BUILD A BEAR WORKSHOP INC
Form 10-Q
May 11, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended April 1, 2017

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: 001-32320

BUILD-A-BEAR WORKSHOP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**43-1883836**
(State or Other Jurisdiction of Incorporation or Organization)	**(IRS Employer Identification No.)**

1954 Innerbelt Business Center Drive
St. Louis, Missouri **63114**

(Address of Principal Executive Offices) (Zip Code)

(314) 423-8000

(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 website, 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 emerging growth company. See definitions of "large accelerated filer," "accelerated filer" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Emerging growth company Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 14(a) of the Exchange Act.

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

As of May 5, 2017, there were 16,002,021 issued and outstanding shares of the registrant's common stock.

BUILD-A-BEAR WORKSHOP, INC.

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PART I-FINANCIAL INFORMATION

Item 1. Financial Statements.

BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share data)

	April 1, 2017 (Unaudited)	December 31, 2016	April 2, 2016 (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 35,627	$ 32,483	$ 30,778
Inventories	53,315	51,885	53,982
Receivables	6,395	12,939	10,440
Prepaid expenses and other current assets	10,158	12,737	15,070
Total current assets	105,495	110,044	110,270
Property and equipment, net of accumulated depreciation of $173,804; $172,333 and $185,915, respectively	73,246	74,924	68,886
Deferred tax assets	9,543	8,256	10,863
Other intangible assets, net	1,588	1,721	1,557
Other assets, net	2,384	4,650	4,439
Total Assets	$ 192,256	$ 199,595	$ 196,015
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	$ 21,921	$ 27,861	$ 27,812
Accrued expenses	14,141	15,897	17,960
Gift cards and customer deposits	31,841	37,070	31,617
Deferred revenue	1,838	2,029	2,485
Other current liabilities	69	-	-

Total current liabilities	69,810	82,857	79,874
Deferred rent	16,460	15,438	13,167
Deferred franchise revenue	528	565	681
Other liabilities	1,879	1,623	1,213
Stockholders' equity:			
Preferred stock, par value $0.01, Shares authorized: 15,000,000; No shares issued or outstanding at April 1, 2017, December 31, 2016 and April 2, 2016	-	-	-
Common stock, par value $0.01, Shares authorized: 50,000,000; Issued and outstanding: 16,002,935; 15,856,927 and 15,815,211 shares, respectively	160	159	158
Additional paid-in capital	68,902	68,001	65,713
Accumulated other comprehensive loss	(12,505)	(12,727)	(10,614)
Retained earnings	47,022	43,679	45,823
Total stockholders' equity	103,579	99,112	101,080
Total Liabilities and Stockholders' Equity	$ 192,256	$ 199,595	$ 196,015

See accompanying notes to condensed consolidated financial statements.

BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED INCOME STATEMENTS
AND STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands, except share and per share data)

	Thirteen weeks ended April 1, 2017	Thirteen weeks ended April 2, 2016
Revenues:		
Net retail sales	$88,586	$94,056
Commercial revenue	1,607	481
Franchise fees	439	439
Total revenues	90,632	94,976
Costs and expenses:		
Cost of merchandise sold - retail	46,868	48,557
Cost of merchandise sold - commercial	891	249
Selling, general and administrative	37,649	39,681
Store preopening	639	1,244
Interest (income) expense, net	(10)	(27)
Total costs and expenses	86,037	89,704
Income before income taxes	4,595	5,272
Income tax expense	1,830	1,754
Net income	$2,765	$3,518
Foreign currency translation adjustment	222	(643)
Comprehensive income	$2,987	$2,875
Income per common share:		
Basic	$0.17	$0.22
Diluted	$0.17	$0.22
Shares used in computing common per share amounts:		
Basic	15,539,939	15,410,699
Diluted	15,709,591	15,592,347

See accompanying notes to condensed consolidated financial statements.

