WINMARK CORP
Form 10-K
March 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 30, 2017, 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: 000-22012

WINMARK CORPORATION

(exact name of registrant as specified in its charter)

Minnesota	41-1622691
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

605 Highway 169 North, Suite 400, Minneapolis, Minnesota 55441

(Address of Principal Executive Offices) (Zip Code)

Registrant’s Telephone Number, Including Area Code: (763) 520-8500

Securities registered pursuant to Section 12 (b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, no par value per share	NASDAQ Global Market

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

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

Yes No

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

Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	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 13(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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter was $316,418,727.

Shares of no par value Common Stock outstanding as of March 5, 2018: 3,849,506 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Registrant's Annual Meeting of Shareholders to be held on April 25, 2018 have been incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this report

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PART I

ITEM 1: BUSINESS

Background

We are a franchisor of five value-oriented retail store concepts that buy, sell and trade gently used merchandise. Each of our retail store brands emphasizes consumer value by offering high-quality used merchandise at substantial savings from the price of new merchandise and by purchasing customers' used goods that have been outgrown or are no longer used. Our concepts also offer a limited amount of new merchandise to customers. As of December 30, 2017, we had 1,211 franchised stores across the United States and Canada. In addition, we provide franchise consulting and advisory services to new and emerging franchisors through Winmark Franchise Partners, which we launched in 2017.

We operate a middle-market equipment leasing business through our wholly owned subsidiary, Winmark Capital Corporation. Our middle-market leasing business serves large and medium-sized businesses and focuses on technology-based assets which typically cost more than $250,000. The businesses we target generally have annual revenue of between $30 million and several billion dollars. We generate middle-market equipment leases primarily through business alliances, equipment vendors and directly from customers.

Additionally, we operate a small-ticket financing business through our wholly owned subsidiary, Wirth Business Credit, Inc. Our small-ticket financing business serves small businesses and focuses on assets which generally have a cost of $5,000 to $100,000.

Our significant assets are located within the United States, and we generate all revenues from United States operations other than franchising revenues from Canadian operations of approximately $3.8 million, $3.3 million and $2.9 million for 2017, 2016 and 2015, respectively. For additional financial information, please see Item 6 — Selected Financial Data and Item 8 — Financial Statements and Supplementary Data. We were incorporated in Minnesota in 1988.

Franchise Operations

Our retail brands with their fiscal year 2017 system-wide sales, which we define as estimated revenues generated by all franchise locations, are summarized as follows:

Plato's Closet® - $456 million.

We began franchising the Plato's Closet brand in 1999. Plato's Closet stores buy and sell used clothing and accessories geared toward the teenage and young adult market. Customers have the opportunity to sell their used items to Plato's Closet stores and to purchase quality used clothing and accessories at prices lower than new merchandise.

Once Upon A Child® - $329 million.

We began franchising the Once Upon A Child brand in 1993. Once Upon A Child stores buy and sell used and, to a lesser extent, new children's clothing, toys, furniture, equipment and accessories. This brand primarily targets parents of children ages infant to 12 years. These customers have the opportunity to sell their used children's items to a Once Upon A Child store when outgrown and to purchase quality used children's clothing, toys, furniture and equipment at prices lower than new merchandise.

Play It Again Sports® - $223 million.

We began franchising the Play It Again Sports brand in 1988. Play It Again Sports stores buy, sell, trade and consign used and new sporting goods, equipment and accessories for a variety of athletic activities including team sports (baseball/softball, hockey, football, lacrosse, soccer), fitness, ski/snowboard and golf among others. The stores offer a flexible mix of merchandise that is adjusted to adapt to seasonal and regional differences.

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Style Encore® - $37 million.

We began franchising the Style Encore brand in 2013. Style Encore stores buy and sell used women's apparel, shoes and accessories. Customers have the opportunity to sell their used items to Style Encore stores and to purchase quality used clothing, shoes and accessories at prices lower than new merchandise.

Music Go Round® - $33 million.

We began franchising the Music Go Round brand in 1994. Music Go Round stores buy, sell, trade and consign used and, to a lesser extent, new musical instruments, speakers, amplifiers, music-related electronics and related accessories.

The following table presents the royalties and franchise fees contributed by our franchised retail brands for each of the past three years and the corresponding percentage of consolidated revenues for each such year:

	Total Royalties and Franchise Fees (in millions)			% of Consolidated Revenue		
	2015	2016	2017	2015	2016	2017
Plato's Closet	$ 19.1	$ 19.5	$ 20.2	27.5 %	29.2 %	29.0 %
Once Upon A Child	13.0	14.2	14.5	18.7	21.3	20.8
Play It Again Sports	9.5	9.2	9.3	13.6	13.9	13.3
Style Encore	1.2	1.7	2.2	1.8	2.6	3.1
Music Go Round	0.9	1.0	1.0	1.3	1.5	1.4
	$ 43.7	$ 45.6	$ 47.2	62.9 %	68.5 %	67.6 %

The following table presents a summary of our retail brands franchising activity for the fiscal year ended December 30, 2017:

	TOTAL 12/31/2016	OPENED	CLOSED	TOTAL 12/30/2017	AVAILABLE FOR RENEWAL	COMPLETED RENEWALS	% RENEWED
Plato's Closet Franchises - US and Canada	468	14	(6)	476	26	26	100 %

Once Upon A Child Franchises - US and Canada	348	18	(6)	360	24	24	100	%
Play It Again Sports Franchises - US and Canada	283	6	(8)	281	18	17	94	%
Style Encore Franchises - US and Canada	52	11	(2)	61	—	—	N/A	
Music Go Round Franchises - US	35	0	(2)	33	4	4	100	%
Total Franchised Stores	1,186	49	(24)	1,211	72	71	99	%

Retail Brands Franchising Overview

We use franchising as a business method of distributing goods and services through our retail brands to consumers. We, as franchisor, own a retail business brand, represented by a service mark or similar right, and an operating system for the franchised business. We then enter into franchise agreements with franchisees and grant the franchisee the right to use our business brand, service marks and operating system to manage a retail business. Franchisees are required to operate their retail businesses according to the systems, specifications, standards and formats we develop for the business brand. We train the franchisees how to operate the franchised business. We also provide continuing support and service to our franchisees.

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

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

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Offering Value-Oriented Merchandise

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

Attracting Franchisees

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

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

At December 30, 2017, we had 62 signed retail franchise agreements, of which the majority are expected to open in 2018.

We began franchising in Canada in 1991 and, as of December 30, 2017, had 101 franchised retail stores open in Canada. The Canadian retail stores are operated by franchisees under agreements substantially similar to those used in the United States.

Retail Brand Franchise Support

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

Training

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

Field Support

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

Purchasing

During training each franchisee is taught how to evaluate, purchase and price used goods directly from customers. We have developed specialized computer point-of-sale systems for our brands that provide the franchisee with standardized pricing information to assist in the purchasing of used items.

We provide centralized buying services, which on a limited basis include credit and billing for the Play It Again Sports franchisees. Our Play It Again Sports franchise system uses several major vendors for new product including Nautilus, Wilson Sporting Goods, Champro Sports, Easton Sports, CCM Hockey and Bauer Hockey. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered.

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

Our typical Once Upon A Child franchised store purchases approximately 30% of its new product from Rachel’s Ribbons, Wild Side Accessories, Melissa & Doug and Nuby. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered.

