WINMARK CORP
Form 424B3
August 04, 2008

**Filed Pursuant to Rule 424(b)(3)**

**File Number 333-133393**

**PROSPECTUS SUPPLEMENT NO. 3**

**to Prospectus, as amended and restated,**

**declared effective on March 27, 2008**

**(Registration No. 333-133393)**

**WINMARK CORPORATION**

This Prospectus Supplement No.3 supplements our Prospectus, as amended and restated, declared effective March 27, 2008 (as previously supplemented by the prospectus supplements dated May 12, 2008 and June 16, 2008, collectively, the Prospectus ).

You should read this Prospectus Supplement No. 3 together with the Prospectus.

This Prospectus Supplement No. 3 includes the attached Current Report on Form 10-Q of Winmark Corporation as filed by us with the Securities and Exchange Commission on August 1, 2008.

The information contained herein, including the information attached hereto, supplements and supersedes, in part, the information contained in the Prospectus. This Prospectus Supplement No. 3 should be read in conjunction with the Prospectus, and is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 3 supersedes the information contained in the Prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS SUPPLEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus Supplement No. 3 is August 4, 2008.

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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-Q

| | |
|---|---|
| **x** | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934** |
| | **For the quarter ended June 28, 2008** |

**or**

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

**For the transition period from to**

**Commission File Number: 000-22012**

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# WINMARK CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Minnesota** | **41-1622691** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**4200 Dahlberg Drive, Suite 100, Minneapolis, MN 55422-4837**

(Address of principal executive offices) (Zip Code)

**(763) 520-8500**

(Registrant s telephone number, including area code)

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

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act:

Large accelerated filer o Accelerated filer o

Non-accelerated filer o Smaller reporting company x

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

Yes o No x

Common stock, no par value, 5,523,383 shares outstanding as of July 25, 2008.

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**WINMARK CORPORATION AND SUBSIDIARIES**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1: Financial Statements**

**WINMARK CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED BALANCE SHEETS**

(unaudited)

| | June 28, 2008 | December 29, 2007 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 2,585,200 | $ 1,253,000 |
| Receivables, less allowance for doubtful accounts of $53,500 and $52,200 | 2,136,400 | 2,312,300 |
| Net investment in leases - current | 16,356,400 | 10,554,900 |
| Income tax receivable | 831,800 | 166,300 |
| Inventories | 70,700 | 145,000 |
| Prepaid expenses | 977,200 | 1,104,900 |
| Deferred income taxes | 208,200 | 208,200 |
| Total current assets | 23,165,900 | 15,744,600 |
| | | |
| Net investment in leases long-term | 29,186,600 | 31,331,600 |
| Long-term investments | 7,360,000 | 7,496,500 |
| Long-term notes receivables, net | 49,400 | 59,700 |
| Property and equipment, net | 612,700 | 667,400 |
| Other assets | 625,800 | 625,800 |
| Deferred income taxes | 1,021,200 | 1,021,200 |
| | $ 62,021,600 | $ 56,946,800 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current Liabilities: | | |
| Current line of credit | $ 3,741,600 | $ 7,553,600 |
| Current renewable subordinated notes | 4,217,800 | 3,535,900 |
| Accounts payable | 1,149,400 | 1,414,100 |
| Accrued liabilities | 2,843,000 | 2,501,900 |
| Current discounted lease rentals | 948,700 | 27,400 |
| Rents received in advance | 1,729,100 | 1,385,900 |
| Current deferred revenue | 1,104,000 | 1,132,300 |
| Total current liabilities | 15,733,600 | 17,551,100 |
| | | |
| Long-term line of credit | 11,198,300 | 8,685,000 |
| | | |
| Long-term renewable subordinated notes | 17,081,300 | 17,486,000 |
| | | |
| Long-term discounted lease rentals | 1,720,200 | |
| | | |
| Long-term deferred revenue | 619,000 | 556,000 |
| | | |
| Shareholders Equity: | | |

| | | | | |
|---|---|---|---|---|
| Common stock, no par, 10,000,000 shares authorized, 5,526,459 and 5,417,775 shares issued and outstanding | | 1,438,600 | | 305,900 |
| Retained earnings | | 14,230,600 | | 12,362,800 |
| | | | | |
| Total shareholders equity | | 15,669,200 | | 12,668,700 |
| | $ | 62,021,600 | $ | 56,946,800 |

