amount of goodwill was determined by calculating the difference between the Company's net investment in

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Tomsten less its pro rata share of Tomsten's net worth. During the third quarter of 2012, the Company ceased providing management services to Tomsten and the Company's Chairman and Chief Executive Officer resigned from Tomsten's Board of Directors.

The Company has a \$2.0 million investment in senior subordinated promissory notes with warrants in BridgeFunds Limited ( BridgeFunds ). BridgeFunds advances funds to claimants involved in civil litigation to cover litigation expenses. Monthly prepayment of the principal of such notes in an amount equal to Available Cash Flow (as defined within the agreements governing the notes) is required. In July 2012, the Company entered into an amendment to the agreement governing the notes whereby the maturity date of all of the outstanding notes was changed to June 30, 2013. During the nine months ended September 29, 2012, the Company did not receive any payments of principal or interest on the notes. The Company stopped accruing interest on this investment as of September 30, 2010. The Company has deemed this investment to be impaired, and in evaluating the investment for impairment has determined that its present value of expected future cash flows, discounted at the effective interest rate on the notes of 15%, is less than the recorded investment in the notes. In developing its estimate of expected future cash flows, the Company used certain information obtained from BridgeFunds

Table of Contents

concerning existing liabilities, claimant cases outstanding and historical default rates on claimant advances, and made certain assumptions regarding the timing of case settlements, the payment of future liabilities and future default rates. The Company recognized \$883,100 in impairment charges during 2011 and established a corresponding valuation allowance accordingly. The Company recognized an additional \$660,700 charge to increase the valuation allowance in the third quarter of 2012, primarily as a result of a decrease in the BridgeFunds portfolio of receivables with no improvement in portfolio performance. As of September 29, 2012, the \$0.7 million net investment balance inclusive of \$0.2 million of related interest receivable is classified as long-term based on expected payments from Available Cash Flow.

**5. Investment in Leasing Operations:**

Investment in leasing operations consists of the following:

	September 29, 2012	December 31, 2011
<b>Direct financing and sales-type leases:</b>		
Minimum lease payments receivable	\$ 26,733,300	\$ 27,413,300
Estimated residual value of equipment	2,501,900	2,764,400
Unearned lease income net of initial direct costs deferred	(4,647,100)	(4,217,000)
Security deposits	(2,651,000)	(2,448,800)
Equipment installed on leases not yet commenced	12,438,500	6,489,200
<b>Total investment in direct financing and sales-type leases</b>	<b>34,375,600</b>	<b>30,001,100</b>
Allowance for credit losses	(802,000)	(803,800)
<b>Net investment in direct financing and sales-type leases</b>	<b>33,573,600</b>	<b>29,197,300</b>
<b>Operating leases:</b>		
Operating lease assets	1,349,400	1,218,900
Less accumulated depreciation and amortization	(785,000)	(567,300)
<b>Net investment in operating leases</b>	<b>564,400</b>	<b>651,600</b>
<b>Total net investment in leasing operations</b>	<b>\$ 34,138,000</b>	<b>\$ 29,848,900</b>

As of September 29, 2012, the \$34.1 million total net investment in leases consists of \$10.7 million classified as current and \$23.4 million classified as long-term. As of December 31, 2011, the \$29.8 million total net investment in leases consists of \$11.7 million classified as current and \$18.1 million classified as long-term.

As of September 29, 2012, leased assets with one customer approximated 10% of the Company's total assets.

Future minimum lease payments receivable under lease contracts and the amortization of unearned lease income, net of initial direct costs deferred, is as follows for the remainder of fiscal 2012 and the full fiscal years thereafter as of September 29, 2012:

	<b>Direct Financing and Sales-Type Leases</b>		<b>Operating Leases</b>
	<b>Minimum Lease</b>	<b>Income</b>	<b>Minimum Lease</b>
	<b>Payments Receivable</b>	<b>Amortization</b>	<b>Payments Receivable</b>
2012	\$ 4,239,300	\$ 1,263,800	\$ 262,600
2013	13,224,200	2,576,000	1,552,100

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2014	6,813,400	692,300	132,400
2015	1,957,100	108,300	
2016	499,300	6,700	
Thereafter	\$ 26,733,300	\$ 4,647,100	\$ 1,947,100

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Table of Contents

The activity in the allowance for credit losses for leasing operations during the first nine months of 2012 and 2011, respectively, is as follows:

	September 29, 2012		September 24, 2011	
Balance at beginning of period	\$	803,800	\$	907,800
Provisions charged to expense		(69,600)		8,200
Recoveries		195,900		248,500
Deductions for amounts written-off		(128,100)		(288,100)
Balance at end of period	\$	802,000	\$	876,400

The Company's investment in direct financing and sales-type leases ( Investment In Leases ) and allowance for credit losses by loss evaluation methodology are as follows:

	September 29, 2012		December 31, 2011	
	Investment In Leases	Allowance for Credit Losses	Investment In Leases	Allowance for Credit Losses
Collectively evaluated for loss potential	\$ 34,375,600	\$ 802,000	\$ 30,001,100	\$ 803,800
Individually evaluated for loss potential				
Total	\$ 34,375,600	\$ 802,000	\$ 30,001,100	\$ 803,800

The Company's key credit quality indicator for its investment in direct financing and sales-type leases is the status of the lease, defined as accruing or non-accruing. Leases that are accruing income are considered to have a lower risk of loss. Non-accrual leases are those that the Company believes have a higher risk of loss. The following table sets forth information regarding the Company's accruing and non-accrual leases. Delinquent balances are determined based on the contractual terms of the lease.

