WINMARK CORP Form 10-Q November 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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, 2007

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

For the transition period from

Commission File Number 000-22012

to

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 Number)

4200 Dahlberg Drive, Suite 100

Golden Valley, MN 55422-4837

(Address of Principal Executive Offices, Zip Code)

(Registrant s Telephone Number, Including Area Code 763-520-8500)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes: x No: o

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

Large accelerated filer: O Accelerated filer: O Non-Accelerated filer: X

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

Yes: o No: x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock, no par value, 5,419,136 shares outstanding as of November 5, 2007.

WINMARK CORPORATION AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

<u>Item 1.</u> <u>Financial Statements (Unaudited)</u>

CONSOLIDATED CONDENSED BALANCE SHEETS:

September 29, 2007 and December 30, 2006

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS:

Three Months Ended

September 29, 2007 and September 30, 2006

Nine Months Ended September 29, 2007 and September 30, 2006

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS:

Nine Months Ended

September 29, 2007 and September 30, 2006

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

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

<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>

<u>Item 4.</u> <u>Controls and Procedures</u>

PART II. OTHER INFORMATION

<u>Item 1.</u> <u>Item 1 has been omitted since the item is inapplicable or the answer is negative.</u>

Item 1A. Risk Factors

<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>

<u>Item 3 & 4</u> <u>Item 3 and Item 4 have been omitted since these items are inapplicable or the answer is negative.</u>