The accompanying notes are an integral part of these financial statements

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**WINMARK CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | **June 28, 2008** | **June 30, 2007** | **June 28, 2008** | **June 30, 2007** |
| REVENUE: | | | | |
| Royalties | $ 5,303,800 | $ 4,846,500 | $ 10,635,400 | $ 9,999,400 |
| Leasing income | 1,907,000 | 995,800 | 3,859,600 | 1,771,500 |
| Merchandise sales | 975,000 | 1,193,600 | 1,907,800 | 2,452,700 |
| Franchise fees | 386,100 | 417,400 | 913,600 | 717,400 |
| Other | 145,400 | 109,300 | 278,300 | 248,500 |
| Total revenue | 8,717,300 | 7,562,600 | 17,594,700 | 15,189,500 |
| COST OF MERCHANDISE SOLD | 940,700 | 1,148,000 | 1,834,600 | 2,355,200 |
| LEASING EXPENSE | 463,100 | 197,400 | 949,000 | 333,200 |
| PROVISION FOR CREDIT LOSSES | 269,200 | 165,300 | 654,300 | 279,700 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 5,138,500 | 4,923,600 | 10,324,300 | 9,802,900 |
| Income from operations | 1,905,800 | 1,128,300 | 3,832,500 | 2,418,500 |
| LOSS FROM EQUITY INVESTMENTS | (60,700) | (197,400) | (136,500) | (252,200) |
| INTEREST EXPENSE | (340,200) | (387,600) | (688,600) | (720,600) |
| INTEREST AND OTHER INCOME | 59,000 | 171,400 | 131,800 | 300,800 |
| Income before income taxes | 1,563,900 | 714,700 | 3,139,200 | 1,746,500 |
| PROVISION FOR INCOME TAXES | (633,400) | (284,200) | (1,271,400) | (686,200) |
| NET INCOME | $ 930,500 | $ 430,500 | $ 1,867,800 | $ 1,060,300 |
| EARNINGS PER SHARE BASIC | $ .17 | $ .08 | $ .34 | $ .19 |
| EARNINGS PER SHARE DILUTED | $ .17 | $ .08 | $ .34 | $ .19 |
| WEIGHTED AVERAGE SHARES OUTSTANDING BASIC | 5,534,781 | 5,447,697 | 5,517,807 | 5,516,214 |
| WEIGHTED AVERAGE SHARES OUTSTANDING DILUTED | 5,562,319 | 5,560,564 | 5,548,482 | 5,638,543 |

The accompanying notes are an integral part of these financial statements

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**WINMARK CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

(Unaudited)

| | Six Months Ended June 28, 2008 | Six Months Ended June 30, 2007 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $ 1,867,800 | $ 1,060,300 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 171,300 | 143,700 |
| Allowance for doubtful accounts | 300 | 1,700 |
| Provision for credit losses | 536,100 | 253,600 |
| Compensation expense related to stock options | 415,200 | 291,100 |
| Loss from equity investment | 136,500 | 252,200 |
| Deferred initial direct costs, net of amortization | (286,500) | (427,000) |
| Change in operating assets and liabilities: | | |
| Receivables | 185,900 | (22,300) |
| Income tax receivable | (665,500) | (243,600) |
| Inventories | 74,300 | (38,900) |
| Prepaid expenses | 127,700 | 409,700 |
| Deferred income taxes | | 134,700 |
| Accounts payable | (264,700) | (475,400) |
| Accrued liabilities | 341,100 | 75,700 |
| Additions to advance and security deposits | 644,900 | 629,600 |
| Deferred revenue | 34,700 | 172,400 |
| Net cash provided by operating activities | 3,319,100 | 2,217,500 |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (116,600) | (255,300) |
| Purchase of equipment for lease contracts | (12,276,000) | (12,145,200) |
| Principal collections on lease receivables | 7,797,100 | 4,053,400 |
| Net cash used for investing activities | (4,595,500) | (8,347,100) |
| FINANCING ACTIVITIES: | | |
| Proceeds from borrowings on line of credit | 3,000,000 | 11,900,000 |
| Payments on line of credit | (4,298,700) | |
| Proceeds from issuance of subordinated notes | 889,300 | 1,383,100 |
| Payments on subordinated notes | (612,100) | (2,021,200) |
| Repurchase of common stock | (308,000) | (4,765,100) |
| Proceeds from exercises of options and warrants | | 104,600 |
| Proceeds from discounted lease rentals | 2,912,600 | |
| Tax benefit on exercised options and warrants | 1,025,500 | 40,700 |
| Net cash provided by financing activities | 2,608,600 | 6,642,100 |
| INCREASE IN CASH AND CASH EQUIVALENTS | 1,332,200 | 512,500 |
| Cash and cash equivalents, beginning of period | 1,253,000 | 1,037,800 |
| Cash and cash equivalents, end of period | $ 2,585,200 | $ 1,550,300 |
| SUPPLEMENTAL DISCLOSURES: | | |