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BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(dollars in thousands)

	Thirteen weeks ended	
	April 1, 2017	**April 2, 2016**
Cash flows from operating activities:		
Net income	$2,765	$3,518
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	3,926	3,811
Deferred taxes	1,905	4
Stock-based compensation	1,016	671
Store asset impairment	82	50
Provision for doubtful accounts	56	-
Loss on disposal of property and equipment	-	111
Change in assets and liabilities:		
Inventories	(1,263)	146
Receivables	6,511	2,748
Prepaid expenses and other assets	2,628	(562)
Accounts payable and accrued expenses	(7,265)	(14,691)
Lease related liabilities	999	1,023
Gift cards and customer deposits	(5,273)	(3,654)
Deferred revenue	(232)	(180)
Net cash provided by (used in) operating activities	5,855	(7,005)
Cash flows from investing activities:		
Purchases of property and equipment, net	(2,178)	(6,185)
Purchases of other assets and other intangible assets	(112)	-
Proceeds from maturity of short-term investments	-	1,461
Net cash used in investing activities	(2,290)	(4,724)
Cash flows from financing activities:		
Proceeds from the exercise of employee stock options, net of withholding tax payments	(358)	(410)
Payments made under capital leases	(16)	-
Purchases of Company's common stock	-	(1,469)
Net cash used in financing activities	(374)	(1,879)
Effect of exchange rates on cash	(47)	(810)
Net decrease in cash and cash equivalents	3,144	(14,418)

Cash and cash equivalents, beginning of period	32,483	45,196
Cash and cash equivalents, end of period	$35,627	$30,778

See accompanying notes to condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited and have been prepared by Build-A-Bear Workshop, Inc. and its subsidiaries (collectively, the Company) pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet of the Company as of December 31, 2016 was derived from the Company's audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and reflect all adjustments which are, in the opinion of management, necessary to summarize fairly the financial position of the Company and the results of the Company's operations and cash flows for the periods presented. All of these adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Because of the seasonal nature of the Company's operations, results of operations of any single reporting period should not be considered as indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fiscal year ended December 31, 2016, which were included in the Company's annual report on Form 10-K filed with the SEC on March 16, 2017.

The Company adopted Accounting Standards Update (ASU) No. 2016-09, *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting,* effective January 1, 2017. The Company made an accounting policy election to account for forfeitures as they occur. The impact of this election, along with the adoption of the other provisions of the standard in the first quarter of 2017, was to increase deferred tax assets by $1.6 million, increase additional paid-in-capital by $0.3 million, increase retained earnings by $1.9 million and decrease taxes payable by $0.6 million.

Additionally, the Company early adopted ASU No. 2016-16, *Income Taxes – Intra-Entity Transfers of Assets Other Than Inventory,* effective January 1, 2017. Using the modified retrospective method, the impact of the adoption of the standard in the first quarter of 2017 was to increase deferred tax assets by $1.0 million, decrease other assets, net by $2.3 million and decrease retained earnings by $1.3 million.

2. Prepaid Expenses and Other Assets

Prepaid expenses and other current assets consist of the following (in thousands):

	April 1, 2017	December 31, 2016	April 2, 2016
Prepaid rent	$5,132	$ 7,191	$7,833
Other	5,026	5,546	7,237
Total	$10,158	$ 12,737	$15,070

3. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	April 1, 2017	December 31, 2016	April 2, 2016
Accrued wages, bonuses and related expenses	$7,512	$ 5,596	$9,373
Sales tax payable	2,354	5,075	2,049
Accrued rent and related expenses	3,996	4,615	4,579
Current income taxes payable	279	611	1,959
Total	$14,141	$ 15,897	$17,960

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4. Stock-based Compensation

For the thirteen weeks ended April 1, 2017 and April 2, 2016, selling, general and administrative expenses include $1.0 million and $0.7 million of stock-based compensation expense, respectively. As of April 1, 2017, there was $5.9 million of total unrecognized compensation expense related to nonvested restricted stock and option awards which is expected to be recognized over a weighted-average period of 1.8 years.