<u>Item 5.</u> <u>Other Information</u>

Item 6. Exhibits

2

PART I. FINANCIAL INFORMATION

ITEM 1: Financial Statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

Deferred income taxes 191,500 191,500 Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term receivables, net 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 82,300 Turrent Liabilities 49,664,400 87,606,100 Current line of credit 6,990,200 600,000 Current renewable subordinated notes 2,528,000 3,239,600 Accounts payable 823,900 1,608,100 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 1,116,100 Total current liabilities 14,621,600 12,138,600 Long-term line of credit 6,515,800 12,138,600 <t< th=""><th></th><th>Se</th><th>ptember 29, 2007</th><th colspan="2">December 30, 2006</th></t<>		Se	ptember 29, 2007	December 30, 2006	
Cash and cash equivalents \$ 812,900 \$ 1,037,800 Receivables, less allowance for doubtful accounts of \$45,800 and \$66,900 2,030,000 5,2773,400 Net investment in leases current 9,639,300 5,7774,000 Income tax receivable 783,100 812,700 Inventories 1,017,800 1,435,100 Prepaid expenses 1,017,800 1,455,000 Prepaid expenses 1,017,800 11,500,000 Total current assets 19,500 11,500,000 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 96,700 17,500,000 Long-term investments 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 20,580,000 832,300 Deferred income taxes 594,500 832,300 Deferred income taxes 894,900 \$ 37,606,100 Current Liabilities \$ 96,900 \$ 37,606,100 Current flico of credit \$ 5,990,000 \$ 5,900,000 Current flico of credit \$ 2,258,000 3,2	ASSETS				
Receivables, less allowance for doubtful accounts of \$45,800 and \$66,900 2,108,000 2,203,500 Net investment in leases current 9639,300 5,777,400 Income tax receivable 783,100 1812,700 Inventories 67,000 68,700 Prepaid expenses 1,017,800 1,435,100 Deferred income taxes 191,500 191,500 Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term receivables, net 96,700 73,800 Other assets 677,900 573,500 Deferred income taxes 394,500 625,800 Deferred income taxes 594,500 32,300 Curre	Current Assets:				
Net investment in leases current 9,639,300 5,777,400 Income tax receivable 783,100 812,700 Income tax receivable 763,000 68,700 Inventories 67,000 68,700 Prepaid expenses 1,017,800 1,435,100 Deferred income taxes 191,500 115,267,00 Net investment in lease long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term investments 9,500,000 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 679,900 832,300 Deferred income taxes 69,90,000 832,300 Current Liabilities 80,900,000 800,000 Current line of credit 80,900,000 90,000 800,000 Current menewable subordinated notes 2,528,000 3,239,600 Accrued liabilities 81,400 157,300 Current discounted lease rentals 81,400 157,300 <	Cash and cash equivalents	\$	812,900	\$ 1,037,800	
Income tax receivable 783,100 812,700 Inventories 67,000 68,700 Prepaid expenses 1,017,800 1,435,100 Deferred income taxes 191,500 191,500 Total current assets 19,500 11,500,000 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term receivables, net 677,900 73,800 Property and equipment, net 677,900 573,800 Deferred income taxes 594,500 832,300 Deferred income taxes 594,500 832,300 Deferred income taxes 594,604,00 37,600,100 LABILITIES AND SHAREHOLDERS EQUITY Current Liabilities 2,528,000 3,239,600 Current Expensive subordinated notes 2,528,000 3,239,600 Current discounted lease rentals 81,400 157,300 Accounts payable 2,104,200 2,009,700 Current discounted lease rentals 1,105,400 19,200,000	Receivables, less allowance for doubtful accounts of \$45,800 and \$66,900		2,108,000	2,203,500	
Inventories 67,000 68,700 Prepaid expenses 1,017,800 1,435,100 Deferred income taxes 191,500 11,500,700 Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 95,00,000 11,500,000 Long-term receivables, net 96,700 573,500 Other assets 625,800 625,800 Deferred income taxes 625,800 832,300 Other assets 625,800 832,300 Deferred income taxes \$ 96,46,400 \$ 37,606,100 Current lide of credit \$ 96,90,200 \$ 600,000 Current Liabilities \$ 6,990,200 \$ 600,000 Current trenewable subordinated notes 2,528,000 3,239,600 Accound liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 1,116,00 Total curr	Net investment in leases current		9,639,300	5,777,400	
Prepaid expenses 1,017,800 1,435,100 Deferred income taxes 191,500 191,500 Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 17,3800 Long-term receivables, net 96,700 573,800 Other assets 625,800 625,800 Deferred income taxes 594,500 832,300 User assets 625,800 832,300 Deferred income taxes 594,500 832,300 Other assets 6294,500 \$ 37,506,100 Turnet in come taxes 594,500 \$ 600,000 Current Liabilities: 2,528,000 \$ 600,000 Current bline of credit \$ 6,990,200 \$ 600,000 Accounts payable 81,400 157,300 Current discounted lease rentals 81,400	Income tax receivable		783,100	812,700	
