WINMARK CORP
Form 10-Q
July 25, 2011
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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 June 25, 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, 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 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 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

Common stock, no par value, 4,971,456 shares outstanding as of July 19, 2011.

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WINMARK CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1: Financial Statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

		June 25, 2011		December 25, 2010
ASSETS				
Current Assets:				
Cash and cash equivalents	$	1,036,000	$	2,257,100
Marketable securities		7,400		161,000
Receivables, less allowance for doubtful accounts of $18,600 and $17,000		1,643,700		1,841,300
Net investment in leases - current		12,226,700		13,856,700
Income tax receivable				294,700
Inventories		50,300		85,900
Prepaid expenses		324,100		382,600
Total current assets		15,288,200		18,879,300
Net investment in leases - long-term		17,716,200		16,802,500
Long-term investments, less allowance for losses of $252,900 and $0		4,500,900		3,973,800
Property and equipment, net		1,655,900		1,785,900
Other assets		677,500		680,500
	$	39,838,700	$	42,122,000
LIABILITIES AND SHAREHOLDERS EQUITY				
Current Liabilities:				
Line of credit	$		$	8,800,000
Accounts payable		2,039,300		1,274,200
Income tax payable		1,449,500		
Accrued liabilities		2,276,700		1,513,600
Discounted lease rentals		203,600		530,400
Rents received in advance		256,600		291,800
Deferred revenue		1,402,400		1,041,700
Deferred income taxes		1,832,500		1,832,500
Total current liabilities		9,460,600		15,284,200
Long-Term Liabilities:				
Discounted lease rentals		9,300		26,500
Rents received in advance		517,000		696,900
Deferred revenue		819,800		767,600
Other liabilities		1,282,200		1,678,000
Deferred income taxes		655,800		655,800
Total long-term liabilities		3,284,100		3,824,800
Shareholders Equity:				
Common stock, no par, 10,000,000 shares authorized, 4,968,789 and 5,020,739 shares issued and outstanding				513,700

Accumulated other comprehensive loss		(600)		
Retained earnings		27,094,600		22,499,300
Total shareholders equity		27,094,000		23,013,000
	$	39,838,700	$	42,122,000

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

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WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 25, 2011	**June 26, 2010**	**June 25, 2011**	**June 26, 2010**
REVENUE:				
Royalties	$ 6,819,300	$ 6,368,300	$ 13,872,100	$ 12,731,800
Leasing income	6,980,200	2,345,800	10,215,200	4,870,700
Merchandise sales	833,000	550,500	1,334,400	1,045,200
Franchise fees	245,000	305,000	320,000	528,500
Other	347,300	309,500	588,000	545,700
Total revenue	15,224,800	9,879,100	26,329,700	19,721,900
COST OF MERCHANDISE SOLD	794,200	520,200	1,277,100	991,200
LEASING EXPENSE	3,340,200	439,300	3,858,900	986,600
PROVISION FOR CREDIT LOSSES	(24,100)	(160,200)	21,300	11,900
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	5,030,400	4,877,200	9,876,300	9,733,100
Income from operations	6,084,100	4,202,600	11,296,100	7,999,100
LOSS FROM EQUITY INVESTMENTS	(142,900)	(102,000)	(219,900)	(122,200)
IMPAIRMENT OF INVESTMENT IN NOTES	(252,900)		(252,900)	
INTEREST EXPENSE	(26,900)	(273,100)	(58,000)	(561,300)
INTEREST AND OTHER INCOME	13,900	103,000	31,100	280,700
Income before income taxes	5,675,300	3,930,500	10,796,400	7,596,300
PROVISION FOR INCOME TAXES	(2,275,100)	(1,591,800)	(4,369,900)	(3,076,500)
NET INCOME	$ 3,400,200	$ 2,338,700	$ 6,426,500	$ 4,519,800
EARNINGS PER SHARE BASIC	$ .68	$ .47	$ 1.29	$ .89
EARNINGS PER SHARE DILUTED	$ .65	$ .45	$ 1.23	$ .87
WEIGHTED AVERAGE SHARES OUTSTANDING BASIC	4,980,844	5,025,944	4,985,220	5,077,179
WEIGHTED AVERAGE SHARES OUTSTANDING DILUTED	5,239,443	5,189,925	5,227,468	5,193,154

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

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WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended	
	June 25, 2011	**June 26, 2010**
OPERATING ACTIVITIES:		
Net income	$ 6,426,500	$ 4,519,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	242,700	238,000
Provision for credit losses	21,300	11,900
Compensation expense related to stock options	351,100	343,200
Loss (gain) on sale of marketable securities	600	(75,800)
Loss from equity investments	219,900	122,200
Impairment of investment in notes	252,900	
Deferred initial direct costs	(179,600)	(123,100)
Amortization of deferred initial direct costs	335,800	400,000
Change in operating assets and liabilities:		
Receivables	197,600	133,200
Income tax receivable / payable	1,744,600	(314,300)
Inventories	35,600	(27,100)
Prepaid expenses	58,500	73,100
Accounts payable	765,100	66,000
Accrued and other liabilities	367,300	703,300
Advance and security deposits	19,300	413,300
Other assets	3,000	
Deferred revenue	412,900	121,100
Net cash provided by operating activities	11,275,100	6,604,800
INVESTING ACTIVITIES:		
Purchase of investments	(1,000,000)	
Proceeds from sale of marketable securities	160,400	1,081,300
Purchase of marketable securities	(8,400)	(476,900)
Purchases of property and equipment	(112,700)	(149,000)
Purchase of equipment for lease contracts	(10,947,800)	(8,544,900)
Principal collections on lease receivables	10,908,300	10,437,400
Net cash provided by (used for) investing activities	(1,000,200)	2,347,900
FINANCING ACTIVITIES:		
Proceeds from line of credit	1,500,000	
Payments on line of credit	(10,300,000)	(1,968,100)
Proceeds from issuance of subordinated notes		146,800
Payments on subordinated notes		(2,769,600)
Repurchases of common stock	(3,313,500)	(3,930,100)
Proceeds from exercises of stock options	729,100	670,800
Dividends paid	(249,200)	(100,600)
Proceeds from discounted lease rentals		74,600
Tax benefits on exercised stock options	137,600	68,500
Net cash used for financing activities	(11,496,000)	(7,807,700)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,221,100)	1,145,000
Cash and cash equivalents, beginning of period	2,257,100	9,490,800
Cash and cash equivalents, end of period	$ 1,036,000	$ 10,635,800
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	$ 130,900	$ 1,216,400

Cash paid for income taxes	$	2,329,600	$	3,443,400

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

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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 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 six months ended June 25, 2011 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:

- 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. The Company s investment in BridgeFunds notes was valued based on Level 3 inputs (see Note 4).

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

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4. Investments:

Marketable Securities

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

	June 25, 2011		December 25, 2010	
	Cost	Fair Value	Cost	Fair Value
Equity securities	$ 8,400	$ 7,400	$ 161,000	$ 161,000

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

	June 25, 2011	December 25,2010
Unrealized gains	$	$
Unrealized losses	(1,000)	
Net unrealized losses	$ (1,000)	$

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

	Three Months Ended		Six Months Ended	
	June 25, 2011	June 26, 2010	June 25, 2011	June 26, 2010
Realized gains	$	$ 2,100	$	$ 75,800
Realized losses				
Net realized gains/(losses)	$	$ 2,100	$	$ 75,800

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

Other Long-Term Investments

The Company has an investment in Tomsten, Inc. (Tomsten), the parent company of Archiver s retail chain. Archiver s is a retail concept created to help people preserve and enjoy their photographs. The Company has invested a total of $8.5 million in the purchase of common stock of Tomsten (including $1.0 million invested in June 2011 pursuant to a Rights Offering by Tomsten). The Company s investment currently represents 22.0% of the outstanding common stock of Tomsten (which represents an increase from 18.3% prior to the Company s participation in the Rights Offering in June 2011.) As of June 25, 2011, $0.3 million of the Company s investment, with a current carrying amount of $2.8

million, is attributable to goodwill. The amount of goodwill was determined by calculating the difference between the Company s net investment in Tomsten less its pro rata share of Tomsten s net worth. The Company also provides management services to Tomsten.

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 2011, 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, 2012. During the six months ended June 25, 2011, the Company received $28,200 in payments of interest and did not receive any payments of principal on the notes. The Company stopped accruing interest on this investment as of September 30, 2010. In evaluating this investment for impairment during the second quarter of 2011, the Company 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 concerning existing liabilities, claimant cases outstanding and historic default rates on claimant advances, and made certain

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assumptions regarding the timing of case settlements, the payment of future liabilities and future default rates. The Company recognized a $252,900 impairment charge and established a corresponding valuation allowance in the second quarter of 2011. As of June 25, 2011, the $1.75 million net investment balance is classified as long-term based on expected payments from Available Cash Flow, and $0.2 million of related interest receivable is included in current receivables.

