

BUILD A BEAR WORKSHOP INC
Form 10-Q
December 13, 2018

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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 November 3, 2018

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, every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition

period for complying with any new or revised financial accounting standards provided pursuant to Section 14(a) of the Exchange Act.

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

As of December 7, 2018, there were 14,956,224 issued and outstanding shares of the registrant's common stock.

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BUILD-A-BEAR WORKSHOP, INC.

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Table of Contents**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)

	November 3, 2018 (Unaudited)	December 30, 2017	October 28, 2017 (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 8,631	\$ 30,445	\$ 11,381
Inventories	57,309	53,136	62,854
Receivables	12,962	13,302	8,717
Prepaid expenses and other current assets	16,848	13,346	9,102
Total current assets	95,750	110,229	92,054
Property and equipment, net	73,343	77,751	76,876
Deferred tax assets	6,783	6,381	11,391
Other intangible assets, net	887	995	1,182
Other assets, net	2,091	2,633	2,546
Total Assets	\$ 178,854	\$ 197,989	\$ 184,049
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$ 18,179	\$ 18,942	\$ 18,595
Accrued expenses	7,559	15,189	12,839
Gift cards and customer deposits	18,580	33,926	29,198
Short-term borrowings	7,250	-	-
Deferred revenue and other	2,006	1,806	2,208
Total current liabilities	53,574	69,863	62,840
Deferred rent	18,066	17,906	17,904
Deferred franchise revenue	1,557	1,208	492
Other liabilities	1,765	1,697	1,280
Commitments and contingencies			

Stockholders' equity:

Preferred stock, par value \$0.01, Shares authorized: 15,000,000; No shares issued or outstanding at November 3, 2018, December 30, 2017 and October 28, 2017	-	-	-
Common stock, par value \$0.01, Shares authorized: 50,000,000; Issued and outstanding: 14,956,711, 15,515,960 and 15,917,449 shares, respectively	150	155	159
Additional paid-in capital	68,274	68,962	70,215
Accumulated other comprehensive loss	(12,049)	(11,562)	(11,973)
Retained earnings	47,517	49,760	43,132
Total stockholders' equity	103,892	107,315	101,533
Total Liabilities and Stockholders' Equity	\$ 178,854	\$ 197,989	\$ 184,049

See accompanying notes to condensed consolidated financial statements.

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

	Thirteen weeks ended		Thirty-nine weeks ended	
	November	October 28,	November	October 28,
	3,	2017	3,	2017
	2018		2018	
Revenues:				
Net retail sales	\$65,298	\$74,441	\$227,760	\$239,567
Commercial revenue	2,171	1,196	4,245	5,320
International franchising	1,225	514	3,051	1,647
Total revenues	68,694	76,151	235,056	246,534
Costs and expenses:				
Cost of merchandise sold - retail	42,129	43,267	134,115	132,062
Cost of merchandise sold - commercial	773	502	1,843	2,581
Cost of merchandise sold - international franchising	731	56	1,650	313
Total cost of merchandise sold	43,633	43,825	137,608	134,956
Consolidated gross profit	25,061	32,326	97,448	111,578
Selling, general and administrative expense	35,069	36,196	109,334	111,204
Interest expense (income), net	(16	) 7	5	(9
Income (loss) before income taxes	(9,992	) (3,877	) (11,891	) 383
Income tax expense (benefit)	(3,928	) (1,350	) (4,381	) 237
Net income (loss)	\$(6,064	) \$(2,527	) \$(7,510	) \$146
Foreign currency translation adjustment	(34	) (72	) (1,249	) 523
Comprehensive (loss) income	\$(6,098	) \$(2,599	) \$(8,759	) \$669
Income (loss) per common share:				
Basic	\$(0.42	) \$(0.16	) \$(0.51	) \$0.01
Diluted	\$(0.42	) \$(0.16	) \$(0.51	) \$0.01
Shares used in computing common per share amounts:				
Basic	14,590,614	15,599,675	14,597,255	15,602,498
Diluted	14,590,614	15,599,675	14,597,255	15,780,253

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

(Dollars in thousands)

	Thirty-nine weeks ended November 3, 2018	October 28, 2017
Cash flows used in operating activities:		
Net income	\$ (7,510)	\$ 146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,186	12,057
Stock-based compensation	2,624	2,815
Asset impairment	626	69
Deferred taxes	(3,207)	(381)
Provision for doubtful accounts	-	344
(Gain) Loss on disposal of property and equipment	66	(95)
Change in assets and liabilities:		
Inventories	(174)	(5,617)
Receivables	(4,116)	1,668
Prepaid expenses and other assets	(3,803)	(1,702)
Accounts payable and accrued expenses	(6,230)	(6,416)
Lease related liabilities	1,071	2,319
Gift cards and customer deposits	(637)	(5,039)
Deferred revenue	149	(398)
Net cash used in operating activities	(8,955)	(230)
Cash flows used in investing activities:		
Purchases of property and equipment	(8,853)	(14,225)

Purchases of other assets and other intangible assets	-		(286)
Proceeds from property insurance	84		310	
Net cash used in investing activities	(8,769	)	(14,201)
Cash flows provided by (used in) financing activities:				
Proceeds from the exercise of employee stock options, net of withholding tax payments	(134	)	(467)
Borrowings under line of credit	7,250		-	
Payments made under capital leases	(72	)	(60)
Purchases of Company's common stock	(1,927	)	(998)
Net cash provided by (used in) financing activities	5,117		(1,525)
Effect of exchange rates on cash	(261	)	(359)
Net decrease in cash and cash equivalents	(12,868	)	(16,315)
Cash and cash equivalents, beginning of period	21,499		27,696	
Cash and cash equivalents, end of period	\$	8,631	\$	11,381
Supplemental disclosure of cash flow information:				
Net cash paid during the period for income taxes	\$	2,320	\$	1,010

See accompanying notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited and have been prepared by Build-A-Bear Workshop, Inc. and its subsidiaries (collectively, the “Company”) pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet of the Company as of December 30, 2017 was derived from the Company’s audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and reflect all adjustments which are, in the opinion of management, necessary to summarize fairly the financial position of the Company and the results of the Company’s operations and cash flows for the periods presented. All of these adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Because of the seasonal nature of the Company’s operations, results of operations of any single reporting period should not be considered as indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the fiscal year ended December 30, 2017, which were included in the Company’s Annual Report on Form 10-K filed with the SEC on March 15, 2018. Certain amounts in prior fiscal periods have been reclassified to conform with the presentation adopted in the current fiscal year.

Change in Fiscal Year

In January 2018, the Company's Board of Directors approved a change in the Company’s fiscal year-end, which previously ended on the Saturday closest to December 31, to the Saturday closest to January 31. This change was effective following the end of the Company's 2017 fiscal year. The first 12-month fiscal year under the new calendar will encompass February 4, 2018 through February 2, 2019. Recast historical unaudited financial information for the thirteen and thirty-nine weeks ended October 28, 2017 is included in the consolidated financial statements and accompanying notes.