| | | | | |
|---|---|---|---|---|
| Cash paid for interest | $ | 1,254,600 | $ | 843,100 |
| Cash paid for income taxes | $ | 863,400 | $ | 672,900 |

The accompanying notes are an integral part of these financial statements

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**WINMARK CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**1. Management s Interim Financial Statement Representation:**

The accompanying condensed financial statements have been prepared by Winmark Corporation and subsidiaries (the Company ), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has a 52/53 week year which ends on the last Saturday in December. The information in the condensed financial statements includes normal recurring adjustments and reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of such financial statements. This report should be read in conjunction with the audited financial statements and the notes thereto included in the Company s latest Annual Report on Form 10-K.

Revenues and operating results for the six months ended June 28, 2008 are not necessarily indicative of the results to be expected for the full year.

**2. Organization and Business:**

The Company offers licenses to operate franchises using the service marks Play it Again Sports®, Once Upon A Child®, Music Go Round®, Plato s Closet® and Wirth Business Credit®. In addition, the Company sells inventory to its Play It Again Sports® franchisees through its buying group. The Company also operates both small-ticket and middle-market equipment leasing businesses.

**3. Long-Term Investments:**

The Company has an investment in Tomsten, the parent company of Archiver s retail chain. Archiver s is a retail concept created to help people preserve and enjoy their photographs. The Company has invested a total of $7.5 million in the purchase of common stock of Tomsten. The Company s investment currently represents 18.3% of the outstanding common stock of Tomsten. The Company s investment was originally accounted for using the cost method based upon an analysis that included the fact that no officers or directors of the Company served as officers or directors of Tomsten, and the existence of a voting agreement between the Company and Tomsten, appointing officers of Tomsten as the Company s proxy with the right to vote the Tomsten shares held by the Company.

On October 2, 2007, the Company changed its relationship with Tomsten, primarily by (i) John Morgan, our Chairman and Chief Executive Officer, joining Tomsten s board of directors and (ii) Tomsten and Winmark eliminating the voting agreement between the parties. Due to these factors, the Company determined that it was necessary to change the accounting treatment for its investment in Tomsten from the cost method (which had been in place since the date of the Company s first investment in August 2002) to the equity method of accounting. At the date of the change in accounting treatment, the Company s historical financial statements were adjusted retroactively to reflect the portion of Tomsten s operating losses attributable to the Company s ownership from the date of the original investment. (See Note 7.) As of June 28, 2008, $3.1 million of the Company s investment, with a current carrying cost of $5.4 million, is attributable to goodwill. The amount of goodwill was determined by calculating the difference between the Company s net investment in Tomsten less its pro rata share of Tomsten s net worth.

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On October 13, 2004, the Company made a commitment to lend $2.0 million to BridgeFunds Limited at an annual rate of 12% pursuant to several senior subordinated promissory notes. BridgeFunds Limited advances funds to claimants involved in civil litigation to cover litigation expenses. At December 29, 2007 and June 28, 2008, the Company had previously funded the $2.0 million commitment. In addition, the Company has received a warrant to purchase approximately 257,000 shares of BridgeFunds which currently represents approximately 7.0% of the equity of BridgeFunds on a fully diluted basis. On August 23, 2007, in connection with raising capital, BridgeFunds Limited completed a restructuring where all assets and liabilities, including the warrant, were assigned to and assumed by BridgeFunds, LLC.