	0-60 Days Delinquent and Accruing		61-90 Days Delinquent and Accruing		September 29, 2012 Over 90 Days Delinquent and Accruing		Non-Accrual		Total	
Middle-Market	\$	32,469,600	\$		\$		\$		\$	32,469,600
Small-Ticket		1,899,100		6,900						1,906,000
Total Investment in Leases	\$	34,368,700	\$	6,900	\$		\$		\$	34,375,600

	0-60 Days Delinquent and Accruing		61-90 Days Delinquent and Accruing		December 31, 2011 Over 90 Days Delinquent and Accruing		Non-Accrual		Total	
Middle-Market	\$	25,650,500	\$	932,100	\$		\$		\$	26,582,600
Small-Ticket		3,351,400		48,300				18,800		3,418,500
Total Investment in Leases	\$	29,001,900	\$	980,400	\$		\$	18,800	\$	30,001,100

Table of Contents**6. New Accounting Pronouncements:**

In June 2011, the Financial Accounting Standards Board ( FASB ) amended its accounting guidance on the presentation of other comprehensive income ( OCI ) in an entity 's financial statements. The amended guidance eliminates the option to present the components of OCI as part of the statement of changes in shareholders ' equity and provides two options for presenting OCI: in a statement included in the income statement or in a separate statement immediately following the income statement. The amendments do not change the guidance for the items that have to be reported in OCI or when an item of OCI has to be moved into net income. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted the amended presentation guidance in its quarterly report on Form 10-Q for the fiscal period ended March 31, 2012 (see Consolidated Condensed Statements of Comprehensive Income) and such adoption has not impacted the consolidated results of the Company.

In September 2011, the FASB amended its accounting guidance on testing goodwill for impairment by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The amendments do not change the guidance for how goodwill is calculated or when goodwill is tested for impairment. The amendments are effective for fiscal years beginning after December 15, 2011. The Company adopted the new guidance on January 1, 2012 and such adoption has not impacted the consolidated results of the Company.

**7. Earnings Per Share:**

The following table sets forth the presentation of shares outstanding used in the calculation of basic and diluted earnings per share ( EPS ):

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
Denominator for basic EPS - weighted average common shares	5,013,822	4,970,046	5,041,023	4,980,160
Dilutive shares associated with option plans	208,897	293,297	216,034	259,264
Denominator for diluted EPS - weighted average common shares and dilutive potential common shares	5,222,719	5,263,343	5,257,057	5,239,424
Options excluded from EPS calculation - anti-dilutive	23,270	2,614	18,863	10,640

**8. Shareholders' Equity:***Dividends*

On January 18, 2012, the Company 's Board of Directors approved the payment of a \$0.03 per share quarterly cash dividend and \$5.00 per share special cash dividend (the Special Dividend ) to shareholders of record at the close of business on February 8, 2012, both of which were paid on

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March 1, 2012. The Special Dividend totaled \$25.4 million and was financed by a combination of cash on hand as well as net borrowings under the Line of Credit of \$12.8 million. (See Note 9 Line of Credit ).

On April 25, 2012, the Company's Board of Directors approved the payment of a \$0.04 per share quarterly cash dividend to shareholders of record at the close of business on May 9, 2012, which was paid on June 1, 2012.

Table of Contents

On July 25, 2012, the Company's Board of Directors approved the payment of a \$0.04 per share quarterly cash dividend to shareholders of record at the close of business on August 8, 2012, which was paid on September 4, 2012.

***Repurchase of Common Stock***

In the first nine months of 2012, the Company repurchased 92,652 shares of its common stock for an aggregate purchase price of \$4.9 million or \$52.82 per share. These repurchase transactions reduced the dollar amount of common stock on the balance sheet to zero, with the remainder recorded to retained earnings. Under the Board of Directors' authorization, as of September 29, 2012, the Company has the ability to repurchase an additional 403,220 shares of its common stock. Repurchases may be made from time to time at prevailing prices, subject to certain restrictions on volume, pricing and timing.

***Stock Option Plans and Stock-Based Compensation***

The Company had authorized up to 750,000 shares of common stock be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2001 Stock Option Plan (the 2001 Plan). The 2001 Plan expired on February 20, 2011. The Company has authorized up to 250,000 shares of common stock to be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2010 Stock Option Plan (the 2010 Plan).

The Company also sponsors a Stock Option Plan for Nonemployee Directors (the Nonemployee Directors Plan) and has reserved a total of 300,000 shares for issuance to directors of the Company who are not employees.

Stock option activity under the 2001 Plan, 2010 Plan and Nonemployee Directors Plan (collectively, the Option Plans) as of September 29, 2012 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Intrinsic Value
Outstanding at December 31, 2011	668,614	\$ 24.31	6.62	\$ 22,101,800
Granted	72,500	53.30		
Exercised	(130,287)	20.12		
Outstanding at September 29, 2012	610,827	\$ 28.65	6.85	\$ 15,616,100
Exercisable at September 29, 2012	341,938	\$ 18.79	5.63	\$ 11,528,500

During the nine months ended September 29, 2012, option holders surrendered 31,351 shares of previously owned common stock as payment for option shares exercised as provided for by the Option Plans. All unexercised options at September 29, 2012 have an exercise price equal to the fair market value on the date of the grant.