Our typical Music Go Round franchised store purchases approximately 50% of its new product from KMC/Musicorp, RapcoHorizon Company, D’Addario, GHS Corporation and Ernie Ball. The loss of any of the above vendors would change the vendor mix, but not significantly change our products offered.

There are no significant vendors of new products to our typical Plato’s Closet and Style Encore franchised stores as new product is an extremely low percentage of sales for these brands.

Retail Advertising and Marketing

We encourage our franchisees to implement a marketing program that includes the following: television, radio, point-of-purchase materials, in store signage and local store marketing programs as well as email marketing promotions, website promotions and participation in social and digital media. Franchisees of the respective retail brands are required to spend a minimum of 5% of their gross sales on approved advertising and marketing. Franchisees may be required to participate in regional cooperative advertising groups.

Computerized Point-Of-Sale Systems

We require our retail brand franchisees to use a retail information management computer system in each store, which has evolved with the development of new technology. This computerized point-of-sale system is designed specifically for use in our franchise retail stores. The current system includes our proprietary Data Recycling System

software, a dedicated server, two or more work station registers, a receipt printer, a report printer and a bar code scanner, together with software modules for inventory management, cash management and customer information management. Our franchisees purchase the computer hardware from us. The Data Recycling System software is designed to accommodate buying of used merchandise. This system provides franchisees with an important management tool that reduces errors, increases efficiencies and enhances inventory control. We provide point-of-sale system support through our Computer Support Center located at our Company headquarters.

The Retail Franchise Agreement

We enter into franchise agreements with our franchisees. The following is a summary of certain key provisions of our current standard retail brand franchise agreement. Except as noted, the franchise agreements used for each of our retail brands are generally the same.

Each franchisee must execute our franchise agreement and pay an initial franchise fee. At December 30, 2017, the franchise fee for all brands was $25,000 for an initial store in the U.S. and $33,500CAD for an initial store in Canada. Once a franchisee opens its initial store, it can open additional stores, in any brand, by paying a $15,000 franchise fee for a store in the U.S. and $20,000CAD for a store in Canada, provided an acceptable territory is available and the franchisee meets the brand's additional store standards. The franchise fee for our initial retail store and additional retail store in Canada is based upon the exchange rate applied to the United States franchise fee on the last business day of the preceding fiscal year. The franchise fee in March 2018 for an initial retail store in Canada will be $31,500CAD, and an additional retail store in Canada will be $19,000CAD. Typically, the franchisee's initial store is open for business approximately 12 months from the date the franchise agreement is signed. The franchise agreement has an initial term of 10 years, with subsequent 10-year renewal periods, and grants the franchisee an exclusive geographic area, which will vary in size depending upon population, demographics and other factors. Under current franchise agreements, franchisees of the respective brands are required to pay us weekly continuing fees (royalties) equal to the percentage of

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gross sales outlined in their Franchise Agreements, generally ranging from 4% to 5% for all of our brands except Music Go Round, which is 3%.

Each Franchisee is required to pay us an annual marketing fee of $500 or $1,000. Each new or renewing franchisee is required to spend 5% of its gross sales for advertising and promoting its franchised store. Existing franchisees with older Franchise Agreements may only be required to spend 3% to 4% of their gross sales on advertising and promotion. Currently, for all of the retail brands except Play It Again Sports, we have the option to increase the minimum advertising expenditure requirement from 5% to 6% of the franchisee's gross sales, of which up to 2% would be paid to us as an advertising fee for deposit into an advertising fund. While we currently do not have the option to increase the advertising expenditure requirement for Play It Again Sports franchisees, we may also require those franchisees to pay 2% of their gross sales into an advertising fund. This fund, if initiated, would be managed by us and would be used for advertising and promotion of the franchise system.

During the term of a franchise agreement, franchisees agree not to operate directly or indirectly any competitive business. In addition, franchisees agree that after the end of the term or termination of the franchise agreement, franchisees will not operate any competitive business for a period of two years and within a reasonable geographic area.

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

Renewal of the Franchise Relationship

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

We believe that renewing a significant number of these franchise relationships is important to the success of the Company. During the past three years, we renewed 99% of franchise agreements up for renewal.

Retail Franchising Competition

Retailing, including the sale of teenage, children's and women's apparel, sporting goods and musical instruments, is highly competitive. Many retailers have substantially greater financial and other resources than we do. Our franchisees compete with established, locally owned retail stores, discount chains and traditional retail stores for sales of new merchandise. Full line retailers generally carry little or no used merchandise. Resale, thrift and consignment shops and garage and rummage sales offer competition to our franchisees for the sale of used merchandise. Also, our franchisees increasingly compete with online used and new goods marketplaces such as eBay, craigslist and many others.

Our Plato's Closet franchise stores primarily compete with specialty apparel stores such as American Eagle, Gap, Abercrombie & Fitch, Old Navy, Hollister and Forever 21. We compete with other franchisors in the teenage resale clothing retail market.

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

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

Our Style Encore franchise stores compete with a wide range of women's apparel stores. We also compete with other franchisors in the women's resale clothing retail market.

Our Music Go Round franchise stores compete with large musical instrument retailers such as Guitar Center as well as local independent musical instrument stores.

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

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

Winmark Franchise Partners™

During 2017, we announced the launch of an initiative to provide consulting services, support and capital to emerging franchisors. Under the Winmark Franchise Partners mark, we leverage our experience in franchising through strategic partnering with select companies interested in franchising to grow their brands. We anticipate that this concept will create additional revenue streams while being synergistic with our existing business.

Equipment Leasing Operations

We operate a middle-market leasing business through Winmark Capital Corporation, a wholly owned subsidiary. We operate a small-ticket financing business through Wirth Business Credit, Inc., a wholly owned subsidiary. We incorporated both of these subsidiaries in April 2004. To differentiate ourselves from our competitors in the leasing industry, we offer innovative lease and financing products and concentrate on building long-term relationships with our customers and business alliances.

Winmark Capital Corporation

Winmark Capital Corporation is engaged in the business of providing non-cancelable leases for high-technology and business-essential assets to both larger organizations and smaller, growing companies. We target businesses with annual revenue between $30 million and several billion dollars. We focus on transactions that have terms from two to three years. Such transactions are generally larger than $250,000 and include high-technology equipment and/or

business essential equipment, including computers, telecommunications equipment, storage systems, network equipment and other business-essential equipment. The leases are retained in our portfolio to accommodate equipment additions and upgrades to meet customers' changing needs.

Industry

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

Generally, high-technology equipment, such as information technology equipment, does not suffer from material physical deterioration if properly maintained. As required under our leases, our leased equipment must be kept under continual maintenance, in accordance with the manufacturer's specifications, most often provided by the manufacturer. The economic life and residual value of information technology equipment is subject to, among other things, the development of technological improvements and changes in sale and maintenance terms initiated by the manufacturer.

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Business Strategy

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

- Relationship Focus. We maintain a focused, long-term, customer-service approach to our business.
- Full Service. We can service the equipment leasing needs of both large organizations as well as smaller, growing companies.
- Asset Ownership. We differentiate ourselves with our commitment to retain ownership of our leases throughout the lease term.

Leasing and Sales Activities

Our middle-market lease products are marketed nationally through our offices in Minneapolis, Minnesota and Santa Barbara, California.

We market our leasing services directly to end-users and indirectly through business alliances, and through vendors of equipment, software, value-added services and consulting services. We directly market to customers and prospects by telephone canvassing and by establishing relationships with business alliances in the local business community.