Deferred income taxes 191,500 191,500 Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 823,300 Deferred for cit \$49,664,400 \$76,000 LIABILITIES AND SHAREHOLDERS EQUITY Current Liabilities: Current line of credit \$6,990,200 \$600,000 Current line of credit \$6,990,200 \$600,000 Accounts payable \$2,528,000 3,239,600 Accounts payable assistant discounted lease rentals \$1,100,000 2,002,700 Current discounted lease rentals \$1,119,700 479,300 Current deferred revenue \$1,119,700 479,300 Cung-term in deferred revenue \$1,621,600 \$1,116,100 Cong-term discounted lease rentals <t< td=""><td>Inventories</td><td></td><td>67,000</td><td>68,700</td></t<>	Inventories		67,000	68,700	
Total current assets 14,619,600 11,526,700 Net investment in leases long-term 23,549,900 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term receivables, net 66,700 573,800 Property and equipment, net 677,900 625,800 Other assets 625,800 625,800 Deferred income taxes 594,500 832,300 LIABILITIES AND SHAREHOLDERS EQUITY Current Liabilities: Current enewable subordinated notes 6,990,200 3,239,600 Accounts payable 823,900 1,608,100 Accounts payable 823,900 1,608,100 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 1,116,100 Total current liabilities 14,682,800 9,230,100 Long-term ineo of credit 6,515,800 <	Prepaid expenses		1,017,800	1,435,100	
Net investment in leases long-term 23,549,000 12,474,000 Long-term investments 9,500,000 11,500,000 Long-term receivables, net 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 832,300 LABILITIES AND SHAREHOLDERS EQUITY Current Liabilities V Current liabilities of credit \$ 6,990,200 \$ 600,000 Current discounted lease rentals \$ 6,990,200 \$ 600,000 Accrued liabilities 2,528,000 3,239,600 Accounts payable 83,300 1,608,100 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 1,116,100 Total current liabilities 1,462,800 9,230,100 Long-term renewable subordinated notes 14,621,600 12,138,600	Deferred income taxes		191,500	191,500	
Long-term investments 9,500,000 11,500,000 Long-term receivables, net 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 832,300 LABILITIES AND SHAREHOLDERS EQUITY Current Liabilities: Current line of credit \$ 6,990,200 \$ 600,000 Current renewable subordinated notes 2,528,000 3,239,600 Accounts payable 823,900 \$ 600,000 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 9,230,100 Long-term line of credit 6,515,800 9,230,100 Long-term line of credit 6,515,800 14,602,600 9,230,100 Long-term deferred revenue 537,000 41,000 Shareholders Equity: 550,000 550,000 Cong-term deferred revenue	Total current assets		14,619,600	11,526,700	
Long-term investments 9,500,000 11,500,000 Long-term receivables, net 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 832,300 LABILITIES AND SHAREHOLDERS EQUITY Current Liabilities: Current line of credit \$ 6,990,200 \$ 600,000 Current renewable subordinated notes 2,528,000 3,239,600 Accounts payable 823,900 \$ 600,000 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 9,230,100 Long-term line of credit 6,515,800 9,230,100 Long-term line of credit 6,515,800 14,602,600 9,230,100 Long-term deferred revenue 537,000 41,000 Shareholders Equity: 550,000 550,000 Cong-term deferred revenue					
Long-term receivables, net 96,700 73,800 Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Deferred income taxes 594,500 37,606,100 LABILITIES AND SHAREHOLDERS EQUITY Current Liabilities Current line of credit 6,990,200 600,000 Current line of credit 86,990,200 600,000 Current line of credit 86,990,200 600,000 Current line of credit 823,900 1,608,100 Accounts payable 823,900 1,608,100 Accounts payable 81,400 2,029,700 Current discounted lease rentals 81,400 157,300 Current discounted lease rentals 1,119,700 479,300 Current discounted ferred revenue 1,335,400 11,116,100 Cong-term line of credit 6,515,800 12,138,600 Long-term discounted lease rentals 14,621,600 12,138,600 Long-term deferred revenue					
Property and equipment, net 677,900 573,500 Other assets 625,800 625,800 Defered income taxes \$94,500 \$32,300 LIABILITIES AND SHAREHOLDERS EQUITY Current Liabilities: Current line of credit \$6,990,200 \$600,000 Current renewable subordinated notes 2,528,000 3,239,600 Accounts payable 823,900 1,608,100 Accrued liabilities 2,104,200 2,029,700 Current discounted lease rentals 81,400 157,300 Rents received in advance 1,119,700 479,300 Current deferred revenue 1,035,400 1,116,100 Total current liabilities 14,682,800 9,230,100 Long-term line of credit 6,515,800 12,138,600 Long-term discounted lease rentals 14,621,600 12,138,600 Long-term discounted lease rentals 537,000 441,400 Cong-term deferred revenue 537,000 441,400					