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The fair value of options granted under the Option Plans during the first nine months of 2012 and 2011 were estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions and results:

	Nine Months Ended	
	September 29, 2012	September 24, 2011
Risk free interest rate	0.88%	1.94%
Expected life (years)	6	6
Expected volatility	31.4%	28.0%
Dividend yield	2.06%	.32%
Option fair value	\$ 12.95	\$ 11.28

Table of Contents

Compensation expense of \$683,000 and \$552,800 relating to the vested portion of the fair value of stock options granted was expensed to Selling, General and Administrative Expenses in the first nine months of 2012 and 2011, respectively. As of September 29, 2012, the Company had \$2.3 million of total unrecognized compensation expense related to stock options that is expected to be recognized over the remaining weighted average period of approximately 2.4 years.

**9. Line of Credit:**

On January 30, 2012, the Company's Line of Credit with The PrivateBank and Trust Company and BMO Harris Bank N.A. was amended to, among other things, provide the consent of the lenders for the payment of the Special Dividend and to amend certain financial covenant calculations to remove the effect of the Special Dividend in such calculations.

On February 29, 2012, the Line of Credit was amended to, among other things, increase the aggregate commitments from \$30.0 million to \$35.0 million and extend the termination date from July 31, 2014 to February 29, 2016.

During the nine months ended September 29, 2012, the Line of Credit was used to finance in part the Special Dividend (as indicated above) and has been and will continue to be used for general corporate purposes. Borrowings under the Line of Credit are subject to certain borrowing base limitations, and the Line of Credit is secured by a lien against substantially all of the Company's assets, contains customary financial conditions and covenants, and requires maintenance of minimum levels of debt service coverage and tangible net worth and maximum levels of leverage (all as defined within the Line of Credit). As of September 29, 2012, the Company was in compliance with all of its financial covenants and the Company's borrowing availability under the Line of Credit was \$35.0 million (the lesser of the borrowing base or the aggregate commitments). There were \$10.7 million in borrowings outstanding under the Line of Credit bearing interest ranging from 2.97% to 3.75%, leaving \$24.3 million available for additional borrowings.

**10. Discounted Lease Rentals:**

The Company utilized certain lease receivables and underlying equipment as collateral to borrow from financial institutions at a weighted average rate of 2.98% at September 29, 2012 on a non-recourse basis.

**11. Segment Reporting:**

The Company currently has two reportable business segments, franchising and leasing. The franchising segment franchises value-oriented retail store concepts that buy, sell, trade and consign merchandise. The leasing segment includes (i) Winmark Capital Corporation, a middle-market equipment leasing business and (ii) Wirth Business Credit, Inc., a small ticket financing business. Segment reporting is intended to give financial statement users a better view of how the Company manages and evaluates its businesses. The Company's internal management reporting is the basis for the information disclosed for its business segments and includes allocation of shared-service costs. Segment assets are those that are directly used in or identified with segment operations, including cash, accounts receivable, prepaids, inventory, property and

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equipment and investment in leasing operations. Unallocated assets include corporate cash and cash equivalents, marketable securities, current and long-term investments, deferred tax amounts and other corporate assets. Inter-segment balances and transactions have been eliminated. The following tables summarize financial information by segment and provide a reconciliation of segment contribution to operating income:

Table of Contents

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
<b>Revenue:</b>				
Franchising	\$ 10,486,400	\$ 9,400,700	\$ 28,835,100	\$ 25,475,200
Leasing	4,312,700	2,372,800	9,989,800	12,628,000
Total revenue	\$ 14,799,100	\$ 11,773,500	\$ 38,824,900	\$ 38,103,200
<b>Reconciliation to operating income:</b>				
Franchising segment contribution	\$ 6,235,900	\$ 5,637,400	\$ 15,335,700	\$ 13,090,500
Leasing segment contribution	2,227,600	1,008,300	5,000,500	4,851,300
Total operating income	\$ 8,463,500	\$ 6,645,700	\$ 20,336,200	\$ 17,941,800
<b>Depreciation:</b>				
Franchising	\$ 83,400	\$ 92,200	\$ 253,600	\$ 280,700
Leasing	23,800	26,700	73,000	80,900
Total depreciation	\$ 107,200	\$ 118,900	\$ 326,600	\$ 361,600

	As of	
	September 29, 2012	December 31, 2011
<b>Identifiable assets:</b>		
Franchising	\$ 3,131,600	\$ 7,753,200
Leasing	35,480,300	33,374,000
Unallocated	4,530,100	6,618,500
Total	\$ 43,142,000	\$ 47,745,700

**ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.****Overview**

As of September 29, 2012, we had 958 franchises operating under the Plato's Closet, Play it Again Sports, Once Upon a Child and Music Go Round brands and had a leasing portfolio of \$34.1 million. Management closely tracks the following financial criteria to evaluate current business operations and future prospects: royalties, leasing activity, and selling, general and administrative expenses.

Our most profitable source of franchising revenue is royalties received from our franchise partners. During the first nine months of 2012, our royalties increased \$3.2 million or 14.8% compared to the first nine months of 2011.