We generally lease high-technology and other business-essential equipment. Additionally, we may lease operating system and application software to our customers, but typically only with a hardware lease. Our standard lease agreement, entered into with each customer, is a noncancelable “net” lease which contains “hell-or-high water” provisions under which the customer, upon acceptance of the equipment, must make all lease payments regardless of any defects or performance of the equipment, and which require the customer to maintain and service the equipment, insure the equipment against casualty loss and pay all property, sales and other taxes related to the equipment. We retain ownership of the equipment we lease and, in the event of default by the customer, we or the financial institution to whom the lease payment has been assigned may declare the customer in default, accelerate all lease payments due under the lease and pursue other available remedies, including repossession of the equipment. Upon expiration of the initial term or extended lease term, depending on the structure of the lease, the customer may:

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

If the equipment is returned to us, it will typically be sold into the secondary-user marketplace.

Wirth Business Credit, Inc.

Our small-ticket financing operation serves the needs of small businesses. Small-ticket financing transactions are typically between $5,000 and $100,000, have terms of between two and four years and cover business essential assets, including computers, printing equipment, security systems, telecommunications equipment, production equipment and other assets. Our financing transactions are generally full pay out transactions, which means, after paying all required payments under the financing agreement, the customer owns the asset. Key elements of our small-ticket business strategy include a focus on both business owners and equipment vendor relationships as well as providing fast credit decisions, flexible terms and an easy to understand process.

The small ticket finance industry is highly fragmented and competitive. Small business owners typically finance their businesses through one of many possible sources including banks, vendor captive finance companies, leasing brokers, credit card companies and independent leasing companies. These sources of funding typically limit their focus to certain types of transactions and may base their decision on credit quality, geography, size of transaction, type of asset or other criteria.

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Financing

To date, we have funded the vast majority of our leases internally using our available cash or debt.

Winmark Capital Corporation may from time to time arrange permanent financing of leases through non-recourse discounting of lease rentals with various financial institutions at fixed interest rates. The proceeds from the assignment of the lease rentals will generally be equal to the present value of the remaining lease payments due under the lease, discounted at the interest rate charged by the financial institution. Interest rates obtained under this type of financing are negotiated on a transaction-by-transaction basis and reflect the financial strength of the customer, the term of the lease and the prevailing interest rates. In the event of a default by a customer in non-recourse financing, the financial institution has a first lien on the underlying leased equipment, with no further recourse against us. The institution may, however, take title to the collateral in the event the customer fails to make lease payments or certain other defaults by the customer occur under the terms of the lease. Our use of lease discounting is dependent upon having leases that are attractive to financial institutions as well as our available cash balances.

Equipment Leasing Competition

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

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

Government Regulation

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

franchisees and competition with franchisees.

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

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

Trademarks and Service Marks

Plato's Closet®, Once Upon A Child®, Play It Again Sports®, Style Encore®, Music Go Round®, Winmark®, Wirth Business Credit® and Winmark Capital®, among others, are our registered service marks. We have filed a trademark registration for Winmark Franchise Partners™. These marks are of considerable value to our business. We intend to protect our service marks by appropriate legal action where and when necessary. Each service mark registration must be renewed every 10 years. We have taken, and intend to continue to take, all steps necessary to renew the registration of all our material service marks.

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Seasonality

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

Employees

As of December 30, 2017, we employed 107 employees.

Available Information

We maintain a Web site at www.winmarkcorporation.com, the contents of which are not part of or incorporated by reference into this Annual Report on Form 10-K. We make our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K (and amendments to those reports) available on our Web site via a link to the U.S. Securities and Exchange Commission (SEC) Web site, free of charge, as soon as reasonably practicable after such reports have been filed with or furnished to the SEC.

ITEM 1A: RISK FACTORS

We are dependent on franchise renewals.

Each of our franchise agreements is 10 years long. At the end of the term of each franchise agreement, each franchisee may, if certain conditions are met, "renew" the franchise relationship by signing a new 10-year franchise agreement. As of December 30, 2017 each of our five franchised retail brands have the following number of franchise agreements that will expire over the next three years:

	2018	2019	2020

Plato’s Closet	30	45	46
Once Upon A Child	16	27	29
Play It Again Sports	13	16	26
Music Go Round	3	4	2
Style Encore	—	—	—
	62	92	103

We believe that renewing a significant number of these franchise relationships is important to our continued success. If a significant number of franchise relationships are not renewed, our financial performance would be materially and adversely impacted.

We are dependent on new franchisees.

Our ability to generate increased revenue and achieve higher levels of profitability depends in part on increasing the number of franchises open. Unfavorable macro-economic conditions may affect the ability of potential franchisees to obtain external financing and/or impact their net worth, both of which could lead to a lower level of openings than we have historically experienced. There can be no assurance that we will sustain our current level of franchise openings.

We are in the early stages of a new franchising initiative.

We are currently investing in a new initiative to provide consulting services, support and capital to emerging franchisors. There can be no assurance that we will be successful in this undertaking and that it will not have a negative impact on our financial performance.

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We may make additional investments outside of our core businesses.

From time to time, we have and may continue to make investments both inside and outside of our current businesses. To the extent that we make additional investments that are not successful, such investments could have a material adverse impact on our financial results.

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

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

Our retail franchisees are dependent on supply of used merchandise.

Our retail brands are based on offering customers a mix of used and new merchandise. As a result, the ability of our franchisees to obtain continuing supplies of high quality used merchandise is important to the success of our brands. Supply of used merchandise comes from the general public and is not regular or highly reliable. In addition, adherence to federal and state product safety and other requirements may limit the amount of used merchandise available to our franchisees. In addition to laws and regulations that apply to businesses generally, our franchised retail stores may be subject to state or local statutes or ordinances that govern secondhand dealers. There can be no assurance that our franchisees will avoid supply problems with respect to used merchandise.

We may be unable to collect accounts receivable from franchisees.

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

We operate in extremely competitive industries.

Retailing, including the sale of teenage, children's and women's apparel, sporting goods and musical instruments, is highly competitive. Many retailers have significantly greater financial and other resources than us and our franchisees. Individual franchisees face competition in their markets from retailers of new merchandise and, in certain instances, resale, thrift and other stores that sell used merchandise. We may face additional competition as our franchise systems expand and if additional competitors enter the used merchandise market.

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

We are subject to credit risk in our lease portfolio and our allowance for credit losses may be inadequate to absorb losses.

In our leasing business, if we inaccurately assess the creditworthiness of our customers, we may experience a higher number of lease defaults than expected, which would reduce our earnings. For our middle-market customers, we serve a wide range of businesses from smaller companies that may be financed by venture capital investors to larger organizations that may be financed by private equity firms and larger independent public or private companies. In many cases, our credit analysis relies on the customer's current or projected financials. If we fail to adequately assess the risks of our customer's business plans, we may experience credit losses. For our small-ticket customers, there is typically only limited publicly available financial and other information about their businesses. Accordingly, in making credit decisions, we rely upon the accuracy of information from the small business owner and/or third party sources, such as credit reporting agencies. If the information we obtain from small business owners and/or third party sources is incorrect, our ability to make appropriate credit decisions will be impaired.

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We may incur concentration of credit risk in our lease portfolio. As of December 30, 2017, leased assets with one customer represented approximately 30% of our total net investment in leases.

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

Deterioration in economic or business conditions may negatively impact our leasing business.