**4. Investment in Leasing Operations:**

Investment in leasing operations consists of the following:

| | June 28, 2008 | | December 29, 2007 | |
|---|---|---|---|---|
| Minimum lease payments receivable | $ | 53,145,100 | $ | 38,948,800 |
| Estimated residual value of equipment | | 2,075,900 | | 1,472,800 |
| Unearned lease income net of initial direct costs deferred | | (9,693,300) | | (7,583,800) |
| Security deposits | | (1,601,100) | | (1,299,300) |
| Allowance for credit losses | | (788,100) | | (613,800) |
| Equipment installed on leases not yet commenced | | 2,404,500 | | 10,961,800 |
| Total net investment in leases | | 45,543,000 | | 41,886,500 |
| Less: net investment in leases current | | (16,356,400) | | (10,554,900) |
| Net investment in leases long-term | $ | 29,186,600 | $ | 31,331,600 |

The Company had $480,000 and $26,600 of net charge-offs during the first six months of 2008 and 2007, respectively.

As of June 28, 2008, leased assets with one customer approximated 14% of the Company s total assets, of which $2.3 million of the customer commitment is secured by a letter of credit.

Minimum lease payments receivable under lease contracts and the amortization of unearned lease income, net of initial direct costs and fees deferred is as follows for the remainder of fiscal 2008 and the full fiscal years thereafter as of June 28, 2008:

| Fiscal Year | | Minimum Lease Payments Receivable | | Income Amortization |
|---|---|---|---|---|
| 2008 | $ | 10,442,700 | $ | 3,079,400 |
| 2009 | | 20,608,100 | | 4,015,000 |
| 2010 | | 13,709,100 | | 1,856,200 |
| 2011 | | 5,695,300 | | 599,000 |
| 2012 | | 2,491,000 | | 140,600 |
| Thereafter | | 198,900 | | 3,100 |
| | $ | 53,145,100 | $ | 9,693,300 |

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**5. Accounting for Stock-Based Compensation:**

Financial Accounting Standards Board (FASB) Statement No. 123, *Share-Based Payment* (revised 2004) requires the cost of all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated financial statements based on the grant date fair value of those awards. In accordance with Statement No. 123R, this cost is recognized over the period for which an employee is required to provide service in exchange for the award. Statement No. 123R requires that the benefits associated with tax deductions in excess of recognized compensation expense be reported as a financing cash flow rather than as an operating cash flow. The Company uses the straight-line method of expensing graded vesting awards. Compensation expense of $415,200 and $291,100 relating to the vested portion of the fair value of stock options granted was expensed to Selling, General and Administration Expenses in the first six months of 2008 and 2007, respectively.

The Company estimates the fair value of options granted using the Black-Scholes option valuation model. We estimate the volatility of our common stock at the date of grant based on our historical volatility rate, consistent with SFAS No. 123(R) and Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB 107). Our decision to use historical volatility was based upon the lack of actively traded options on our common stock. We estimate the expected term based upon historical option exercises. The risk-free interest rate assumption is based on observed interest rates for the volatility period. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, we amortize the fair value on a straight-line basis. All options are amortized over the vesting periods.

In accordance with SFAS 123R, the fair value of each option granted in 2008 and 2007 was estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

| Year Granted | Option Fair Value | Risk Free Interest Rate | Expected Life (Years) | Expected Volatility | Dividend Yield |
|---|---|---|---|---|---|
| 2008 | | | | | |
| 2007 | $ 5.76 / $6.16 / $6.93 | 4.55% / 3.54% / 3.67% | 5 / 5 / 6 | 27.2% / 25.3% / 25.4% | none |

**6. New Accounting Pronouncements**

Effective December 30, 2007, the Company adopted SFAS No. 157, Fair Value Measurements ( SFAS No.157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. The adoption of SFAS No. 157 did not have a material impact on the Company s financial condition or results of operations.

SFAS No. 157 defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also describes three levels of inputs that may be used to measure fair value:

- Level 1 quoted prices in active markets for identical assets and liabilities.

- Level 2 observable inputs other than quoted prices in active markets for identical assets and liabilitie