Recent Accounting Pronouncements – Adopted in the current year

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2018-15, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40). This standard amends the existing guidance to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a

service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). During the thirteen weeks ended November 3, 2018, the Company adopted this standard and it did not have a material impact on the condensed consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, Income Taxes (Topic 740)—Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118, that codified SEC Staff Accounting Bulletin (“SAB”) No. 118, as it relates to allowing for recognition of provisional amounts related to the U.S. Tax Cuts and Jobs Act (“TCJA”) in the event that the accounting is not complete and a reasonable estimate can be made. Where necessary information is not available, prepared, or analyzed to determine a reasonable estimate, no provisional amount should be recorded. The guidance allows for a measurement period of up to one year from the enactment date to finalize the accounting related to the TCJA. The Company has applied the guidance in this update to its financial statements for the thirty-nine weeks ended November 3, 2018 and will finalize and record any adjustments related to the TCJA within the one year measurement period.

Effective December 31, 2017, the Company adopted Accounting Standards Codification (“ASC”) 606, Revenue from Contracts with Customers, and all the related amendments using the modified retrospective method for contracts that were not completed as of December 31, 2017. ASC 606 requires an entity to 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. The standard also 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. Nearly all of the Company’s revenue is derived from retail sales (including e-commerce sites) and is recognized when control of the merchandise is transferred to the customer.

The Company’s most significant ASC 606 impact relates to accounting for gift card breakage. The Company's adjustment for gift card breakage reflects the impact of the change to recognize gift card breakage proportionately as gift card balances are used rather than when it is deemed remote that the unused gift card balance would be redeemed, as done for certain categories of gift cards under the previous standards. In addition, the Company has identified minor changes to the timing of revenues for certain outbound licensing arrangements and international franchise agreements.

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As a result of this change, the Company expects a negative impact to revenue and pre-tax income of \$3.9 million in fiscal 2018 with the remaining balance of the cumulative effect adjustment predominantly impacting fiscal years 2019 and 2020. The comparative historical financial information has not been restated and continues to be reported under the accounting standards in effect for those periods. As a result of applying the modified retrospective method to transition to ASC 606, the following adjustments were made to the consolidated balance sheet as of December 31, 2017 (dollars in thousands):

Balance Sheet	Balance as of	Adjustments	Balance as of
	December 30,	due to ASC 606	December 31,
	2017		2017
Assets			
Prepaid expenses and other current assets	\$ 13,346	\$ (13	) \$ 13,333
Deferred tax assets	6,381	(2,880	) 3,501
Adjustment: assets		\$ (2,893)
Liabilities			
Accrued expenses ⁽¹⁾	15,189	151	15,340
Gift cards and customer deposits	33,926	(12,297	) 21,629
Stockholders' equity			
Retained Earnings	49,760	9,253	59,013
Adjustment: liabilities and stockholders' equity		\$ (2,893)

(1) - The impact on the balances due to the adoption of ASC 606 includes income tax payable.

The following tables reflect the impact of adoption of ASC 606 for select accounts on the Company's condensed consolidated statement of income for the thirteen and thirty-nine weeks ended November 3, 2018 and its condensed consolidated balance sheet as of November 3, 2018 and the amounts as if the previous standards were in effect ("Without Adoption of ASC 606") (dollars in thousands):

Income Statement	For the thirteen weeks ended November 3, 2018			For the thirty-nine weeks ended November 3, 2018		
	As	Without	Effect	As	Without	Effect
			of	Reported		of

	Reported adoption of ASC 606			adoption of ASC 606		
Income Statement						
Net retail sales	\$65,298	\$66,039	\$ (741)	\$227,760	\$229,842	\$(2,082)
Commercial revenue	2,171	2,171	-	4,245	4,245	-
International franchising	1,225	1,225	-	3,051	3,051	-
Total revenues	68,694	69,435	(741)	235,056	237,138	(2,082)
Total costs and expenses	-	-	-	-	-	-
Income tax expense	(3,928)	(3,637)	291	(4,381)	(3,614)	767
Net loss	\$(6,064)	\$(5,614)	\$(450)	\$(7,510)	\$(6,195)	\$(1,315)

	November 3, 2018		
	As Reported	Without adoption of ASC 606	Effect of Change
Balance Sheet			
Liabilities			
Accrued expenses ⁽¹⁾	\$7,559	\$8,175	\$616
Gift cards and customer deposits ⁽¹⁾	18,580	28,795	10,215
Stockholders' equity			
Retained earnings ⁽¹⁾	47,517	39,579	(7,938)
Net effect of Change in Liabilities and Stockholders' equity			\$2,893

(1) - The impact on the balances without adoption of ASC 606 includes the activity for the thirty-nine weeks ended November 3, 2018, and the December 31, 2017 adjustment.

The impact of adoption of ASC 606 on the Company's condensed consolidated statement of cash flows from operating activities for the thirteen and thirty-nine weeks ended November 3, 2018 was not significant.

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Recently Issued Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update (“ASU”) 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 will be effective for the Company beginning in fiscal 2019. In 2017, the Company established a cross-functional team to use a detailed approach to assess the impact of the new standard. The Company is in the process of implementing new lease accounting software to assess the portfolio of leases, assist in the quantification of the expected impact on the consolidated balance sheet and to facilitate the calculations of the related accounting entries and disclosures. Lease data, required for lease accounting, has been extracted and loaded into the software solution. While the Company has not yet completed its evaluation of the impact the new lease accounting guidance will have on its consolidated financial statements, the Company expects the new standard to have a material impact on the consolidated balance sheet with the addition of significant right-of-use assets and related liabilities because the Company's retail location leases are currently deemed to be operating leases.

2. Revenue

Nearly all of the Company’s revenue is derived from retail sales (including e-commerce sites) and is recognized when control of the merchandise is transferred to the customer. The Company accounts for revenue in accordance with ASC 606 which was adopted December 31, 2017 (See Note 1— Basis of Presentation and Note 7 — Stockholder's Equity for additional information). The Company's disaggregated revenue is fully disclosed as net sales to external customers by reporting segment and by geographic area (See Note 10 — Segment Information for additional information). The Company's direct-to-consumer reporting segment represents nearly 97% of consolidated revenue. The majority of these sales transactions are single performance obligations that are recorded when control is transferred to the customer.

The following is a description of principal activities from which the Company generates its revenue, by reportable segment.

