WINMARK CORP
Form 10-K
March 20, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of

the Securities Exchange Act of 1934

For the fiscal year ended December 30, 2006 **Commission File Number: 000-22012**

WINMARK CORPORATION

(Exact name of Registrant as specified in its charter)

Minnesota	**41-1622691**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

4200 Dahlberg Drive, Suite 100, Minneapolis, MN 55422-4837
(Address of principal executive offices) (Zip Code)
Registrant s telephone number: **(763) 520-8500**

Securities registered pursuant to Section 12 (b) of the Act: Common Stock, no par value per share

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes x No o

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

Large Accelerated filer o Accelerated filer o Non-Accelerated x

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

Yes o No x

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the closing sale price of such stock as of the last business day of registrant s most recently completed second fiscal quarter, as reported on the Nasdaq Market, was $46,833,323.

Shares of no par value Common Stock outstanding as of March 16, 2007: 5,467,445 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Registrant s Annual Meeting of Shareholders to be held on May 2, 2007 have been incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this report.

WINMARK CORPORATION AND SUBSIDIARIES

INDEX TO ANNUAL REPORT ON FORM 10-K

PART I

ITEM 1: BUSINESS

Background

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

We also operate a middle-market equipment leasing business through our wholly-owned subsidiary Winmark Capital Corporation. Our middle-market leasing business serves large and medium-sized businesses and focuses on assets which generally have a cost of more than $250,000. We generate middle-market equipment leases primarily through business alliances, equipment vendors and directly from customers.

We also operate a small-ticket financing business through our wholly-owned subsidiary Wirth Business Credit, Inc. (formerly known as Winmark Business Solutions, Inc.). Our small-ticket financing business serves small businesses and focuses on assets which generally have a cost of $5,000 to $250,000. We generate financing business directly from customers, and also through our Wirth Business Credit franchisees.

Our significant assets are located within the United States, and we generate all revenues from United States operations other than franchising revenues from Canadian operations of approximately $1.8 million, $1.7 million and $1.8 million for 2006, 2005 and 2004, respectively. We were incorporated in Minnesota in 1988.

Franchise Operations

Our four retail brands with their fiscal year 2006 system-wide sales, defined as revenues generated by all franchise owned locations, are summarized as follows:

Play It Again Sports® - $254 million.

We began franchising the Play It Again Sports® brand in 1988. Play It Again Sports® franchises sell, buy, trade and consign used and new sporting goods, equipment and accessories for a variety of athletic activities including hockey, wheeled sports (in-line skating, skateboards, etc.), fitness, ski/snowboard, golf and baseball/softball. The franchises offer a flexible mix of merchandise that is adjusted to adapt to seasonal and regional differences. Play It Again Sports® is known for providing the highest value to the customer by offering a mix of used and new sporting goods. For the years ended 2006, 2005 and 2004, Play It Again Sports® contributed royalties and franchise fees of $10.4 million, $10.2 million and $10.3 million, respectively. As a percentage of consolidated revenues for 2006, 2005 and 2004, these amounts equaled 38.1%, 38.4% and 37.9%, respectively.

Once Upon A Child® - $115 million.

We began franchising the Once Upon A Child® brand in 1993. Once Upon A Child® franchises sell and buy used and new children s clothing, toys, furniture, equipment and accessories. This store brand primarily targets cost-conscious parents of children ages infant to 10 years with emphasis on children ages seven years old and under. These customers have the opportunity to sell their used children s items to a Once Upon A Child® franchise when outgrown and to purchase quality used children s clothing, toys, furniture and equipment at prices lower than new merchandise. New merchandise is offered to supplement the used merchandise. For the years ended 2006, 2005 and 2004, Once Upon A Child® contributed royalties and franchise fees of $4.9 million, $4.3 million, and $4.1 million, respectively. As a percentage of consolidated revenues for 2006, 2005 and 2004, these amounts equaled 17.7%, 16.2% and 15.0%, respectively.

Plato s Closet® - $100 million.

We began franchising the Plato s Closet® brand in 1999. Plato s Closet® franchises sell and buy used and new clothing and accessories geared toward the teenage and young adult market. Customers have the opportunity to sell their used items to a Plato s Closet® franchise when unused or outgrown and to purchase quality used clothing and accessories at prices lower than new merchandise. For the years ended 2006, 2005 and 2004, Plato s Closet® contributed royalties and franchise fees of $4.2 million, $3.5 million and $2.6 million, respectively. As a percentage of consolidated revenues for 2006, 2005 and 2004, these amounts equaled 15.2%, 13.3% and 9.6%, respectively.

Music Go Round® - $25 million.

We began franchising the Music Go Round® brand in 1994. Music Go Round® franchises sell, buy, trade and consign used and new musical instruments, speakers, amplifiers, music-related electronics and related accessories for parents of children who play musical instruments, as well as professional and amateur musicians. For the years ended 2006, 2005 and 2004, Music Go Round® contributed royalties and franchise fees of $0.8 million, $0.9 million and $0.9 million, respectively. As a percentage of consolidated revenues for 2006, 2005 and 2004, these amounts equaled 2.8%, 3.3% and 3.2%, respectively.

In addition to our four retail brands, we also franchise a small-ticket leasing business.

Wirth Business Credit

We began franchising the Wirth Business Credit business in 2006. Wirth Business Credit, Inc. franchises leasing and financing services businesses that provide franchisees an array of small-ticket equipment leasing and financing options funded through Winmark or its affiliates to offer to customers for business essential equipment and assets. Wirth Business Credit franchisees are paid a transaction fee for each leasing or financing transaction funded through Winmark or its affiliates, and as such Winmark Corporation does not receive royalties from Wirth Business Credit franchisees.