The following table is a summary of the balances and activity related to stock options for the thirteen weeks ended April 1, 2017:

	Options	
	Shares	**Weighted Average Exercise Price**
Outstanding, December 31, 2016	757,784	$ 9.91
Granted	72,051	8.85
Exercised	769	6.21
Forfeited	23,549	13.49
Canceled or expired	—	—
Outstanding, April 1, 2017	805,517	$ 9.71

The following table is a summary of the balances and activity for time-based and performance-based restricted stock for the thirteen weeks ended April 1, 2017:

	Restricted Stock		**Performance Shares**	
	Shares	**Weighted Average Grant Date Fair Value**	**Shares**	**Weighted Average Grant Date Fair Value**
Outstanding, December 31, 2016	316,116	$ 13.30	241,141	$ 15.39
Granted	205,878	8.85	83,897	8.85
Vested	104,795	13.01	6,473	20.54
Forfeited	18,337	13.42	15,098	14.21
Canceled or expired	—	—	13,704	13.68
Outstanding, April 1, 2017	398,862	$ 11.07	289,763	$ 13.66

The total fair value of shares of time-based and performance-based restricted stock vested during the thirteen weeks ended April 1, 2017 and April 2, 2016 was $1.5 million and $1.2 million, respectively.

In March 2017, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established consolidated total pre-tax income goals for fiscal 2017, 2018 and 2019. These shares have a payout opportunity ranging from 25% to 200% of the target number of shares. In 2017, 13,704 performance shares issued in fiscal 2016 were canceled as the pre-established pre-tax income objectives for 2016 were not achieved.

The outstanding performance shares as of April 1, 2017 consist of the following:

	Performance Shares
Earned shares subject to time-based restrictions at actual	6,473
Unearned shares subject to performance-based restrictions at target:	
2015 - 2017 consolidated total revenues	50,000
2016 - 2018 consolidated total revenues	149,393
2017 - 2019 consolidated pre-tax income	83,897
Performance shares outstanding, April 1, 2017	289,763

5. Income Taxes

The effective tax rate was 39.8% for the thirteen weeks ended April 1, 2017, compared to 33.3% for the thirteen weeks ended April 2, 2016. In the first quarter of fiscal 2017, the effective tax rate differed from the statutory rate of 34% primarily due to the implementation of the new accounting standard related to the accounting for the tax impact of equity awards vesting.

6. Stockholders' Equity

The following table sets forth the changes in stockholders' equity for the thirteen weeks ended April 1, 2017 and April 2 2016:

	Thirteen weeks ended	
	April 1, 2017	**April 2, 2016**
Beginning balance	$99,112	$99,414
Stock-based compensation	1,016	671
Shares issued under employee stock plans	(358)	(411)
Adoption of new accounting standards	822	-
Share repurchase and retirement	-	(1,469)
Other comprehensive income (loss)	222	(643)
Net income	2,765	3,518
Ending balance	$103,579	$101,080

7. Income per Share

The Company uses the two-class method to compute basic and diluted income per common share. The following table sets forth the computation of basic and diluted income per share (in thousands, except share and per share data):

	Thirteen weeks ended	
	April 1, 2017	**April 2, 2016**

NUMERATOR:		
Net income before allocation of earnings to participating securities	$2,765	$3,518
Less: Earnings allocated to participating securities	59	73
Net income after allocation of earnings to participating securities	$2,706	$3,445
DENOMINATOR:		
Weighted average number of common shares outstanding - basic	15,539,939	15,410,699
Dilutive effect of share-based awards	169,652	181,648
Weighted average number of common shares outstanding - dilutive	15,709,591	15,592,347
Basic income per common share attributable to Build-A-Bear Workshop, Inc. stockholders:	$0.17	$0.22
Diluted income per common share attributable to Build-A-Bear Workshop, Inc. stockholders	$0.17	$0.22

In calculating diluted earnings per share for the thirteen week periods ended April 1, 2017 and April 2, 2016, options to purchase 287,385 shares and 154,655 shares, respectively, of common stock that were outstanding at the end of the period were not included in the computation of diluted income per share due to their anti-dilutive effect.