The Company’s direct-to-consumer segment includes the operating activities of corporately-managed stores, other retail-delivered operations and online sales. Direct-to-consumer revenue is recognized when control of the merchandise is transferred to the customer and for the Company's online sales, generally upon delivery to the customer. Revenue is measured as the amount of consideration, including any discounts or incentives, the Company expects to receive in exchange for transferring the merchandise. Product returns have historically averaged less than one-tenth of one percent due to the interactive nature of sales, where consumers customize their own stuffed animal.

The Company has elected to exclude from revenue all collected sales, value add and other taxes paid by its customers.

For the Company's gift cards, revenue is deferred for single transactions until redemption including any related gift card discounts. Historically, most gift card redemptions have occurred within three years of acquisition and approximately 75% of gift cards have been redeemed within the first twelve months. In addition, unredeemed gift cards or breakage revenue is recorded in proportion to the customer's redemption period using an estimated breakage rate based on historical experience. For certain qualifying transactions, a portion of revenue transactions are deferred for the obligation related to the Company's loyalty program or when a material right in the form of a future discount is granted. In these transactions, the transaction price is allocated to the separate performance obligations based on the relative standalone selling price. The standalone selling price for the points earned for the Company's loyalty program is estimated using the net retail value of the merchandise purchased, adjusted for estimated breakage based on historical redemption patterns. The revenue associated with the initial merchandise purchased is recognized immediately and the value assigned to the points is deferred until the points are redeemed, forfeited or expired. In regards to the consolidated balance sheet, contract liabilities for gift cards are classified as gift cards and customer deposits.

The Company's commercial segment includes transactions with other businesses and are mainly comprised of licensing the Company's intellectual properties for third-party use and wholesale sales of merchandise, including supplies and fixtures. Revenue for wholesale sales is recognized when control of the merchandise or fixtures is transferred to the customer, which generally occurs upon delivery to the customer. The license agreements provide the customer with highly interrelated rights that are not distinct in the context of the contract and therefore, have been accounted for as a single performance obligation and recognized as licensee sales occur. If the contract includes a guaranteed minimum, the minimum guarantee is recognized on a straight-line basis over the guarantee term until such time as royalties earned through licensee sales exceed the minimum guarantee. The Company classifies these guaranteed minimum contract liabilities as deferred revenue on the consolidated balance sheet.

The Company's international franchising segment includes the activities with franchisees who operate store locations in certain countries and includes development fees, sales-based royalties and merchandise, including supplies and fixture sales. The Company's obligations under the franchise agreement are ongoing and include operations and product development support and training, generally concentrated around new store openings. These obligations are highly interrelated rights that are not distinct in the context of the contract and, therefore, have been accounted for as a single performance obligation and recognized as franchisee sales occur. If the contract includes an initial, one-time nonrefundable development fee, this fee is recognized on a straight-line basis over the term of the franchise agreement, which may extend for periods up to 25 years. The Company classifies these initial, one-time nonrefundable franchise fee contract liabilities as deferred revenue on the consolidated balance sheet. Revenue from merchandise and fixture sales is recognized when control is transferred to the franchisee which generally occurs upon delivery to the customer.

The Company also incurs expenses directly related to the startup of new franchises, including finder's fees, legal and travel costs as well as expenses related to its ongoing support of the franchisees, predominantly travel and employee compensation. Accordingly, the Company's policy is to capitalize the finder's fee, an incremental cost, and expense all other costs as incurred. Additionally, the Company amortizes these capitalized costs into expense in the same pattern as the development fee's recording of revenue as described previously.

3. Prepaid Expenses and Other Current Assets

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

	November 3, 2018	December 30, 2017	October 28, 2017
Prepaid occupancy	\$ 7,767	\$ 7,688	\$ 2,737
Prepaid income taxes	3,315	887	871
Other	5,766	4,771	5,494
Total	\$ 16,848	\$ 13,346	\$ 9,102

As of November 3, 2018, prepaid income taxes reflect the impact of seasonality on the timing of income tax payments as well as the payments related to the one fiscal month transition period for the change in fiscal year.

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Accrued expenses consist of the following (in thousands):

	November 3, 2018	December 30, 2017	October 28, 2017
Accrued wages, bonuses and related expenses	\$ 3,064	\$ 5,863	\$7,844
Sales tax payable	1,203	4,858	2,013
Accrued rent and related expenses	3,007	3,679	3,014
Current income taxes payable	285	789	(32)
Total	\$ 7,559	\$ 15,189	\$12,839

5. Stock-based Compensation

On March 14, 2017, the Company's Board of Directors (the Board) adopted, subject to stockholder approval, the Build-A-Bear Workshop, Inc. 2017 Omnibus Incentive Plan (the Incentive Plan). On May 11, 2017, at the Company's 2017 Annual Meeting of Stockholders, the Company's stockholders approved the Incentive Plan. The Incentive Plan, which is administered by the Compensation and Development Committee of the Board, permits the grant of stock options (including both incentive and non-qualified stock options), stock appreciation rights, restricted stock, cash and other stock-based awards, some of which may be performance-based pursuant to the terms of the Incentive Plan. The Board may amend, modify or terminate the Incentive Plan at any time, except as otherwise provided in the Incentive Plan. The Incentive Plan will terminate on March 14, 2027, unless earlier terminated by the Board. The number of shares of the Company's common stock authorized for issuance under the Incentive Plan is 1,000,000, plus shares of stock subject to outstanding awards made under the Company's Third Amended and Restated 2004 Stock Incentive Plan that on or after March 21, 2017 may be forfeited, expire or be settled for cash.

For the thirteen and thirty-nine weeks ended November 3, 2018, selling, general and administrative expense includes \$0.9 million and \$2.6 million, respectively, of stock-based compensation expense. For the thirteen and thirty-nine weeks ended October 28, 2017, selling, general and administrative expense includes \$0.8 million and \$2.8 million, respectively, of stock-based compensation expense. As of November 3, 2018, there was \$3.9 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.

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The following table is a summary of the balances and activity for stock options for the thirty-nine weeks ended November 3, 2018:

	Options	Weighted
	Shares	Average
		Exercise
		Price
Outstanding, February 4, 2018	791,567	\$ 9.67
Granted	213,687	8.60
Exercised	(53,040)	5.20
Forfeited	—	-
Canceled or expired	—	-
Outstanding, November 3, 2018	952,214	\$ 9.68

The following table is a summary of the balances and activity related to time-based and performance-based restricted stock for the thirty-nine weeks ended November 3, 2018:

	Restricted Stock		Performance	
		Weighted	Shares	Weighted
		Average		Average
	Shares	Grant	Shares	Grant
		Date		Date
		Fair		Fair
		Value		Value
Outstanding, February 4, 2018	357,412	\$ 10.96	289,615	\$ 13.66
Granted	205,434	8.67	83,256	8.60
Vested	(177,960)	11.82	(6,323)	20.58
Forfeited	(1,391)	13.64	(1,280)	13.69
Canceled or expired	—	—	(50,000)	20.80
Outstanding, November 3, 2018	383,495	\$ 9.33	315,268	\$ 11.05

The total fair value of shares vested during the thirty-nine weeks ended November 3, 2018 and October 28, 2017 was \$2.2 million and \$2.3 million, respectively.

