

BUILD A BEAR WORKSHOP INC
Form 10-Q
November 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 1, 2016

OR

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

For the transition period from _____ to _____

Commission file number: 001-32320

BUILD-A-BEAR WORKSHOP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware 43-1883836
(State or Other Jurisdiction of (IRS Employer

Incorporation or Organization) Identification No.)

1954 Innerbelt Business Center Drive
63114
St. Louis, Missouri
(Address of Principal Executive Offices) (Zip Code)

(314) 423-8000

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

Act). Yes No

As of November 4, 2016, there were 15,850,618 issued and outstanding shares of the registrant's common stock.

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BUILD-A-BEAR WORKSHOP, INC.

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PART I-FINANCIAL INFORMATION**Item 1. Financial Statements****BUILD-A-BEAR
WORKSHOP,
INC. AND
SUBSIDIARIES
CONDENSED
CONSOLIDATED
BALANCE
SHEETS**(Dollars in
thousands, except
share and per share
data)

| | October 1, 2016 (Unaudited) | January 2, 2016 | October 3, 2015 (Unaudited) |
|--|---|--------------------------------|---|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 11,780 | \$45,196 | \$ 37,146 |
| Inventories | 59,398 | 53,877 | 55,591 |
| Receivables | 8,787 | 13,346 | 8,053 |
| Prepaid expenses and other current assets | 13,752 | 16,312 | 16,651 |
| Total current assets | 93,717 | 128,731 | 117,441 |
| Property and equipment, net of accumulated depreciation of \$179,584; \$183,686 and \$183,179, respectively | 71,984 | 67,741 | 60,090 |
| Deferred tax assets | 10,737 | 10,864 | 2,734 |
| Other intangible assets, net | 1,653 | 1,738 | 1,211 |
| Other assets, net | 4,806 | 4,260 | 1,828 |
| Total Assets | \$ 182,897 | \$213,334 | \$ 183,304 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 26,242 | \$42,551 | \$ 29,927 |
| Accrued expenses | 11,918 | 19,286 | 14,197 |
| Gift cards and customer deposits | 27,094 | 35,391 | 28,048 |
| Deferred revenue | 2,030 | 2,633 | 2,635 |
| Total current liabilities | 67,284 | 99,861 | 74,807 |
| Deferred rent | 15,278 | 12,156 | 12,327 |
| Deferred franchise revenue | 603 | 728 | 782 |

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| | | | |
|---|------------|-----------|------------|
| Other liabilities | 1,008 | 1,175 | 1,111 |
| Stockholders' equity: | | | |
| Preferred stock, par value \$0.01, Shares authorized: 15,000,000; No shares issued or outstanding at October 1, 2016, January 2, 2016 and October 3, 2015 | - | - | - |
| Common stock, par value \$0.01, Shares authorized: 50,000,000; Issued and outstanding: 15,850,629; 15,795,891 and 16,871,591 shares, respectively | 159 | 158 | 169 |
| Additional paid-in capital | 67,197 | 66,009 | 69,880 |
| Accumulated other comprehensive loss | (11,994) | (9,971) | (9,272) |
| Retained earnings | 43,362 | 43,218 | 33,500 |
| Total stockholders' equity | 98,724 | 99,414 | 94,277 |
| Total Liabilities and Stockholders' Equity | \$ 182,897 | \$213,334 | \$ 183,304 |

See accompanying notes to condensed consolidated financial statements.

**BUILD-A-BEAR
WORKSHOP, INC.
AND
SUBSIDIARIES
CONDENSED
CONSOLIDATED
STATEMENTS OF
INCOME AND
COMPREHENSIVE
INCOME (LOSS)
(Unaudited)**

(Dollars in thousands,
except share and per
share data)

| | Thirteen weeks ended | | Thirty-nine weeks ended | |
|--|-----------------------------|----------------------------|--------------------------------|----------------------------|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Revenues: | | | | |
| Net retail sales | \$81,870 | \$84,303 | \$249,854 | \$256,246 |
| Commercial revenue | 1,322 | 795 | 2,601 | 2,159 |
| Franchise fees | 556 | 525 | 1,407 | 1,624 |
| Total revenues | 83,748 | 85,623 | 253,862 | 260,029 |
| Costs and expenses: | | | | |
| Cost of merchandise sold - retail | 46,461 | 46,117 | 137,778 | 140,288 |
| Cost of merchandise sold - commercial | 535 | 551 | 1,213 | 1,093 |
| Selling, general and administrative | 33,404 | 36,826 | 110,135 | 109,736 |
| Store preopening | 571 | 817 | 2,969 | 1,079 |
| Interest expense (income), net | (19) | (56) | (58) | (148) |
| Total costs and expenses | 80,952 | 84,255 | 252,037 | 252,048 |
| Income before income taxes | 2,796 | 1,368 | 1,825 | 7,981 |
| Income tax expense | 955 | 301 | 767 | 721 |
| Net income | \$1,841 | \$1,067 | \$1,058 | \$7,260 |
| Foreign currency translation adjustment | (298) | (770) | (2,023) | (574) |
| Comprehensive income (loss) | \$1,543 | \$297 | \$(965) | \$6,686 |
| Income per common share: | | | | |
| Basic | \$0.12 | \$0.06 | \$0.07 | \$0.42 |
| Diluted | \$0.11 | \$0.06 | \$0.07 | \$0.42 |
| Shares used in computing common per share amounts: | | | | |
| Basic | 15,518,115 | 16,670,358 | 15,471,759 | 16,834,968 |
| Diluted | 15,691,004 | 16,890,722 | 15,650,143 | 17,071,591 |

See accompanying notes to condensed consolidated financial statements.

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

| | Thirty-nine weeks ended October 1, 2016 | October 3, 2015 |
|--|--|------------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 1,058 | \$ 7,260 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 11,573 | 12,262 |
| Stock-based compensation | 2,259 | 1,533 |
| Deferred taxes | (236) | 40 |
| Impairment of store assets | 298 | 296 |
| Provision for doubtful accounts | - | 14 |
| Trade credit utilization | - | 185 |
| Loss on disposal of property and equipment | 269 | 199 |
| Change in assets and liabilities: | | |
| Inventories | (6,296) | (3,877) |
| Receivables | 4,079 | 3,317 |
| Prepaid expenses and other assets | 363 | (768) |
| Accounts payable and accrued expenses | (22,663) | (16,662) |
| Lease related liabilities | 3,621 | (1,018) |
| Gift cards and customer deposits | (7,986) | (5,302) |
| Deferred revenue | (684) | (176) |
| | (14,345) | (2,697) |

| | | | | |
|---|---------|--------|---------|--------|
| Net cash used in operating activities | | | | |
| Cash flows from investing activities: | | | | |
| Purchases of property and equipment | (17,647 |) | (11,645 |) |
| Purchases of other assets and other intangible assets | (566 |) | (1,219 |) |
| Purchases of short term investments | - | | (1,551 |) |
| Proceeds from sale or maturity of short term investments | 1,461 | | 793 | |
| Cash used in investing activities | (16,752 |) | (13,622 |) |
| Cash flows from financing activities: | | | | |
| Proceeds from the exercise of employee stock options, net of withholding tax payments | (513 |) | (479 |) |
| Purchases of Company's common stock | (1,469 |) | (11,084 |) |
| Net cash used in financing activities | (1,982 |) | (11,563 |) |
| Effect of exchange rates on cash | (337 |) | (361 |) |
| Net decrease in cash and cash equivalents | (33,416 |) | (28,243 |) |
| Cash and cash equivalents, beginning of period | 45,196 | | 65,389 | |
| Cash and cash equivalents, end of period | \$ | 11,780 | \$ | 37,146 |