The following table presents a summary of our franchising activity for the fiscal year ended December 30, 2006:

	TOTAL 12/31/05	**OPENED**	**CLOSED**	**TOTAL 12/30/06**	**AVAILABLE FOR RENEWAL**	**COMPLETED RENEWALS**	**% RENEWED**
Play It Again Sports®							
Franchises - US and Canada	396	14	(22)	388	9	9	100%
Once Upon A Child®							
Franchises - US and Canada	206	12	(4)	214	16	16	100%
Plato s Closet®							
Franchises - US	159	24	(2)	181			N/A
Music Go Round®							
Franchises - US	42	0	(1)	41	9	9	100%
Total Franchised Stores	803	50	(29)	824	34	34	100%
Wirth Business Credit							
Franchises - US	0	12	0	12			N/A
Total	803	62	(29)	836	34	34	100%

3

Retail Brands Franchising Overview

We use franchising as a business method of distributing goods and services through our retail brands to consumers. We also use franchising as a method to originate small-ticket leasing transactions with our Wirth Business Credit franchises. We discuss our Wirth Business Credit franchise system in the Equipment Leasing Operation Subsection of this Business Section. We, as franchisor, own a retail business brand, represented by a service mark or similar right, and an operating system for the franchised business. We then enter into franchise agreements with franchisees and grant the franchisee the right to use our business brand, service marks and operating system to manage a retail business. Franchisees are required to operate their retail businesses according to the systems, specifications, standards and formats we develop for the business brand. We train the franchisees on how to operate the franchised business. We also provide continuing support and service to our franchisees.

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

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

We have and we intend to reinvest operating cash flow generated from our business into:

- supporting the current franchise systems;
- making investments in infrastructure to support our corporate needs; and
- pursuing new business opportunities such as Wirth Business Credit, Inc., Winmark Capital Corporation and other business opportunities.

Offering Value-Oriented Merchandise

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

Attracting Franchisees

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

- have a sufficient net worth,
- have prior business experience, and
- intend to be integrally involved with the management of the business.

At December 30, 2006, we had 55 signed franchise agreements that are expected to open in 2007. Of these, 54 are retail brand franchises.

4

We began franchising in Canada in 1991 and, as of December 30, 2006, had 62 franchised retail stores open in Canada. The Canadian retail stores are operated by franchisees under agreements substantially similar to those used in the United States.

Retail Brand Franchise Support

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

Training

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

Field Support

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

Purchasing

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

We provide centralized buying services including credit and billing for the Play It Again Sports® franchisees. Upon credit approval, Play It Again Sports® franchisees may order through the buying group, in which case, product is shipped directly to the store by the vendor. We are invoiced by the vendor, and in turn, we invoice the franchisee adding a 4% service fee to cover our costs of operating the buying group. Our Play It Again Sports® franchise system uses several major vendors including Keys Fitness, Horizon Fitness, Easton Sporting Goods, The Hockey Company and Bauer Nike Hockey. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered.

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

Our typical Once Upon A Child® franchised store purchases approximately 50% of its new product from Graco, Million Dollar Baby and Dorel Juvenile Group. While we believe that there are several other vendors that could adequately replace the loss of any of these three major vendors, it would alter the selection of product offered.

There are no significant vendors to our typical Plato s Closet® franchised store.

Retail Advertising and Marketing

We encourage our franchisees to implement a marketing program that includes one or more of the following: television, radio, direct mail, point-of-purchase materials, in store signage and local store marketing programs. Through these mediums, we advertise that we buy, sell and trade used and new items. Franchisees of the respective retail brands are required to spend the following minimum percentage of their gross sales on approved advertising and marketing: Play It Again Sports® - 5%, Once Upon A Child® - 5%, Plato s Closet® - 4% and Music Go Round® - 3%. The advertising percentage for new Plato s Closet® franchises will increase to 5% in 2007. In addition, Play It Again Sports®, Once Upon A Child® and Music Go Round® franchisees are required to pay us an annual marketing fee of $500. Franchisees may be required to participate in regional cooperative advertising groups. Plato s Closet® franchisees with agreements dated prior to and after March 15, 2005 are required to pay us an annual marketing fee of $500 and $1,000, respectively.

Computerized Point-Of-Sale Systems

We require our retail brand franchisees to use a retail information management computer system in each store, which has evolved with the development of new technology. This computerized point-of-sale system is designed specifically for use in our franchise retail stores. The current system includes our proprietary Data Recycling System software, a dedicated server, one or more work station registers, a receipt printer, a report printer and a bar code scanner, together with software modules for inventory management, cash management and customer information management. We generally require franchisees to purchase their computer hardware from us. We charge a fee of approximately 4% for handling and configuration of systems sold through us. The Data Recycling System software is designed to accommodate buying and consigning of used merchandise. This system provides franchisees with an important management tool that reduces errors, increases efficiencies and enhances inventory control. We provide both computer software and hardware support for the system through our Computer Support Center located at our Company headquarters.

Winmark Business Solutions

We established Winmark Business Solutions to provide business support services to franchisees and other small businesses. We provide a web site that:

- aggregates the purchasing power of small businesses, including our franchisees, which allows us to more effectively negotiate arrangements for products and services critical to most small businesses;

- provides an easy point of contact between vendors and small businesses;

- provides small business owners information and tools that will help them be successful at every stage of their small business;

- provides equipment leasing options for small businesses; and

- provides advertising and promotional opportunities for small businesses.

6

We have established preferred provider relationships with high quality vendors that provide small businesses a host of critical services. Included in the array of services available through the web site are accounting, tax and payroll services, copying and printing services, purchase of office supplies, credit card processing, loss prevention, business insurance, computer/POS equipment, and more. A small business becomes a member of Winmark Business Solutions by registration, which is free.

Other Support Services

We assist each new franchisee with retail store site location by providing demographic data and general site selection information. A third party vendor provides design layouts and opening materials including pricing materials, stationary, signage, fixtures, slat wall and carpeting. Additional communication with retail brand franchisees is made through weekly news updates, emails, broadcast faxes, extranet and semi-annual or annual conferences which generally include trade shows.

The Retail Franchise Agreement

We enter into franchise agreements with our franchisees. The following is a summary of certain key provisions of our current standard retail brand franchise agreement. Except as noted, the franchise agreements used for each of our business brands are generally the same. The Franchise Agreement signed by Wirth Business Credit franchisees is described in the Equipment Leasing Operation subsection of this Business Section.