In March 2018, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established consolidated total pre-tax income growth objectives for fiscal 2018, 2019 and 2020. In addition, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established consolidated revenue growth objectives for fiscal 2018, 2019 and 2020. These shares have a payout opportunity ranging from 25% to 200% of the target number of shares. In 2017, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established pre-tax income growth objectives for 2017, 2018 and 2019. In 2016, the Company awarded three-year performance-based restricted stock subject to the achievement of pre-established cumulative total revenue goals for fiscal 2016, 2017 and 2018.

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The outstanding performance shares as of November 3, 2018 consist of the following:

	Performance Shares
Unearned shares subject to performance-based restrictions at target:	
2016 - 2018 consolidated cumulative total revenues	148,115
2017 - 2019 consolidated pre-tax income growth objectives	83,897
2018 - 2020 consolidated total revenue growth objectives	20,756
2018 - 2020 consolidated pre-tax income growth objectives	62,500
Performance shares outstanding, November 3, 2018	315,268

6. Income Taxes

The effective tax rate was 39.3% and 36.8% for the thirteen and thirty-nine weeks ended November 3, 2018, respectively, compared to 34.8% and 61.9% for the thirteen and thirty-nine weeks ended October 28, 2017, respectively. The 2018 effective tax differed from the statutory rate of 21% primarily due to the jurisdictional mix of earnings. The fiscal 2017 effective tax rate differed from the statutory rate of 34% primarily due to the effect of discrete tax items.

On December 22, 2017, the Tax Cuts and Job Act (“Tax Reform Act”) was enacted, which significantly changes U.S. tax law effective by, among other things, lowering the maximum corporate income tax statutory rate from 35% to 21%, implementing a territorial tax system and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The Tax Reform Act was effective as of January 1, 2018. The Company recorded a provisional tax charge of \$1.4 million for the re-measurement of its U.S. net deferred tax assets in fiscal 2017 but it does not anticipate a significant charge for the one-time transition tax on the deemed repatriation of foreign earnings. The Global Intangible Low-Taxed Income (“GILTI”) provisions of the Tax Reform Act require a company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary’s tangible assets. The Base-Eroding Anti-abuse Tax (“BEAT”) provisions of the Tax Reform Act assess tax on certain payments made by a U.S. company to a related foreign company. The Company does not expect the incremental tax charge due to GILTI or BEAT to be significant. In accordance with SAB 118 and ASU 2018-05, the financial reporting impact of the Tax Reform Act is expected to be completed in the fourth quarter of fiscal 2018.

7. Stockholders' Equity

The following table sets forth the changes in stockholders' equity (in thousands) for the thirteen and thirty-nine week periods ended November 3, 2018 and October 28, 2017:

	For the thirteen weeks ended November 3, 2018					For the thirteen weeks ended October 28, 2017				
	Common stock	APIC (1)	AOCI (2)	Retained earnings	Total	Common stock	APIC (1)	AOCI (2)	Retained earnings	Total
Balance, beginning	\$ 150	\$ 67,383	\$(12,015)	\$ 53,811	\$ 109,329	\$ 160	\$ 69,936	\$(11,901)	\$ 46,169	\$ 104,364
Share repurchase and retirement	(1)	(267)		(230)	(498)	(1)	(487)		(510)	(998)
Stock-based compensation		935			935		776			776
Shares issued under employee stock plans	1	223			224		(10)			(10)
Other comprehensive loss			(34)		(34)			(72)		(72)
Net income				(6,064)	(6,064)				(2,527)	(2,527)
Balance, ending	150	68,274	(12,049)	47,517	\$ 103,892	159	70,215	(11,973)	43,132	101,533

	For the thirty-nine weeks ended November 3, 2018					For the thirty-nine weeks ended October 28, 2017				
	Common stock	APIC (1)	AOCI (2)	Retained earnings	Total	Common stock	APIC (1)	AOCI (2)	Retained earnings	Total
Balance, beginning	\$ 150	\$ 66,843	\$(10,800)	\$ 55,908	\$ 112,101	\$ 159	\$ 68,355	\$(12,496)	\$ 43,496	\$ 99,514
Share repurchase and retirement	(2)	(1,058)		(867)	(1,927)	(1)	(487)		(510)	(998)
Stock-based compensation		2,624			2,624		2,815			2,815
	2	(153)			(151)	1	(468)			(467)

Shares issued
under
employee stock
plans

Other	18		(14	)	4					
Other comprehensive loss			(1,249	)	(1,249	)		523		523
Net income			(7,510	)	(7,510	)			146	146
Balance, ending	150	68,274	(12,049)	47,517	103,892	159	70,215	(11,973)	43,132	101,533

(1) - Additional paid-in capital ("APIC")

(2) - Accumulated other comprehensive income (loss) ("AOCI")

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In August 2017, the Company's Board of Directors authorized a share repurchase program of up to \$20.0 million. From the date of such authorization through November 3, 2018, the Company has repurchased 1.3 million shares at an average price of \$8.75 per share for an aggregate amount of \$11.2 million.

8. 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	
	November 3, 2018	October 28, 2017	November 3, 2018	October 28, 2017
NUMERATOR:				
Net income (loss) before allocation of earnings to participating securities	\$ (6,064)	\$ (2,527)	\$ (7,510)	\$ 146
Less: Earnings allocated to participating securities	-	-	-	2
Net income	\$ (6,064)	\$ (2,527)	\$ (7,510)	\$ 144
DENOMINATOR:				
Weighted average number of common shares outstanding - basic	14,590,614	15,599,675	14,597,255	15,602,498
Dilutive effect of share-based awards:	-	-	-	177,755
Weighted average number of common shares outstanding - dilutive	14,590,614	15,599,675	14,597,255	15,780,253
Basic income (loss) per common share attributable to Build-A-Bear Workshop, Inc. stockholders	\$ (0.42)	\$ (0.16)	\$ (0.51)	\$ 0.01
Diluted income (loss) per common share attributable to Build-A-Bear Workshop, Inc. stockholders	\$ (0.42)	\$ (0.16)	\$ (0.51)	\$ 0.01

In calculating diluted income per share for the thirteen and thirty-nine week periods ended November 3, 2018, options to purchase 594,183 and 563,661 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 28, 2017, the number of options to purchase common shares that were excluded from the calculation were 381,738 and 328,050 shares, respectively.

9. Comprehensive Income (Loss)

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 U.S. Dollar. The accumulated other comprehensive income (loss) balance at November 3, 2018 and October 28, 2017 was comprised entirely of foreign currency translation. For the thirteen and thirty-nine weeks ended November 3, 2018 and October 28, 2017, there were no reclassifications out of accumulated other comprehensive loss.

Table of Contents**10. Segment Information**

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

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

	Direct-to- Consumer	Commercial	International Franchising	Total
Thirteen weeks ended November 3, 2018				
Net sales to external customers	\$ 65,298	\$ 2,171	\$ 1,225	\$68,694
Income (loss) before income taxes	(11,406)	1,054	360	(9,992)
Capital expenditures	1,742	-	-	1,742
Depreciation and amortization	4,022	-	26	4,048
Thirteen weeks ended October 28, 2017				
Net sales to external customers	\$ 74,441	\$ 1,196	\$ 514	\$76,151
Income (loss) before income taxes	(4,788)	472	439	(3,877)
Capital expenditures	5,185	-	-	5,185
Depreciation and amortization	4,149	1	15	4,165
Thirty-nine weeks ended November 3, 2018				
Net sales to external customers	\$ 227,760	\$ 4,245	\$ 3,051	\$235,056
Income (loss) before income taxes	(14,577)	1,705	981	(11,891)
Capital expenditures	8,853	-	-	8,853
Depreciation and amortization	12,159	1	26	12,186
Thirty-nine weeks ended October 28, 2017				
Net sales to external customers	\$ 239,567	\$ 5,320	\$ 1,647	\$246,534
Income (loss) before income taxes	(2,316)	2,194	505	383
Capital expenditures	14,511	-	-	14,511
Depreciation and amortization	12,008	2	47	12,057

Total Assets as of:				
November 3, 2018	\$ 166,833	\$ 6,625	\$ 5,396	\$178,854
October 28, 2017	175,957	6,045	2,047	184,049

The Company's reportable segments are primarily determined by the types of products and services that each offers. 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 November 3, 2018				
Net sales to external customers	\$56,440	\$11,575	\$679	\$68,694
Thirteen weeks ended October 28, 2017				
Net sales to external customers	\$61,165	\$15,372	\$(386)	\$76,151
Thirty-nine weeks ended November 3, 2018				
Net sales to external customers	\$198,372	\$35,005	\$1,679	\$235,056
Property and equipment, net	64,249	9,075	19	73,343
Thirty-nine weeks ended October 28, 2017				
Net sales to external customers	\$204,128	\$41,874	\$532	\$246,534
Property and equipment, net	67,479	9,364	33	76,876

For purposes of this table only:

- (1) North America includes the United States, Canada, Puerto Rico and international franchising revenue in Mexico
- (2) Europe includes the United Kingdom, Ireland, Denmark and international franchising revenue in Europe
- (3) Other includes international franchising revenue outside of North America and Europe and a corporately-managed store in China

11. Contingencies

In the normal course of business, the Company is subject to legal proceedings, government inquiries and claims, and other commercial disputes. If one or more of these matters 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 these types of contingencies when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. Gain contingencies are recorded when the underlying uncertainty has been settled.

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Assessments made by the United Kingdom customs authority in 2012 have been appealed by the Company, which has paid the disputed duty, strictly under protest, pending the outcome of the continuing dispute, and this is included in receivables in the DTC segment. The United Kingdom customs authority is contesting the Company's appeal. The Company maintains a provision against the related receivable, based on a current evaluation of collectability, using the latest facts available in the dispute. As of November 3, 2018, the Company had a gross receivable balance of \$3.8 million and a reserve of \$3.0 million, leaving a net receivable of \$0.8 million. However, the Company continues to vigorously dispute the customs audit findings and believes that the outcome of this dispute will not have a material adverse impact on the results of operations, liquidity or financial position of the Company.

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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 the 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 fiscal year ended December 30, 2017, as filed with the SEC, and include the following:

we depend upon the shopping malls in which we are located to attract guests to our stores and a decline in mall traffic could adversely affect our financial performance and profitability;

if we are unable to generate interest in and demand for our interactive retail experience and products, including being able to identify and respond to consumer preferences in a timely manner, our sales, financial condition and profitability could be adversely affected;

consumer interests change rapidly and our success depends on the ongoing effectiveness of our marketing and online initiatives to build consumer affinity for our brand, drive consumer demand for key products and generate traffic for our stores;

decline in general global economic conditions could lead to disproportionately reduced consumer demand for our products, which represent relatively discretionary spending, and have an adverse effect on our liquidity and profitability;

we may not be able to operate our international corporately-managed locations profitably;

our merchandise is manufactured by foreign manufacturers and we transact business in various foreign countries; therefore, the availability and costs of our products, as well as our product pricing, may be negatively affected by risks associated with international manufacturing and trade and foreign currency fluctuations;

if we are unable to renew, renegotiate or replace our store leases or enter into leases for new stores on favorable terms, or if we violate any of the terms of our current leases, our growth and profitability could be harmed;

we are subject to a number of risks related to disruptions, failures or security breaches of our information technology infrastructure. If we improperly obtain or are unable to protect our data or violate privacy or security laws or expectations, we could be subject to liability as well as damage to our reputation;

we may not be able to evolve our store locations to align with market trends or to effectively manage our overall portfolio of stores which could adversely affect our ability to grow and could significantly harm our profitability;

we may not be able to operate successfully if we lose key personnel, are unable to hire qualified additional personnel, or experience turnover of our management team;

we may suffer negative publicity or be sued if the manufacturers of our merchandise or of Build-A-Bear branded merchandise sold by our licensees ship any products that do not meet current safety standards or production requirements or if such products are recalled or cause injuries;

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

we rely on a few vendors to supply substantially all of our merchandise, and significant price increases or any disruption in their ability to deliver merchandise could harm our ability to source products and supply inventory to

our stores;

our company-owned distribution center which services the majority of our stores in North America and our third-party distribution center providers used in the western United States and Europe may experience disruptions in their ability to support our stores or may operate inefficiently;

we may fail to renew, register or otherwise protect our trademarks or other intellectual property and may be sued by third parties for infringement or, misappropriation of their proprietary rights, which could be costly, distract our management and personnel and which could result in the diminution in value of our trademarks and other important intellectual property;

we may suffer negative publicity or be sued if the manufacturers of our merchandise violate labor laws or engage in practices that consumers believe are unethical;

our profitability could be adversely affected by fluctuations in petroleum products prices;

if we are unable to effectively manage our international franchises, attract new franchisees or if the laws relating to our international franchises change, our growth and profitability could be adversely affected and we could be exposed to additional liability;

our business may be adversely impacted at any time by a significant variety of competitive threats;

we may suffer negative publicity or a decrease in sales or profitability if the products from other companies that we sell in our stores do not meet our quality standards or fail to achieve our sales expectations;

we may be unsuccessful in acquiring businesses or engaging in other strategic transactions, which may negatively affect our financial condition and profitability;

fluctuations in our operating results could reduce our cash flow and we may be unable to repurchase shares at all or at the times or in the amounts we desire or the results of our share repurchase program may not be as beneficial as we would like;

fluctuations in our quarterly results of operations could cause the price of our common stock to substantially decline; limited public float and trading volume for our common stock may have an adverse impact and cause significant fluctuation of market price; and

our certificate of incorporation and bylaws and Delaware law contain provisions that may prevent or frustrate attempts to replace or remove our current management by our stockholders, even if such replacement or removal may be in our stockholders' best interests.

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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 guests participate in the stuffing, fluffing, dressing, accessorizing and naming of their own teddy bears and other stuffed animals. As of November 3, 2018, we operated 371 stores globally and had 94 franchised stores operating internationally under the Build-A-Bear Workshop brand. In addition to our stores, we sell products on our company-owned e-commerce sites, third party e-commerce marketplaces, franchisee sites and through third party retail locations under wholesale agreements.

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”)** – Corporately-managed retail stores located in the United States, the United Kingdom, Canada, China, Denmark, Ireland and Puerto Rico and two e-commerce sites;

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

• **International Franchising** – Sales-based royalties and merchandise, including supplies and fixture sales, as well as development fees and other revenue from international operations under franchise agreements.

Selected financial data attributable to each segment for the thirteen and thirty-nine week periods ended November 3, 2018 and October 28, 2017 are set forth in the notes to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Strategy

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

Development of our experiential retail model to diversify and expand the impact and reach of our brand globally: We expect to continue to diversify our real estate portfolio to focus on places where families are increasingly going to shop or going for entertainment. We have been actively identifying and securing more tourist locations. We also expect to continue to diversify our store portfolio inclusive of a new, lower capital, more flexible “concourse shop” model. We expect to continue to make improvements to our aged store fleet by leveraging our new Discovery format in conjunction with select natural lease events such as lease renewals or terminations. Overall, these locations continue to perform ahead of heritage locations in both sales and profitability. In addition, we expect to continue to grow e-commerce sales. We expect to expand globally through existing and new franchise agreements including the

recently added franchises in China and India.

Leverage the power of our brand and intellectual properties to build margin accretive revenue streams: To meet the needs of our core consumer base (girls and boys ages 3 to 12) while systematically building secondary consumer segments (including collectors, gift-givers and teen-plus), we expect to continue to develop and expand offerings of successful intellectual properties balanced with core products and a comprehensive program of key licensed products. We expect to leverage the power of both our Build-A-Bear brand as well as our other intellectual properties to further develop our outbound licensed programs and expand these and other margin accretive revenue streams. We also expect to build the entertainment aspects of our business model as we continue to develop content to connect with consumers beyond our retail stores including mobile apps, music videos and other entertainment opportunities to increase engagement, improve efficiency and lead to profitable sales growth.

Long-Term Profitability Improvement: We are focused on improving profitability through the execution of our stated strategies detailed above as well as disciplined expense management and on-going efforts in process and systems upgrades. While we continue to monitor consolidated comparable sales as an important metric in our business, we believe that total revenue growth and profitability improvement are more indicative of the progress in our business initiatives on a go forward basis.

Retail Stores:

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

	Thirty-nine weeks ended			October 28, 2017				
	November 3, 2018			North				
	Europe	Asia	Total	Europe	Asia	Total		
	America			America				
Beginning of period	294	59	1	354	277	60	1	338
Opened	27	1		28	26	1	-	27
Closed	(9)	(2)		(11)	(11)	(3)	-	(14)
End of period	312	58	1	371	292	58	1	351

During 2018, we have continued to make improvements to our aged store fleet by leveraging the new Discovery format in conjunction with select natural lease events. As of November 3, 2018, 37% of our store base was in an updated Discovery design. We also expect to close certain stores in accordance with natural lease events as an ongoing part of our real estate management and day-to-day operational plans. Current plans include expansion into more non-traditional locations, made possible in part by concourse shops. Concourse shops are stand-alone retail units that occupy approximately 200 square feet designed to be operated in open, concourse areas of malls or other covered pedestrian areas.

Table of Contents***International Franchise Revenue:***

Our first franchisee location was opened in November 2003. All franchised stores have similar signage, store layout, merchandise characteristics and guest experience as our corporately-managed stores. As of November 3, 2018, 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 franchised stores opened and closed for the periods presented below are summarized as follows:

	Thirty-nine weeks ended	
	November 3, 2018	
	2018	2017
Beginning of period	100	92
Opened	11	11
Closed	(17)	(14)
End of period	94	89

In the ordinary course of business, we anticipate signing additional master franchise agreements and terminating other such agreements. We believe there is a market potential for approximately 300 international stores outside of the United States, Canada, the United Kingdom and Ireland. We continue to expect franchisees to leverage the new formats that have been developed for our corporately-managed operations and sourcing changes that have significantly reduced the capital and expenses required to open stores. We expect to continue to develop market expansion through both new and existing franchisees in 2018 and beyond. For example, our new China franchise partner operates four locations and plans to open up to 10 locations by the end of fiscal year 2018. In addition, we have made progress to open our first stores in India by the end of fiscal year 2018.

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. Percentages will not total due to cost of merchandise sold being expressed as a percentage of net retail sales, commercial revenue, international franchising as well as immaterial rounding:

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

	Thirteen weeks ended		Thirty-nine weeks ended	
	November	October	November	October
	3,	28,	3,	28,
	2018	2017	2018	2017
Revenues:				
Net retail sales	95.0 %	97.7 %	96.9 %	97.2 %
Commercial revenue	3.2	1.6	1.8	2.2
International franchising	1.8	0.7	1.3	0.7
Total revenues	100.0	100.0	100.0	100.0
Costs and expenses:				
Cost of merchandise sold - retail ⁽¹⁾	64.5	58.1	58.9	55.1
Cost of merchandise sold - commercial ⁽¹⁾	35.6	42.0	43.4	48.5
Cost of merchandise sold - international franchising ⁽¹⁾	59.7	10.9	54.1	19.0
Total cost of merchandise sold	63.5	57.6	58.5	54.7
Consolidated gross profit	36.5	42.4	41.5	45.3
Selling, general and administrative	51.1	47.5	46.5	45.1
Interest expense (income), net	(0.0)	0.0	0.0	(0.0)
Income before income taxes	(14.5)	(5.1)	(5.1)	0.2
Income tax (benefit) expense	(5.7)	(1.8)	(1.8)	0.1
Net income (loss)	(8.8)	(3.3)	(3.2)	0.1
Retail Gross Margin	35.5 %	41.9 %	41.1 %	44.9 %

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

(2) Retail gross margin represents net retail sales less cost of merchandise sold - retail; retail gross margin percentage represents retail gross margin divided by net retail sales.

Table of Contents***Thirteen weeks ended November 3, 2018 compared to thirteen weeks ended October 28, 2017***

Total revenues. Consolidated revenues decreased 9.8%, including a 7.4% decrease in North America and a 23.1% decrease in Europe, and also inclusive of a 17.8% increase in consolidated e-commerce sales. European results continue to reflect the impact of the ongoing uncertainty surrounding Brexit, as well as the May 2018 implementation of new privacy laws, which severely inhibited the Company's ability to directly market to guests.

Net retail sales for the thirteen weeks ended November 3, 2018 were \$65.3 million, compared to \$74.4 million for the thirteen weeks ended October 29, 2017, a decrease of \$9.1 million, or 12.3%. The components of this decrease are as follows:

	Thirteen Weeks Ended November 3, 2018 (dollars in millions)
Decrease in existing store and ecommerce sales	\$ (8.1)
Increase from new stores	3.0
Impact of store closures	(3.3)
Impact of foreign currency translation	(0.3)
Change in deferred revenue estimates, including gift card breakage	(0.4)
	\$ (9.1)

The revenue decrease was driven primarily by the strategic de-emphasis of our historically successful National Teddy Bear Day promotion to avoid the potential of long lines and frustrated guests on the heels of the Pay Your Age Day events in mid-July 2018. Second, our U.K. business continued to decline due to a challenging retail environment brought on by Brexit and the May 2018 implementation of new privacy laws that have significantly inhibited our ability to build our contact database and market directly to our guests. Third, we had a negative \$2.5 million impact from the January 2018 closure of our previously most productive store and the adoption of the new revenue recognition standard (See Note 1 — Basis of Presentation and Note 2 — Revenue for additional information). Finally, organic family traffic to traditional malls continued to struggle which we believe was exacerbated by the comparative lack of high impact animated films that tend to bring our target demographic to malls with co-located theaters. Historically, we have seen increased traffic and sales associated with child-friendly film releases.

Commercial revenue was \$2.2 million for the thirteen weeks ended November 3, 2018 compared to \$1.2 million for the thirteen weeks ended October 28, 2017. The \$1.0 million increase related primarily to outbound brand licensing activity.

Retail gross margin. Retail gross margin dollars decreased \$8.0 million to \$23.2 million compared to the fiscal 2017 third quarter. The retail gross margin rate declined 640 basis points to 35.5% including approximately 150 basis points related to non-cash store impairment charges outside of the U.S. and the adoption of the new revenue recognition standard as well as approximately 370 basis points related to the deleverage of fixed occupancy costs. The remaining decline was driven primarily by higher promotional activity related to the residual effects of Pay Your Age Day as well as the deleverage of warehouse distribution costs in the quarter. Notably, total occupancy and distribution costs were flat even with a higher store count resulting in a lower average cost per store.

Selling, general and administrative. Selling, general and administrative expenses (“SGA”) were \$35.1 million for the thirteen weeks ended November 3, 2018, a decline of \$1.1 million compared to the thirteen weeks ended October 28, 2017. The decrease was primarily driven by lower payroll and advertising costs.

Interest expense (income), net. Interest expense (income) was less than \$0.1 million for both the thirteen weeks ended November 3, 2018 and October 28, 2017, respectively.

Provision for income taxes. The income tax provision was a benefit of \$3.9 million with a tax rate of 39.3% for the thirteen weeks ended November 3, 2018 as compared to an income tax benefit of \$1.4 million with a tax rate of 34.8% for the thirteen weeks ended October 28, 2017. In the third quarter of fiscal 2018, the effective tax rate differed from the statutory rate of 21% primarily due to the jurisdictional mix of earnings. In the third quarter of fiscal 2017, the effective tax rate differed from the statutory rate of 34% primarily due to the effect of discrete items.

Thirty-nine weeks ended November 3, 2018 compared to thirty-nine weeks ended October 28, 2017

Total revenues. Net retail sales for the thirty-nine weeks ended November 3, 2018 were \$227.8 million, compared to \$239.6 million for the thirty-nine weeks ended October 28, 2017, a decrease of \$11.8 million, or 4.9%. The components of this decrease are as follows:

**Thirty-nine
weeks**

	ended
	November
	3, 2018
	(dollars in
	millions)
Decrease in existing store and ecommerce sales	\$ (10.2)
Increase from new stores	10.4
Impact of store closures	(11.5)
Impact of foreign currency translation	1.9
Change in deferred revenue estimates, including gift card breakage	(2.4)
	\$ (11.8)

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The decrease in net retail sales included the \$2.1 million impact from the adoption of the new revenue recognition standard (See Note 1 — Basis of Presentation and Note 2 — Revenue for additional information). In addition, our previously most productive store closed in January 2018 and Toys“R”Us conducted liquidation proceedings which we believe negatively impacted sales at our stores, particularly those in closer proximity to a liquidating Toys“R”Us location, during the first twenty-six weeks of fiscal 2018.

Commercial revenue was \$4.2 million for the thirty-nine weeks ended November 3, 2018 compared to \$5.3 million for the thirty-nine weeks ended October 28, 2017. The \$1.1 million decrease related primarily to the nature and timing of the prior year's wholesale orders.

Retail gross margin. Retail gross margin was \$93.6 million for the thirty-nine weeks ended November 3, 2018 compared to \$107.5 million for the thirty-nine weeks ended October 28, 2017, a decrease of \$13.9 million, or 12.9%. As a percentage of net retail sales, retail gross margin was 41.1% for the thirty-nine weeks ended November 3, 2018 compared to 44.9% for the thirty-nine weeks ended October 28, 2017. This 380 basis-point gross margin decrease was largely driven by the deleverage in fixed occupancy and distributions costs, contraction in merchandise margin due to the higher promotional activity associated with the Pay Your Age events and approximately 70 basis points related to non-cash store impairment charges outside of the U.S. and the adoption of the new revenue recognition standard

Selling, general and administrative (“SGA”). SGA was \$109.3 million for the thirty-nine weeks ended November 3, 2018, compared to \$111.2 million for the thirty-nine weeks ended October 28, 2017, a decrease of \$1.9 million, or 1.7%. The decrease in SGA was primarily due to reduced advertising spend and lower payroll costs.

Interest expense (income), net. Interest expense (income) was less than \$0.1 million for both the thirty-nine weeks ended November 3, 2018 and October 28, 2017, respectively.

Provision for income taxes. The income tax provision was a benefit of \$4.4 million with a tax rate of 36.8% for the thirty-nine weeks ended November 3, 2018 as compared to income tax expense of \$0.2 million with a tax rate of 61.9% for the thirty-nine weeks ended October 28, 2017. In the first thirty-nine weeks of fiscal 2018, the effective tax rate differed from the statutory rate of 21% primarily due to the jurisdictional mix of earnings. In the first thirty-nine weeks of fiscal 2017, the effective tax rate differed from the statutory rate of 34% primarily due to the effect of discrete tax items. The statutory rate decreased to 21% as a result of the enactment of the Tax Cut and Jobs Act on December 22, 2017.