5. Investment in Leasing Operations:

Investment in leasing operations consists of the following:

		June 25, 2011		December 25, 2010
Direct financing and sales-type leases:				
Minimum lease payments receivable	$	26,420,800	$	30,244,700
Estimated residual value of equipment		2,573,400		3,449,400
Unearned lease income net of initial direct costs deferred		(3,743,700)		(4,925,200)
Security deposits		(2,279,200)		(2,044,900)
Equipment installed on leases not yet commenced		7,118,600		4,806,000
Total investment in direct financing and sales-type leases		30,089,900		31,530,000
Allowance for credit losses		(845,500)		(907,800)
Net investment in direct financing and sales-type leases		29,244,400		30,622,200
Operating leases:				
Operating lease assets		934,100		520,200
Less accumulated depreciation and amortization		(235,600)		(483,200)
Net investment in operating leases		698,500		37,000
Total net investment in leasing operations	$	29,942,900	$	30,659,200

As of June 25, 2011, the $29.9 million total net investment in leases consists of $12.2 million classified as current and $17.7 million classified as long-term. As of December 25, 2010, the $30.7 million total net investment in leases consists of $13.9 million classified as current and $16.8 million classified as long-term.

As of June 25, 2011, leased assets with one customer approximated 15% 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 2011 and the full fiscal years thereafter as of June 25, 2011:

	Direct Financing and Sales-Type Leases:				Operating Leases:	
		Minimum Lease Payments Receivable		Income Amortization		Minimum Lease Payments Receivable
2011	$	8,676,700	$	1,573,400	$	741,200
2012		11,007,800		1,481,400		1,424,400

2013	3,623,000	421,900	1,444,900
2014	1,406,000	178,300	120,400
2015	1,208,400	82,600	
Thereafter	498,900	6,100	
	$ 26,420,800	$ 3,743,700	$ 3,730,900

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The activity in the allowance for credit losses for leasing operations during the first six months of 2011 and 2010, respectively, is as follows:

	June 25, 2011	June 26, 2010
Balance at beginning of period	$ 907,800	$ 1,339,400
Provisions charged to expense	21,300	11,900
Recoveries	178,700	285,500
Deductions for amounts written-off	(262,300)	(490,400)
Balance at end of period	$ 845,500	$ 1,146,400

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:

	June 25, 2011		December 25, 2010	
	Investment In Leases	Allowance for Credit Losses	Investment In Leases	Allowance for Credit Losses
Collectively evaluated for loss potential	$ 30,089,900	$ 845,500	$ 31,530,000	$ 907,800
Individually evaluated for loss potential				
Total	$ 30,089,900	$ 845,500	$ 31,530,000	$ 907,800

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.

	June 25, 2011				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 24,688,300	$	$	$	$ 24,688,300
Small-Ticket	5,358,600	13,600		29,400	5,401,600
Total Investment in Leases	$ 30,046,900	$ 13,600	$	$ 29,400	$ 30,089,900

	December 25, 2010				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 23,474,400	$	$	$	$ 23,474,400
Small-Ticket	7,832,200	138,800		84,600	8,055,600
Total Investment in Leases	$ 31,306,600	$ 138,800	$	$ 84,600	$ 31,530,000

6. Accounting for Stock-Based Compensation:

The Company recognizes the cost of all share-based payments to employees, including grants of employee stock options, in the consolidated financial statements based on the grant date fair value of those awards. This cost is recognized over the period for which an employee is required to provide service in exchange for the award. Compensation expense of $351,100 and $343,200 relating to the vested portion of the fair value of stock options granted was expensed to Selling, General and Administrative Expenses in the first six months of 2011 and 2010, respectively.

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The Company estimates the fair value of options granted using the Black-Scholes option valuation model. The Company estimates the volatility of its common stock at the date of grant based on its historical volatility rate over the expected term. The Company s decision to use historical volatility was based upon the lack of actively traded options on its common stock. The Company estimates the expected term based upon historical option exercises. The risk-free interest rate assumption is based on observed interest rates for the expected term. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, the Company amortizes the fair value on a straight-line basis. All options are amortized over the vesting periods.

The fair value of each option granted in 2011 and 2010 was estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

Year Granted	Option Fair Value	Risk Free Interest Rate	Expected Life (Years)	Expected Volatility	Dividend Yield
2011	$11.28	1.94%	6	28.0%	.32%
2010	$9.80 / $10.11	2.43% / 2.28%	6 / 6	28.3% / 27.8%	.26% / .24%

7. New Accounting Pronouncements:

In July 2010, the Financial Accounting Standards Board (FASB) issued new accounting guidance that requires new disclosures about an entity s allowance for credit losses and the credit quality of its financing receivables. Existing disclosures are amended to require an entity to provide certain disclosures on a disaggregated basis by portfolio segment or by class of financing receivables. The new and amended disclosures that relate to information as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company adopted the new and amended disclosures that relate to information as of the end of a reporting period in its annual report on Form 10-K for the fiscal year ending December 25, 2010 and adopted the new and amended disclosures that relate to information for activity that occurs during a reporting period in its quarterly report on Form 10-Q for the fiscal period ending March 26, 2011. See Note 5 for disclosures related to this adoption. The adoption of these disclosure requirements has not had an impact on the consolidated results of the Company.