In an economic slowdown or recession, our equipment leasing businesses may face an increase in delinquent payments, lease defaults and credit losses. The volume of leasing business for our new and existing customers may decline, as well as the credit quality of our customers. Because we extend credit to many emerging and leveraged companies through our subsidiary Winmark Capital Corporation and primarily to small businesses through our subsidiary Wirth Business Credit, Inc., our customers may be particularly susceptible to economic slowdowns or recessions.   Any protracted economic slowdowns or recessions may make it difficult for us to maintain the volume of lease originations for new and existing customers, and may deteriorate the credit quality of new leases. Any of these events may slow the growth of our leasing portfolio and impact the profitability of our leasing operations.

We are subject to restrictions in our line of credit and note facilities. Additionally, we are subject to counter party risk in our line of credit facility.

The terms of our $50.0 million line of credit and $37.5 million note facility impose certain operating and financial restrictions on us and require us to meet certain financial tests including tests related to minimum levels of debt service coverage and tangible net worth and maximum levels of leverage. As of December 30, 2017, we were in compliance with all of our financial covenants under these facilities; however, failure to comply with these covenants in the future may result in default under one or both of these sources of capital and could result in acceleration of the related indebtedness. Any such acceleration of indebtedness would have an adverse impact on our business activities and financial condition.

Sustained credit market deterioration could jeopardize the counterparty obligations of one or both of the banks participating in our line of credit facility, which could have an adverse impact on our business if we are not able to replace such credit facility or find other sources of liquidity on acceptable terms.

We have indebtedness.

We incurred indebtedness in connection with the purchase of shares in the 2015 Tender Offer and the 2017 Tender Offer (see Note 6 — "Shareholders' Equity (Deficit)" and Note 7 — "Debt"). We expect to generate the cash necessary to pay our expenses, finance our leasing business and to pay the principal and interest on all of our outstanding debt from cash flows provided by operating activities and by opportunistically using other means to repay or refinance our obligations as we determine appropriate. Our ability to pay our expenses, finance our leasing business and meet our debt service obligations depends on our future performance, which may be affected by financial, business, economic, and other factors. If we do not have enough money to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell assets, borrow more money or raise equity. In such an event, we may not be able to refinance our debt, sell assets, borrow more money or raise equity on terms acceptable to us or at all. Also, our ability to carry out any of these activities on favorable terms, if at all, may be further impacted by any financial or credit crisis which may limit access to the credit markets and increase our cost of capital.

We are subject to government regulation.

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

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Additional legislation, both at the federal and state levels, could expand pre-sale disclosure requirements, further regulate substantive aspects of the franchise relationship and require us to file our franchise offering circulars with additional states. Future franchise legislation could impose costs or other burdens on us that could have a material adverse impact on our operations. In addition, evolving labor and employment laws, rules and regulations could result in potential claims against us as a franchisor for labor and employment related liabilities that have historically been borne by franchisees.

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

We may be unable to protect against data security risks.

We have implemented security systems with the intent of maintaining the physical security of our facilities and protecting our employees, franchisees, lessees, customers', clients' and suppliers' confidential information and information related to identifiable individuals against unauthorized access through our information systems or by other electronic transmission or through the misdirection, theft or loss of physical media. These include, for example, the appropriate encryption of information. Despite such efforts, we are subject to potential breach of security systems which may result in unauthorized access to our facilities or the information we are trying to protect. Because the techniques used to obtain unauthorized access are constantly changing and becoming increasingly more sophisticated and often are not recognized until launched against a target, we may be unable to anticipate these techniques or implement sufficient preventative measures. If unauthorized parties gain physical access to one of our facilities or electronic access to our information systems or such information is misdirected, lost or stolen during transmission or transport, any theft or misuse of such information could result in, among other things, unfavorable publicity, governmental inquiry and oversight, difficulty in marketing our services, allegations by our customers and clients that we have not performed our contractual obligations, litigation by affected parties and possible financial obligations for damages related to the theft or misuse of such information, any of which could have a material adverse effect on our business.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

ITEM 2: PROPERTIES

We lease 41,016 square feet at our headquarters facility in Minneapolis, Minnesota. We are obligated to pay rent monthly under the lease, and will pay an average of $664,000 annually over the remaining term that expires in 2019. We are also obligated to pay estimated taxes and operating expenses as described in the lease, which change annually. The total rentals, taxes and operating expenses paid may increase if we exercise any of our rights to acquire additional space described in the lease. We are in the process of renewing the lease for our headquarters facility, and our facilities are sufficient to meet our current and immediate future needs.

ITEM 3: LEGAL PROCEEDINGS

We are not a party to any material litigation and are not aware of any threatened litigation that would have a material adverse effect on our business.

ITEM 4: MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

Market Information, Holders, Dividends

Winmark Corporation's common stock trades on the NASDAQ Global Market under the symbol "WINA". The table below sets forth the high and low sales prices of our common stock as reported by NASDAQ for the quarterly periods indicated:

FY 2017:	First	Second	Third	Fourth
High	$ 127.50	$ 137.75	$ 136.90	$ 139.05
Low	$ 109.90	$ 112.00	$ 124.70	$ 121.55

FY 2016:	First	Second	Third	Fourth
High	$ 101.61	$ 102.00	$ 109.49	$ 133.08
Low	$ 88.00	$ 91.26	$ 92.12	$ 102.55

At March 5, 2018, there were 3,849,506 shares of common stock outstanding held by approximately 66 shareholders of record. Shareholders of record do not include holders who beneficially own common stock held in nominee or "street name".

We declared and paid cash dividends per common share of the following amounts in each of the quarterly periods indicated:

	First	Second	Third	Fourth
FY 2017:	$ 0.10	$ 0.11	$ 0.11	$ 0.11
FY 2016:	$ 0.07	$ 0.10	$ 0.10	$ 0.10

Any future declaration of dividends will be subject to the discretion of our Board of Directors and subject to our results of operations, financial condition, cash requirements, compliance with loan covenants and other factors deemed relevant by our Board of Directors.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan(1)	Maximum Number of Shares that may yet be Purchased Under the Plan
October 1, 2017 to November 4, 2017	—	$ —	—	142,988
November 5, 2017 to December 2, 2017	—	$ —	—	142,988
December 3, 2017 to December 30, 2017	—	$ —	—	142,988

(1) The Board of Directors' authorization for the repurchase of shares of the Company's common stock was originally approved in 1995 with no expiration date. The total shares approved for repurchase has been increased by additional Board of Directors' approvals and is currently limited to 5,000,000 shares, of which 142,988 may still be repurchased.

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Performance Graph

In accordance with the rules of the SEC, the following graph compares the performance of our common stock on the NASDAQ Stock Market to the NASDAQ US Benchmark TR composite index and to the NASDAQ US Benchmark Retail TR industry index, of which we are a component. The graph compares on an annual basis the cumulative total shareholder return on $100 invested on December 29, 2012 through our fiscal year ended December 30, 2017 and assumes reinvestment of all dividends. The performance graph is not necessarily indicative of future investment performance.

