WINMARK CORP
Form 10-K
March 15, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2011,

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

WINMARK CORPORATION

(exact name of registrant as specified in its charter)

Minnesota	**41-1622691**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

605 Highway 169 North, Suite 400, Minneapolis, Minnesota 55441

(Address of Principal Executive Offices) (Zip Code)

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

Securities registered pursuant to Section 12 (b) of the Act:

Title of Each Class	**Name of Each Exchange On Which Registered**
Common Stock, no par value per share	Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter was $54,996,087.

Shares of no par value Common Stock outstanding as of March 5, 2012: 5,075,954 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Registrant s Annual Meeting of Shareholders to be held on April 25, 2012 have been incorporated by reference into **Items 10, 11, 12, 13 and 14** of Part III of this report.

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WINMARK CORPORATION AND SUBSIDIARIES

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PART I

ITEM 1: BUSINESS

Background

We are a franchisor of four value-oriented retail store concepts that buy, sell, trade and consign merchandise. Each of our retail store brands emphasizes consumer value by offering high-quality used merchandise at substantial savings from the price of new merchandise and by purchasing customers used goods that have been outgrown or are no longer used. Our concepts also offer a limited amount of new merchandise to customers.

We operate a middle-market equipment leasing business through our wholly owned subsidiary, Winmark Capital Corporation. Our middle-market leasing business serves large and medium-sized businesses and focuses on technology-based assets which typically cost more than $250,000. The businesses we target generally have annual revenue of between $30 million and several billion dollars. We generate middle-market equipment leases primarily through business alliances, equipment vendors and directly from customers.

We also operate a small-ticket financing business through our wholly owned subsidiary, Wirth Business Credit, Inc. Our small-ticket financing business serves small businesses and focuses on assets which generally have a cost of $5,000 to $100,000.

The Company also provides management services to Tomsten, Inc. (d/b/a Archiver s). In connection with these services, John L. Morgan, our Chairman and Chief Executive Officer serves as Chairman and Chief Executive Officer of Tomsten, Inc.

Our significant assets are located within the United States, and we generate all revenues from United States operations other than franchising revenues from Canadian operations of approximately $2.5 million, $2.2 million and $1.8 million for 2011, 2010 and 2009, respectively. For additional financial information, please see Item 6 Selected Financial Data and Item 8 Financial Statements and Supplementary Data. We were incorporated in Minnesota in 1988.

Franchise Operations

Our four retail brands with their fiscal year 2011 system-wide sales, defined as estimated revenues generated by all franchise owned locations, are summarized as follows:

Plato s Closet® - $299 million.

We began franchising the Plato s Closet brand in 1999. Plato s Closet stores buy and sell used clothing and accessories geared toward the teenage and young adult market. Customers have the opportunity to sell their used items to Plato s Closet stores and to purchase quality used clothing and accessories at prices lower than new merchandise. For the years ended 2011, 2010 and 2009, Plato s Closet contributed royalties and franchise fees of $12.6 million, $10.3 million and $8.5 million, respectively. As a percentage of consolidated revenues for 2011, 2010 and 2009, these amounts equaled 24.5%, 25.1% and 22.8% respectively.

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Play It Again Sports® - $241 million.

We began franchising the Play It Again Sports brand in 1988. Play It Again Sports stores buy, sell, trade and consign used and new sporting goods, equipment and accessories for a variety of athletic activities including team sports (baseball/softball, hockey, football, lacrosse, soccer), fitness, ski/snowboard and golf among others. The stores offer a flexible mix of merchandise that is adjusted to adapt to seasonal and regional differences. For the years ended 2011, 2010 and 2009, Play It Again Sports contributed royalties and franchise fees of $10.0 million, $9.7 million and $9.1 million, respectively. As a percentage of consolidated revenues for 2011, 2010 and 2009, these amounts equaled 19.5%, 23.7% and 24.3%, respectively.

Once Upon A Child® - $195 million.

We began franchising the Once Upon A Child brand in 1993. Once Upon A Child stores buy and sell used and, to a lesser extent, new children s clothing, toys, furniture, equipment and accessories. This brand primarily targets parents of children ages infant to 12 years. These customers have the opportunity to sell their used children s items to a Once Upon A Child store when outgrown and to purchase quality used children s clothing, toys, furniture and equipment at prices lower than new merchandise. For the years ended 2011, 2010 and 2009, Once Upon A Child contributed royalties and franchise fees of $8.1 million, $7.0 million and $6.4 million, respectively. As a percentage of consolidated revenues for 2011, 2010 and 2009, these amounts equaled 15.8%, 17.0% and 17.1%, respectively.

Music Go Round® - $25 million.

We began franchising the Music Go Round brand in 1994. Music Go Round stores buy, sell, trade and consign used and, to a lesser extent, new musical instruments, speakers, amplifiers, music-related electronics and related accessories. For the years ended 2011, 2010 and 2009, Music Go Round contributed royalties and franchise fees of $0.8 million each year, respectively. As a percentage of consolidated revenues for 2011, 2010 and 2009, these amounts equaled 1.5%, 1.9% and 2.0% respectively.