During the first nine months of 2012, we purchased \$17.4 million in equipment for lease customers compared to \$15.6 million in the first nine months of 2011. Overall, our leasing portfolio (net investment in leases – current and long-term) increased to \$34.1 million at September 29, 2012 from \$29.8 million at December 31, 2011. Leasing income net of leasing expense during the first nine months of 2012 was \$8.7 million compared to \$8.4 million in the same period last year. Fluctuations in period-to-period leasing income and leasing expense result primarily from the manner and timing in which leasing income and leasing expense is recognized over the term of each particular lease in accordance with accounting guidance applicable to leasing. For this reason, we believe that more meaningful levels of leasing activity are the purchases of equipment for lease customers and the medium- to long-term trend in the size of the leasing portfolio. Our earnings are also impacted by credit

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losses. During the first nine months of 2012, our provision for credit losses decreased to \$(69,600) from \$8,200 in the first nine months of 2011.

Table of Contents

Management continually monitors the level and timing of selling, general and administrative expenses. The major components of selling, general and administrative expenses include salaries, wages and benefits, advertising, travel, occupancy, legal and professional fees. During the first nine months of 2012, selling, general and administrative expense increased \$1.1 million, or 8.1%, compared to the first nine months of 2011.

Management also monitors several nonfinancial factors in evaluating the current business operations and future prospects including franchise openings and closings and franchise renewals. The following is a summary of our franchising activity for the first nine months ended September 29, 2012:

	TOTAL 12/31/11	OPENED	CLOSED	TOTAL 9/29/12	NINE MONTHS ENDED 9/29/12 AVAILABLE FOR RENEWAL	COMPLETED RENEWALS
<u>Plato's Closet</u>						
Franchises - US and Canada	324	26	(0)	350	24	24
<u>Play It Again Sports</u>						
Franchises - US and Canada	325	2	(10)	317	51	48
<u>Once Upon A Child</u>						
Franchises - US and Canada	247	11	(1)	257	3	3
<u>Music Go Round</u>						
Franchises - US	34	1	(1)	34	0	0
Total Franchised Stores	930	40	(12)	958	78	75

Renewal activity is a key focus area for management. Our franchisees sign 10-year agreements with us. The renewal of existing franchise agreements as they approach their expiration is an indicator that management monitors to determine the health of our business and the preservation of future royalties. During the first nine months of 2012, we renewed 75 of the 78 franchise agreements available for renewal.

Our ability to grow our operating income is dependent on our ability to: (i) effectively support our franchise partners so that they produce higher revenues, (ii) open new franchises, (iii) increase lease originations and minimize write-offs in our leasing portfolios, and (iv) control our selling, general and administrative expenses.

Table of Contents**Results of Operations**

The following table sets forth selected information from our Consolidated Condensed Statements of Operations expressed as a percentage of total revenue:

	Three Months Ended		Nine Months Ended	
	September 29, 2012	September 24, 2011	September 29, 2012	September 24, 2011
<b>Revenue:</b>				
Royalties	62.0%	68.4%	64.8%	57.5%
Leasing income	29.1	20.1	25.7	33.0
Merchandise sales	4.9	5.6	5.4	5.3
Franchise fees	2.8	4.4	2.5	2.2
Other	1.2	1.5	1.6	2.0
<b>Total revenue</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Cost of merchandise sold	(4.6)	(5.4)	(5.1)	(5.0)
Leasing expense	(5.2)	(2.5)	(3.4)	(10.9)
Provision for credit losses		0.1	0.2	
Selling, general and administrative expenses	(33.0)	(35.8)	(39.3)	(37.0)
Income from operations	57.2	56.4	52.4	47.1
Loss from equity investments	(2.5)	(1.9)	(1.7)	(1.2)
Impairment of investment in notes	(4.5)	(2.5)	(1.7)	(1.4)
Interest expense	(0.7)	(0.2)	(0.8)	(0.2)
Interest and other income (expense)	0.1	(0.1)	0.1	
Income before income taxes	49.6	51.7	48.3	44.3
Provision for income taxes	(20.8)	(22.1)	(19.5)	(18.3)
Net income	28.8%	29.6%	28.8%	26.0%

**Comparison of Three Months Ended September 29, 2012 to Three Months Ended September 24, 2011****Revenue**

Revenues for the quarter ended September 29, 2012 totaled \$14.8 million compared to \$11.8 million for the comparable period in 2011.

**Royalties and Franchise Fees**

Royalties increased to \$9.2 million for the third quarter of 2012 from \$8.0 million for the third quarter of 2011, a 14.1% increase. The increase was primarily due to higher Plato's Closet and Once Upon A Child royalties of \$0.7 million and \$0.3 million, respectively. The increase in royalties for these brands is primarily due to higher franchisee retail sales in these brands as well as having 30 additional Plato's Closet franchise stores in the third quarter of 2012 compared to the same period last year.

Franchise fees decreased to \$411,000 for the third quarter of 2012 compared to \$516,200 for the third quarter of 2011, primarily as a result of opening five fewer franchises in the 2012 period compared to the same period in 2011.

Table of Contents

*Leasing Income*

Leasing income increased to \$4.3 million for the third quarter of 2012 compared to \$2.4 million for the same period in 2011. The increase is primarily due to a higher level of equipment sales to customers.

*Merchandise Sales*

Merchandise sales include the sale of product to franchisees either through the Play It Again Sports buying group, or through our Computer Support Center (together, Direct Franchisee Sales). Direct Franchisee Sales increased to \$716,600 for the third quarter of 2012 compared to \$664,300 in the same period of 2011. The increase is due an increase in technology purchases by our franchisees, partially offset by decreased buying group sales.