Each franchisee must execute our franchise agreement and pay an initial franchise fee. At December 30, 2006, the franchise fee for all brands was $20,000 for an initial store in the U.S. and $26,500CAD for an initial store in Canada. Once a franchisee opens its initial store, it can open additional stores, in any brand, by paying a $15,000 franchise fee for a store in the U.S. and $20,000CAD for a store in Canada, provided an acceptable territory is available and the franchisee meets minimum standards. Beginning in 2007, the franchise fees for our initial retail store and additional retail store in Canada will be based upon the exchange rate applied to the United States fee on the last business day of the preceding fiscal year. The franchise fee in 2007 for an initial retail store will be $23,300CAD, and an additional retail store $17,500CAD. Typically, the franchisee s initial store is open for business within 270 days from the date the franchise agreement is signed. The franchise agreement has an initial term of 10 years, with subsequent 10-year renewal periods, and grants the franchisee an exclusive geographic area, which will vary in size depending upon population, demographics and other factors. A renewal fee equal to $5,000 is payable to us as part of any franchise renewal. As an incentive, we generally refund the renewal fee if a franchisee modernizes its store to meet our standards. Under current franchise agreements, franchisees of the respective brands are required to pay us weekly continuing fees (royalties) equal to the following percentage of gross sales: Play It Again Sports® - 5%, Once Upon A Child® - 5%, Plato s Closet® - 4% and Music Go Round® - 3%. Upon completion of the initial 10-year term, Play It Again Sports® and Once Upon A Child® royalties are adjusted to 4%. Play It Again Sports® franchisees opening their second or additional store pay us a 4% royalty for that store.

Each franchisee is required to pay us an annual marketing fee of $500 ($1,000 for each new Plato s Closet® franchisee). Each Play It Again Sports® and Once Upon A Child® franchisee is required to spend 5% of its gross sales for advertising and promoting its franchised store. We have the option to increase the minimum advertising expenditure requirement for these franchises to 6% of the franchisee s gross sales, of which up to 2% would be paid to us as an advertising fee for deposit in an advertising fund. This fund, if initiated, would be managed by us and would be used for advertising and promotion of the franchise system. Music Go Round® franchisees are required to spend at least 3% of gross sales for approved advertising. We have the option to increase the minimum advertising expenditure requirement for these franchises to a total of 4% of the franchisee s gross sales, of which up to 1.5% would be paid to us as an advertising fee for deposit into an advertising fund. Plato s Closet® franchisees are required to spend at least 4% of gross sales for approved advertising. In 2007, the advertising percentage for Plato s Closet® franchise agreements will increase to require new franchisees to spend at least 5% of gross sales for approved advertising. We have an option to increase the minimum advertising expenditure requirement for these franchises up to at total of 6% of franchisee s gross sales, of which up to 2% would be paid to us as an advertising fee for deposit into an advertising fund.

During the term of a franchise agreement, franchisees agree not to operate directly or indirectly any competitive business. In addition, franchisees agree that after the end of the term or termination of the franchise agreement, franchisees will not operate any competitive business for a period of one year and within a reasonable geographic area. We will pursue enforcement of our noncompetition clause vigorously; however, these noncompetition clauses are not enforceable in certain states or in all circumstances.

Although our franchise agreements contain provisions designed to assure the quality of a franchisee s operations, we have less control over a franchisee s operations than we would if we owned and operated a retail store. Under the franchise agreement, we have a right of first refusal on the sale of any franchised store, but we are not obligated to repurchase any franchise.

Renewal of the Franchise Relationship

At the end of the 10-year term of each franchise agreement, each franchisee has the option to renew the franchise relationship by signing a new 10-year franchise agreement. If a franchisee chooses not to sign a new franchise agreement, a franchisee must comply with all post termination obligations including the franchisee s noncompetition clause discussed above. This noncompetition clause may not be enforceable in certain states or in all circumstances. We may choose not to renew the franchise relationship only when permitted by the franchise agreement and applicable state law.

In 2006, 9 Play It Again Sports® franchise agreements expired. Of those franchise relationships, 9 were renewed with the signing of a new 10-year franchise agreement. In 2007, 2008 and 2009, 19, 10 and 16 Play It Again Sports® franchise agreements will expire, respectively.

In 2006, 16 Once Upon A Child® franchise agreements expired. Of those franchise relationships, 16 were renewed with the signing of a new 10-year franchise agreement. In 2007, 2008 and 2009, 12, 8 and 19 Once Upon A Child® franchise agreements will expire, respectively.

In 2006, 9 Music Go Round® franchise agreements expired. Of those franchise agreements, 9 were renewed with the signing of a new 10-year franchise agreement. In 2007, 2008 and 2009, 7, 7, and 5 Music Go Round® franchise agreements will expire, respectively.

None of our Plato s Closet® franchise agreements will expire in 2007 or 2008. In 2009, 7 Plato s Closet® franchise agreements will expire.

None of our Wirth Business Credit franchise agreements will expire in 2007, 2008 or 2009.

We believe that renewing a significant number of these franchise relationships is important to the success of the Company.

Retail Franchising Competition

Retailing, including the sale of sporting goods, children s and teenage apparel, and musical instruments, is highly competitive. Many retailers have substantially greater financial and other resources than we do. Our franchisees compete with established, locally owned retail stores, discount chains and traditional retail stores for sales of new merchandise. Full line retailers generally carry little or no used merchandise. Resale, thrift and consignment shops and garage and rummage sales offer some competition to our franchisees for the sale of used merchandise. Also, our franchisees increasingly compete with online used and new goods retailers such as eBay, Harmony Central and many others. We are aware of, and compete with, one franchisor of stores which sells new and used sporting equipment, two franchisors of stores which sell used and new children s clothing, toys and accessories and one franchisor of teen apparel stores.

Our Play It Again Sports® franchisees compete with large retailers such as Dick s Sporting Goods, The Sports Authority as well as regional and local sporting goods stores. We also compete with Target and Wal-Mart.

Our Once Upon A Child® franchisees compete primarily with large retailers such as Babies R Us, Wal-Mart, Target Stores and various specialty children s retail stores such as Gap Kids. We compete with one other franchisor in the specialty children s retail market.

Our Plato s Closet® franchise stores compete with specialty apparel stores primarily such as Gap, Abercrombie & Fitch, Old Navy, Banana Republic and The Limited. We compete with one other franchisor in the teenage clothing retail market.

Our Music Go Round® franchise stores compete with large musical instrument retailers such as Guitar Center and Sam Ash Music. We do not believe we compete with any other franchisor directly in the used and new musical instrument market.

Our retail franchises may face additional competition in the future. This could include additional competitors that may enter the used merchandise market. We believe that our franchisees will continue to be able to compete with other retailers based on the strength of our value-oriented brands and the name recognition associated with our service marks.