See accompanying notes to condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited and have been prepared by Build-A-Bear Workshop, Inc. and its subsidiaries (collectively, the Company) pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet of the Company as of January 2, 2016 was derived from the Company's audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and reflect all adjustments which are, in the opinion of management, necessary to summarize fairly the financial position of the Company and the results of the Company's operations and cash flows for the periods presented. All of these adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Because of the seasonal nature of the Company's operations, results of operations of any single reporting period should not be considered as indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fiscal year ended January 2, 2016, which were included in the Company's annual report on Form 10-K filed with the SEC on March 17, 2016.

A reclassification was made in the current year presentation of the consolidated balance sheet as of October 3, 2015. The Company adjusted the classification of the impact of shares repurchased, which had previously been recorded as a deduction to additional paid-in capital, to a deduction which was allocated between additional paid-in capital and retained earnings. As a result of this reclassification, retained earnings were reduced by \$10.5 million and additional paid-in capital was increased by the same amount.

Additionally, the Company early adopted ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*, effective January 2, 2016, retrospectively. Adoption resulted in a \$1.7 million decrease in total current assets, a \$2.7 million increase in non-current deferred tax assets and a \$1.0 million decrease in non-current other assets, net on the Consolidated Balance Sheet as of October 3, 2015, compared to the prior period presentation. The adoption had no impact on results of operations.

2. Prepaid Expenses and Other Current Assets

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

| | October 1, 2016 | January 2, 2016 | October 3, 2015 |
|-----------------------|--------------------------------|--------------------------------|--------------------------------|
| Prepaid rent | \$6,986 | \$7,852 | \$8,328 |
| Short-term investment | - | 1,458 | 1,512 |
| Other | 6,766 | 7,002 | 6,811 |
| Total | \$13,752 | \$16,312 | \$16,651 |

3. Accrued Expenses

Accrued expenses consist of the following (in thousands):

| | October 1, 2016 | January 2, 2016 | October 3, 2015 |
|---|--------------------------------|--------------------------------|--------------------------------|
| Accrued wages, bonuses and related expenses | \$5,216 | \$8,035 | \$7,376 |
| Sales tax payable | 2,027 | 6,374 | 2,375 |
| Accrued rent and related expenses | 3,919 | 4,307 | 3,819 |
| Current income taxes payable | 756 | 570 | 627 |
| Total | \$11,918 | \$19,286 | \$14,197 |

4. Stock-based Compensation

For the thirteen and thirty-nine weeks ended October 1, 2016, selling, general and administrative expense includes \$0.8 million and \$2.3 million, respectively, of stock-based compensation expense. For the thirteen and thirty-nine weeks ended October 3, 2015, selling, general and administrative expense includes \$0.6 million and \$1.5 million, respectively, of stock-based compensation expense. As of October 1, 2016, there was \$4.8 million of total unrecognized compensation expense related to unvested restricted stock and option awards which is expected to be recognized over a weighted-average period of 1.4 years.

The following table is a summary of the balances and activity for the plan related to time-based and earned performance-based restricted stock for the thirty-nine weeks ended October 1, 2016:

| | Restricted Stock | | Performance Shares | |
|------------------------------|-------------------------|---|---------------------------|---|
| | Shares | Weighted Average Grant Date Fair Value | Shares | Weighted Average Grant Date Fair Value |
| Outstanding, January 2, 2016 | 276,553 | \$ 11.93 | 84,062 | \$ 20.70 |
| Granted | 201,978 | 13.59 | 175,945 | 13.69 |
| Vested | 152,155 | 11.21 | 7,039 | 20.56 |
| Forfeited | 10,191 | 13.46 | — | — |
| Canceled or expired | — | — | 12,493 | 20.56 |
| Outstanding, October 1, 2016 | 316,185 | \$ 13.31 | 240,475 | \$ 15.58 |

In March 2016, the Company awarded performance-based restricted stock subject to the achievement of pre-established net income objectives for fiscal 2016. Additionally, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established cumulative consolidated total net revenue goals for fiscal 2016, 2017 and 2018. These shares have a payout opportunity ranging from 50% to 200% of the target number of shares. In 2016, the number of shares earned relating to the performance shares issued in 2015 subject to the achievement of pre-established pre-tax income objectives for fiscal 2015 was 21,118.

The total fair value of shares vested during the thirty-nine weeks ended October 1, 2016 and October 3, 2015 was \$1.7 million and \$4.0 million, respectively.

The following table is a summary of the balances and activity for stock options for the thirty-nine weeks ended October 1, 2016:

| | Options | |
|------------------------------|----------------|--|
| | Shares | Weighted Average Exercise Price |
| Outstanding, January 2, 2016 | 574,851 | \$ 8.30 |
| Granted | 211,995 | 13.69 |
| Exercised | 24,103 | 5.92 |
| Forfeited | — | — |
| Canceled or expired | — | — |
| Outstanding, October 1, 2016 | 762,743 | \$ 9.88 |

5. Income Taxes

In years prior to 2015, the Company recorded a valuation allowance on substantially all of its domestic deferred tax assets. The effective tax rate was 34.2% and 42.0% for the thirteen and thirty-nine weeks ended October 1, 2016, respectively, compared to 22.0% and 9.0% for the thirteen and thirty-nine weeks ended October 3, 2015, respectively. The 2016 effective tax rate differed from the statutory rate of 34% primarily due to the effect of permanent differences. The 2015 effective tax rate differed from the statutory rate primarily attributable to the partial release of the valuation allowance on its domestic deferred tax assets as of October 3, 2015.