*Cost of Merchandise Sold*

Cost of merchandise sold includes in-bound freight and the cost of merchandise associated with Direct Franchisee Sales. Cost of merchandise sold increased to \$684,400 for the third quarter of 2012 compared to \$631,500 in the same period of 2011. The increase was due to an increase in Direct Franchisee Sales discussed above. Cost of merchandise sold as a percentage of Direct Franchisee Sales for the third quarter of 2012 and 2011 was 95.5% and 95.1%, respectively.

*Leasing Expense*

Leasing expense increased to \$0.8 million for the third quarter of 2012 compared to \$0.3 million for the third quarter of 2011. The increase is primarily due to an increase in the associated cost of equipment sales to customers discussed above.

*Provision for Credit Losses*

Provision for credit losses was \$(1,700) for the third quarter of 2012 compared to \$(13,100) for the third quarter of 2011. Provision levels for the periods presented were impacted by net recoveries as well as a lower level of delinquencies, primarily in the small-ticket financing business portion of our leasing segment. During the third quarter of 2012, we had total net recoveries of \$17,900 compared to total net recoveries of \$44,100 in the third quarter of 2011.

*Selling, General and Administrative*

Selling, general and administrative expenses increased 15.7% to \$4.9 million in the third quarter of 2012 from \$4.2 million in the same period of 2011. The increase was primarily due to an increase in compensation, benefits and sales commission expense.

***Loss from Equity Investments***

During the third quarter of 2012 and 2011, we recorded losses of \$372,300 and \$224,700, respectively, from our investment in Tomsten (representing our pro-rata share of losses for the periods).

***Impairment of Investment in Notes***

During the third quarter of 2012 and 2011, we recorded impairment charges of \$660,700 and \$293,200, respectively, for our investment in BridgeFunds notes as a result of our estimate of expected future cash flows from the investment. (See Note 4 Investments ).

Table of Contents

***Interest Expense***

Interest expense increased to \$110,200 for the third quarter of 2012 compared to \$26,200 for the third quarter of 2011. The increase is due to higher corporate borrowings.

***Interest and Other Income (Expense)***

During the third quarter of 2012, we had interest and other income of \$14,300 compared to \$(9,000) of interest and other income (expense) in the third quarter of 2011.

***Income Taxes***

The provision for income taxes was calculated at an effective rate of 41.9% and 42.8% for the third quarter of 2012 and 2011, respectively. The lower effective rate in 2012 compared to 2011 is primarily due to a decrease in state taxes.

**Comparison of Nine Months Ended September 29, 2012 to Nine Months Ended September 24, 2011**

***Revenue***

Revenues for the first nine months of 2012 totaled \$38.8 million compared to \$38.1 million for the comparable period in 2011.

***Royalties and Franchise Fees***

Royalties increased to \$25.2 million for the first nine months of 2012 from \$21.9 million for the first nine months of 2011, a 14.8% increase. The increase was due to higher Plato's Closet and Once Upon A Child royalties of \$2.3 million and \$1.1 million, respectively. The increase in royalties for these brands is primarily due to higher franchisee retail sales in these brands as well as having 30 additional Plato's Closet franchise stores in the first nine months of 2012 compared to the same period last year.

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Franchise fees increased to \$966,000 for the first nine months of 2012 compared to \$836,200 for the first nine months of 2011, primarily as a result of opening six more franchises in the 2012 period compared to the same period in 2011.

### *Leasing Income*

Leasing income decreased to \$10.0 million for the first nine months of 2012 compared to \$12.6 million million for the same period in 2011. The decrease is due to a lower level of equipment sales to customers.

### *Merchandise Sales*

Merchandise sales include the sale of product to franchisees either through the Play It Again Sports buying group, or through our Computer Support Center (together, Direct Franchisee Sales ). Direct Franchisee Sales increased to \$2.1 million for the first nine months of 2012 compared to \$2.0 million in the same period of 2011. The increase is due to an increase in technology purchases by our franchisees, partially offset by decreased buying group sales.

Table of Contents

***Cost of Merchandise Sold***

Cost of merchandise sold includes in-bound freight and the cost of merchandise associated with Direct Franchisee Sales. Cost of merchandise sold increased to \$2.0 million for the first nine months of 2012 compared to \$1.9 million in the same period of 2011. The increase was due to an increase in direct Franchisee Sales discussed above. Cost of merchandise sold as a percentage of Direct Franchisee Sales for the first nine months of 2012 and 2011 was 95.2% and 95.5%, respectively.

***Leasing Expense***

Leasing expense decreased to \$1.3 million for the first nine months of 2012 compared to \$4.1 million for the first nine months of 2011. The decrease is due to a decrease in the associated cost of equipment sales to customers discussed above.

***Provision for Credit Losses***

Provision for credit losses was \$(69,600) for the first nine months of 2012 compared to \$8,200 for the first nine months of 2011. Provision levels for the periods presented were impacted by net recoveries/write-offs as well as a lower level of delinquencies, primarily in the small-ticket financing business portion of our leasing segment. During the first nine months of 2012, we had total net recoveries of \$67,800 compared to total net write-offs of \$39,600 in the first nine months of 2011.

***Selling, General and Administrative***

Selling, general and administrative expenses increased 8.1% to \$15.2 million in the first nine months of 2012 from \$14.1 million in the same period of 2011. The increase was primarily due to an increase in compensation, benefits and sales commission expense.