We also face competition in connection with the sale of franchises. Our prospective franchisees frequently evaluate other franchise opportunities before purchasing a franchise from us. We compete with other franchise companies for franchisees based on the following factors, among others: amount of initial investment, franchise fee, royalty rate, profitability, franchisor services and industry. We believe that our franchise brands are competitive with other franchises based on the fees we charge, our franchise support services and the performance of our existing franchise brands.

Equipment Leasing Operations

We are engaged in the business of providing non-cancelable leases for high-technology and business-essential equipment to both larger organizations and smaller, growing companies. We started our equipment leasing operations in April of 2004, and we are currently in the early stages of this portion of our business.

9

We operate our middle-market leasing operation through Winmark Capital Corporation, a wholly owned subsidiary of the Company. We operate our small-ticket financing operation through Wirth Business Credit, Inc., a wholly owned subsidiary of the Company (formerly known as Winmark Business Solutions, Inc.). We incorporated both of the corporations on April 2, 2004. To differentiate ourselves from our competitors in the leasing industry, we offer innovative lease and financing products and concentrate on building long-term, relationship-based associations with our customers and business alliances.

Winmark Capital Corporation

Winmark Capital Corporation focuses on middle-market transactions that generally have terms from two to five years and are with large organizations. We target businesses with revenue of $25,000,000 or more. Such transactions are generally larger than $250,000 and, cover high-technology equipment, including computers, telecommunications equipment, point-of-sale systems and other business-essential equipment. The leases are flexible in structure to accommodate equipment additions and upgrades to meet customers changing needs. These leases are retained in our portfolio.

Industry

The high-technology equipment industry has been characterized by rapid and continuous advancements permitting broadened user applications and reductions in processing costs. The introduction of new equipment generally does not cause existing equipment to become obsolete but usually does cause the market value of existing equipment to decrease to reflect the improved performance per dollar cost of the new equipment. Users frequently replace equipment as their existing equipment becomes inappropriate for their needs or as increased data processing capacity is required, creating a secondary market in used equipment.

Generally, high-technology equipment, such as data processing equipment, does not suffer from material physical deterioration if properly maintained. Our leased equipment is kept under continual maintenance obtained directly from the manufacturer or, in some cases, other service organizations. The economic life and residual value of data processing equipment is subject to, among other things, the development of technological improvements and changes in sale and lease terms initiated by the manufacturer.

Business Strategy

Our business strategy allows us to differentiate ourselves from our competitors in the leasing industry. Key elements of this strategy include:

- Relationship Focus. We maintain a focused, long-term, customer-service approach to our business.

- Full Service. We can service the equipment leasing needs of large organizations through our middle-market operations and small organizations through our small-ticket operations. Our enterprise-wide capabilities allow us to service the needs of a large company and its many small business affiliates.

- Asset Ownership. We typically retain ownership of our leases and the underlying equipment.

Leasing and Sales Activities

Our middle-market lease products are marketed nationally through our principal office in Golden Valley, Minnesota and our satellite offices in Boulder, Colorado, Charlotte, North Carolina and Santa Barbara, California.

10

We market our leasing services directly to end-users and indirectly through business alliances, and through vendors of equipment, software, value-added services and consulting services. Our sales representatives attend trade shows and directly market to customers and prospects by telephone canvassing. We may also advertise in magazines or other periodicals in targeted industries.

We generally lease high-technology and other business-essential equipment for terms ranging from two to five years. Our standard lease agreements, entered into with each customer, are noncancelable net leases which contain hell-or-high water provisions under which the customer, upon acceptance of the equipment, must make all lease payments regardless of any defects or performance of the equipment, and which require the customer to maintain and service the equipment, insure the equipment against casualty loss and pay all property, sales and other taxes related to the equipment. We typically retain ownership of the equipment we lease and, in the event of default by the customer, we or the financial institution to whom the lease payment has been assigned may declare the customer in default, accelerate all lease payments due under the lease and pursue other available remedies, including repossession of the equipment. Upon expiration of the initial term or extended lease term, depending on the structure of the lease, the customer may:

- return the equipment to us;
- renew the lease for an additional term; or
- purchase the equipment.

If the equipment is returned to us, it will be either re-leased to another customer or sold into the secondary-user marketplace.

Additionally, we may lease operating system and application software to our customers, but typically only with a hardware lease.

Wirth Business Credit, Inc.

Our small-ticket financing operation serves the needs of small businesses. Small-ticket financing transactions are typically between $5,000 and $250,000, have terms of between two and five years and cover business essential assets, including computers, printing equipment, security systems, telecommunications equipment, car wash equipment, production equipment and other assets. Small-ticket financing products are marketed under the trade name Wirth Business Credit directly through our employed sales representatives or through our network of Wirth Business Credit franchisees.

Industry

The small ticket finance industry is highly fragmented and competitive. Small business owners typically finance their businesses through one of many possible sources including banks, vendor captive finance companies, leasing brokers, credit card companies and independent leasing companies. These sources of funding typically limit their focus to certain types of transactions and may base their decision on credit quality, geography, size of transaction, type of asset or other criteria. The small-ticket finance industry is very competitive, however, small business owners do not generally receive the same level of customer service as larger businesses do. Small business owners desire products that are convenient, easy to understand, competitive and come from a trusted source.

Business Strategy

Key elements of our small-ticket business strategy include:

- Local Presence. Through a network of franchisees, Wirth Business Credit maintains a local presence in its markets.

- Relationship Focus. We maintain a focused, long-term, customer-service approach to our business. In our small-ticket segment, we establish relationships with companies that control or have influence over multiple smaller businesses such as franchisors, equipment vendors and associations.

- Customer Service. We understand that small business owners desire a convenient, flexible financing solution. We provide fast credit decisions, flexible terms and an easy to understand process.

Leasing and Sales Activities

We originate financing transactions through sales persons employed by Wirth Business Credit, Inc. and through our Wirth Business Credit franchisees. We focus our sales efforts on establishing relationships with organizations with influence over many small businesses such as vendors, franchisors and trade associations.

As described below, we franchise the right to operate small businesses under the name Wirth Business Credit . Our franchisees in our Wirth Business Credit franchise system are dedicated to originating equipment lease and financing transactions. Our franchisees build business relationships at the local level and also have the support and infrastructure of a national leasing company.

We generally finance business-essential assets for terms ranging from two to five years. Our financing transactions are generally full pay out transactions, which means, after paying all required payments under the financing agreement, the customer owns the asset.