6. Income per Share

The Company uses the two-class method to compute basic and diluted net income or loss per common share. In periods of net loss, no effect is given to the Company's participating securities as they do not contractually participate in the losses of the Company. The following table sets forth the computation of basic and diluted net income per share (in thousands, except share and per share data):

| | Thirteen weeks ended | | Thirty-nine weeks ended | |
|--|-----------------------------|----------------------------|--------------------------------|----------------------------|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| NUMERATOR: | | | | |
| Net income before allocation of earnings to participating securities | \$1,841 | \$1,067 | \$1,058 | \$7,260 |
| Less: Earnings allocated to participating securities | 39 | 18 | 22 | 140 |
| Net income after allocation of earnings to participating securities | \$1,802 | \$1,049 | \$1,036 | \$7,120 |
| DENOMINATOR: | | | | |
| Weighted average number of common shares outstanding - basic | 15,518,115 | 16,670,358 | 15,471,759 | 16,834,968 |
| Dilutive effect of share-based awards | 172,889 | 220,364 | 178,384 | 236,623 |
| Weighted average number of common shares outstanding - dilutive | 15,691,004 | 16,890,722 | 15,650,143 | 17,071,591 |
| Basic income per common share attributable to Build-A-Bear Workshop, Inc. stockholders | \$0.12 | \$0.06 | \$0.07 | \$0.42 |
| Diluted income per common share attributable to Build-A-Bear Workshop, Inc. stockholders | \$0.11 | \$0.06 | \$0.07 | \$0.42 |

In calculating diluted income per share for the thirteen and thirty-nine week periods ended October 1, 2016, options to purchase 302,628 and 253,374 shares of common stock, respectively, that were outstanding at the end of the period were not included in the computation of diluted income per share due to their anti-dilutive effect. For the thirteen and thirty-nine week periods ended October 3, 2015, the number of options to purchase common shares that were excluded from the calculation was 71,366 and 61,569 shares, respectively.

7. Comprehensive Income

The difference between comprehensive income or loss and net income or loss results from foreign currency translation adjustments on the balance sheets of subsidiaries whose functional currency is not the US Dollar. The accumulated

other comprehensive loss balance at October 1, 2016, January 2, 2016 and October 3, 2015 is comprised entirely of foreign currency translation. For the thirteen and thirty-nine weeks ended October 1, 2016 and October 3, 2015, there were no reclassifications out of accumulated other comprehensive loss.

8. Segment Information

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

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

| | Retail | Commercial | International Franchising | Total |
|---|---------------|-------------------|--------------------------------------|--------------|
| Thirteen weeks ended October 2, 2016 | | | | |
| Net sales to external customers | \$81,870 | \$ 1,322 | \$ 556 | \$83,748 |
| Income before income taxes | 1,881 | 667 | 248 | 2,796 |
| Capital expenditures, net | 6,321 | - | 10 | 6,331 |
| Depreciation and amortization | 3,935 | 1 | 18 | 3,954 |
| Thirteen weeks ended October 3, 2015 | | | | |
| Net sales to external customers | \$84,303 | \$ 795 | \$ 525 | \$85,623 |
| Income before income taxes | 1,120 | 182 | 66 | 1,368 |
| Capital expenditures, net | 6,753 | 7 | 25 | 6,785 |
| Depreciation and amortization | 3,996 | 1 | 32 | 4,029 |
| Thirty-nine weeks ended October 1, 2016 | | | | |
| Net sales to external customers | \$249,854 | \$ 2,601 | \$ 1,407 | \$253,862 |
| Income before income taxes | 429 | 1,080 | 316 | 1,825 |
| Capital expenditures, net | 18,178 | - | 35 | 18,213 |
| Depreciation and amortization | 11,506 | 2 | 65 | 11,573 |
| Thirty-nine weeks ended October 3, 2015 | | | | |
| Net sales to external customers | \$256,246 | \$ 2,159 | \$ 1,624 | \$260,029 |
| Income before income taxes | 6,539 | 1,003 | 439 | 7,981 |
| Capital expenditures, net | 12,800 | 7 | 57 | 12,864 |
| Depreciation and amortization | 12,159 | 1 | 102 | 12,262 |
| Total Assets as of: | | | | |
| October 1, 2016 | \$174,510 | \$ 5,968 | \$ 2,419 | \$182,897 |
| October 3, 2015 | \$177,067 | \$ 4,765 | \$ 1,472 | \$183,304 |

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

| | North America (1) | Europe (2) | Other (3) | Total |
|--------------------------------------|----------------------------------|-----------------------|----------------------|--------------|
| Thirteen weeks ended October 2, 2016 | | | | |
| Net sales to external customers | \$68,227 | \$14,955 | \$566 | \$83,748 |
| Property and equipment, net | 62,377 | 8,385 | 1,222 | 71,984 |

Thirteen weeks ended October 3, 2015

| | | | | |
|---------------------------------|----------|----------|-------|----------|
| Net sales to external customers | \$66,202 | \$19,065 | \$356 | \$85,623 |
| Property and equipment, net | 53,544 | 6,546 | - | 60,090 |

Thirty-nine weeks ended October 1, 2016

| | | | | |
|---------------------------------|-----------|----------|---------|-----------|
| Net sales to external customers | \$209,105 | \$43,592 | \$1,165 | \$253,862 |
| Property and equipment, net | 62,377 | 8,385 | 1,222 | 71,984 |

Thirty-nine weeks ended October 3, 2015

| | | | | |
|---------------------------------|-----------|----------|---------|-----------|
| Net sales to external customers | \$207,321 | \$51,693 | \$1,015 | \$260,029 |
| Property and equipment, net | 53,544 | 6,546 | - | 60,090 |

For purposes of this table only:

- (1) North America includes the United States, Canada, Puerto Rico and franchise business in Mexico
- (2) Europe includes the United Kingdom, Ireland, Denmark and franchise businesses in Europe
- (3) Other includes franchise businesses outside of North America and Europe and, beginning in 2016, a company-owned store in China

9. Contingencies

In the normal course of business, the Company is subject to regular examination by various taxing authorities for years not closed by the statute of limitations. If one or more of these examinations has an unfavorable resolution, it is possible that the results of operations, liquidity or financial position of the Company could be materially affected in any particular period. The Company accrues a liability for this type of contingency when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. Assessments made by the United Kingdom customs authority in 2012 have been appealed by the Company, which has paid \$2.6 million in disputed duty, strictly under protest, pending the outcome of the continuing dispute, and this is included in receivables in the DTC segment. The United Kingdom customs authority is contesting the Company's appeal. The Company maintains a provision against the related receivable for its best estimate of probable loss, based on the latest facts available in the dispute. However, the Company continues to vigorously dispute the customs audit findings and believes that the outcome of this dispute will not have a material adverse impact on the results of operations, liquidity or financial position of the Company.

10. Recently Issued Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which will replace most existing revenue recognition guidance in U.S. GAAP. The core principle of the ASU is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. ASU 2014-09 will be effective for the Company beginning in fiscal 2018, and allows for both retrospective and modified retrospective methods of adoption. Early adoption beginning in fiscal 2017 is permitted. The Company is in the process of determining the method and timing of adoption and assessing the impact of ASU 2014-09 on its consolidated financial statements.

In August 2014, the FASB issued disclosure guidance that requires the Company to evaluate, at each annual and interim period, whether substantial doubt exists about its ability to continue as a going concern, and if applicable, to provide related disclosures. The new guidance will be effective for the Company for the year ending December 31, 2016. This guidance is not currently expected to have a material effect on our financial statement disclosures upon adoption, although the ultimate impact will be dependent on our financial condition and expected operating outlook at such time.