The accompanying notes are an integral part of these financial statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

		Three Months Ended			Nine Months Ended			
	Se	eptember 29, 2007	S	eptember 30, 2006	S	eptember 29, 2007	S	eptember 30, 2006
REVENUE:								
Royalties	\$	5,208,700	\$	4,800,000	\$	15,208,100	\$	14,320,500
Merchandise sales		797,600		1,452,600		3,250,300		3,533,300
Leasing income		1,173,200		523,100		2,944,700		1,209,800
Franchise fees		584,100		305,000		1,301,500		980,700
Other		188,200		158,900		436,700		441,900
Total revenue		7,951,800		7,239,600		23,141,300		20,486,200
COST OF MERCHANDISE SOLD		764,300		1,381,900		3,119,500		3,378,600
LEASING EXPENSE		268,700		84,500		601,900		131,200
SELLING, GENERAL AND ADMINISTRATIVE								
EXPENSES		4,729,600		4,206,300		14,812,200		12,934,600
Income from operations		2,189,200		1,566,900		4,607,700		4,041,800
INTEREST EXPENSE		(381,300)		(307,900)		(1,101,900)		(429,300)
INTEREST AND OTHER INCOME		122,500		145,300		423,300		746,600
Income before income taxes		1,930,400		1,404,300		3,929,100		4,359,100
PROVISION FOR INCOME TAXES		(744,200)		(566,100)		(1,533,500)		(1,757,200)
NET INCOME	\$	1,186,200	\$	838,200	\$	2,395,600	\$	2,601,900
EARNINGS PER SHARE BASIC	\$.22	\$.15	\$.44	\$.45
EARNINGS PER SHARE DILUTED	\$.21	\$.14	\$.43	\$.43
WEIGHTED AVERAGE SHARES OUTSTANDING								
BASIC		5,437,805		5,632,042		5,490,077		5,841,047
WEIGHTED AVERAGE SHARES OUTSTANDING								
DILUTED		5,555,770		5,853,968		5,610,951		6,056,690

The accompanying notes are an integral part of these financial statements

4

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

		Nine Mont	hs Ended	
	Sep	tember 29, 2007	Sep	tember 30, 2006
OPERATING ACTIVITIES:				
Net income	\$	2,395,600	\$	2,601,900
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		222,300		141,200
Allowance for doubtful accounts		(19,000)		(143,300)
Provision for credit losses		351,300		228,900
Gain on sale of investment		(60,000)		(360,000)
Compensation expense related to stock options		488,100		588,900
Deferred initial direct costs, net of amortization		(625,600)		(181,800)
Loss from disposal of property and equipment				1,400
Change in operating assets and liabilities:				
Receivables		91,600		(334,500)
Income tax receivable		29,600		527,000
Inventories		1,700		(17,700)
Prepaid expenses		417,300		(671,400)
Deferred income taxes		237,800		
Accounts payable		(784,200)		(288,100)
Accrued liabilities		74,500		433,400
Additions to advance and security deposits		1,101,000		597,900
Deferred revenue		14,900		220,800
Net cash provided by operating activities		3,936,900		3,344,600
INVESTING ACTIVITIES:				
Proceeds from sale of investment		2,060,000		360,000
Purchase of investments				(500,000)
Purchases of property and equipment		(326,700)		(240,400)
Purchase of equipment for lease contracts		(21,396,400)		(11,622,300)
Principal collections on lease receivables		6,155,400		2,627,500
Net cash used for investing activities		(13,507,700)		(9,375,200)
FINANCING ACTIVITIES:				
Proceeds from line of credit		15,300,000		
Payments on line of credit		(2,394,000)		
Proceeds from issuance of subordinated notes		4,419,000		15,340,800
Payments on subordinated notes		(2,647,600)		
Repurchase of common stock		(5,536,800)		(12,177,200)
Proceeds from exercises of options and warrants		104,600		613,800
Tax benefit on exercised options		100,700		607,300
Net cash provided by financing activities		9,345,900		4,384,700
DECREASE IN CASH AND CASH EQUIVALENTS		(224,900)		(1,645,900)
Cash and cash equivalents, beginning of period		1,037,800		2,947,700
Cash and cash equivalents, end of period	\$	812,900	\$	1,301,800
SUPPLEMENTAL DISCLOSURES:				
Cash paid for interest	\$	1,446,400	\$	