Wirth Business Credit Franchise System

We franchise the right to operate a small business equipment leasing and finance franchise under the brand Wirth Business Credit . Franchisees in the Wirth Business Credit franchise system market and sell small business equipment leasing and financing services offered by us.

Attracting Franchisees

Our franchise marketing program for Wirth Business Credit seeks to attract prospective franchisees with a desire to operate their own sales and marketing business who:

- have a sufficient net worth;

- have prior sales or small business experience; and

- intend to be integrally involved in the operation of the franchise.

Franchise Support

As a franchisor of Wirth Business Credit , our lease originations volume depends heavily on our ability to support competitive and successful Wirth Business Credit franchisees. We emphasize the following areas of franchise support and assistance in our Wirth Business Credit franchise system:

- Training;

- Marketing; and

- Ongoing Support.

12

Training

Each franchisee must attend our training program prior to operation. Soon after signing the franchise agreement, a Wirth Business Credit franchisee is required to participate in our training program. We begin with pre-training. At pre-training, we cover, among other topics, sales basics, owning your own business and valuation. Our franchisees next come to our headquarters for a week-long training session. This week-long training session covers the basics of leasing, market orientation, lead generation, selling to vendors, owning your own business, business planning, credit basics, marketing, computer and software training and the nature of our franchise relationship.

After the initial week of training, we continue to support our Wirth Business Credit franchisees. We provide sales support to our franchisees through our national sales staff in Minneapolis. Franchisees have the ability to interact with our national sales staff at any time. Our national sales team provides the opportunity to each franchisee to work together on monthly sales planning and analysis. In addition, we deliver new tools and programs to our franchisees periodically.

Our national sales staff generates national account relationships that provide leads and transactions for our franchisees. We have established and seek to establish relationships with vendors, franchisors and other organizations that have a national scope of operations. These national accounts benefit our franchisees and us through increased lease volume. If a national account generates a transaction in the Market Area of a franchisee, then the franchisee is paid for that transaction as if the franchisee originated it.

We have an annual conference for our franchise system. At the conference, our franchisees have the opportunity to learn from each other and from us new information about how to operate more effectively. They also have the opportunity to learn from each other what sales and marketing approaches are working in their marketplace.

Marketing

We encourage our franchisees to implement a marketing program that includes one or more of the following: direct mail, direct email, advertising in approved industry and business publications, joining networking groups, telemarketing and radio. Franchisees are required to spend 4% of their compensation on developing new customers in their local Market Area. In addition, franchisees are required to pay us an annual marketing fee of $500. Franchisees may be required to participate in regional cooperative advertising groups.

Ongoing Support

Franchisees primary contact with us is through an operations manager. The role of the operations manager is to support our franchisees by expediting the lease transaction process. An operations manager ensures credit applications are complete, interfaces with the credit department, manages vendor relations and documents transactions a Wirth Business Credit franchisee submits. In addition, we provide any changes to the franchise system to our franchisees as they are available. We provide all updates to our Operations Manual to franchisees. We continue to develop marketing materials to assist franchisees in the generation of financing transactions.

Computer and Software

We require our franchisees to use our Tri-Link Lease Management computer system. This computer system allows our franchisees to submit and track leasing transactions. It also allows us to manage the lease transaction process.

The Franchise Agreement

We enter into 10-year franchise agreements with our franchisees. The following is a summary of certain key provisions of our current standard franchise agreement.

Each franchisee must execute our franchise agreement and pay an initial franchise fee. The Initial Franchise Fee for our standard Market Area is $30,000. However, we are currently offering a reduced Initial Franchise Fee to prospective franchisees. This program, which we call the Pioneer Program, reduces the Initial Franchise Fee to $20,000. In addition, $15,000 of the $20,000 fee is eligible for reimbursement from us if a franchisee spends amounts on qualified marketing expenditures within 12 months of signing the Franchise Agreement, effectively reducing the Initial Franchise Fee to $5,000. This amount may increase depending on the size of the Market Area.

Our franchisees pay no continuing fees in the form of royalty payments like the retail brand franchisees. Instead, a Wirth Business Credit franchisee s compensation depends on the mark-up a franchisee adds to a transaction. Franchisees are paid monthly.

Our franchisees can only fund their transactions through us. During the term of a franchise agreement, franchisees agree not to operate any competitive business directly or indirectly. In addition, franchisees agree that after the end of the term or termination of the franchise agreement, franchisees will not operate any competitive business for 18 months within a reasonable geographic area. We will pursue enforcement of our non-competition clause vigorously; however, these non-competition clauses are not enforceable in certain states or all circumstances.

At the end of the term of each 10-year term of each Wirth Business Credit franchise agreement, each franchisee has the option to renew the franchise relationship by signing a new 10-year franchise agreement. If a franchisee chooses not to sign a new franchise agreement, a franchisee must comply with all post termination obligations including the franchisee s non-competition clause.

We compete with various other franchise opportunities for franchisees. The small-ticket leasing industry is very competitive. Our franchisees compete directly with many financial institutions, many of which have greater financial resources than us. We are not aware of any other companies offering similar franchising opportunities in the small-ticket financing industry.

Financing

Our ability to arrange financing is important to our middle-market leasing and our small-ticket financing businesses.

Winmark Capital Corporation will from time to time arrange permanent financing of leases through non-recourse discounting of lease rentals with various financial institutions at fixed interest rates. The proceeds from the assignment of the lease rentals will be generally equal to the present value of the remaining lease payments due under the lease, discounted at the interest rate charged by the financial institution. Interest rates obtained under this type of financing will be negotiated on a transaction-by-transaction basis and reflect the financial strength of the customer, the term of the lease and the prevailing interest rates. For leases discounted on a non-recourse basis, the financial institution will have no recourse against us unless we are in default of the terms of the agreement under which the lease and the leased equipment will be assigned to the institution as collateral. The institution may, however, take title to the collateral in the event the customer fails to make lease payments or certain other defaults by the customer occur under the terms of the lease.

To date, we have funded the vast majority of our leases internally using our available cash. Leases are funded internally for a variety of reasons, including:

- we may have a sufficient amount of cash on hand;
- lease amounts are too small to be attractive to financial institutions;
- the credit strength of the customer is acceptable only for recourse funding; or
- when we intend to discount a lease but the discounting process has not been completed.