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

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting* (ASU 2016-09). The standard is intended to simplify several areas of accounting for share based compensation arrangements, including the income tax impact, classification in the statement of cash flows and forfeitures. ASU 2016-09 will be effective for the Company beginning with the interim periods of fiscal 2017. Early adoption is permitted. The Company is in the process of determining the method and timing of adoption and assessing the impact of ASU 2016-09 on its consolidated financial statements.

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, *Income Taxes – Intra-Entity Transfers of Assets Other Than Inventory* (ASU 2016-16). The standard is intended to address diversity in practice and

complexity in financial reporting, particularly for intra-entity transfers of intellectual property. ASU 2016-16 will be effective for the Company beginning with the interim periods of fiscal 2018 and requires the modified retrospective method of adoption. Early adoption is permitted. The Company is in the process of determining timing of adoption and assessing the impact of ASU 2016-16 on its consolidated financial statements.

11. Subsequent Event

On November 2, 2016, the Company drew \$3.9 million on its line of credit. This balance is expected to fluctuate throughout the remainder of the fourth quarter and is expected to be repaid before the end of the year.

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

Cautionary Notice Regarding Forward-Looking Statements

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties, and we undertake no obligation to update these statements except as required by federal securities laws. Our actual results may differ materially from the results discussed in the forward-looking statements. These risks and uncertainties include, without limitation, those detailed under the caption "Risk Factors" in the Company's annual report on Form 10-K for the year ended January 2, 2016, as filed with the SEC, and the following:

- general global economic conditions may deteriorate, which could lead to disproportionately reduced consumer demand for our products, which represent relatively discretionary spending;
- customer traffic may decrease in the shopping malls where we are located, on which we depend to attract guests to our stores;
- we may be unable to generate interest in and demand for our interactive retail experience, or to identify and respond to consumer preferences in a timely fashion;
- our marketing and on-line initiatives may not be effective in generating sufficient levels of brand awareness and guest traffic;
- we may be unable to generate comparable sales growth;
- we may be unable to effectively operate or manage the overall portfolio of our company-owned stores;
- the outcome of the strategic alternatives evaluation process announced on May 3, 2016 is uncertain and the process may or may not result in any changes to the company's business plan or lead to a specific action or transaction;
- we may improperly obtain or be unable to adequately protect customer information in violation of privacy or security laws or customer expectations;
- we may be unable to renew or replace our store leases, or enter into leases for new stores on favorable terms or in favorable locations, or may violate the terms of our current leases;
- the availability and costs of our products could be adversely affected by risks associated with international manufacturing and trade, including foreign currency fluctuation;
- our products could become subject to recalls or product liability claims that could adversely impact our financial performance and harm our reputation among consumers;
- we may not be able to operate our international company-owned stores profitably;
- we may lose key personnel, be unable to hire qualified additional personnel, or experience turnover of our management team;
- we are susceptible to disruption in our inventory flow due to our reliance on a few vendors;
- we may be unable to effectively manage our international franchises or laws relating to those franchises may change;
- we may fail to renew, register or otherwise protect our trademarks or other intellectual property;
- we are subject to risks associated with technology and digital operations;
- we may suffer negative publicity or be sued due to violations of labor laws or unethical practices by manufacturers of our merchandise;
- we may be unable to operate our company-owned distribution center efficiently or our third-party distribution center providers may perform poorly;

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

our plans to leverage the Build-A-Bear brand to drive strategic expansion may not be successful;

our market share could be adversely affected by a significant, or increased, number of competitors;

we may suffer negative publicity or negative sales if the non-proprietary toy products we sell in our stores do not meet our quality or sales expectations;

poor global economic conditions could have a material adverse effect on our liquidity and capital resources;

fluctuations in our quarterly results of operations could cause the price of our common stock to substantially decline;

and

we may be unable to repurchase shares of our common stock at optimal times or amounts.

Overview

We are the only global company that offers an interactive “make your own stuffed animal” retail entertainment experience under the Build-A-Bear Workshop brand, in which our guests stuff, fluff, dress, accessorize and name their own teddy bears and other stuffed animals. As of October 1, 2016, we operated 271 stores in the United States, Canada and Puerto Rico (collectively, North America), 58 stores in the United Kingdom, Ireland and Denmark (collectively, Europe), and one store in China and we had 80 franchised stores operating internationally under the Build-A-Bear Workshop brand.

On May 2, 2016, the Company announced that its Board of Directors had authorized an exploration of a full range of strategic alternatives to enhance total shareholder value. The Company has retained Guggenheim Securities, LLC as its financial advisor and Bryan Cave LLP as its legal counsel to assist with the strategic review. No timetable has been set for the Company’s review process. The Company does not expect to comment further or update the market with any additional information on the process unless and until its Board of Directors deems disclosure appropriate or necessary. There is no assurance that this exploration will result in any strategic alternatives being announced or executed.

We operate in three segments that share the same infrastructure, including management, systems, merchandising and marketing, and generate revenues as follows:

• **Direct-to-consumer (“DTC”)** – Company-owned retail stores located in North America, Europe and, beginning in 2016, China and two e-commerce sites;

• **International Franchising** – Other international stores operated under franchise agreements; and

• **Commercial** – Transactions with other businesses, mainly comprised of wholesale product sales and licensing our intellectual property, including entertainment properties, for third-party use.

Our company has been executing a multi-year turnaround plan since late 2012 to improve both consolidated comparable sales and profitability with an immediate goal of achieving sustained profitability. In 2015, we delivered our third consecutive year of consolidated comparable sales growth and improved profitability and believe that we are positioned to evolve our goal to one of sustained profitable growth.

In fiscal 2016, we expect to continue to build on these successes to reach more people, in more places, with more products and do it more profitably as we deliver on our MORE strategy. To this end, we are refreshing our brand, updating our aging fleet with our Discovery store, expanding globally, securing new licensed programs and developing proprietary intellectual property to extend our core consumer business and expanding our wholesale and outbound licensing programs which we expect to drive incremental, margin-accretive business.

Selected financial data attributable to each segment for the thirteen and thirty-nine week periods ended October 1, 2016 and October 3, 2015 are set forth in the notes to our condensed consolidated financial statements included elsewhere in this quarterly report on Form 10-Q.