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ITEM 6: SELECTED FINANCIAL DATA

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

	Fiscal Year Ended (in thousands except per share data)				
	December 30, 2017	December 31, 2016	December 26, 2015	December 27, 2014	December 28, 2013
Revenue:					
Royalties	$ 45,644	$ 43,995	$ 41,908	$ 38,972	$ 36,344
Leasing income	18,470	17,283	21,566	16,247	14,524
Merchandise sales	2,572	2,217	2,817	2,729	2,327
Franchise fees	1,530	1,625	1,788	1,990	1,459
Other	1,530	1,460	1,369	1,241	1,077
Total revenue	69,746	66,580	69,448	61,179	55,731
Cost of merchandise sold	2,433	2,101	2,653	2,620	2,206
Leasing expense	3,269	2,324	5,759	1,631	1,592
Provision for credit losses	9	18	(150)	63	(45)
Selling, general and administrative expenses	25,251	23,836	24,095	23,806	22,198
Income from operations	38,784	38,301	37,091	33,059	29,780
Interest expense	(2,366)	(2,343)	(1,802)	(484)	(213)
Interest and other income (expense)	13	(12)	(64)	14	23
Income before income taxes	36,431	35,946	35,225	32,589	29,590
Provision for income taxes	(11,866)	(13,728)	(13,425)	(12,522)	(11,358)
Net income	$ 24,565	$ 22,218	$ 21,800	$ 20,067	$ 18,232
Earnings per common share - diluted	$ 5.66	$ 5.13	$ 4.69	$ 3.85	$ 3.48
Weighted average shares outstanding - diluted	4,340	4,330	4,652	5,217	5,241
Cash dividends per common share	$ 0.43	$ 0.37	$ 0.27	$ 5.23	$ 0.19
Balance Sheet Data:					
Working capital	$ 11,912	$ 15,436	$ 16,920	$ 3,857	$ 24,376
Total assets	48,405	48,582	47,406	54,728	53,036
Total debt	67,588	45,400	66,400	18,500	—
Shareholders' equity (deficit)	(30,678)	(7,852)	(30,674)	21,610	38,145
Selected Financial Ratios:					
Return on average assets	50.7 %	46.3 %	42.7 %	37.2 %	37.8 %

Return on average equity	N/A	%	N/A	%	N/A	%	67.2	%	65.0	%

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

As of December 30, 2017, we had 1,211 franchises operating under the Plato's Closet, Once Upon A Child, Play It Again Sports, Style Encore and Music Go Round brands and had a leasing portfolio of $41.3 million. Management closely tracks the following financial criteria to evaluate current business operations and future prospects: royalties, leasing activity, and selling, general and administrative expenses.

Our most significant source of franchising revenue is royalties received from our franchisees. During 2017, our royalties increased $1.6 million or 3.7% compared to 2016.

Leasing income net of leasing expense in 2017 was $15.2 million compared to $15.0 million in 2016. Fluctuations in period-to-period leasing income and leasing expense result primarily from the manner and timing in which leasing income and leasing expense is recognized over the term of each particular lease in accordance with accounting guidance

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applicable to leasing. For this reason, we believe that more meaningful levels of leasing activity are the purchases of equipment for lease customers and the medium- to long-term trend in the size of the leasing portfolio. During 2017, we purchased $25.4 million in equipment for lease customers compared to $26.2 million in 2016 and $22.2 million in 2015. Our leasing portfolio (net investment in leases — current and long-term) was $41.3 million at December 30, 2017 compared to $41.4 million at December 31, 2016 and $39.0 million at December 26, 2015.

Management continually monitors the level and timing of selling, general and administrative expenses. The major components of selling, general and administrative expenses include salaries, wages and benefits, advertising, travel, occupancy, legal and professional fees. During 2017, selling, general and administrative expense increased $1.4 million, or 5.9%, compared to the same period last year.

Management also monitors several nonfinancial factors in evaluating the current business operations and future prospects including franchise openings and closings and franchise renewals. The following is a summary of our franchising activity for the fiscal year ended December 30, 2017:

	TOTAL 12/31/2016	OPENED	CLOSED	TOTAL 12/30/2017	AVAILABLE FOR RENEWAL	COMPLETED RENEWALS	% RENEWED	
Plato's Closet Franchises - US and Canada	468	14	(6)	476	26	26	100	%
Once Upon A Child Franchises - US and Canada	348	18	(6)	360	24	24	100	%
Play It Again Sports Franchises - US and Canada	283	6	(8)	281	18	17	94	%
Style Encore Franchises - US and Canada	52	11	(2)	61	—	—	N/A	
Music Go Round	35	—	(2)	33	4	4	100	%

Franchises - US								
Total Franchised Stores	1,186	49	(24)	1,211	72	71	99	%

Renewal activity is a key focus area for management. Our franchisees sign 10-year agreements with us. The renewal of existing franchise agreements as they approach their expiration is an indicator that management monitors to determine the health of our business and the preservation of future royalties. In 2017, we renewed 99% of franchise agreements up for renewal. This percentage of renewal has ranged between 97% and 100% during the last three years.

Our ability to grow our operating income is dependent on our ability to: (i) effectively support our franchise partners so that they produce higher revenues, (ii) open new franchises, (iii) increase lease originations and minimize write-offs in our leasing portfolios, and (iv) control our selling, general and administrative expenses. A detailed description of the risks to our business along with other risk factors can be found in Item 1A “Risk Factors”.

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Results of Operations

The following table sets forth selected information from our Consolidated Statements of Operations expressed as a percentage of total revenue and the percentage change in the dollar amounts from the prior period:

	Fiscal Year Ended December 30, 2017		December 31, 2016		December 26, 2015		Fiscal 2017 over (under) 2016		Fiscal 2016 over (under) 2015	
Revenue:										
Royalties	65.4	%	66.1	%	60.3	%	3.7	%	5.0	%
Leasing income	26.5		26.0		31.0		6.9		(19.9)	
Merchandise sales	3.7		3.3		4.1		16.0		(21.3)	
Franchise fees	2.2		2.4		2.6		(5.9)		(9.1)	
Other	2.2		2.2		2.0		4.8		6.6	
Total revenue	100.0		100.0		100.0		4.8		(4.1)	
Cost of merchandise sold	(3.5)		(3.2)		(3.8)		15.8		(20.8)	
Leasing expense	(4.7)		(3.5)		(8.3)		40.7		(59.7)	
Provision for credit losses	—		—		0.2		(51.4)		112.4	
Selling, general and administrative expenses	(36.2)		(35.8)		(34.7)		5.9		(1.1)	
Income from operations	55.6		57.5		53.4		1.3		3.3	
Interest expense	(3.4)		(3.5)		(2.6)		1.0		30.0	
Interest and other income (expense)	—		—		(0.1)		205.7		(80.8)	
Income before income taxes	52.2		54.0		50.7		1.3		2.0	
Provision for income taxes	(17.0)		(20.6)		(19.3)		(13.6)		2.3	
Net income	35.2	%	33.4	%	31.4	%	10.6	%	1.9	%

Revenue

Revenues for the year ended December 30, 2017 totaled $69.7 million compared to $66.6 million and $69.4 million for the comparable periods in 2016 and 2015, respectively.

Royalties and Franchise Fees

Royalties increased to $45.6 million for 2017 from $44.0 million for the same period in 2016, a 3.7% increase. The increase was due to higher Plato's Closet, Style Encore and Once Upon A Child royalties of $0.8 million, $0.5 million and $0.4 million, respectively. The increase in royalties for these brands is primarily from having 29 additional franchise stores across these brands in 2017 compared to 2016 and from higher franchisee retail sales. In 2016, royalties increased $2.1 million compared to 2015. This increase was primarily due to having 36 additional franchise stores in 2016 compared to 2015. Fiscal years 2017 and 2015 were 52-week years, while fiscal 2016 was a 53-week year, which also impacted the comparability of royalty revenue.

Franchise fees were $1.5 million for 2017 compared to $1.6 million for 2016 and $1.8 million for 2015. The decreases in franchise fees primarily resulted from opening fewer franchises. Franchise fees include initial franchise fees from the sale of new franchises and transfer fees related to the transfer of existing franchises. Franchise fee revenue is recognized when the franchise opens or when the franchise agreement is assigned to a buyer of a franchise. An overview of retail brand franchise fees is presented in the Franchising subsection of the Business section (Item 1).

Leasing Income

Leasing income increased to $18.5 million in 2017 compared to $17.3 million for the same period in 2016. The increase is primarily due to a higher level of equipment sales to customers. Leasing income in 2016 decreased $4.3 million compared to 2015 primarily due to a lower level of equipment sales to customers.

Merchandise Sales

Merchandise sales include the sale of product to franchisees either through our Computer Support Center or through the Play It Again Sports buying group (together, "Direct Franchisee Sales"). Direct Franchisee Sales increased to $2.6

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million in 2017 from $2.2 million in 2016. The increase is primarily due to an increase in technology purchases by our franchisees. Direct Franchisee Sales in 2016 decreased $0.6 million compared to 2015 as a result of decreased technology purchases by our franchisees.

Cost of Merchandise Sold

Cost of merchandise sold includes in-bound freight and the cost of merchandise associated with Direct Franchisee Sales. Cost of merchandise sold increased to $2.4 million in 2017 from $2.1 million in 2016. The increase was due to an increase in Direct Franchisee Sales in 2017 discussed above. Cost of merchandise sold in 2016 decreased $0.6 million compared to 2015 due to a decrease in Direct Franchisee Sales in 2016 discussed above. Cost of merchandise sold as a percentage of Direct Franchisee Sales for 2017, 2016 and 2015 was 94.6%, 94.8% and 94.2%, respectively.

Leasing Expense

Leasing expense increased to $3.3 million in 2017 compared to $2.3 million in 2016. The increase is primarily due to an increase in the associated costs of equipment sales to customers discussed above. Leasing expense in 2016 decreased $3.5 million compared to 2015 due to a decrease in the associated cost of equipment sales to customers discussed above.

Provision for Credit Losses

Provision for credit losses was $9,000 in 2017 compared to $18,500 in 2016 and $(149,700) in 2015. The provision level for 2015 was impacted by net recoveries in the leasing portfolio.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 5.9% to $25.3 million in 2017 from $23.8 million in 2016. The increase was primarily due to increases in compensation and benefit expenses, advertising production and outside services, inclusive of amounts related to our launch of Winmark Franchise Partners. The $0.3 million, or 1.1%, decrease in selling, general and administrative expenses in 2016 compared to 2015 was primarily due to decreases in compensation and benefit expenses.

Interest Expense

Interest expense increased to $2.4 million in 2017 compared to $2.3 million in 2016. The increase is primarily due to higher average interest rates on corporate borrowings during 2017 when compared to 2016. Interest expense in 2016 increased $0.5 million compared to 2015 due to higher average corporate borrowings during 2016 when compared to 2015.

Interest and Other Income (Expense)

During 2017, we had interest and other income of $12,900 compared to $(12,200) and $(63,700) of interest and other expense in 2016 and 2015, respectively. Income and other expense in 2015 included losses on sales of marketable securities.

Income Taxes

The provision for income taxes was calculated at an effective rate of 32.6%, 38.2% and 38.1% for 2017, 2016 and 2015, respectively. The lower effective rate in 2017 compared to 2016 is primarily due to the impact of the change in the federal rate from 35% to 21% on our deferred tax assets and liabilities (See Note 10 – "Income Taxes") and from a tax benefit on the exercise of non-qualified stock options as a result of our adoption of a new accounting standard (ASU 2016-09) in 2017. (See Note 2 – "Recently Adopted Accounting Pronouncements"). The higher effective rate for 2016 compared to 2015 is primarily due to an increase in state taxes.

In future periods, we expect the above referenced reduction in federal tax rate to provide us with the benefit of a lower effective tax rate than we experienced in 2017, 2016 and 2015.

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Segment Comparison of Fiscal Years 2017, 2016 and 2015

We currently have two reportable business segments, franchising and leasing. The franchising segment franchises value-oriented retail store concepts that buy, sell, trade and consign merchandise as well as provides strategic consulting services related to franchising. The leasing segment includes (i) Winmark Capital Corporation, our middle-market equipment leasing business and (ii) Wirth Business Credit, Inc., our small-ticket financing business. Segment reporting is intended to give financial statement users a better view of how we manage and evaluate our businesses. Our internal management reporting is the basis for the information disclosed for our business segments and includes allocation of shared-service costs. The following tables summarize financial information by segment and provide a reconciliation of segment contribution to income from operations:

	Year Ended December 30, 2017	December 31, 2016	December 26, 2015
Revenue:			
Franchising	$ 51,275,700	$ 49,296,700	$ 47,882,100
Leasing	18,470,200	17,283,600	21,565,700
Total revenue	$ 69,745,900	$ 66,580,300	$ 69,447,800
Reconciliation to income from operations:			
Franchising segment contribution	$ 29,493,500	$ 28,650,400	$ 26,891,000
Leasing segment contribution	9,291,100	9,650,600	10,199,700
Total income from operations	$ 38,784,600	$ 38,301,000	$ 37,090,700

Franchising Segment Operating Income

The franchising segment’s 2017 operating income increased by $0.8 million, or 2.9%, to $29.5 million from $28.7 million for 2016. The increase in segment contribution was primarily due to increased royalty revenues; partially offset by an increase in selling, general and administrative expenses. The $1.8 million increase in the franchising segment’s 2016 operating income from 2015 was primarily due to increased royalty revenues.

Leasing Segment Operating Income

The leasing segment’s operating income for 2017 decreased by $0.4 million, or 3.7%, to $9.3 million from $9.7 million for 2016. The decrease in segment contribution was due to an increase in selling, general and administrative expenses. The $0.5 million decrease in the leasing segment’s 2016 operating income from 2015 was due to a decrease in leasing income net of leasing expense.

Liquidity and Capital Resources

Our primary sources of liquidity have historically been cash flow from operations and borrowings. The components of the Consolidated Statements of Operations that reduce our net income but do not affect our liquidity include non-cash items for depreciation and compensation expense related to stock options.

We ended 2017 with $1.1 million in cash and cash equivalents compared to $1.3 million in cash and cash equivalents at the end of 2016.

Operating activities provided $25.2 million of cash during 2017 compared to $26.3 million provided during 2016 and $22.3 million provided during 2015. The decrease in cash provided by operating activities in 2017 compared to 2016 was primarily due to an increase in cash paid for income taxes. A contributing factor to the increase in cash provided by operating activities in 2016 compared to 2015 was a decrease in cash paid for income taxes.

Investing activities provided $0.1 million of cash during 2017 compared to $3.2 million used during 2016 and $4.5 million provided during 2015. Our most significant investing activities consist of the purchase of equipment for lease contracts and principal collections on lease receivables, as our franchising business is not capital intensive. Purchase of equipment for lease customers in 2017 was $25.4 million compared to $26.2 million in 2016 and $22.2 million in 2015.

During 2017, principal collections on lease receivables were $25.3 million compared to $23.0 million during 2016 and $26.6 million during 2015.