We will rely on recourse bank facilities to fund both our middle-market and small-ticket portfolios**.** We currently have a $20 million line of credit with LaSalle Bank, N.A. with the ability to increase the line of credit to $25 million if certain conditions are met. We may also use the proceeds from our offering of $50 million in principal of unsecured subordinated debt of varying interest rates and maturity dates filed on Form S-1 effective June 14, 2006, to fund both our middle-market and small-ticket portfolios. As of December 30, 2006, we have $15.38 million outstanding in unsecured subordinated notes.

Equipment Leasing Competition

We compete with a variety of equipment financing sources that are available to businesses, including: national, regional and local finance companies that provide lease and loan products; financing through captive finance and leasing companies affiliated with major equipment manufacturers; corporate credit cards; and commercial banks, savings and loans, and credit unions. Many of these companies are substantially larger than we are and have considerably greater financial, technical and marketing resources than we do.

Some of our competitors have a lower cost of funds and access to funding sources that are not available to us. A lower cost of funds could enable a competitor to offer leases with yields that are much less than the yields that we use to price our leases, which might force us to lower our yields or lose lease origination volume. In addition, certain of our competitors may have higher risk tolerances or different risk assessments, which could enable them to establish more origination sources and end user customer relationships and increase their market share. We have and will continue to encounter significant competition.

Government Regulation

Fourteen states, the Federal Trade Commission and three Canadian Provinces impose pre-sale franchise registration and/or disclosure requirements on franchisors. In addition, a number of states have statutes which regulate substantive aspects of the franchisor-franchisee relationship such as termination, nonrenewal, transfer, discrimination among franchisees and competition with franchisees.

Additional legislation, both at the federal and state levels, could expand pre-sale disclosure requirements, further regulate substantive aspects of the franchise relationship and require us to file our franchise offering circulars with additional states. We cannot predict the effect of future franchise legislation, but do not believe there is any imminent legislation currently under consideration which would have a material adverse impact on our operations.

Although most states do not directly regulate the commercial equipment lease financing business, certain states require licensing of lenders and finance companies, and impose limitations on interest rates and other charges, and a disclosure of certain contract terms and constrain collection practices. We believe that we are currently in compliance with all material statutes and regulations that are applicable to our business.

Trademarks and Service Marks

Play It Again Sports®, Once Upon A Child®, Plato s Closet®, Music Go Round®, Winmark®, Winmark Business Solutions®, Winmark Capital® and LeaseManager®, among others, are our registered service marks. A trademark application for Wirth Business Credit has been filed with the United States Patent and Trademark Office. These marks are of considerable value to our business. We intend to protect our service marks by appropriate legal action where and when necessary. Each service mark registration must be renewed every 10 years. We have taken, and intend to continue to take all steps necessary to renew the registration of all our material service marks.

Seasonality

Our Play It Again Sports® and Music Go Round® franchise brands have experienced higher than average sales volumes during the holiday shopping season. Our Once Upon A Child® and Plato s Closet® franchise brands have experienced higher than average sales volumes during the spring months and, along with our Music Go Round® brand, also during the back to school season. Overall, the different seasonal trends of our brands partially offset each other and do not result in significant seasonality trends on a Company-wide basis. Our equipment leasing business is not seasonal; however, quarter to quarter results may vary significantly.

Employees

As of December 30, 2006, we employed 104 full-time employees, of which 14 were salespersons, 58 were support personnel and 32 were administrative.

ITEM 1A: RISK FACTORS

We are dependent on franchise renewals.

Each of our franchise agreements is 10 years long. At the end of the term of each franchise agreement, each franchisee has the option to renew the franchise relationship by signing a new 10-year franchise agreement. In 2006, of the 9 franchisees that had their Play It Again Sports® franchise agreement expire, 9 signed new 10-year franchise agreements. In 2007, 2008 and 2009, 19, 10 and 16 Play It Again Sports® franchise agreements will expire, respectively. In 2006, of the 16 franchisees that had their Once Upon A Child® franchise agreement expire, 16 signed new 10-year franchise agreements. In 2007, 2008 and 2009, 12, 8 and 19 Once Upon A Child® franchise agreements will expire, respectively. In 2006, of the 9 franchisees that had Music Go Round® franchise agreement expire, 9 signed new 10-year franchise agreements. In 2007, 2008 and 2009, 7, 7 and 5 Music Go Round® franchise agreements will expire, respectively. In 2006, none of our Plato s Closet® franchise agreements expired. None of our Plato s Closet® franchise agreements will expire in 2007 or 2008 and 7 Plato s Closet® franchise agreements will expire in 2009. We believe that renewing a significant number of these franchise relationships is extremely important to our continued success. If a significant number of franchise relationships are not renewed our financial performance would be materially and adversely affected.

We have suffered declines in the number of Play It Again Sports® franchises.

The number of our Play It Again Sports® franchises has continued to decline. In 1999, Play It Again Sports® closed 58 stores and opened 12 stores, a net loss of 46 stores. In 2000, Play It Again Sports® closed 64 stores and opened 15 stores, a net loss of 49 stores. In 2001, Play It Again Sports® closed 59 stores and opened 10 stores, a net loss of 49 stores. In 2002, Play It Again Sports® closed 35 stores and opened 7 stores, a net loss of 28 stores. In 2003, Play It Again Sports® closed 37 stores and opened 10 stores, a net loss of 27 stores. In 2004, Play It Again Sports® closed 27 stores and opened 12 stores, a net loss of 15 stores. In 2005, Play It Again Sports® closed 26 stores and opened 10 stores, a net loss of 16 stores. In 2006, Play It Again Sports® closed 22 stores and opened 14 stores, a net loss of 8 stores. It is extremely important to our future success that the net loss of Play It Again Sports® stores be slowed and ultimately reversed. We believe that a certain number of stores will close each year. Our objective is to minimize store closings by continuing our investment in franchisee support services such as franchisee training, Winmark Business Solutions and the Winmark computer support center, by investing capital to improve Winmark s proprietary point-of-sale software system and continuing to train our field operations personnel to better serve franchisee needs. There can be no assurance that we will be successful in reducing or reversing the decline in Play It Again Sports® franchises. If we are not successful, it would have a material adverse effect on our financial condition and results of operation.

We are dependent on new franchisees.

Our ability to generate increased revenue and achieve higher levels of profitability depends in part on increasing the number of franchises open. We believe that many larger and smaller markets will continue to provide significant opportunities for sales of franchises and that we can sustain approximately our current annual level of openings. However, there can be no assurance that we will sustain this level of franchise openings.

