BUILD A BEAR WORKSHOP INC
Form 10-Q
May 10, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2007

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: 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)	*(I.R.S. 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 þ No o

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

Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

Yes þ No o

As of May 4, 2007, there were 20,607,648 issued and outstanding shares of the registrant s common stock.

BUILD-A-BEAR WORKSHOP, INC.
INDEX TO FORM 10-Q

Table of Contents

PART I-FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2007	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 42,375	$ 53,109
Inventories	48,013	50,905
Receivables	6,028	7,389
Prepaid expenses and other current assets	17,854	11,805
Deferred tax assets	2,437	2,388
Total current assets	116,707	125,596
Property and equipment, net	129,455	130,347
Goodwill	36,374	36,927
Other intangible assets, net	2,984	2,873
Other assets, net	4,972	4,027
Total Assets	$ 290,492	$ 299,770
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 44,167	$ 46,761
Accrued expenses	12,378	16,301
Gift cards and customer deposits	20,295	28,128
Deferred revenue	6,613	6,454
Total current liabilities	83,453	97,644
Deferred franchise revenue	2,418	2,297
Deferred rent	36,466	34,754
Other liabilities	308	352
Deferred tax liabilities	460	459
Stockholders equity:		
Preferred stock, par value $0.01, Shares authorized: 15,000,000; No shares issued or outstanding at March 31, 2007 and December 30, 2006		
Common stock, par value $0.01, Shares authorized: 50,000,000; Issued and outstanding: 20,594,729 and 20,537,421 shares, respectively	206	205
Additional paid-in capital	84,796	88,866
Other comprehensive income	(1,868)	(997)
Retained earnings	84,253	76,190

Total stockholders equity		167,387		164,264
Total Liabilities and Stockholders Equity	$	290,492	$	299,770

See accompanying notes to condensed consolidated financial statements.

3

Table of Contents

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

	Thirteen weeks ended	
	March 31, 2007	**April 1, 2006**
Revenues:		
Net retail sales	$ 115,883	$ 97,730
Franchise fees	695	690
Licensing revenue	236	211
Total revenues	116,814	98,631
Costs and expenses:		
Cost of merchandise sold	62,140	49,860
Selling, general and administrative	41,544	35,451
Store preopening	688	615
Interest expense (income), net	(545)	(866)
Total costs and expenses	103,827	85,060
Income before income taxes	12,987	13,571
Income tax expense	4,922	5,225
Net income	$ 8,065	$ 8,346
Earnings per common share:		
Basic	$ 0.40	$ 0.42
Diluted	$ 0.39	$ 0.41
Shares used in computing common per share amounts:		
Basic	20,281,820	20,078,876
Diluted	20,525,347	20,401,378

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Thirteen weeks ended	
	March 31, 2007	**April 1, 2006**
Cash flows from operating activities:		
Net income	$ 8,065	$ 8,346
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	6,260	4,782
Deferred taxes	39	(847)
Tax benefit from stock option exercises	(159)	(405)
Loss (gain) on disposal of property and equipment	10	(13)
Stock-based compensation	587	493
Change in assets and liabilities:		
Inventories	4,057	(3,435)
Receivables	1,358	(667)
Prepaid expenses and other assets	(6,952)	(504)
Accounts payable	(4,424)	(2,731)
Accrued expenses and other liabilities	(9,808)	(6,772)
Net cash used in operating activities	(967)	(1,753)
Cash flows from investing activities:		
Purchases of property and equipment	(4,944)	(9,662)
Purchases of other assets and other intangible assets	(644)	(301)
Escrow Deposit		(36,893)
Net cash used in investing activities	(5,588)	(46,856)
Cash flows from financing activities:		
Exercise of employee stock options and employee stock purchases	347	652
Purchases of Company s common stock	(4,670)	
Tax benefit from stock option exercises	159	405
Net cash (used in) provided by financing activities	(4,164)	1,057
Effect of exchange rates on cash	(15)	
Net decrease in cash and cash equivalents	(10,734)	(47,552)
Cash and cash equivalents, beginning of period	53,109	90,950
Cash and cash equivalents, end of period	$ 42,375	$ 43,398
Supplemental disclsoure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 8,106	$ 7,326

Noncash Transactions:		
Return of common stock in lieu of tax witholdings and option exercises	$ 494	$ 211

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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 30, 2006 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 30, 2006 included in the Company s annual report on Form 10-K filed with the SEC on March 15, 2007.