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 existing store and e-commerce sales; (3) fluctuations in the profitability of our stores; (4) the timing and frequency of the sales of licensed products tied to major theatrical releases, our marketing initiatives, including national media and other public relations events; (5) changes in foreign currency exchange rates; (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 typically associated with a lease event such as an expiration or lease triggered clause; 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 retailer that has toy products as part of our revenue model, our sales are highest in our fourth quarter. The timing of holidays and school vacations can impact our quarterly results. We cannot assure you 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. For example, the 2014 fiscal fourth quarter had 14 weeks and the transition period ended February 3, 2018 had five 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, investments in information technology infrastructure 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.

A summary of our operating, investing and financing activities are shown in the following table (dollars in thousands):

**Thirty-nine weeks
ended
November October
3, 28,**

	2018	2017
Net cash used in operating activities	\$(8,955)	\$(230)
Net cash used in investing activities	(8,769)	(14,201)
Net cash provided by (used in) financing activities	5,117	(1,525)
Effect of exchange rates on cash	(261)	(359)
Net decrease in cash and cash equivalents	\$(12,868)	\$(16,315)

Operating Activities. Cash used in operating activities increased \$8.7 million for the thirty-nine weeks ended November 3, 2018, as compared to the thirty-nine weeks ended October 28, 2017. This decrease in cash from operating activities was primarily driven by the higher net loss for the thirty-nine weeks ended November 3, 2018 as compared to the thirty-nine weeks ended October 28, 2017.

Investing Activities. Cash used in investing activities decreased \$5.4 million for the thirty-nine weeks ended November 3, 2018, as compared to the thirty-nine weeks ended October 28, 2017. This decrease in cash from investing activities was primarily driven by a lower use of cash related to store construction and upgrades, and purchases of information technology infrastructure for the thirty-nine weeks ended November 3, 2018 as compared to the thirty-nine weeks ended October 28, 2017.

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Financing Activities. Cash provided by financing activities increased \$6.6 million for the thirty-nine weeks ended November 3, 2018, as compared to the thirty-nine weeks ended October 28, 2017. This increase in cash from financing activities was primarily driven by short-term borrowings of \$7.3 million from our line of credit, partially offset by \$0.9 million of additional purchases of our common stock for the thirty-nine weeks ended November 3, 2018 as compared to the thirty-nine weeks ended October 28, 2017.

Capital Resources. As of November 3, 2018, we had a consolidated cash balance of \$8.6 million and approximately 50% of this balance was domiciled within 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. On May 4, 2017, we amended the credit agreement, extending the expiration date to December 31, 2018 and increasing the amount of permitted lease and rental payments for personal property from \$100,000 to \$1.0 million. The bank line provides availability of \$35.0 million. Borrowings under the credit agreement are secured by our assets and a pledge of 66% of our ownership interest in certain of our foreign subsidiaries. The credit agreement 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, and 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 November 3, 2018: (i) we were in compliance with all covenants; (ii) there were \$7.25 million in borrowings under our line of credit; and (iii) there was approximately \$27.75 million available for borrowing under the line of credit. We may incur borrowings in amounts that are expected to fluctuate throughout the remainder of the year and all of which we expect to repay before the end of the fiscal year.

In fiscal 2018, we expect to spend a total of \$14 to \$15 million on capital expenditures. Capital spending through the thirty-nine weeks ended November 3, 2018 totaled \$8.9 million, on track with our full year plans. Capital spending in fiscal 2018 is expected to primarily support our store activity, including both remodels and new stores, and investments in information technology 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, 2018.

In August 2017, our Board of Directors authorized a share repurchase program of up to \$20 million. This program authorized us to purchase up to \$20 million of our common stock in the open market (including through 10b5-1 trading plans), or through privately negotiated transactions. The primary source of funding for the program is expected to be cash on hand. The timing and amount of share repurchases, if any, will depend on price, market conditions, applicable regulatory requirements, and other factors. The program authorizes us to repurchase shares through September 30, 2020, and does not require us to repurchase any specific number of shares, and may be modified,

suspended or terminated at any time without prior notice. Shares repurchased under the program will be subsequently retired. From the date of such authorization through November 3, 2018, we have repurchased 1.3 million shares at an average price of \$8.75 per share for an aggregate amount of \$11.2 million.

Off-Balance Sheet Arrangements

None.

Inflation

We do not believe that inflation has had a material adverse impact on our business or operating results during the periods presented. We cannot provide assurance, however, that our business will not be affected by inflation in the future.

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 15, 2018, which includes audited consolidated financial statements for our 2017, 2016 and 2015 fiscal years. There have been no material changes to the critical accounting estimates disclosed in the 2017 Form 10-K.

Recent Accounting Pronouncements

See Note 1 to the Condensed Consolidated Financial Statements — Basis of Presentation — Recently Issued Accounting Pronouncements

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 December 30, 2017 as filed with the SEC on March 15, 2018.

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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 of the end of the period covered by this report. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us 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 November 3, 2018, 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 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 material changes to our risk factors as disclosed in our Annual Report on Form 10-K for the year ended December 30, 2017 as filed with the Securities and Exchange Commission on March 15, 2018.

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 (2)
Aug. 5, 2018 – Sep. 1, 2018	188	\$ 8.35	-	\$ 9,293,740
Sep. 2, 2018 – Oct. 6, 2018	46,870	\$ 8.47	46,768	\$ 8,897,650
Oct. 7, 2017 – Nov. 3, 2018	12,620	\$ 8.17	12,500	\$ 8,795,529
Total	59,678	\$ 8.41	59,268	\$ 8,795,529

(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 quarter. Our equity incentive plans provide that the value of shares delivered to us to pay the withholding tax obligations is calculated at the closing trading price of our common stock on the date the relevant transaction occurs.

(2) In August 2017, the Board of Directors adopted a share repurchase program authorizing the repurchase of up to \$20 million of our common stock. This program authorizes the Company to repurchase shares through September 30, 2020 and does not require the Company to repurchase any specific number of shares, and may be modified, suspended or terminated at any time without prior notice. Shares repurchased under the program will be subsequently retired.

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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	<u>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)</u>
3.1	<u>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)</u>
3.2	<u>Amended and Restated Bylaws, as amended through February 23, 2016 (incorporated by reference from Exhibit 3.1 of our Current Report on Form 8-K, filed on February 24, 2016)</u>
4.1	<u>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)</u>
31.1	<u>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)</u>
31.2	<u>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)</u>
32.1	<u>Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the President and Chief Executive Officer)</u>
32.2	<u>Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the Chief Financial Officer)</u>
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

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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: December 13, 2018

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)