We are dependent upon our chief executive officer.

Our success depends greatly on the efforts and abilities of our key executive John L. Morgan, our chairman of the board and chief executive officer. The loss of the services of Mr. Morgan could materially harm our business. Such a loss would also divert management attention away from operational issues.

We may sell franchises for a territory, but the franchisee may not open.

We believe that a substantial majority of franchises sold but not opened will open within the time period permitted by the applicable franchise agreement or we will be able to resell the territories for most of the terminated or expired franchises. However, there can be no assurance that substantially all of the currently sold but unopened franchises will open and commence paying royalties to us. At December 30, 2006, we had 55 franchise agreements expected to open in 2007.

We are dependent on supply of used merchandise.

Our retail brands are based on offering customers a mix of used and new merchandise. As a result, obtaining continuing supplies of high quality used merchandise is important to the success of our brands. Supply of used merchandise comes from the general public and is not regular or highly reliable. There can be no assurance that we will avoid supply problems with respect to used merchandise.

We may be unable to collect accounts receivable from franchisees.

In the event that our ability to collect accounts receivable significantly declines from current rates, we may incur additional charges that would affect earnings. If we are unable to collect payments due from our franchisees, it would materially adversely affect our results of operation and financial condition.

We operate in extremely competitive industries.

Retailing, including the sale of sporting goods, childrens and teenage apparel and musical instruments, is highly competitive. Many retailers have significantly greater financial and other resources than us and our franchisees. Individual franchisees face competition in their markets from retailers of new merchandise and, in certain instances, resale, thrift and other stores that sell used merchandise. To date, our franchisees have not faced a high degree of competition in the sale of used merchandise, but do so in connection with the sale of new merchandise. However, we may face additional competition as our franchise systems expand and if additional competitors enter the used merchandise market.

Our equipment leasing businesses compete with a variety of equipment financing sources that are available to businesses, including: national, regional, and local finance companies that provide leases and loan products; financing through captive finance and leasing companies affiliated with major equipment manufacturers; and commercial banks, savings and loans and credit unions. Many of these companies are substantially larger than we are and have considerably greater financial, technical and marketing resources than we do. There can be no assurances that we will be able to successfully compete with these larger competitors.

We are in the early stages of our equipment leasing operations and there can be no assurance that

we will be successful.

We began our equipment leasing operations in April of 2004. We began franchising Wirth Business Credit in 2006. As a result, there can be no assurance that any of our planned future leasing activities will be successful. An inability to successfully launch and operate our equipment leasing business will have a material negative affect on our financial results.

We are subject to credit risk from nonpayment or slow payments in our lease portfolio.

In our leasing business, if we inaccurately assess the creditworthiness of our customers, we may experience a higher number of lease defaults than expected, which would reduce our earnings. For our smaller customers, there is typically only limited publicly available financial and other information about their businesses and they often do not have audited financial statements. Accordingly, in making credit decisions, we rely upon the accuracy of information from the small business owner and/or third party sources, such as credit reporting agencies. If the information we obtain from small business owners and/or third party sources is incorrect, our ability to make appropriate credit decisions will be impaired.

If losses from leases exceed our allowance for credit losses, our operating income will be reduced. In connection with our leases, we record an allowance for credit losses to provide for estimated losses. Determining the appropriate level of the allowance is an inherently uncertain process and therefore our determination of this allowance may prove to be inadequate to cover losses in connection with our portfolio of leases. Losses in excess of our allowance for credit losses would cause us to increase our provision for credit losses, reducing or eliminating our operating income.

We must control our selling, general and administrative expense to be successful.

Our ability to control the amount, and rate of growth in, selling, general and administrative expenses and the impact of unusual items resulting from our ongoing evaluation of our business strategies, asset valuations and organizational structures is important to our financial success. We expect to incur significant additional expenses in connection with the launch of Wirth Business Credit and Winmark Capital Corporation. In the near term, our leasing income will not exceed our expenses. We cannot assure any investor that we will be able to control such items of expense.

We have made minority investments outside of our franchise and leasing businesses and have

suffered losses in these investments.

We currently have investments in three private companies.

We have purchased $7.5 million of the common stock of Tomsten, Inc., a privately held corporation, (d/b/a Archiver s) or 18.3% of the total outstanding common stock. Archiver s is a retail concept created to help people preserve and enjoy their photographs. Archiver s stores feature a wide variety of photo-safe products, including photo albums, scrapbooks and scrapbook supplies, frames, rubber stamps, and photo storage and organization products.

We have purchased $2 million of preferred stock in Commercial Credit Group, Inc. (CCG), an equipment leasing company specializing in construction, transportation and waste management equipment. In February of 2006, the Company entered into a Redemption Agreement and an Investment Agreement with CCG. As a result the Company s investment in CCG was redeemed for $2.0 million plus a transaction fee of $360,000. In addition, the Company purchased from CCG $2.0 million of newly issued 14.75% Senior Subordinated Notes due in 2011.

On October 13, 2004, we made a commitment to lend $2 million to BridgeFunds Limited at an annual rate of 12% pursuant to several senior subordinated promissory notes. Each note has a maturity of five years. BridgeFunds Limited advances funds to claimants involved in civil litigation to cover litigation expenses. We have funded our $2 million commitment. In addition, we own a warrant to purchase 13.8% of the equity of BridgeFunds on a fully diluted basis. BridgeFunds Limited s success depends upon its ability to continue to raise capital. There can be no assurance that BridgeFunds Limited will be able to raise capital to fund its operations.

Each of our minority investments is either in a relatively new or unproven business. Any of these businesses may not succeed and ultimately be forced to cease operations. Also, there is not a market for the equity of Tomsten, Inc. and our ability to receive our investment back and realize a cash return on our investment in these companies will depend on: the development of a market for such companies equity; or the sale of such companies. BridgeFunds and Commercial Credit Group may not have the ability to pay interest on amounts owed to us or to repay principal amounts owed to us. In addition, there is no market for the equity of BridgeFunds Limited, and, as a result, our warrant to purchase 13.8% of the stock of BridgeFunds Limited may be of no value.

We do not have the ability (whether by vote, contract or otherwise) to control the actions of any of these companies. The loss of our entire investment in any one or all of our minority investments would have a material negative impact on our financial results.