The following table presents a summary of our retail brands franchising activity for the fiscal year ended December 31, 2011:

Plato s Closet							
Franchises - US and Canada	301	24	(1)	324	23	23	100%
Play It Again Sports							
Franchises - US and Canada	328	8	(11)	325	50	50	100%
Once Upon A Child							
Franchises - US and Canada	241	10	(4)	247	7	7	100%

Music Go Round							
Franchises - US	33	1	(0)	34			N/A
Total Franchised Stores	903	43	(16)	930	80	80	100%

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Retail Brands Franchising Overview

We use franchising as a business method of distributing goods and services through our retail brands to consumers. We, as franchisor, own a retail business brand, represented by a service mark or similar right, and an operating system for the franchised business. We then enter into franchise agreements with franchisees and grant the franchisee the right to use our business brand, service marks and operating system to manage a retail business. Franchisees are required to operate their retail businesses according to the systems, specifications, standards and formats we develop for the business brand. We train the franchisees how to operate the franchised business. We also provide continuing support and service to our franchisees.

We have developed value-oriented retail brands based on a mix of used and, to a lesser extent, new merchandise. We franchise rights to franchisees who open franchised locations under such brands. The key elements of our franchise strategy include:

- franchising the rights to operate retail stores offering value-oriented merchandise;
- attracting new, qualified franchisees; and
- providing initial and continuing support to franchisees.

Offering Value-Oriented Merchandise

Our retail brands provide value to consumers by purchasing and reselling used merchandise that consumers have outgrown or no longer use at substantial savings from the price of new merchandise. By offering a combination of high-quality used and value-priced new merchandise, we benefit from consumer demand for value-oriented retailing. In addition, we believe that among national retail operations our retail store brands provide a unique source of value to consumers by purchasing used merchandise. We also believe that the strategy of buying used merchandise increases consumer awareness of our retail brands.

Attracting Franchisees

Our franchise marketing program for retail brands seeks to attract prospective franchisees with experience in management and operations and an interest in being the owner and operator of their own business. We seek franchisees who:

- have a sufficient net worth;
- have prior business experience; and

- intend to be integrally involved with the management of the business.

At December 31, 2011, we had 44 signed retail franchise agreements that are expected to open in 2012.

We began franchising in Canada in 1991 and, as of December 31, 2011, had 65 franchised retail stores open in Canada. The Canadian retail stores are operated by franchisees under agreements substantially similar to those used in the United States.

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Retail Brand Franchise Support

As a franchisor, our success depends upon our ability to develop and support competitive and successful franchise brands. We emphasize the following areas of franchise support and assistance.

Training

Each franchisee must attend our training program regardless of prior experience. Soon after signing a franchise agreement, the franchisee is required to attend new owner orientation training. This course covers basic management issues, such as preparing a business plan, lease evaluation, evaluating insurance needs and obtaining financing. Our training staff assists each franchisee in developing a business plan for their retail store with financial and cash flow projections. The second training session is centered on store operations. It covers, among other things, point-of-sale computer training, inventory selection and acquisition, sales, marketing and other topics. We provide the franchisee with operations manuals that we periodically update.

Field Support

We provide operations personnel to assist the franchisee in the opening of a new business. We also have an ongoing field support program designed to assist franchisees in operating their retail stores. Our franchise support personnel visit each retail store periodically and, in most cases, a business assessment is made to determine whether the franchisee is operating in accordance with our standards. The visit is also designed to assist franchisees with operational issues.

Purchasing

During training each franchisee is taught how to evaluate, purchase and price used goods. In addition to purchasing used products from customers who bring merchandise to the store, the franchisee is also encouraged to develop sources for purchasing used merchandise in the community. Franchisees typically do not repair or recondition used products, but rather, purchase quality used merchandise that may be put directly on display for resale on an *as is* basis. We have developed specialized computer point-of-sale systems for our brands that provide the franchisee with standardized pricing information to assist in the purchasing of used items. Play It Again Sports, Once Upon A Child and Music Go Round also use buying guides to assist franchisees in pricing used items.

We provide centralized buying services, which on a limited basis include credit and billing for the Play It Again Sports franchisees. Upon credit approval, Play It Again Sports franchisees may order through the buying group, in which case, product is shipped directly to the store by the vendor. We are invoiced by the vendor, and in turn, we invoice the franchisee adding a 4% service fee to cover our costs of operating the buying group. Our Play It Again Sports franchise system uses several major vendors including Horizon Fitness, Nautilus, Wilson Sporting Goods, Champro Sporting Goods, Easton-Bell Sports, RBK CCM Hockey and Bauer Hockey. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered. The amount of product being sold through the buying group is significantly lower than it has been in the past due to a greater number of franchisees having direct relationships with vendors.

To provide the franchisees of our Play It Again Sports, Once Upon A Child and Music Go Round systems a source of affordable new product, we have developed relationships with our significant vendors and negotiated prices for our franchisees to take advantage of the buying power a franchise system brings.

Our typical Once Upon A Child franchised store purchases approximately 30% of its new product from Graco, Million Dollar Baby, Dorel Juvenile Group and North Gates. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered.