

WINMARK CORP
Form 10-Q
April 23, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 29, 2014

or

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

For the transition period from to

Commission File Number: 000-22012

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, 5,121,458 shares outstanding as of April 15, 2014.

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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)

	March 29, 2014	December 28, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,411,800	\$ 10,642,600
Marketable securities	791,600	736,500
Receivables, less allowance for doubtful accounts of \$4,500 and \$4,300	1,047,800	1,205,500
Net investment in leases - current	17,174,700	17,239,900
Income tax receivable		166,500
Inventories	96,700	96,700
Prepaid expenses	581,700	587,300
Total current assets	22,104,300	30,675,000
Net investment in leases - long-term	22,841,900	20,301,400
Property and equipment, net	1,405,200	1,382,200
Other assets	677,500	677,500
	\$ 47,028,900	\$ 53,036,100
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Line of credit	\$ 14,000,000	\$
Accounts payable	1,616,700	2,441,400
Income tax payable	1,829,200	
Accrued liabilities	2,126,400	1,233,100
Discounted lease rentals	378,900	424,900
Deferred revenue	2,288,800	2,199,900
Deferred income taxes	4,208,200	4,208,200
Total current liabilities	26,448,200	10,507,500
Long-Term Liabilities:		
Discounted lease rentals	204,300	277,400
Deferred revenue	1,238,700	1,180,700
Other liabilities	1,480,500	1,489,000
Deferred income taxes	1,436,800	1,436,800
Total long-term liabilities	4,360,300	4,383,900
Shareholders Equity:		
Common stock, no par, 10,000,000 shares authorized, 5,144,589 and 5,143,530 shares issued and outstanding	2,506,500	2,949,500
Accumulated other comprehensive loss	(13,900)	(4,100)
Retained earnings	13,727,800	35,199,300

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Total shareholders equity	16,220,400	38,144,700
	\$ 47,028,900	\$ 53,036,100

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	
	March 29, 2014	March 30, 2013
REVENUE:		
Royalties	\$ 8,810,000	\$ 8,474,900
Leasing income	4,375,600	3,407,800
Merchandise sales	788,000	665,700
Franchise fees	349,000	414,600
Other	230,000	185,400
Total revenue	14,552,600	13,148,400
COST OF MERCHANDISE SOLD	754,700	641,100
LEASING EXPENSE	306,600	279,700
PROVISION FOR CREDIT LOSSES	38,900	13,800
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	6,017,900	5,537,900
Income from operations	7,434,500	6,675,900
INTEREST EXPENSE	(62,100)	(89,500)
INTEREST AND OTHER INCOME (EXPENSE)	100	(10,200)
Income before income taxes	7,372,500	6,576,200
PROVISION FOR INCOME TAXES	(2,820,600)	(2,518,700)
NET INCOME	\$ 4,551,900	\$ 4,057,500
EARNINGS PER SHARE BASIC	\$.88	\$.81
EARNINGS PER SHARE DILUTED	\$.86	\$.78
WEIGHTED AVERAGE SHARES OUTSTANDING BASIC	5,148,519	4,997,322
WEIGHTED AVERAGE SHARES OUTSTANDING DILUTED	5,307,946	5,202,696

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

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WINMARK CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended	
	March 29, 2014	March 30, 2013
NET INCOME	\$ 4,551,900	\$ 4,057,500
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX:		
Unrealized net gains (losses) on marketable securities:		
Unrealized holding net gains (losses) arising during period	(12,000)	3,400
Reclassification adjustment for net gains included in net income	(3,800)	
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX	(15,800)	3,400
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME:		
Unrealized net gains/losses on marketable securities:		
Unrealized holding net gains arising during period	4,600	(1,300)
Reclassification adjustment for net gains included in net income	1,400	
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME	6,000	(1,300)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	(9,800)	2,100
COMPREHENSIVE INCOME	\$ 4,542,100	\$ 4,059,600

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)

	Three Months Ended	
	March 29, 2014	March 30, 2013
OPERATING ACTIVITIES:		
Net income	\$ 4,551,900	\$ 4,057,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	105,300	107,000
Provision for credit losses	38,900	13,800
Compensation expense related to stock options	344,500	261,700
Gain on sale of marketable securities	(9,400)	
Deferred initial direct costs	(520,300)	(172,900)
Amortization of deferred initial direct costs	163,600	140,800
Tax benefits on exercised stock options	(60,000)	
Change in operating assets and liabilities:		
Receivables	157,700	26,000
Income tax receivable / payable	2,061,700	2,158,800
Inventories		(800)
Prepaid expenses	5,600	22,700
Accounts payable	(824,700)	(375,200)
Accrued and other liabilities	876,600	311,400
Rents received in advance and security deposits	(41,100)	265,100
Deferred revenue	146,900	(92,900)
Net cash provided by operating activities	6,997,200	6,723,000
INVESTING ACTIVITIES:		
Proceeds from sale of marketable securities	463,000	
Purchase of marketable securities	(524,500)	
Purchase of property and equipment	(128,300)	(53,600)
Purchase of equipment for lease contracts	(6,499,900)	(4,673,500)
Principal collections on lease receivables	4,272,600	4,530,300
Net cash used for investing activities	(2,417,100)	(196,800)
FINANCING ACTIVITIES:		
Proceeds from borrowings on line of credit	14,000,000	
Payments on line of credit		(6,300,000)
Repurchases of common stock	(1,075,100)	(269,600)
Proceeds from exercises of stock options	227,600	120,600
Dividends paid	(26,023,400)	(200,000)
Proceeds from discounted lease rentals		80,900
Tax benefits on exercised stock options	60,000	
Net cash used for financing activities	(12,810,900)	(6,568,100)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(8,230,800)	(41,900)
Cash and cash equivalents, beginning of period	10,642,600	2,233,400
Cash and cash equivalents, end of period	\$ 2,411,800	\$ 2,191,500

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SUPPLEMENTAL DISCLOSURES:

Cash paid for interest	\$	29,800	\$	84,700
Cash paid for income taxes	\$	762,300	\$	359,800

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 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 three months ended March 29, 2014 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®, Once Upon A Child®, Play It Again Sports®, Music Go Round® and Style Encore®. 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.

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4. Investments:

Marketable Securities

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

	March 29, 2014		December 28, 2013	
	Cost	Fair Value	Cost	Fair Value
Equity securities	\$ 814,000	\$ 791,600	\$ 743,100	\$ 736,500

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

	March 29, 2014		December 28, 2013	
	Unrealized gains	\$ 5,800	\$ 6,800	
Unrealized losses	(28,200)	(13,400)		
Net unrealized losses	\$ (22,400)	\$ (6,600)		

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

	Three Months Ended	
	March 29, 2014	March 30, 2013
Realized gains	\$ 22,200	\$
Realized losses	(12,800)	
Net realized gains	\$ 9,400	\$

Amounts reclassified out of accumulated other comprehensive loss into earnings is determined by using the average cost of the security when sold. Gross realized gains (losses) reclassified out of accumulated other comprehensive loss into earnings are included in Interest and Other Income (Expense) and the related tax benefits (expenses) are included in the Provision for Income Taxes lines of the Consolidated Condensed Statements of Operations.

5. Investment in Leasing Operations:

Investment in leasing operations consists of the following:

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	March 29, 2014	December 28, 2013
Direct financing and sales-type leases:		
Minimum lease payments receivable	\$ 38,245,300	\$ 35,450,900
Estimated residual value of equipment	3,953,400	4,348,800
Unearned lease income net of initial direct costs deferred	(6,700,400)	(4,963,400)
Security deposits	(3,276,300)	(3,325,600)
Equipment installed on leases not yet commenced	8,570,300	6,718,000
Total investment in direct financing and sales-type leases	40,792,300	38,228,700
Allowance for credit losses	(870,600)	(822,700)
Net investment in direct financing and sales-type leases	39,921,700	37,406,000
Operating leases:		
Operating lease assets	375,200	1,353,500
Less accumulated depreciation and amortization	(280,300)	(1,218,200)
Net investment in operating leases	94,900	135,300
Total net investment in leasing operations	\$ 40,016,600	\$ 37,541,300

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As of March 29, 2014, the \$40.0 million total net investment in leases consists of \$17.2 million classified as current and \$22.8 million classified as long-term. As of December 28, 2013, the \$37.5 million total net investment in leases consists of \$17.2 million classified as current and \$20.3 million classified as long-term.

As of March 29, 2014, no customer had leased assets totaling more than 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 2014 and the full fiscal years thereafter as of March 29, 2014:

	Direct Financing and Sales-Type Leases		Operating Leases	
	Minimum Lease	Income	Minimum Lease	
	Payments Receivable	Amortization	Payments Receivable	
2014	\$ 17,918,600	\$ 4,101,800	\$ 204,800	
2015	15,189,200	2,200,900	76,800	
2016	4,953,500	396,500		
2017	184,000	1,200		
2018				
Thereafter	\$ 38,245,300	\$ 6,700,400	\$ 281,600	

The activity in the allowance for credit losses for leasing operations during the first three months of 2014 and 2013, respectively, is as follows:

	March 29, 2014		March 30, 2013	
Balance at beginning of period	\$	822,700	\$	775,800
Provisions charged to expense		38,900		13,800
Recoveries		9,000		21,300
Deductions for amounts written-off				(10,900)
Balance at end of period	\$	870,600	\$	800,000

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:

	March 29, 2014		December 28, 2013	
	Investment	Allowance for	Investment	Allowance for
	In Leases	Credit Losses	In Leases	Credit Losses
Collectively evaluated for loss potential	\$ 40,792,300	\$ 870,600	\$ 38,228,700	\$ 822,700
Individually evaluated for loss potential				
Total	\$ 40,792,300	\$ 870,600	\$ 38,228,700	\$ 822,700

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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.

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	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	March 29, 2014 Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	\$ 39,281,800	\$	\$	\$ 322,300	\$ 39,604,100
Small-Ticket	1,188,200				1,188,200
Total Investment in Leases	\$ 40,470,000	\$	\$	\$ 322,300	\$ 40,792,300

	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	December 28, 2013 Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	\$ 36,716,100	\$	\$	\$ 416,400	\$ 37,132,500
Small-Ticket	1,096,200				1,096,200
Total Investment in Leases	\$ 37,812,300	\$	\$	\$ 416,400	\$ 38,228,700

6. 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	
	March 29, 2014	March 30, 2013
Denominator for basic EPS weighted average common shares	5,148,519	4,997,322
Dilutive shares associated with option plans	159,427	205,374
Denominator for diluted EPS weighted average common shares and dilutive potential common shares	5,307,946	5,202,696
Options excluded from EPS calculation anti-dilutive	13,938	9,299

7. Shareholders Equity:

Dividends

On January 29, 2014, the Company's Board of Directors approved the payment of a \$0.05 per share quarterly cash dividend to shareholders of record at the close of business on February 12, 2014, which was paid on March 3, 2014.

On February 4, 2014, the Company's Board of Directors approved the payment of a \$5.00 per share special cash dividend (the 2014 Special Dividend) to shareholders of record at the close of business February 17, 2014, which was paid on March 3, 2014. The 2014 Special Dividend totaled \$25.8 million and was financed by a combination of cash on hand as well as net borrowings under the Line of Credit of \$13.0 million (see Note 8 Line of Credit).

Repurchase of Common Stock

In the first three months of 2014 the Company repurchased 14,066 shares of its common stock for an aggregate price of \$1,075,100 or \$76.43 per share. Under the Board of Directors' authorization, as of March 29, 2014, the Company has the ability to repurchase an additional 318,664 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.

Table of Contents**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. As of March 29, 2014, 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, as of March 29, 2014, 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 March 29, 2014 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Intrinsic Value
Outstanding at December 28, 2013	526,712	\$ 42.87	7.33	\$ 26,446,700
Exercised	(15,125)	15.05		
Outstanding at March 29, 2014	511,587	\$ 43.69	7.14	\$ 16,222,100
Exercisable at March 29, 2014	258,762	\$ 30.50	5.92	\$ 11,418,400

No options were granted during the three months ended March 29, 2014 or the three months ended March 30, 2013. All unexercised options at March 29, 2014 have an exercise price equal to the fair market value on the date of the grant.

Compensation expense of \$344,500 and \$261,700 relating to the vested portion of the fair value of stock options granted was expensed to Selling, General and Administrative Expenses in the first three months of 2014 and 2013, respectively. As of March 29, 2014, the Company had \$3.0 million of total unrecognized compensation expense related to stock options that is expected to be recognized over the remaining weighted average vesting period of approximately 2.4 years.

8. Line of Credit

On February 21, 2014, the Company's Line of Credit with The PrivateBank and Trust Company and BMO Harris Bank N.A. was amended to, among other things, amend certain financial covenant calculations to remove the effect of the 2014 Special Dividend in such calculations, to reduce the applicable margin on the interest rate options, and to extend the termination date from February 29, 2016 to February 28, 2018.

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The Line of Credit provides for an aggregate commitment of \$35.0 million, subject to certain borrowing base limitations. During the first three months of 2014, the Line of Credit was used to finance in part the 2014 Special Dividend (as indicated above) 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 March 29, 2014, the Company was in compliance with all of its financial covenants. There were \$14.0 million in borrowings outstanding under the Line of Credit bearing interest ranging from 2.40% to 3.25%, leaving \$21.0 million available for additional borrowings.

Table of Contents**9. Discounted Lease Rentals:**

The Company utilized certain lease receivables and underlying expenses as collateral to borrow from financial institutions at a weighted average rate of 3.27% at March 29, 2014 on a non-recourse basis.

10. 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 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:

	Three Months Ended	
	March 29, 2014	March 30, 2013
Revenue:		
Franchising	\$ 10,177,000	\$ 9,740,600
Leasing	4,375,600	3,407,800
Total revenue	\$ 14,552,600	\$ 13,148,400
Reconciliation to operating income:		
Franchising segment contribution	\$ 4,701,200	\$ 4,834,100
Leasing segment contribution	2,733,300	1,841,800
Total operating income	\$ 7,434,500	\$ 6,675,900
Depreciation:		
Franchising	\$ 83,100	\$ 84,200
Leasing	22,200	22,800
Total depreciation	\$ 105,300	\$ 107,000

	As of	
	March 29, 2014	December 28, 2013
Identifiable assets:		
Franchising	\$ 2,534,100	\$ 7,407,400
Leasing	41,499,000	42,490,800
Unallocated	2,995,800	3,137,900
Total	\$ 47,028,900	\$ 53,036,100

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

As of March 29, 2014, we had 1,021 franchises operating under the Plato's Closet, Once Upon A Child, Play it Again Sports, Music Go Round and Style Encore brands and had a leasing portfolio of \$40.0 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 three months of 2014, our royalties increased \$0.3 million or 4.0% compared to the first three months of 2013.

During the first three months of 2014, we purchased \$6.5 million in equipment for lease customers compared to \$4.7 million in the first three months of 2013. Overall, our leasing portfolio (net investment in leases – current and long-term) increased to \$40.0 million at March 29, 2014 from \$37.5 million at December 28, 2013. Leasing income net of leasing expense during the first three months of 2014 was \$4.1 million compared to \$3.1 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.

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 three months of 2014, selling, general and administrative expense increased \$0.5 million, or 8.7%, compared to the first three months of 2013.

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 three months ended March 29, 2014:

	TOTAL 12/28/13	OPENED	CLOSED	TOTAL 3/29/14	THREE MONTHS ENDED 3/29/14 AVAILABLE FOR RENEWAL	COMPLETED RENEWALS
Plato's Closet						
Franchises - US and Canada	391	6	0	397	6	6
Once Upon A Child						
Franchises - US and Canada	282	6	0	288	12	12
Play It Again Sports						
Franchises - US and Canada	300	0	0	300	11	10

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Music Go Round

Franchises - US	29	0	0	29	1	1
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Style Encore

Franchises - US	3	4	0	7		
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Total Franchised Stores	1,005	16	0	1,021	30	29
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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 three months of 2014, we renewed 29 of the 30 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.

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	
	March 29, 2014	March 30, 2013
Revenue:		
Royalties	60.5%	64.5%
Leasing income	30.1	25.9
Merchandise sales	5.4	5.1
Franchise fees	2.4	3.1
Other	1.6	1.4
Total revenue	100.0%	100.0%
Cost of merchandise sold	(5.2)	(4.9)
Leasing expense	(2.1)	(2.1)
Provision for credit losses	(0.3)	(0.1)
Selling, general and administrative expenses	(41.3)	(42.1)
Income from operations	51.1	50.8
Interest expense	(0.4)	(0.7)
Interest and other income (expense)		(0.1)
Income before income taxes	50.7	50.0
Provision for income taxes	(19.4)	(19.2)
Net income	31.3%	30.8%

Comparison of Three Months Ended March 29, 2014 to Three Months Ended March 30, 2013**Revenue**

Revenues for the first three months of 2014 totaled \$14.6 million compared to \$13.1 million for the comparable period in 2013.

Royalties and Franchise Fees

Royalties increased to \$8.8 million for the first three months of 2014 from \$8.5 million for the first three months of 2013, a 4.0% increase. The increase was due to higher Once Upon A Child and Plato's Closet royalties of \$0.2 million and \$0.1 million, respectively. The increase in royalties for these brands is primarily from having 18 additional Once Upon A Child and 30 additional Plato's Closet franchise stores in the first three months of 2014 compared to the same period last year.

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Franchise fees decreased to \$349,000 for the first three months of 2014 compared to \$414,600 for the first three months of 2013, primarily as a result of opening five fewer franchises in the 2014 period compared to the same period in 2013.

Leasing Income

Leasing income increased to \$4.4 million for the first three months of 2014 compared to \$3.4 million for the same period in 2013. The increase is primarily due to a higher level of equipment sales to customers as well as the classification of certain leases as sales-type leases in accordance with accounting guidance applicable to lessors.

Merchandise Sales

Merchandise sales include the sale of product to franchisees either through our Computer Support Center or through the Play It Again Sports buying group (together, Direct Franchisee Sales). Direct Franchisee Sales increased to \$788,000 for the first three months of 2014 compared to \$665,700 in the same period of 2013. The increase is due to an increase in technology purchases by our franchisees.

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 \$754,700 for the first three months of 2014 compared to \$641,100 in the same period of 2013. 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 three months of 2014 and 2013 was 95.8% and 96.3%, respectively.

Leasing Expense

Leasing expense increased to \$306,600 for the first three months of 2014 compared to \$279,700 for the first three months of 2013. 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 \$38,900 for the first three months of 2014 compared to \$13,800 for the first three months of 2013. The increase in provision for credit losses is primarily due to the increase in lease payments receivable associated with the larger lease portfolio.

Selling, General and Administrative

Selling, general and administrative expenses increased 8.7% to \$6.0 million in the first three months of 2013 from \$5.5 million in the same period of 2012. The increase was primarily due to an increase in compensation and benefits expenses.

Interest Expense

Interest expense decreased to \$62,100 for the first three months of 2014 compared to \$89,500 for the first three months of 2013. The decrease is primarily due to lower average corporate borrowings when compared to last year.

Interest and Other Income (Expense)

During the first three months of 2014, we had interest and other income of \$100 compared to \$(10,200) of interest and other income (expense) in the first three months of 2013. Interest and other income during the first quarter of 2014 included gains on sales of marketable securities that did not occur during the first quarter of 2013. (See Note 4 Investments).

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Income Taxes

The provision for income taxes was calculated at an effective rate of 38.3% for the first three months of 2014 and 2013.

Segment Comparison of Three Months Ended March 29, 2014 to Three Months Ended March 30, 2013

Franchising Segment Operating Income

The franchising segment's operating income for the first three months of 2014 of \$4.7 million was comparable to \$4.8 million for the first three months of 2013.

Leasing Segment Operating Income

The leasing segment's operating income for the first three months of 2014 increased by \$0.9 million to \$2.7 million from \$1.8 million for the first three months of 2013. 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 condensed statement of operations that reduce our net income but do not affect our liquidity include non-cash items for depreciation and compensation expense related to stock options.

We ended the first quarter of 2014 with \$2.4 million in cash and cash equivalents and a current ratio (current assets divided by current liabilities) of 0.8 to 1.0 compared to \$2.2 million in cash and cash equivalents and a current ratio of 1.3 to 1.0 at the end of the first quarter of 2013.

Operating activities provided \$7.0 million of cash during the first three months of 2014 compared to \$6.7 million provided during the same period last year. The increase in cash provided by operating activities in the first three months of 2014 compared to 2013 primarily resulted from the increase in net income.

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Investing activities used \$2.4 million of cash during the first three months of 2014. The 2014 activities consisted primarily of the purchase of equipment for lease customers of \$6.5 million and principal collections on lease receivables of \$4.3 million.

Financing activities used \$12.8 million of cash during the first three months of 2014. Our most significant financing activities during the first quarter of 2014 consisted of \$26.0 million for the payment of dividends, \$1.1 million to repurchase 14,066 shares of our common stock and borrowings on our line of credit of \$14.0 million, with such borrowings incurred primarily to fund in part the dividends and stock repurchases. (See Note 7 Shareholders Equity and Note 8 Line of Credit).

As of March 29, 2014, we had no off balance sheet arrangements.

As of March 29, 2014, 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 \$14.0 million in borrowings outstanding at March 29, 2014 under the Line of Credit bearing interest ranging from 2.40% to 3.25%, leaving \$21.0 million available for additional borrowings.

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The Line of Credit, which has a termination date of February 28, 2018, 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 March 29, 2014, 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 2014.

Critical Accounting Policies

The Company prepares the consolidated condensed 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

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 three months of 2014, the Company collected \$18,700 more than it estimated at December 28, 2013. As of March 29, 2014, the Company's royalty receivable was \$952,800.

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 condensed balance sheet. As of March 29, 2014, deferred franchise fees were \$2,130,100.

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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

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.

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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.

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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 28, 2013 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.

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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 March 29, 2014, 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 \$14.0 million of debt outstanding at March 29, 2014 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 March 29, 2014, a one percent increase in short-term rates would reduce annual pretax earnings by \$140,000. The Company had no interest rate derivatives in place at March 29, 2014.

None of the Company's cash and cash equivalents at March 29, 2014 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 three months ended March 29, 2014. 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 28, 2013. 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 28, 2013.

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
December 29, 2013 to February 1, 2014		\$		332,730
February 2, 2014 to March 1, 2014		\$		332,730
March 2, 2014 to March 29, 2014	14,066	\$ 76.43	14,066	318,664

(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 318,664 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 first quarter covered by this Form 10-Q has been reported.

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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 March 29, 2014, 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.

*Filed Herewith

(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.

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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.

WINMARK CORPORATION

Date: April 23, 2014

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

Date: April 23, 2014

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

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EXHIBIT INDEX

WINMARK CORPORATION

FORM 10-Q FOR QUARTER ENDED MARCH 29, 2014

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