2. Business Acquisition

On April 2, 2006, the Company acquired all of the outstanding shares of The Bear Factory Limited (Bear Factory), a stuffed animal retailer in the United Kingdom, and Amsbra Limited (Amsbra), the Company s former U.K. franchisee (collectively, the U.K. Acquisition). The results of the U.K. Acquisition operations have been included in the consolidated financial statements since that date. In conjunction with those transactions, we obtained 40 retail locations in the United Kingdom and Ireland. The aggregate cash purchase price for the U.K. Acquisition was $39.4 million, excluding cash acquired of $0.3 million. In addition to the cash purchase price, the Company had previously advanced $4.5 million to Amsbra as a note receivable. The amount of this note receivable and the related accrued interest is a component of the purchase price.

The company has not completed its assessment of the U.K. Acquisition assets and liabilities. Until that assessment is complete, the allocation of the purchase price is preliminary and may be subject to revisions.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of Acquisition (in thousands):

Current assets	$ 7,670
Property and equipment	6,192
Goodwill	31,162
Intangibles	1,824
Total assets acquired	46,848
Current liabilites assumed	(9,215)
Loan previously advanced	4,517
Total purchase price	$ 42,150

Table of Contents

The following unaudited pro forma summary presents the Company s revenue, net income, basic earnings per share and diluted earnings per share as if the U.K. Acquisition had occurred on January 1, 2006 (in thousands, except per share data):

	Thirteen Weeks Ended March 31, 2007	April 1, 2006
Revenue	$116,814	$107,764
Net Income	8,065	6,060
Basic earnings per common share:	$ 0.40	$ 0.30
Diluted earnings per common share:	$ 0.39	$ 0.30

Pro forma adjustments have been made to reflect depreciation and amortization using estimated asset values recognized after applying purchase accounting adjustments.

This pro forma information is presented for informational purposes only and is not necessarily indicative of actual results had the acquisition been effected at the beginning of the respective periods presented, and is not necessarily indicative of future results.

3. Goodwill

In connection with our U.K. Acquisition, we acquired goodwill. This asset was recorded in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* and is reported as a component of the Company s retail segment. The following table summarizes the Company s goodwill (in thousands):

U.K. Acquisition	$ 31,162
Acquisition costs	1,005
Severance costs	785
	32,952
Effect of foreign currency translation	3,422
Goodwill, as of March 31, 2007	$ 36,374

4. Stock-based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires companies to recognize the cost of awards of equity instruments, such as stock options and restricted stock, based on the fair value of those awards at the date of grant and eliminates the choice to account for employee stock options under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). The Company adopted SFAS 123R effective January 1, 2006 using the modified prospective method.

Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro forma disclosures in prior periods. Prior to January 1, 2006, the fair value of restricted stock awards was expensed by the Company over the vesting period, while compensation expense for stock options was recognized over the vesting period only to the extent that the grant date market price of the stock exceeded the exercise price of the options.

For the thirteen weeks ended March 31, 2007, selling, general and administrative expense includes $0.6 million ($0.4 million after tax) of stock-based compensation expense. For the thirteen weeks ended April 1, 2006, selling, general and administrative expenses includes $0.5 million ($0.3 million after tax) of stock-based compensation expense.

As of March 31, 2007, there was $8.9 million of total unrecognized compensation expense related to nonvested restricted stock awards and options which is expected to be recognized over a weighted-average period of 3.37 years.

Upon adoption of SFAS 123R, the Company made a policy decision that the straight-line expense attribution method would be utilized for all future stock-based compensation awards with graded vesting.

5. Stock Incentive Plans

In 2000, the Company adopted the 2000 Stock Option Plan. In 2003, the Company adopted the Build-A-Bear Workshop, Inc. 2002 Stock Incentive Plan, and, in 2004, the Company adopted the Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (collectively, the Plans).