We use comparable sales as one of the performance measures for our business. Comparable sales percentage changes are based on net retail sales and exclude the impact of foreign exchange. Stores are considered comparable beginning in their thirteenth consecutive full month of operation. The percentage change in consolidated comparable sales for the periods presented below is as follows:

| Thirteen Weeks Ended | | Thirty-nine Weeks Ended | |
|-----------------------------|----------------|--------------------------------|----------------|
| October | October | October | October |
| 1, | 3, | 1, | 3, |

| | 2016 | 2015 | | 2016 | 2015 | |
|-----------------------------|----------------|-------------|---|----------------|-------------|---|
| Comparable sales change (%) | | | | | | |
| North America | (1.6)% | 0.1 | % | (2.0)% | 1.9 | % |
| Europe | (4.8)% | 9.8 | % | (5.5)% | 13.9 | % |
| Consolidated | (2.2)% | 2.2 | % | (2.6)% | 4.2 | % |
| Stores | (3.2)% | 2.1 | % | (3.1)% | 4.0 | % |
| E-commerce | 25.2 % | 4.1 | % | 11.9 % | 7.9 | % |
| Consolidated | (2.2)% | 2.2 | % | (2.6)% | 4.2 | % |

We believe the decrease in consolidated comparable sales for the fiscal 2016 third quarter is primarily attributable to strong performance of last year's Minion's collection which had a peak in consumer interest fueling significant sales in the early part of last year's third quarter. This decrease was partially offset by the strong performance of our newly remodeled Discovery format stores, particularly in North America. For the first nine months of 2016, we believe the decrease in consolidated comparable sales is primarily attributable to this third quarter decline, partially offset by the positive consolidated comparable sales performance in North America in the first quarter of 2016. We believe the growth in North America in the first quarter was the result of our overall disciplined management of our business and the success of key initiatives of our strategic plan.

We expect to improve consolidated comparable sales through the following key initiatives:

Expanding into more places: In the first nine months of 2016, our 43 Discovery stores continued to deliver positive results compared to our heritage stores on key metrics including sales growth and contribution margin. Through a combination of remodels and new openings, we expect to end 2016 with approximately 55 stores in our Discovery format. We also expect to continue to diversify our real estate portfolio beyond traditional malls with the addition of outlet format stores, concourse shops, shop-in-shops and seasonal pop-up locations;

Attracting more people: We expect to leverage our relationships with key licensors to reach more people, particularly with the teen-plus consumer, through a compelling offering of affinity, collectible, entertainment, sports and fashion properties. In the fourth quarter, we launched our new Trolls collection in advance of DreamWorks Animation's film, *Trolls*, and are updating our Star Wars products in advance of the next film release expected in December. We also expect to build on our nine consecutive quarters of consolidated e-commerce growth with a focus on updated licensed sports merchandise and the expansion of web exclusive products such as the Pokémon offering which includes Pikachu and Eevee collector bundles; and

Developing more products: In addition to our best-in-class licensing relationships, we plan to continue to develop and expand our offering of intellectual property concepts such as Honey Girls, Promise Pets, the holiday-specific Merry Mission and Horses and Hearts collections that are supported by digital content including music, videos and games. By building the story-telling components of the collections, we expect to continue to build units and dollars per transaction as these properties have high attachment rates of accessories to plush.

Stores

Company-owned:

The table below sets forth the number of Build-A-Bear Workshop company-owned stores in North America, Europe and Asia for the periods presented:

| | Thirty-nine Weeks Ended October 1, 2016 | | | | October 3, 2015 | | | |
|---------------------|--|--------|------|-------|------------------|--------|------|-------|
| | North America | Europe | Asia | Total | North America | Europe | Asia | Total |
| Beginning of period | 269 | 60 | - | 329 | 265 | 59 | - | 324 |
| Opened | 15 | 2 | 1 | 18 | 7 | 2 | - | 9 |

| | | | | | | | | | | |
|---------------|------|-----|---|---|------|------|-----|---|---|------|
| Closed | (13) | (4) |) | - | (17) | (15) | (1) |) | - | (16) |
| End of period | 271 | 58 | | 1 | 330 | 257 | 60 | | - | 317 |

During 2016, we expect to expand our owned and operated locations to end the year at approximately 345 stores, including approximately 55 stores in our Discovery format, both domestic and internationally. As of October 1, 2016, we operated 43 stores in our Discovery format. We expect to continue to diversify our real estate portfolio with the addition of more outlet format stores, concourse shops, shop-in-shops and seasonal pop-up locations. Concourse shops are stand-alone shops designed to be in operation in open, concourse areas of malls or other covered pedestrian areas. We plan to update stores primarily in conjunction with natural lease events including new store openings, relocations and lease required remodels. We also expect to close select stores in accordance with natural lease events as an ongoing part of our real estate management and day-to-day operational plans.

International Franchise Locations:

All franchised stores have similar signage, store layout, merchandise characteristics and guest experience as our company-owned stores. As of October 1, 2016, we had eight master franchise agreements, which typically grant franchise rights for a particular country or group of countries, covering an aggregate of 14 countries. The number of traditional international franchised stores opened and closed for the periods presented below are summarized as follows:

**Thirty-nine
weeks ended
October
1, 3,
2016 2015**

| | | |
|---------------------|-----|-----|
| Beginning of period | 77 | 73 |
| Opened | 10 | 7 |
| Closed | (7) | (6) |
| End of period | 80 | 74 |

In the ordinary course of business, we anticipate signing additional master franchise agreements in the future and terminating other such agreements. In 2016, our international strategy is to leverage the improving strength in our company-owned stores to restructure and extend our international footprint. Key franchisees have started to apply our successful real estate strategies including opening pop-up stores to assess long-term potential and adding shop-in-shops with select partners. Additionally, our international franchisees are following our successful lead and adopting the Discovery format with the first franchised Discovery store having opened in September 2016. We expect our franchisees to open Discovery format stores in multiple countries by the end of the year. We expect to develop market expansion through both new and existing franchisees and a company-owned store model. We believe there is a market potential for approximately 300 international stores outside of the countries in North America and Europe where we currently have company-owned stores.

Results of Operations

The following table sets forth, for the periods indicated, selected income statement data expressed as a percentage of total revenues, except where otherwise indicated:

BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

| | Thirteen weeks ended | | Thirty-nine weeks ended | |
|--|-----------------------------|------------------------|--------------------------------|------------------------|
| | October 1, 2016 | October 3, 2015 | October 1, 2016 | October 3, 2015 |
| Revenues: | | | | |
| Net retail sales | 97.8 % | 98.5 % | 98.4 % | 98.5 % |
| Commercial revenue | 1.6 | 0.9 | 1.0 | 0.8 |
| Franchise fees | 0.7 | 0.6 | 0.6 | 0.6 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Costs and expenses: | | | | |
| Cost of merchandise sold - retail ⁽¹⁾ | 56.7 | 54.7 | 55.1 | 54.7 |
| Cost of merchandise sold - commercial ⁽¹⁾ | 40.5 | 69.3 | 46.6 | 50.6 |
| Selling, general and administrative | 39.9 | 43.0 | 43.4 | 42.2 |
| Store preopening | 0.7 | 1.0 | 1.2 | 0.4 |
| Interest expense (income), net | (0.0) | (0.1) | (0.0) | (0.1) |
| Total costs and expenses | 96.7 | 98.4 | 99.3 | 96.9 |
| Income before income taxes | 3.3 | 1.6 | 0.7 | 3.1 |
| Income tax expense | 1.1 | 0.4 | 0.3 | 0.3 |
| Net income | 2.2 | 1.2 | 0.4 | 2.8 |
| Retail Gross Margin % ⁽²⁾ | 43.3 % | 45.3 % | 44.9 % | 45.3 % |

(1) Cost of merchandise sold – retail is expressed as a percentage of net retail sales. Cost of merchandise sold – commercial is expressed as a percentage of commercial revenue.

(2) Retail gross margin percentage represents net retail sales less cost of merchandise sold – retail and is expressed as a percentage of net retail sales.

Thirteen weeks ended October 1, 2016 compared to thirteen weeks ended October 3, 2015***Revenues***

Net retail sales. Net retail sales for the thirteen weeks ended October 1, 2016 were \$81.9 million compared to \$84.3 million for the thirteen weeks ended October 3, 2015, a decrease of \$2.4 million, or 2.9%. The components of this decrease are as follows:

| | Thirteen weeks ended October 1, 2016 (dollars in millions) |
|---|--|
| Impact of store closures | \$ (2.8) |
| Impact of foreign currency translation | (2.7) |
| Increase from new stores | 2.5 |
| Decrease in consolidated comparable sales | (1.7) |
| Change in deferred revenue estimates, including gift card breakage | 1.1 |
| Increase in non-comparable stores, primarily remodels and relocations | 0.8 |
| Increase from other retail | 0.4 |
| | \$ (2.4) |

We believe the decrease in consolidated comparable sales for the thirteen weeks ended October 1, 2016 was primarily attributable to the strong performance of our Minion's collection last year. This decrease was partially offset by, the strong performance of our newly remodeled Discovery format stores, particularly in North America.

Franchise fees and commercial revenue. Commercial revenue increased to \$1.3 million for the thirteen weeks ended October 1, 2016 from \$0.8 million for the thirteen weeks ended October 3, 2015, an increase of \$0.5 million or 66.3%. This increase was primarily attributable to an increase in licensing activities and corporate sales. Revenue from franchise fees was \$0.6 million for the thirteen weeks ended October 1, 2016 compared to \$0.5 million for the thirteen weeks ended October 3, 2015.

Costs and expenses

Retail gross margin. Retail gross margin was \$35.4 million for the thirteen weeks ended October 1, 2016 compared to \$38.2 million for the thirteen weeks ended October 3, 2015, a decrease of \$2.8 million, or 7.3%. As a percentage of net retail sales, retail gross margin was 43.3% for the thirteen weeks ended October 1, 2016 compared to 45.3% for the thirteen weeks ended October 3, 2015. This 200 basis points as a percentage of net retail sales decrease was primarily driven by a 120 basis-point decline in merchandise margin attributable to the unfavorable impact of foreign currency exchange along with promotional activity and the timing of merchandise supplies. In addition, retail gross margin was impacted by deleverage of fixed occupancy costs on lower net retail sales.

Selling, general and administrative. Selling, general and administrative expenses were \$33.4 million for the thirteen weeks ended October 1, 2016 as compared to \$36.8 million for the thirteen weeks ended October 3, 2015, a decrease of \$3.4 million, or 9.3%. As a percentage of total revenues, selling, general and administrative expenses decreased to 39.9% for the thirteen weeks ended October 1, 2016 as compared to 43.0% for the thirteen weeks ended October 3, 2015, a decrease of 310 basis points. The decrease in SG&A was primarily due to a planned redistribution of annual marketing spend versus the prior year third quarter as expenses were shifted to the first half of the year. In addition, SG&A decreased as a result of disciplined expense management, a reduction in performance-based compensation and the impact of foreign currency exchange on our UK-based expenses. These savings were partially offset by expenses associated with the review of strategic alternatives.

Store preopening. Store preopening expenses were \$0.6 million for the thirteen weeks ended October 1, 2016 as compared to \$0.8 million for the thirteen weeks ended October 3, 2015, a decrease of \$0.2 million. Store preopening expenses for the thirteen weeks ended October 1, 2016 were predominantly associated with openings of new and remodeled Discovery format stores in the third quarter along with a portion of planned fourth quarter openings. Store preopening expenses in the prior year period were higher with fewer associated stores as the costs in 2015 were for our first Discovery format stores, including our first location in China.

Interest expense (income), net. Interest income, net of interest expense, was \$19,000 for the thirteen weeks ended October 1, 2016 as compared to \$56,000 for the thirteen weeks ended October 3, 2015.

Provision for income taxes. Income tax expense was \$1.0 million for the thirteen weeks ended October 1, 2016 as compared to \$0.3 million for the thirteen weeks ended October 3, 2015. The effective tax rate was 34.2% for the thirteen weeks ended October 1, 2016 compared to 22.0% for the thirteen weeks ended October 3, 2015. The fluctuation from the 2015 effective rate was primarily attributable to a partial release of the valuation allowance on our domestic deferred tax assets in 2015 due to the pretax book income earned through the thirteen weeks ended October 3, 2015.

*Thirty-nine weeks ended October 2, 2016 compared to thirty-nine weeks ended October 3, 2015***Revenues**

Net retail sales. Net retail sales were \$249.9 million for the thirty-nine weeks ended October 1, 2016 compared to \$256.2 million for the thirty-nine weeks ended October 3, 2015, a decrease of \$6.4 million, or 2.5%. The components of this decrease are as follows:

| | Thirty-nine weeks ended October 1, 2016 (dollars in millions) |
|---|--|
| Impact of store closures | \$ (7.9) |
| Impact of foreign currency translation | (5.0) |
| Increase from new stores | 6.3 |
| Decrease in consolidated comparable sales | (6.0) |
| Change in deferred revenue estimates, including gift card breakage | 3.8 |
| Increase in non-comparable stores, primarily remodels and relocations | 1.3 |
| Increase from other retail | 1.1 |
| | \$ (6.4) |

We believe the decline in consolidated comparable sales for the thirty-nine weeks ended October 1, 2016 is primarily attributable to the strong performance of last year's Minion's collection which had a peak in consumer interest fueling significant sales in last year's second and third quarters. This was partially offset by the strong performance of our newly remodeled Discovery format stores in the fiscal 2016 third quarter, particularly in North America. For the thirty-nine week period, the second and third quarter declines were partially offset by the positive consolidated comparable sales performance in North America in the first quarter of 2016. We believe the growth in North America in the first quarter was the result of our overall disciplined management of our business and the success of key initiatives of our strategic plan.

Franchise fees and commercial revenue. Commercial revenue was \$2.6 million for the thirty-nine weeks ended October 1, 2016 compared to \$2.2 million for the thirty-nine weeks ended October 3, 2015, an increase of \$0.4 million. This increase was primarily attributable to an increase in licensing activities. Revenue from franchise fees was \$1.4 million for the thirty-nine weeks ended October 1, 2016 compared to \$1.6 million for the thirty-nine weeks ended October 3, 2015, a decrease of \$0.2 million.

Cost and expenses

Retail gross margin. Retail gross margin was \$112.1 million for the thirty-nine weeks ended October 1, 2016 compared to \$116.0 million for the thirty-nine weeks ended October 3, 2015, a decrease of \$3.9 million, or 3.3%. As a percentage of net retail sales, retail gross margin decreased to 44.9% for the thirty-nine weeks ended October 1, 2016 from 45.3% for the thirty-nine weeks ended October 3, 2015. This 40 basis point decrease was primarily driven by the expansion of merchandise margin more than offset by unfavorable impact of foreign currency exchange.

Selling, general and administrative. Selling, general and administrative expenses were \$110.1 million for the thirty-nine weeks ended October 1, 2016 compared to \$109.7 million for the thirty-nine weeks ended October 3, 2015, an increase of \$0.4 million, or 0.4%. As a percentage of total revenues, selling, general and administrative expenses were 43.4% for the thirty-nine weeks ended October 1, 2016 as compared to 42.2% for the thirty-nine weeks ended October 3, 2015, an increase of 120 bps. The increase was primarily due to higher expenses in the first half of 2016 related to investments in new business initiatives and international expansion and the year-to-date costs associated with the review of strategic alternatives. These increases were partially offset by lower corporate expenses in the fiscal third quarter.

Store preopening. Store preopening expenses were \$3.0 million for the thirty-nine weeks ended October 1, 2016 as compared to \$1.1 million for the thirty-nine weeks ended October 3, 2015, an increase of \$1.9 million. Store preopening expenses for the thirty-nine weeks ended October 1, 2016 were predominantly associated with openings of new and remodeled Discovery format stores in the first nine months of the year along with a portion of planned fourth quarter openings. The increase in store preopening expenses is primarily attributable to the increase in the number of new and remodeled stores in 2016 as compared to 2015.

Interest expense (income), net. Interest income, net of interest expense, was \$58,000 and \$0.1 million for the thirty-nine weeks ended October 1, 2016 and October 3, 2015, respectively.

Provision for income taxes. Income tax expense was \$0.8 million for the thirty-nine weeks ended October 1, 2016 compared to \$0.7 million for the thirty-nine weeks ended October 3, 2015. The effective tax rate was 42.0% for the thirty-nine weeks ended October 1, 2016 compared to 9.0% for the thirty-nine weeks ended October 3, 2015. The 2016 effective tax rate differed from the statutory rate of 34% primarily due to the effect of permanent differences. The difference from the 2015 effective rate was primarily attributable to a partial release of the valuation allowance on our domestic deferred tax assets in 2015 due to the pretax book income earned through the thirty-nine weeks ended October 3, 2015.

Seasonality and Quarterly Results

Our operating results for one period may not be indicative of results for other periods, and may fluctuate significantly because of a variety of factors, including, but not limited to: (1) changes in general economic conditions and consumer spending patterns; (2) increases or decreases in our comparable store sales; (3) fluctuations in the profitability of our stores; (4) changes in foreign currency exchange rates; (5) the timing and frequency of our marketing initiatives, including national media and other public relations events; (6) the timing of our store openings and closings and related expenses; (7) changes in consumer preferences; (8) the effectiveness of our inventory management; (9) the actions of our competitors or mall anchors and co-tenants; (10) seasonal shopping patterns and holiday and vacation schedules; and (11) weather conditions.

The timing of store closures, remodels and openings may result in fluctuations in quarterly results based on the revenues and expenses associated with each store location. Expenses related to store closings are typically incurred in stages: when the decision is made to close the store; when the closure is communicated to store associates; and at the time of closure. We typically incur most preopening costs for a new store in the three months immediately preceding the store's opening.

As a toy retailer, our sales are highest in our fourth quarter, followed by the first quarter. The timing of holidays and school vacations can impact our quarterly results. We cannot ensure that this will continue to be the case. In addition, for accounting purposes, the quarters of each fiscal year consist of 13 weeks, although we will have a 14-week quarter approximately once every six years. The 2014 fiscal fourth quarter had 14 weeks.

Liquidity and Capital Resources

Our cash requirements are primarily for the relocation and remodeling of existing stores in our new design, opening of new stores, information systems and working capital. Over the past several years, we have met these requirements through capital generated from cash flow provided by operations. We have access to additional cash through our revolving line of credit that has been in place since 2000.

Operating Activities. Cash used in operating activities was \$14.3 million for the thirty-nine weeks ended October 1, 2016, compared to \$2.7 million for the thirty-nine weeks ended October 3, 2015, a change of \$11.6 million. Generally, changes in cash from operating activities are driven by changes in net income and changes in operating assets and liabilities. This decrease in cash used by operating activities over the year ago period was primarily due to the decrease in store contribution and the timing of inventory receipts and payments.

Investing Activities. Cash used in investing activities was \$16.8 million for the thirty-nine weeks ended October 1, 2016 as compared to \$13.6 million for the thirty-nine weeks ended October 3, 2015, an increase of \$3.1 million. Cash used in investing activities during the thirty-nine weeks ended October 1, 2016 primarily related to store construction and upgrades and purchases of information technology infrastructure, partially offset by the maturity of short-term investments. Cash used in investing activities during the thirty-nine weeks ended October 3, 2015 primarily related to construction costs for new and remodeled stores, investments in central office information technology systems, the acquisition of trademarks and other intellectual property and the purchases of short-term investments, net of the proceeds from maturities.

Financing Activities. Financing activities used cash of \$2.0 million in the thirty-nine weeks ended October 1, 2016, as purchases of our common stock used cash of \$1.5 million and exercises of employee stock options, net of shares used for withholding tax payments used \$0.5 million. In the thirty-nine weeks ended October 3, 2015, financing activities used cash of \$11.6 million, as purchases of our common stock used cash of \$11.1 million and exercises of employee stock options, net of shares used for withholding tax payments used \$0.5 million. No borrowings were made under our line of credit in either the thirty-nine weeks ended October 1, 2016 or October 3, 2015.

Capital Resources. As of October 1, 2016, we had a consolidated cash balance of \$11.8 million, over half of which was domiciled outside of the United States. We also have a line of credit, which we can use to finance capital expenditures and working capital needs throughout the year. The bank line provides availability of \$35 million. Borrowings under the credit agreement are secured by our assets and a pledge of 65% of our ownership interest in certain of our foreign subsidiaries. The credit agreement expires on December 31, 2017 and contains various restrictions on indebtedness, liens, guarantees, redemptions, mergers, acquisitions or sale of assets, loans, transactions with affiliates and investments. It also prohibits us from declaring dividends without the bank's prior consent, unless such payment of dividends would not violate any terms of the credit agreement. We are also prohibited from repurchasing shares of our common stock unless such repurchase of shares would not violate any terms of the credit agreement; we may not use the proceeds of the line of credit to repurchase shares. Borrowings bear interest at LIBOR plus 1.8%. Financial covenants include maintaining a minimum tangible net worth, maintaining a minimum fixed charge coverage ratio (as defined in the credit agreement) and not exceeding a maximum funded debt to earnings before interest, depreciation and amortization ratio. As of October 1, 2016: (i) we were in compliance with these covenants; (ii) there were no borrowings under our line of credit; and (iii) there was \$35.0 million available for borrowing under the line of credit. On November 2, 2016, we drew \$3.9 million on this line of credit. This balance will fluctuate throughout the remainder of the fourth quarter and is expected to be fully repaid before the end of the year.