In June 2011, the 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. Adoption of this guidance will not have an impact on the consolidated results of the Company.

8. Earnings Per Share:

The Company calculates earnings per share by dividing net income by the weighted average number of shares of common stock outstanding to arrive at the Earnings Per Share - Basic. The Company calculates Earnings Per Share - Diluted by dividing net income by the weighted average number of shares of common stock and dilutive stock equivalents from the exercise of stock options using the treasury stock method.

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The dilutive effect of stock options equivalent to 258,599 shares and 163,981 shares for the three months and 242,248 shares and 115,975 shares for the six months ended June 25, 2011 and June 26, 2010, respectively, were used in the calculation of Earnings Per Share - Diluted. Options totaling 11,459 and 18,752 shares for the three months and 20,006 shares and 35,381 shares for the six months ended June 25, 2011 and June 26, 2010, respectively, were outstanding but were not included in the calculation of Earnings Per Share Diluted because their exercise prices were greater than the average market price of the common shares and, therefore, including the options in the denominator would be anti-dilutive.

9. Shareholders Equity:

Repurchase of Common Stock

In the first six months of 2011, the Company repurchased 94,099 shares for an aggregate purchase price of $3,313,500 or $35.21 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. Since inception of stock repurchase activities in November 1995 through June 25, 2011, the Company has repurchased 4,498,733 shares of its stock at an average price of $15.12 per share. Under the board of directors authorization, as of June 25, 2011, the Company has the ability to repurchase an additional 501,267 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

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 option 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 as of June 25, 2011 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Intrinsic Value
Outstanding at December 25, 2010	644,220	$ 20.45	6.82	$ 7,571,000
Granted	46,500	37.76		
Exercised	(42,149)	17.30		
Outstanding at June 25, 2011	648,571	$ 21.90	6.70	$ 11,415,400

Exercisable at June 25, 2011	370,903	$	18.68	5.44	$	7,444,500

All unexercised options at June 25, 2011 have an exercise price equal to the fair market value on the date of the grant.

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As of June 25, 2011, the Company had $1,766,900 of total unrecognized compensation expense related to stock options that is expected to be recognized over the remaining weighted average period of approximately 2.1 years.

10. Long-term Debt:

As of June 25, 2011, there were no borrowings outstanding under the Company s Line of Credit with the PrivateBank and Trust Company and Harris, N.A.

The Line of Credit, which provides for an aggregate commitment of $30.0 million subject to certain borrowing base limitations, was used to complete the redemption of the Renewal Unsecured Subordinated Notes (as indicated below) and 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 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 June 25, 2011, the Company was in compliance with all of its financial covenants.

Renewable Unsecured Subordinated Notes

In 2006, the Company filed a public offering of up to $50 million of Renewable Unsecured Subordinated Notes that was declared effective in June of that year. Every year since the registration became effective, we have filed Post-Effective Amendments to keep the registration statement effective. On July 30, 2010, the Company redeemed all of its outstanding Renewable Unsecured Subordinated Notes and subsequently deregistered all securities pursuant to the registration. The redemption price equaled 100% of the principal amount, plus accrued and unpaid interest up to the redemption date. The Company borrowed $16.0 million on its Line of Credit to finance the redemption.

The Company made interest payments of $965,900 on the renewable unsecured subordinated notes during the first six months of 2010.

11. 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 5.57% at June 25, 2011 on a non-recourse basis. In the event of a default by a customer in non-recourse financing, the financial institution has a first lien on the underlying leased equipment, with no further recourse against the Company.

12. 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 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.

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The following tables summarize financial information by segment and provide a reconciliation of segment contribution to operating income:

	Three Months Ended		Six Months Ended	
	June 25, 2011	June 26, 2010	June 25, 2011	June 26, 2010
Revenue:				
Franchising	$ 8,224,600	$ 7,513,300	$ 16,074,500	$ 14,811,200
Leasing	7,000,200	2,365,800	10,255,200	4,910,700
Total revenue	$ 15,224,800	$ 9,879,100	$ 26,329,700	$ 19,721,900
Reconciliation to operating income:				
Franchising segment contribution	$ 3,712,300	$ 3,402,000	$ 7,453,100	$ 6,777,000
Leasing segment contribution	2,371,800	800,600	3,843,000	1,222,100
Total operating income	$ 6,084,100	$ 4,202,600	$ 11,296,100	$ 7,999,100
Depreciation and amortization:				
Leasing	$ 3,700	$ 3,500	$ 7,100	$ 7,300
Allocated	118,500	115,000	235,600	230,700
Total depreciation and amortization	$ 122,200	$ 118,500	$ 242,700	$ 238,000

	As of	
	June 25, 2011	December 25, 2010
Identifiable assets:		
Franchising	$ 2,779,700	$ 2,788,000
Leasing	30,754,600	32,962,300