Under the Plans, as amended, up to 3,700,000 shares of common stock were reserved and may be granted to employees and nonemployees of the Company. The Plans allow for the grant of incentive stock options, nonqualified stock options, and restricted stock. Options granted under the Plans expire no later than 10 years from the date of the grant. The exercise price of each incentive stock option shall not be less than 100% of the fair value of the stock subject to the option on the date the option is granted. The exercise price of the nonqualified options shall be determined from time to time by the compensation committee of the board of directors (the Committee). The vesting provision of individual awards is at the discretion of the Committee and generally ranges from one to four years.

(a) Stock Options

The following table is a summary of the balances and activity for the Plans related to stock options for the thirteen weeks ended March 31, 2007:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding, December 30, 2006	529,200	$ 16.10		
Granted				
Exercised	30,505	6.88		
Forfeited	15,000	34.65		
Outstanding, March 31, 2007	483,695	$ 16.10	5.7	$ 5,498
Options Exercisable As Of:				
March 31, 2007	479,945	$ 16.05	5.6	$ 5,482

Table of Contents

The total intrinsic value of options exercised in the thirteen weeks ended March 31, 2007 and April 1, 2006 was approximately $0.7 million and $1.8 million, respectively. The Company generally issues new shares to satisfy option exercises.

(b) Restricted Stock

The following table is a summary of the balances and activity for the Plans related to restricted stock granted as compensation to employees and directors for the thirteen weeks ended March 31, 2007:

	Number of Shares	Weighted Average Grant Date Fair Value per Award
Outstanding, December 30, 2006	227,453	$ 30.06
Granted	215,428	27.48
Vested	51,889	29.23
Canceled or expired	400	27.82
Outstanding, March 31, 2007	390,592	$ 28.75

The total fair value of restricted shares vested during the thirteen weeks ended March 31, 2007 and April 1, 2006 was $1.4 million and $0.4 million, respectively.

(c) Associate Stock Purchase Plan

In October 2004, the Company adopted an Associate Stock Purchase Plan (ASPP). Under the ASPP, substantially all full-time employees are given the right to purchase shares of the Company s common stock, subject to certain limitations, at 85% of the lesser of the fair market value on the purchase date or the beginning of each purchase period. Up to 1,000,000 shares of the Company s common stock are available for issuance under the ASPP. The employees of the Company purchased 5,868 shares at $23.35 per share through the ASPP during the thirteen weeks ended March 31, 2007. The expense recorded related to the ASPP during the thirteen weeks ended March 31, 2007 was determined using the Black-Scholes option pricing model and the provisions of FASB Technical Bulletin 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option* (FTB 97-1), as amended by SFAS 123R. The assumptions used in the option pricing model for the thirteen weeks ended March 31, 2007 were: (a) dividend yield of 0%; (b) volatility of 20%; (c) risk-free interest rate of 6.0%; and (d) an expected life of 0.25 years.

Table of Contents

6. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Thirteen weeks ended March 31, 2007	Thirteen weeks ended April 1, 2006
Net income allocated to common stockholders	$ 8,065	$ 8,346
Weighted average number of common shares outstanding	20,281,820	20,078,876
Effect of dilutive securities:		
Stock options	177,347	283,843
Restricted stock	66,180	38,659
Weighted average number of common shares dilutive	20,525,347	20,401,378
Earnings per share:		
Basic:	$ 0.40	$ 0.42
Diluted	$ 0.39	$ 0.41

In calculating diluted earnings per share for the thirteen weeks ended March 31, 2007, options to purchase 156,588 shares of common stock were outstanding as of the end of the period, but were not included in the computation of diluted earnings per share due to their anti-dilutive effect. An additional 215,028 shares of restricted common stock were outstanding at the end of the period, but excluded from the calculation of diluted earnings per share due to their anti-dilutive effect under the provisions of SFAS No. 128, *Earnings per Share* (SFAS No. 128).

In calculating diluted earnings per share for the thirteen weeks ended April 1, 2006, options to purchase 206,324 shares of common stock were outstanding as of the end of the period, but were not included in the computation of diluted earnings per share due to their anti-dilutive effect. An additional 202,631 shares of restricted common stock were outstanding at the end of the period, but excluded from the calculation of diluted earnings per share due to their anti-dilutive effect under the provisions of SFAS No. 128.

7. Comprehensive Income

Comprehensive income for the thirteen weeks ended March 31, 2007 and April 1, 2006 was $7.2 million and $8.3 million, respectively. The difference between comprehensive income and net income resulted from foreign currency translation adjustments.