Most of our retail stores are located within shopping malls and all are operated under leases classified as operating leases. Our leases in North America typically have a ten-year term and contain provisions for base rent plus percentage rent based on defined sales levels. Many of the leases contain a provision whereby either we or the landlord may terminate the lease after a certain time, typically in the third to fourth year of the lease, if a certain minimum sales volume is not achieved. In addition, some of these leases contain various restrictions relating to change of control of our company. Our leases also subject us to risks relating to compliance with changing mall rules and the exercise of discretion by our landlords on various matters, including rights of termination in some cases.

Our leases in the U.K. and Ireland typically have terms of 10 to 15 years and generally contain a provision whereby every fifth year the rental rate can be adjusted to reflect the current market rates. The leases typically provide the lessee with the first right for renewal at the end of the lease. Real estate taxes also change according to government time schedules to reflect current market rental rates for the locations we lease. Rents are charged quarterly and paid in advance.

In fiscal 2016, we expect to spend a total of approximately \$30 million on capital expenditures. Capital spending through the thirty-nine weeks ended October 1, 2016 totaled \$18.2 million, on track with our full year plans. Capital spending in fiscal 2016 is expected to primarily support our store activity, including both remodels and new stores, and investment in IT infrastructure.

We believe that cash generated from operations and borrowings under our credit agreement will be sufficient to fund our working capital and other cash flow requirements for the near future. Our credit agreement expires on December 31, 2017.

In November 2015, the board adopted a share repurchase program authorizing the repurchase of up to \$15 million of our common stock until March 31, 2016. This program authorized us to purchase our common stock in the open market (including through 10b5-1 trading plans), through privately negotiated transactions, or through an accelerated repurchase transaction. The primary source of funding was cash on hand. The timing and amount of share repurchases depended on price, market conditions, applicable regulatory requirements, and other factors. Shares repurchased under this program were subsequently retired. Under this program, we repurchased approximately 615,000 shares at an average price of \$12.05 per share for an aggregate amount of \$7.4 million. This program expired on March 31, 2016.

Off-Balance Sheet Arrangements

None

Critical Accounting Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the appropriate application of certain accounting policies, which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences could be material to the financial statements.

We believe application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates, including those related to inventory, long-lived assets, revenue recognition and income taxes, are reevaluated on an ongoing basis, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our critical accounting policies and estimates are discussed in and should be read in conjunction with our annual report on Form 10-K, as filed with the Securities and Exchange Commission (SEC) on March 17, 2016, which includes audited consolidated financial statements for our 2015, 2014 and 2013 fiscal years. There have been no material changes to the critical accounting estimates disclosed in the 2015 Form 10-K.

Recent Accounting Pronouncements

None

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There have been no material changes to our Quantitative and Qualitative Disclosures About Market Risk as disclosed in our Annual Report on Form 10-K for the year ended January 2, 2016 as filed with the SEC on March 17, 2016.

Item 4. Controls and Procedures.

Our management, with the participation of our President and Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this report. Our disclosure controls and procedures are designed to ensure that information we are required to disclose in the reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and is accumulated and communicated to management, including our certifying officers, as appropriate to allow timely decisions regarding required disclosure. Based on the foregoing evaluation, our management, including the President and Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of October 1, 2016, the end of the period covered by this Quarterly Report.

It should be noted that our management, including the President and Chief Executive Officer and the Chief Financial Officer, does not expect that our disclosure controls and procedures or internal controls will prevent all error and all fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be

detected.

Changes in Internal Control Over Financial Reporting. The Company's management, with the participation of the Company's President and Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report.

PART II – OTHER INFORMATION**Item 1A. Risk Factors**

There have been no changes to our Risk Factors as disclosed in our Annual Report on Form 10-K for the year ended January 2, 2016 as filed with the Securities and Exchange Commission on March 17, 2016, except for the addition of the following risk factor:

The outcome of the strategic alternatives evaluation process announced on May 3, 2016 is uncertain and the process may or may not result in any changes to the Company's business plan or lead to a specific action or transaction.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**ISSUER PURCHASES OF EQUITY SECURITIES**

| Period | (a) Total Number of Shares (or Units) Purchased (1) | (b) Average Price Paid Per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (2) | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|------------------------------|--|--|---|--|
| Jul. 3, 2016 – Jul. 30, 2016 | 431 | \$ 13.65 | - | \$ - |

| | | | | | |
|--------------------------------------|-------|----------|---|----|---|
| Jul. 31, 2016 – Aug. 27, 2016 | 1,121 | \$ 12.37 | - | \$ | - |
| Aug. 28, 2016 – Oct. 1, 2016 | 460 | \$ 10.57 | - | \$ | - |
| Total | 2,012 | \$ 12.24 | - | | |

(1) Includes shares of our common stock delivered to us in satisfaction of the tax withholding obligation of holders of restricted shares which vested during the applicable period. Our equity incentive plans provide that the value of shares delivered to us to pay the withheld to cover tax obligations is calculated at the closing trading price of our common stock on the date the relevant transaction occurs.

(2) In November 2015, the board adopted a share repurchase program authorizing the repurchase of up to \$15 million of our common stock. Shares repurchased under this program were subsequently retired. This program expired on March 31, 2016.

Item 6. Exhibits

The following is a list of exhibits filed as a part of the quarterly report on Form 10-Q:

Exhibit No. Description

| | |
|---------|---|
| 2.1 | Agreement and Plan of Merger dated April 3, 2000 between Build-A-Bear Workshop, L.L.C. and the Registrant (incorporated by reference from Exhibit 2.1 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142) |
| 3.1 | Third Amended and Restated Certificate of Incorporation (incorporated by reference from Exhibit 3.1 of our Current Report on Form 8-K, filed on November 11, 2004) |
| 3.2 | Amended and Restated Bylaws (incorporated by reference from Exhibit 3.4 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142) |
| 4.1 | Specimen Stock Certificate (incorporated by reference from Exhibit 4.1 to Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142) |
| 31.1 | Rule 13a-14(a)/15d-14(a) certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by the President and Chief Executive Officer) |
| 31.2 | Rule 13a-14(a)/15d-14(a) certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by the Chief Financial Officer) |
| 32.1 | Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the President and Chief Executive Officer) |
| 32.2 | Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the Chief Financial Officer) |
| 101.INS | XBRL Instance |
| 101.SCH | XBRL Extension Schema |
| 101.CAL | XBRL Extension Calculation |
| 101.DEF | XBRL Extension Definition |
| 101.LAB | XBRL Extension Label |
| 101.PRE | XBRL Extension Presentation |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 10, 2016

BUILD-A-BEAR WORKSHOP, INC.
(Registrant)

By: /s/ Sharon John
Sharon John
President and Chief Executive Officer (on behalf of the registrant and as principal executive officer)

By: /s/ Voin Todorovic
Voin Todorovic
Chief Financial Officer

(on behalf of the registrant and as principal financial officer)