8. Comprehensive Income

The difference between comprehensive income and net income results from foreign currency translation adjustments on the balance sheets of subsidiaries whose functional currency is not the U.S. Dollar. The accumulated other comprehensive loss balance at April 1, 2017, December 31, 2016 and April 2, 2016 is comprised entirely of foreign currency translation. For the thirteen weeks ended April 1, 2017 and April 2, 2016, there were no reclassifications out of accumulated other comprehensive loss.

9. Segment Information

The Company's operations are conducted through three operating segments consisting of direct-to-consumer (DTC), formerly retail, international franchising, and commercial. The DTC segment includes the operating activities of company-owned stores in the United States, Canada, the United Kingdom, Ireland, Denmark and China and other retail delivery operations, including the Company's e-commerce sites and temporary stores. The international franchising segment includes the licensing activities of the Company's franchise agreements with store locations in Europe (outside of the United Kingdom, Ireland and Denmark), Asia, Australia, the Middle East, Africa and Mexico. The commercial segment includes the Company's transactions with other businesses, mainly comprised of licensing the Company's intellectual properties for third party use and wholesale activities. The operating segments have discrete sources of revenue, different capital structures and different cost structures. These operating segments represent the basis on which the Company's chief operating decision maker regularly evaluates the business in assessing performance, determining the allocation of resources and the pursuit of future growth opportunities. Accordingly, the Company has determined that each of its operating segments represent a reportable segment. The three reportable segments follow the same accounting policies used for the Company's consolidated financial statements.

Following is a summary of the financial information for the Company's reportable segments (in thousands):

	Direct-to-Consumer	**Commercial**	**International Franchising**	**Total**
Thirteen weeks ended April 1, 2017				
Net sales to external customers	$ 88,586	$ 1,607	$ 439	$ 90,632
Income before income taxes	3,817	603	175	4,595
Capital expenditures, net	2,290	-	-	2,290
Depreciation and amortization	3,908	1	17	3,926
Thirteen weeks ended April 2, 2016				
Net sales to external customers	94,056	481	439	94,976
Income before income taxes	5,196	143	(67)	5,272
Capital expenditures, net	6,179	-	6	6,185
Depreciation and amortization	3,769	1	41	3,811
Total Assets as of:				
April 1, 2017	$ 184,021	$ 5,585	$ 2,650	$ 192,256
April 2, 2016	$ 188,999	$ 5,305	$ 1,711	$ 196,015

The Company's reportable segments are primarily determined by the types of products and services that they offer. Each reportable segment may operate in many geographic areas. The Company allocates revenues to geographic areas based on the location of the customer or franchisee. The following schedule is a summary of the Company's sales to external customers and long-lived assets by geographic area (in thousands):

	North America (1)	**Europe** (2)	**Other** (3)	**Total**
Thirteen weeks ended April 1, 2017				
Net sales to external customers	$76,725	$13,440	$467	$90,632
Property and equipment, net	64,554	8,656	36	73,246
Thirteen weeks ended April 2, 2016				
Net sales to external customers	$79,507	$15,208	$261	$94,976
Property and equipment, net	61,164	7,313	409	68,886

For purposes of this table only:

(1) North America includes the United States, Canada, Puerto Rico and franchise business in Mexico

(2) Europe includes the United Kingdom, Ireland, Denmark and franchise businesses in Europe

(3) Other includes franchise businesses outside of North America and Europe and, beginning in 2016, a company-owned store in China

10. Contingencies

In the normal course of business, the Company is subject to regular examination by various taxing authorities for years not closed by the statute of limitations. If one or more of these examinations has an unfavorable resolution, it is possible that the results of operations, liquidity or financial position of the Company could be materially affected in any particular period. The Company accrues a liability for this type of contingency when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. Gain contingencies are recorded when the underlying uncertainty has been settled. Assessments made by the United Kingdom customs authority in 2012 have been appealed by the Company, which has paid the disputed duty, strictly under protest, pending the outcome of the continuing dispute, and this is included in receivables in the DTC segment. The United Kingdom customs authority is contesting the Company's appeal. The Company maintains a provision against the related receivable based on a current evaluation of collectability, using the latest facts available in the dispute. As of April 1, 2017, the Company had a gross receivable balance of $3.1 million and a reserve of $2.5 million, leaving a net receivable of $0.6 million. However, the Company continues to vigorously dispute the customs audit findings and believes that the outcome of this dispute will not have a material adverse impact on the results of operations, liquidity or financial position of the Company.

