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 Incorporation or Organization)	**(IRS Employer Identification No.)**
1954 Innerbelt Business Center Drive St. Louis, Missouri	**63114**
(Address of Principal Executive Offices)	**(Zip Code)**

(314) 423-8000

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 (Do not check if a smaller reporting company)	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

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 maturitiy 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.

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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 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 Customer*s (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 1,	**October 3,**	**October 1,**	**October 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, 2016	**October 3, 2015**
Beginning of period	77	73
Opened	10	7
Closed	(7)	(6