***Loss from Equity Investments***

During the first nine months of 2012 and 2011, we recorded losses of \$650,400 and \$444,600 respectively, from our investment in Tomsten (representing our pro-rata share of losses for the periods).

***Impairment of Investment in Notes***

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During the first nine months of 2012 and 2011, we recorded impairment charges of \$660,700 and \$546,100, respectively, for our investment in BridgeFunds notes as a result of our estimate of expected future cash flows from the investment. (See Note 4 Investments ).

### *Interest Expense*

Interest expense increased to \$302,300 for the first nine months of 2012 compared to \$84,200 for the first nine months of 2011. The increase is due to higher corporate borrowings.

### *Interest and Other Income (Expense)*

During the first nine months of 2012, we had interest and other income of \$50,600 compared to \$22,100 of interest and other income in the first nine months of 2011.

### *Income Taxes*

The provision for income taxes was calculated at an effective rate of 40.4% and 41.3% for the first nine months of 2012 and 2011, respectively. The lower effective rate in 2012 compared to 2011 is primarily due to a decrease in state taxes.

Table of Contents

**Segment Comparison of Three Months Ended September 29, 2012 to Three Months Ended September 24, 2011**

***Franchising Segment Operating Income***

The franchising segment's operating income for the third quarter of 2012 increased by \$0.6 million, or 10.6%, to \$6.2 million from \$5.6 million for the third quarter of 2011. The increase in segment contribution was due to increased royalty revenue.

***Leasing Segment Operating Income***

The leasing segment's operating income for the third quarter of 2012 increased by \$1.2 million to \$2.2 million from \$1.0 million for the third quarter of 2011. The increase in segment contribution was due to an increase in leasing income net of leasing expense.

**Segment Comparison of Nine Months Ended September 29, 2012 to Nine Months Ended September 24, 2011**

***Franchising Segment Operating Income***

The franchising segment's operating income for the first nine months of 2012 increased by \$2.2 million, or 17.2%, to \$15.3 million from \$13.1 million for the first nine months of 2011. The increase in segment contribution was primarily due to increased royalty revenue.

***Leasing Segment Operating Income***

The leasing segment's operating income for the first nine months of 2012 increased by \$0.1 million to \$5.0 million from \$4.9 million for the first nine months of 2011. The increase in segment contribution was due to an increase in leasing income net of leasing expense.

**Liquidity and Capital Resources**

Our primary sources of liquidity have historically been cash flow from operations and borrowings. The components of the consolidated statement of operations that reduce our net income but do not affect our liquidity include non-cash items for depreciation, compensation expense related to stock options, loss from equity investments and impairment of investment in notes. A significant component of the consolidated

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balance sheet that affects liquidity is our long-term investments. Long-term investments include \$2.5 million of illiquid investments in two private companies: Tomsten, Inc. and BridgeFunds, LLC. (See Note 4 Investments ).

We ended the third quarter of 2012 with \$2.2 million in cash and cash equivalents and a current ratio (current assets divided by current liabilities) of 0.8 to 1.0 compared to \$3.9 million in cash and cash equivalents and a current ratio of 2.1 to 1.0 at the end of the third quarter of 2011.

Operating activities provided \$14.7 million of cash during the first nine months of 2012 compared to \$15.4 million provided during the same period last year. A contributing factor to the decrease in cash provided by operating activities in 2012 compared to 2011 was an increase in the cash paid for income taxes of \$3.2 million.

Investing activities used \$3.7 million of cash during the first nine months of 2012 compared to \$1.9 million used during the same period of 2011. The 2012 activities consisted primarily of the purchase of equipment for lease customers of \$17.4 million, collections on lease receivables of \$12.8 million and proceeds from sale of marketable securities of \$1.4 million.

Table of Contents

Financing activities used \$17.7 million of cash during the first nine months of 2012 compared to \$11.8 million used during the same period of 2011. The 2012 activities consisted primarily of net proceeds and tax benefits from exercises of stock options of \$0.9 million, net borrowings on our line of credit of \$10.7 million, proceeds from discounted lease rentals of \$1.4 million, \$25.9 million used for the payment of dividends and \$4.9 million used to purchase 92,652 shares of our common stock. (See Note 8 Shareholders Equity ).

As of September 29, 2012, we had no off balance sheet arrangements.

As of September 29, 2012, our borrowing availability under our credit agreement with The PrivateBank and Trust Company and BMO Harris Bank, N.A. (the Line of Credit ) was \$35.0 million (the lesser of the borrowing base or the aggregate line of credit). There were \$10.7 million in borrowings outstanding at September 29, 2012 under the Line of Credit bearing interest ranging from 2.97% to 3.75%, leaving \$24.3 million available for additional borrowings.

The Line of Credit, which has a termination date of February 29, 2016, has been and will continue to be used for general corporate purposes. The Line of Credit is secured by a lien against substantially all of our assets, contains customary financial conditions and covenants, and requires maintenance of minimum levels of debt service coverage and tangible net worth and maximum levels of leverage (all as defined within the Line of Credit). As of September 29, 2012, we were in compliance with all of our financial covenants.

We may utilize discounted lease financing to provide funds for a portion of our leasing activities. Rates for discounted lease financing reflect prevailing market interest rates and the credit standing of the lessees for which the payment stream of the leases are discounted. We believe that discounted lease financing will continue to be available to us at competitive rates of interest through the relationships we have established with financial institutions.