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Financing activities used $25.4 million of cash during 2017 compared to $22.8 million used during 2016 and $27.9 million used during 2015. Our most significant financing activities over the past three years have consisted of net borrowings/payments on our debt facilities, the payment of dividends, repurchase of common stock, and net proceeds received from the exercise of stock options. During 2015, we paid $1.2 million in cash dividends and used $74.9 million to purchase 881,518 shares of our common stock including $74.3 million to repurchase 875,000 shares of our common stock in a tender offer (the "2015 Tender Offer"). Net borrowings on our line of credit and notes payable of $47.9 million during 2015 were associated with these activities. During 2016, we made net payments on our Line of Credit and notes payable of $21.0 million, paid $1.5 million in cash dividends, repurchased 17,194 shares of our common stock for $1.6 million and received net proceeds from the exercise of stock options of $1.3 million. During 2017, we paid $1.8 million in cash dividends and used $49.9 million to purchase 400,000 shares of our common stock in a tender offer (the "2017 Tender Offer"). Net borrowings on our line of credit and notes payable of $22.2 million during 2017 were associated with these activities. (See Note 6 — "Shareholders' Equity (Deficit)" and Note 7 — "Debt").

We have debt obligations and future operating lease commitments for our corporate headquarters and satellite office space. As of December 30, 2017, we had no other material outstanding commitments. (See Note 11 — "Commitments and Contingencies"). The following table summarizes our significant future contractual obligations at December 30, 2017:

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations					
Line of Credit(1)(3)	$ 35,400,000	$ —	$ —	$ 35,400,000	$ —
Notes payable(2)(3)	39,901,500	4,906,400	9,788,100	10,445,300	14,761,700
Operating Lease Obligations	1,169,900	718,800	451,100	—	—
Total Contractual Obligations	$ 76,471,400	$ 5,625,200	$ 10,239,200	$ 45,845,300	$ 14,761,700

(1) In addition to the principal payments noted in the table, the Company will incur interest expense on such variable rate debt. Interest rates on amounts outstanding under the Line of Credit at December 30, 2017, ranged from 3.42% to 4.50%.

(2) Includes interest payable quarterly at rates ranging from 5.10% to 5.50% assuming principal payments in accordance with amortizing schedules.

(3) Refer to Part II, Item 8 in this report under Note 7 — "Debt" for additional information regarding long-term debt.

As of December 30, 2017, we had no off-balance sheet arrangements.

We have a revolving credit with CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) and BMO Harris Bank N.A. (the "Line of Credit").

In July 2017, the Line of Credit was amended to, among other things:

· Provide the consent of the lenders for the 2017 Tender Offer;
· Extend the termination date from May 14, 2019 to July 19, 2021;
· Amend the tangible net worth covenant calculation to remove the effect of the 2017 Tender Offer;
· Reduce the applicable margin on interest rate options in connection with LIBOR loans under the Line of Credit;
· Permit us to sell up to $15.0 million in term notes to one or more affiliates or managed accounts of Prudential to partially fund the 2017 Tender Offer.

During 2017, the Line of Credit was used to finance in part the 2017 Tender Offer and has been and will continue to be used for general corporate purposes. In July 2019 and each subsequent July thereafter through the term of the facility, the aggregate commitments under the Line of Credit automatically reduce by $5.0 million. The Line of Credit is secured by a lien against substantially all of our assets, contains customary financial conditions and covenants, and requires maintenance of minimum levels of debt service coverage and tangible net worth and maximum levels of leverage (all as defined within the Line of Credit). As of December 30, 2017, our borrowing availability under our Line of Credit was $50.0 million (the lesser of the borrowing base or the aggregate Line of Credit). There were $35.4 million in borrowings outstanding under the line of credit bearing interest ranging from 3.42% to 4.50%, leaving $14.6 million available for additional borrowings.

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The Line of Credit allows us to choose between two interest rate options in connection with our borrowings. The interest rate options are the Base Rate (as defined) and the LIBOR Rate (as defined) plus an applicable margin of 0% and 2.0% respectively. Interest periods for LIBOR borrowings can be one, two, three, six or twelve months, as selected by us. The Line of Credit also provides for non-utilization fees of 0.25% per annum on the daily average of the unused commitment.

We have a Note Agreement (the "Note Agreement") with Prudential Investment Management, Inc., its affiliates and managed accounts ("Prudential") that was entered into in May 2015.

In July 2017, the Note Agreement was amended to, among other things:

- Provide the consent of Prudential for the 2017 Tender Offer;
- Amend the tangible net worth covenant calculation to remove the effect of the 2017 Tender Offer;
- Provide for a new $12.5 million term loan to partially fund the 2017 Tender Offer.

In August 2017, we issued $12.5 million of Series B notes to finance in part the 2017 Tender Offer. As of December 30, 2017, with the $20.0 million in principal outstanding from the $25.0 million of Series A notes issued in May 2015, the aggregate principal outstanding under the Note Agreement was $32.2 million.

The final maturity of the Series A and Series B notes is 10 years from the issuance date. For the Series A notes, interest at a rate of 5.50% per annum on the outstanding principal balance is payable quarterly, along with required prepayments of the principal of $500,000 quarterly for the first five years, and $750,000 quarterly thereafter until the principal is paid in full. For the Series B notes, interest at a rate of 5.10% per annum on the outstanding principal balance is payable quarterly, along with required prepayments of the principal of $312,500 quarterly until the principal is paid in full. The Series A and Series B notes may be prepaid, at our option, in whole or in part (in a minimum amount of $1.0 million), but prepayments require payment of a Yield Maintenance Amount, as defined in the Note Agreement.

Our obligations under the Note Agreement are secured by a lien against substantially all of our assets, and the Note Agreement contains customary financial conditions and covenants, and requires maintenance of minimum levels of fixed charge coverage and tangible net worth and maximum levels of leverage (all as defined within the Note Agreement).

As of December 30, 2017, we were in compliance with all of the financial covenants under the Line of Credit and Note Agreement.

We incurred increased indebtedness in connection with the purchase of shares in the Tender Offer and, as a result, are more leveraged. We expect to generate the cash necessary to pay our expenses, finance our leasing business and to pay the principal and interest on all of our outstanding debt from cash flows provided by operating activities and by opportunistically using other means to repay or refinance our obligations as we determine appropriate. Our ability to pay our expenses, finance our leasing business and meet our debt service obligations depends on our future performance, which may be affected by financial, business, economic, and other factors including the risk factors described under Item 1A of this report. If we do not have enough money to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell assets, borrow more money or raise equity. In such an event, we may not be able to refinance our debt, sell assets, borrow more money or raise equity on terms acceptable to us or at all. Also, our ability to carry out any of these activities on favorable terms, if at all, may be further impacted by any financial or credit crisis which may limit access to the credit markets and increase our cost of capital.

We may utilize discounted lease financing to provide funds for a portion of our leasing activities. Rates for discounted lease financing reflect prevailing market interest rates and the credit standing of the lessees for which the payment stream of the leases are discounted. We believe that discounted lease financing will continue to be available to us at competitive rates of interest through the relationships we have established with financial institutions.

We believe that the combination of our cash on hand, the cash generated from our franchising business, cash generated from discounting sources and our Line of Credit will be adequate to fund our planned operations through 2018.