Table of Contents

8. Property and Equipment

Property and equipment consist of the following (in thousands):

	March 31, 2007	December 30, 2006
Land	$ 2,261	$ 2,261
Furniture and fixtures	33,221	33,938
Computer hardware	15,862	15,649
Building	14,970	14,970
Leasehold improvements	123,847	122,043
Computer software	14,410	12,988
Construction in progress	4,085	2,200
	208,656	204,049
Less accumulated depreciation	79,201	73,702
	$ 129,455	$ 130,347

9. Income Taxes

The Company adopted the provisions of Financial Standards Accounting Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) on December 31, 2006. The implementation of FIN 48 did not result in an adjustment to the liability for unrecognized income tax benefits. At the adoption date of December 31, 2006, there was approximately $1,207,000 of unrecognized tax benefits, all of which would affect the Company s effective tax rate if recognized. At March 31, 2007, there is approximately $1,207,000 of unrecognized tax benefits. In the short-term, management of the Company does not reasonably expect any significant changes.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of March 31, 2007, there is approximately $86,000 of accrued interest related to uncertain tax positions.

The tax years 2003-2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

10. Segment Information

The Company s operations are conducted through three reportable segments consisting of retail, international franchising, and licensing and entertainment. The retail segment includes the operating activities of company-owned stores in the United States, Canada, the United Kingdom and Ireland, and other retail delivery operations, including the Company s web store and non-traditional store locations such as baseball ballparks. The international franchising segment includes the licensing activities of the Company s franchise agreements with store locations in Europe, Asia, and Australia. The licensing and entertainment segment has been established to market the naming and branding rights of the Company s intellectual properties for third party use. 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. The operating segments have discrete sources of revenue, different capital structures and different cost structures. The reporting segments follow the same accounting policies used for the Company s consolidated financial statements.

Table of Contents

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

	Retail	International Franchising	Licensing & Entertainment	Total
Thirteen weeks ended March 31, 2007				
Net sales to external customers	$115,883	$ 695	$ 236	$116,814
Income before income taxes	12,622	294	71	12,987
Capital expenditures	4,941		3	4,944
Depreciation and amortization	6,126	122	12	6,260
Thirteen weeks ended April 1, 2006				
Net sales to external customers	97,730	690	211	98,631
Income before income taxes	13,170	271	130	13,571
Capital expenditures	9,660	2		9,662
Depreciation and amortization	4,634	146	2	4,782
Total Assets as of:				
March 31, 2007	$286,134	$ 2,427	$ 1,931	$290,492
April 1, 2006	236,472	7,718	1,174	245,364

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 and long-lived assets by geographic area (in thousands):

	North America	United Kingdom & Ireland	Other	Total
Thirteen weeks ended March 31, 2007				
Net sales to external customers	$105,320	$ 10,799	$695	$116,814
Property and equipment, net	113,708	15,731	16	129,455
Thirteen weeks ended April 1, 2006				
Net sales to external customers	97,941		690	98,631
Property and equipment, net	95,172		22	95,194

11. New Accounting Pronouncements

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. The Company is required to adopt SFAS 157 in the first quarter of 2008. The Company is currently assessing the financial impact of SFAS 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits an entity to measure certain financial assets and liabilities at fair value. The statement s objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. This statement becomes effective for fiscal years beginning after November 15, 2007 and should be applied prospectively. It is expected that this statement will not have a material effect on the Company s financial statements.

Table of Contents

12. Subsequent Event

The Company holds a minority interest in Retail Entertainment Concepts, LLC (REC). REC is an early-stage company that has developed an interactive retail concept targeted primarily to boys and their families. REC conducts business under the Ridemakerz ™ brand name. On April 30, 2007, the Company entered into a series of agreements whereby an additional equity investment was made and the Company agreed to perform operational support services for REC. In accordance with the agreements, the Company invested approximately $2.4 million on April 30, 2007, bringing the total investment in REC to approximately $3.0 million. In exchange for performing operational support services the Company will receive additional equity in REC.

Table of Contents

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

The following Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. 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 our annual report on Form 10-K for the year ended December 30, 2006, as filed with the SEC, and the following: we may be unable to generate interest in and demand for our interactive retail experience, or to identify and respond to consumer