We believe that the combination of our cash on hand, the cash generated from our franchising business, cash generated from discounting sources and our Line of Credit will be adequate to fund our planned operations through 2013.

Critical Accounting Policies

The Company prepares the consolidated financial statements of Winmark Corporation and Subsidiaries in conformity with accounting principles generally accepted in the United States of America. As such, the Company is required to make certain estimates, judgments and assumptions that it believes are reasonable based on information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. There can be no assurance that actual results will not differ from these estimates. The critical accounting policies that the Company believes are most important to aid in fully understanding and evaluating the reported financial results include the following:

*Revenue Recognition Royalty Revenue and Franchise Fees*

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The Company collects royalties from each retail franchise based on a percentage of retail store gross sales. The Company recognizes royalties as revenue when earned. At the end of each accounting period, estimates of royalty amounts due are made based on applying historical weekly sales information to the number of weeks of unreported franchisee sales. If there are significant changes in the actual performance of franchisees versus the Company's estimates, its royalty revenue would be impacted. During the first nine months of 2012, the Company collected \$91,300 more than it estimated at December 31, 2011. As of September 29, 2012, the Company's royalty receivable was \$961,100.

Table of Contents

The Company collects initial franchise fees when franchise agreements are signed and recognizes the initial franchise fees as revenue when the franchise is opened, which is when the Company has performed substantially all initial services required by the franchise agreement. Franchise fees collected from franchisees but not yet recognized as income are recorded as deferred revenue in the liability section of the consolidated balance sheet. As of September 29, 2012, deferred franchise fees were \$1,224,200.

*Leasing Income Recognition*

Leasing income for direct financing leases is recognized under the effective interest method. The effective interest method of income recognition applies a constant rate of interest equal to the internal rate of return on the lease. Generally, when a lease is more than 90 days delinquent (where more than three monthly payments are owed), the lease is classified as being on non-accrual and the Company stops recognizing leasing income on that date. Payments received on leases in non-accrual status generally reduce the lease receivable. Leases on non-accrual status remain classified as such until there is sustained payment performance that, in the Company's judgment, would indicate that all contractual amounts will be collected in full.

In certain circumstances, the Company may re-lease equipment in its existing portfolio. As this equipment may have a fair value greater than its carrying amount when re-leased, the Company may be required to account for the lease as a sales-type lease. At inception of a sales-type lease, revenue is recorded that consists of the present value of the future minimum lease payments discounted at the rate implicit in the lease. In subsequent periods, the recording of income is consistent with the accounting for a direct financing lease.

For leases that are accounted for as operating leases, income is recognized on a straight-line basis when payments under the lease contract are due.

*Allowances for Credit Losses*

The Company maintains an allowance for credit losses at an amount that it believes to be sufficient to absorb losses inherent in its existing lease portfolio as of the reporting dates. Leases are collectively evaluated for potential loss. The Company's methodology for determining the allowance for credit losses includes consideration of the level of delinquencies and non-accrual leases, historical net charge-off amounts and review of any significant concentrations.

A provision is charged against earnings to maintain the allowance for credit losses at the appropriate level. If the actual results are different from the Company's estimates, results could be different. The Company's policy is to charge-off against the allowance the estimated unrecoverable portion of accounts once they reach 121 days delinquent. (See Note 5 Investment in Leasing Operations ).

*Stock-Based Compensation*

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The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of the awards on the date of grant using an option-pricing model is affected by stock price as well as assumptions regarding a number of complex and subjective variables. These variables include implied volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

Table of Contents

The Company evaluates the assumptions used to value awards on an annual basis. If factors change and the Company employs different assumptions for estimating stock-based compensation expense in future periods or if the Company decides to use a different valuation model, the future periods may differ significantly from what it has recorded in the current period and could materially affect operating income, net income and earnings per share.

*Impairment of Long-term Investments*

The Company evaluates its long-term equity investments for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying amount may not be recoverable. The impairment, if any, is measured by the difference between the assets' carrying amount and their fair value (as prescribed by applicable accounting guidance), based on the best information available, including market prices, discounted cash flow analysis or other financial metrics that management utilizes to help determine fair value. Judgments made by management related to the fair value of its long-term equity investments are affected by factors such as the ongoing financial performance of the investees, additional capital raised by the investees as well as general changes in the economy. If there are significant changes in the actual performance of the long-term equity investments versus the Company's estimates, the carrying value of these investments could be significantly impacted.

The Company evaluates its long-term note investments for impairment on an annual basis or whenever events or changes in circumstances indicate that it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the notes. The impairment, if any, is measured by the difference between the recorded investment in the notes, including accrued interest, and the present value of expected future cash flows discounted at the effective interest rate of the notes (as prescribed by applicable accounting guidance), based on the best information available to management. Once a note investment is deemed impaired, any significant change in the amount or timing of the expected or actual cash flows requires recalculation of the impairment applying the procedures described above. See Note 4 Long-Term Investments for the Company's discussion of its impaired note investment. Estimates and assumptions made by management related to the expected future cash flows from the notes could be different than the actual cash flows, which could significantly impact the carrying value of these investments.