11. Recently Issued Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles (GAAP). The core principle of the ASU is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. ASU 2014-09 will be effective for the Company beginning in fiscal 2018, and allows for both retrospective and modified retrospective methods of adoption. Early adoption beginning fiscal 2017 is permitted. In 2016, the Company established a cross-functional team to use a bottom-up approach to assess the impact of the new standard. The team is in the process of reviewing current accounting policies and practices to identify potential differences that would result from applying the provisions of the new standard to our existing revenue contracts. To date, the review has focused on net retail sales which represented over 98% of total revenues in 2016. While the team continues to assess all potential impacts of the new standard, the Company expects the most significant impact to result from changes to the accounting for deferred revenue, specifically related to gift cards and the Company’s loyalty program. Currently, the Company expects to adopt ASU 2014-09 effective the first day of fiscal 2018 using the modified retrospective method.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases* (ASU 2016-02), which will replace most existing lease accounting guidance in U.S. GAAP. The core principle of the ASU is that an entity should recognize the rights and obligations resulting from leases as assets and liabilities. ASU 2016-02 requires qualitative and specific quantitative disclosures to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity’s leasing activities, including significant judgments and changes in judgments. ASU 2016-02 will be effective for the Company beginning in fiscal 2019, and requires the modified retrospective method of adoption. Early adoption is permitted. The Company is in the process of determining the timing of adoption and assessing the impact of ASU 2016-02 on its consolidated financial statements.

12. Subsequent Events

In May 2016, the Company amended its existing credit agreement extending the term to December 31, 2018 and increasing the amount of permitted lease and rental payments for personal property from $100,000 to $1 million.

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

Cautionary Notice Regarding Forward-Looking Statements

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties, and we undertake no obligation to update these statements except as required by federal securities laws. Our actual results may differ materially from the results discussed in the forward-looking statements. These risks and uncertainties include, without limitation, those detailed under the caption "Risk Factors" in the Company's annual report on Form 10-K for the year ended December 31, 2016, as filed with the SEC, and the following:

general global economic conditions may deteriorate, which could lead to disproportionately reduced consumer demand for our products, which represent relatively discretionary spending;

customer traffic may decrease in the shopping malls where we are located, on which we depend to attract guests to our stores;

we may be unable to generate interest in and demand for our interactive retail experience, or to identify and respond to consumer preferences in a timely fashion;

our marketing and on-line initiatives may not be effective in generating sufficient levels of brand awareness and guest traffic;

the availability and costs of our products could be adversely affected by risks associated with international manufacturing and trade, including foreign currency fluctuation;

we may suffer disruptions, failures or security breaches of our information technology infrastructure or may improperly obtain or be unable to adequately protect customer information in violation of privacy or security laws or customer expectations;

we may be unable to generate comparable sales growth;

we may be unable to effectively operate or manage the overall portfolio of our company-owned stores;

we may be unable to renew or replace our store leases, or enter into leases for new stores on favorable terms or in favorable locations, or may violate the terms of our current leases;

our products or Build-A-Bear branded products sold by our licensees could fail to meet current safety standards or become subject to recalls or product liability claims that could adversely impact our financial performance and harm our reputation among consumers;

we may not be able to operate our international company-owned stores profitably;

we are subject to risks associated with technology and digital operations;

we may lose key personnel, be unable to hire qualified additional personnel, or experience turnover of our management team;

we are susceptible to disruption in our inventory flow due to our reliance on a few vendors;

we may fail to renew, register or otherwise protect our trademarks or other intellectual property;

we may suffer negative publicity or be sued due to violations of labor laws or unethical practices by manufacturers of our merchandise;

we may be unable to operate our company-owned distribution center efficiently or our third-party distribution center providers may perform poorly;

high petroleum products prices could increase our inventory transportation costs and adversely affect our profitability;

we may be unable to effectively manage our international franchises or laws relating to those franchises may change;