We are subject to government regulation.

As a franchisor, we are subject to various federal and state franchise laws and regulations. Fourteen states, the Federal Trade Commission and three Canadian Provinces impose pre-sale franchise registration and/or disclosure requirements on franchisors. In addition, a number of states have statutes which regulate substantive aspects of the franchisor-franchisee relationship such as termination, nonrenewal, transfer, discrimination among franchisees and competition with franchisees.

Additional legislation, both at the federal and state levels, could expand pre-sale disclosure requirements, further regulate substantive aspects of the franchise relationship and require us to file our franchise offering circulars with additional states. Future franchise legislation could impose costs or other burdens on us that could have a material adverse impact on our operations.

Although most states do not directly regulate the commercial equipment lease financing business, certain states require licensing of lenders and finance companies, and impose limitations on interest rates and other charges, and a disclosure of certain contract terms and constrain collection practices. Laws or regulations may be adopted with respect to our equipment leases or the equipment leasing industry, and collection processes. Any new legislation or regulation, or changes in the interpretation of existing laws, which affect the equipment leasing industry could increase our costs of compliance.

Risk of regulation as an Investment Company

As of December 30, 2006, the value of the Company s investment securities as a percentage of total assets was below 40%. As of December 31, 2005, however, the value of the Company s investment securities stated as a percentage of total assets exceeded 40%. Under the Investment Company Act of 1940 (the 1940 Act), a company may be deemed to be an investment company if the value of its investment securities stated as a percentage of total assets exceeds 40%. The Company believes that it is not an investment company subject to regulation under the 1940 Act. There is a risk, however, that because the Company s investment securities have in the past constituted more than 40% of the Company s total assets, the Company could be subject to regulation by the Securities Exchange Commission as an investment company. There is also a risk that if in the future the Company s investment securities exceed 40% of total assets, the Company could be subject to regulation by the Securities Exchange Commission as an investment company. In either instance, the Commission could take enforcement action in connection with any alleged failure to register as an investment company. Any of these actions would have a material adverse affect on the Company.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

ITEM 2: PROPERTIES

We lease our headquarters facility in Golden Valley, Minnesota. Effective February 1, 2005, we amended our existing lease to add 3,281 square feet bringing our total square feet leased to 34,184. Our base rent under the amended lease remains the same, $218,980 per year. Finally, we have an option at anytime during the remaining term of the lease to rent the entire remaining balance of the building. We are obligated to pay the common area maintenance and other additional rent relating to the entire 34,184 square feet. In 2006, we paid an annual base rent of $218,980 plus common area maintenance charges of approximately $271,600. The lease, as amended, expires in August 2009. Our facilities are sufficient to meet our current needs and our immediate future needs.

ITEM 3: 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 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal year 2006.

PART II

ITEM 5: MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information, Holders, Dividends

Effective December 2, 2003, the trading of our common stock moved from the Nasdaq SmallCap Market, now known as the Nasdaq Capital Market, to the Nasdaq National Market, now known as the Nasdaq Global Market, under the symbol WINA . The table below sets forth the high and low bid prices of our common stock as reported by Nasdaq for the periods indicated:

FY 2006:	First	Second	Third	Fourth	FY 2005:	First	Second	Third	Fourth
High	24.09	27.48	27.13	24.27	High	27.00	23.15	22.56	22.42
Low	20.00	21.30	21.46	18.09	Low	18.50	19.06	15.95	18.67

The above quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions. At March 16, 2007, there were 5,467,445 shares of common stock outstanding held by approximately 710 beneficial shareholders and 135 shareholders of record. We have not paid any cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

	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(2)
January 1, 2006 to February 4, 2006	15,000	$ 21.500	15,000	504,458
February 5, 2006 to March 4, 2006	10,000	23.000	10,000	494,458
March 5, 2006 to April 1, 2006	10,000	23.250	10,000	484,458
April 2, 2006 to May 6, 2006	20,000	23.250	20,000	464,458
May 7, 2006 to June 3, 2006	420,000	23.550	420,000	44,458
June 4, 2006 to July 1, 2006	44,000	23.550	44,000	458
July 2, 2006 to August 5, 2006				458
August 6, 2006 to September 2, 2006				500,458
September 3, 2006 to September 30, 2006				500,458
October 1, 2006 to November 4, 2006				500,458
November 5, 2006 to December 2, 2006	5,000	19.74	5,000	495,458
December 3, 2006 to December 30, 2006				495,458
Total	524,000		524,000	495,458

(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 4,000,000 shares, of which 495,458 may still be repurchased.

(2) On August 15, 2006, the Board of Directors authorized a 500,000 share repurchase.

Winmark Corporation

Comparison of Cumulative Total Return Since

December 28, 2001

ITEM 6: SELECTED FINANCIAL DATA

The following table sets forth selected financial information for the periods indicated. The information should be read in conjunction with the financial statements and related notes discussed in Item 8 and 15, and Management s Discussion and Analysis of Financial Condition and Results of Operations discussed in Item 7.

	Fiscal Year Ended (in thousands except per share data) December 30, 2006	**December 31, 2005(1)**	**December 25, 2004**	**December 27, 2003**	**December 28, 2002**
Revenue:					
Royalties	$ 19,212	$ 17,875	$ 16,889	$ 16,333	$ 16,448
Merchandise sales	4,469	6,655	8,734	13,428	15,466
Leasing income	1,853	437	65		
Franchise fees	1,246	1,052	984	860	769
Other	591	581	530	622	742
Total revenue	27,371	26,600	27,202	31,243	33,425
Cost of merchandise sold	4,283	5,506	7,228	10,692	12,355
Leasing expense	227	7			
Selling, general and administrative expenses	17,499	16,593	13,349	14,156	14,746
Income from operations	5,362	4,494	6,625	6,395	6,324
Gain (loss) from equity investments	250	(1,169)	(195)	(136)	
Gain on sale of marketable securities		27	174	102	31
Interest expense	(729)				
Interest and other income	867	303	267	182	13
Income before income taxes	5,750	3,655	6,871	6,543	6,368

Provision for income taxes	2,329	1,555	2,789	2,530	2,539
Net income	$ 3,421	$ 2,100	$ 4,082	$ 4,013	$ 3,829
Earnings per common share diluted	$ .57	$ .33	$ .63	$ .63	$ .63
Weighted average shares outstanding diluted					