*Forward Looking Statements*

The statements contained in this Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations that are not strictly historical fact, including without limitation, the Company's belief that it will have adequate capital and reserves to meet its current and contingent obligations and operating needs, as well as its disclosures regarding market rate risk are forward looking statements made under the safe harbor provision of the Private Securities Litigation Reform Act. Such statements are based on management's current expectations as of the date of this Report, but involve risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by such forward looking statements. Investors are cautioned to consider these forward looking statements in light of important factors which may result in material variations between results contemplated by such forward looking statements and actual results and conditions. See the section appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 entitled Risk Factors and Part II, Item 1A in this Report for a more complete discussion of certain factors that may cause the Company's actual results to differ from those in its forward looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date they were made. The Company undertakes no obligation to revise or update publicly any forward-looking statements for any reason.

Table of Contents

**ITEM 3: Quantitative and Qualitative Disclosures About Market Risk**

The Company incurs financial markets risk in the form of interest rate risk. Risk can be quantified by measuring the financial impact of a near-term adverse increase in short-term interest rates. At September 29, 2012, the Company had available a \$35.0 million line of credit with The PrivateBank and Trust Company and BMO Harris Bank, N.A. The interest rates applicable to this agreement are based on either the bank's base rate or LIBOR for short-term borrowings (less than three months) or the bank's index rate for borrowings one year or greater. The Company had \$10.7 million of debt outstanding at September 29, 2012 under this line of credit, all of which was in the form of short-term borrowings subject to daily changes in the bank's base rate or LIBOR. The Company's earnings would be affected by changes in these short-term interest rates. With the Company's borrowings at September 29, 2012, a one percent increase in short-term rates would reduce annual pretax earnings by \$107,000. The Company had no interest rate derivatives in place at September 29, 2012.

None of the Company's cash and cash equivalents at September 29, 2012 was invested in money market mutual funds, which are subject to the effects of market fluctuations in interest rates.

Although the Company conducts business in foreign countries, international operations are not material to its consolidated financial position, results of operations or cash flows. Additionally, foreign currency transaction gains and losses were not material to the Company's results of operations for the nine months ended September 29, 2012. Accordingly, the Company is not currently subject to material foreign currency exchange rate risks from the effects that exchange rate movements of foreign currencies would have on its future costs or on future cash flows it would receive from its foreign activity. To date, the Company has not entered into any foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

**ITEM 4: Controls and Procedures**

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of its disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). Based upon, and as of the date of that evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. There was no change in the Company's internal control over financial reporting during its most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****ITEM 1: Legal Proceedings**

We are not a party to any material litigation and are not aware of any threatened litigation that would have a material adverse effect on our business.

**ITEM 1A: Risk Factors**

In addition to the other information set forth in this report, including the important information in Forward-Looking Statements, you should carefully consider the Risk Factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. If any of those factors were to occur, they could materially adversely affect the Company's financial condition or future results, and could cause its actual results to differ materially from those expressed in its forward-looking statements in this report. The Company is aware of no material changes to the Risk Factors discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

**ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds****Purchase of Equity Securities by the Issuer and Affiliated Purchasers**

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan(1)	Maximum Number of Shares that may yet be Purchased Under the Plan
July 1, 2012 to August 4, 2012	11,424	\$ 53.25	11,424	435,192
August 5, 2012 to September 1, 2012	13,065	\$ 54.34	13,065	422,127
September 2, 2012 to September 29, 2012	18,907	\$ 52.92	18,907	403,220

(1) The Board of Directors' authorization for the repurchase of shares of the Company's common stock was originally approved in 1995 with no expiration date. The total shares approved for repurchase has been increased by additional Board of Directors' approvals and is currently limited to 5,000,000 shares, of which 403,220 may still be repurchased.

**ITEM 3: Defaults Upon Senior Securities**

None.

**ITEM 4: Mine Safety Disclosures**

Not applicable.

**ITEM 5: Other Information**

All information required to be reported in a report on Form 8-K during the period covered by this Form 10-Q has been reported.

Table of Contents

**ITEM 6: Exhibits**

- 3.1 Articles of Incorporation, as amended (Exhibit 3.1)(1)
- 3.2 By-laws, as amended and restated to date (Exhibit 3.2)(2)
- 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 Interactive Data Files Pursuant to Rule 405 of Regulation S-T: Financial statements from the quarterly report on Form 10-Q of Winmark Corporation and Subsidiaries for the quarter ended September 29, 2012, formatted in XBRL: (i) Consolidated Condensed Balance Sheets, (ii) Consolidated Condensed Statements of Operations, (iii) Consolidated Condensed Statements of Comprehensive Income, (iv) Consolidated Condensed Statements of Cash Flows, and (v) Notes to Consolidated Condensed Financial Statements.+

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\*Filed Herewith

+ Pursuant to Rule 406T of Regulation S-T, the interactive data files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

(1) Incorporated by reference to the specified exhibit to the Registration Statement on Form S-1, effective August 24, 1993 (Reg. No. 333-65108).

(2) Incorporated by reference to the specified exhibit to the Annual Report on Form 10-K for the fiscal year ended December 30, 2006.

Table of Contents

**SIGNATURES**

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

Date: October 25, 2012

By: /s/ John L. Morgan  
John L. Morgan  
Chairman of the Board and Chief Executive Officer  
(principal executive officer)

Date: October 25, 2012

By: /s/ Anthony D. Ishaug  
Anthony D. Ishaug  
Chief Financial Officer and Treasurer  
(principal financial and accounting officer)

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## Table of Contents

### EXHIBIT INDEX

#### WINMARK CORPORATION

#### FORM 10-Q FOR QUARTER ENDED SEPTEMBER 29, 2012

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