Critical Accounting Policies

The Company prepares the consolidated financial statements of Winmark Corporation and Subsidiaries in conformity with accounting principles generally accepted in the United States of America. As such, the Company is required to

make certain estimates, judgments and assumptions that it believes are reasonable based on information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. There can be no assurance that actual results will not differ from these estimates. The critical accounting policies that the Company believes are most important to aid in fully understanding and evaluating the reported financial results include the following:

Revenue Recognition — Royalty Revenue and Franchise Fees

The Company collects royalties from each retail franchise based on a percentage of retail store gross sales. The Company recognizes royalties as revenue when earned. At the end of each accounting period, estimates of royalty amounts due are made based on applying historical weekly sales information to the number of weeks of unreported franchisee sales. If there are significant changes in the actual performance of franchisees versus the Company's estimates, its royalty revenue would be impacted. During 2017, the Company collected $52,200 less than it estimated at December 31, 2016. As of December 30, 2017, the Company's royalty receivable was $1,574,500.

The Company collects initial franchise fees when franchise agreements are signed and recognizes the initial franchise fees as revenue when the franchise is opened, which is when the Company has performed substantially all initial services required by the franchise agreement. Franchise fees collected from franchisees but not yet recognized as income are recorded as deferred revenue in the liability section of the consolidated balance sheet. As of December 30, 2017, deferred franchise fees were $1,267,100.

Leasing Income Recognition

Leasing income for direct financing leases is recognized under the effective interest method. The effective interest method of income recognition applies a constant rate of interest equal to the internal rate of return on the lease. Generally, when a lease is more than 90 days delinquent (when more than three monthly payments are owed), the lease is classified as being on non-accrual and the Company stops recognizing leasing income on that date. Payments received on leases in non-accrual status generally reduce the lease receivable. Leases on non-accrual status remain classified as such until there is sustained payment performance that, in the Company's judgment, would indicate that all contractual amounts will be collected in full.

In certain circumstances, the Company may re-lease equipment in its existing portfolio. As this equipment may have a fair value greater than its carrying amount when re-leased, the Company may be required to account for the lease as a sales-type lease. At inception of a sales-type lease, revenue is recorded that consists of the present value of the future minimum lease payments discounted at the rate implicit in the lease. In subsequent periods, the recording of income is consistent with the accounting for a direct financing lease.

For leases that are accounted for as operating leases, income is recognized on a straight-line basis when payments under the lease contract are due.

Allowance for Credit Losses

The Company maintains an allowance for credit losses at an amount that it believes to be sufficient to absorb losses inherent in its existing lease portfolio as of the reporting dates. Leases are collectively evaluated for potential loss. The Company's methodology for determining the allowance for credit losses includes consideration of the level of delinquencies and non-accrual leases, historical net charge-off amounts and review of any significant concentrations.

A provision is charged against earnings to maintain the allowance for credit losses at the appropriate level. If the actual results are different from the Company's estimates, results could be different. The Company's policy is to charge-off against the allowance the estimated unrecoverable portion of accounts once they reach 121 days delinquent. (See Note 4 — "Investment in Leasing Operations").

Stock-Based Compensation

The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of the awards on the date of grant using an option-pricing model is affected by stock price as well as assumptions regarding a number of complex and subjective variables. These variables include implied

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volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

The Company evaluates the assumptions used to value awards on an annual basis. If factors change and the Company employs different assumptions for estimating stock-based compensation expense in future periods or if the Company decides to use a different valuation model, the future periods may differ significantly from what it has recorded in the current period and could materially affect operating income, net income and earnings per share.

Recent Accounting Pronouncements

See Note 2, “Significant Accounting Policies — Recent Accounting Pronouncements”.

Outlook

Forward Looking Statements

The statements contained Item 1 “Business”, Item 1A “Risk Factors”, in this Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, and in Item 8 “Financial Statements and Supplemental Data” that are not strictly historical fact, including without limitation, the Company’s statements relating to growth opportunities, its ability to open new franchises, its ability to manage costs in the future, the number of franchises it believes will open, growth and performance of its lease portfolio, prospects for and anticipated revenue streams for Winmark Franchise Partners, its future cash requirements, its future effective tax rate, allowance for credit losses and its belief that it will have adequate capital and reserves to meet its current and contingent obligations and operating needs, as well as its disclosures regarding market rate risk, are forward looking statements made under the safe harbor provision of the Private Securities Litigation Reform Act. Such statements are based on management’s current expectations as of the date of this report but involve risks, uncertainties and other factors which may cause actual results to differ materially from those contemplated by such forward looking statements. Investors are cautioned to consider these forward looking statements in light of important factors which may result in material variations between results contemplated by such forward looking statements and actual results and conditions including, but not limited to, the risk factors discussed in Section 1A of this report. You should not place undue reliance on these forward-looking statements, which speak only as of the date they were made. The Company undertakes no obligation to revise or update publicly any forward-looking statement for any reason.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company incurs financial markets risk in the form of interest rate risk. Risk can be quantified by measuring the financial impact of a near-term adverse increase in short-term interest rates. At December 30, 2017, the Company had available a $50.0 million line of credit with CIBC Bank USA and BMO Harris Bank N.A. The interest rates applicable to this agreement are based on either the bank's base rate or LIBOR for short-term borrowings (twelve months or less). The Company had $35.4 million of debt outstanding at December 30, 2017 under this line of credit, all of which was in the form of short-term borrowings subject to daily changes in the bank's base rate or LIBOR. The Company's earnings would be affected by changes in these short-term interest rates. With the Company's borrowings at December 30, 2017, a one percent increase in short-term rates would reduce annual pretax earnings by $354,000. The Company had no interest rate derivatives in place at December 30, 2017.

None of the Company's cash and cash equivalents at December 30, 2017 was invested in money market mutual funds, which are subject to the effects of market fluctuations in interest rates.

Foreign currency transaction gains and losses were not material to the Company's results of operations for the year ended December 30, 2017, as less than 6% of the Company's total revenues and 1% of expenses were denominated in a foreign currency. Based upon these revenues and expenses, a 10% increase or decrease in the foreign currency exchange rates would impact annual pretax earnings by approximately $365,000. To date, the Company has not entered into any foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

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ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Winmark Corporation and Subsidiaries

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WINMARK CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	December 30, 2017	December 31, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,073,200	$ 1,252,900
Marketable securities	—	199,900
Receivables, less allowance for doubtful accounts of $400 and $2,100	1,796,000	1,479,200
Restricted cash	90,000	40,000
Net investment in leases - current	15,332,300	17,004,800
Income tax receivable	2,161,800	1,678,800
Inventories	97,100	87,500
Prepaid expenses	814,800	1,050,700
Total current assets	21,365,200	22,793,800
Net investment in leases — long-term	25,945,300	24,410,700
Property and equipment:		
Furniture and equipment	2,895,200	2,866,600
Building and building improvements	1,447,200	1,447,200
Less - accumulated depreciation and amortization	(3,855,600)	(3,544,200)
Property and equipment, net	486,800	769,600
Goodwill	607,500	607,500
	$ 48,404,800	$ 48,581,600
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Notes payable, net of unamortized debt issuance costs of $13,900 and $10,000	$ 3,236,100	$ 1,990,000
Accounts payable	2,073,000	1,692,000
Accrued liabilities	1,837,300	1,811,100
Discounted lease rentals	570,800	—
Deferred revenue	1,736,200	1,864,700
Total current liabilities	9,453,400	7,357,800
Long-term Liabilities:		
Line of credit	35,400,000	23,400,000
Notes payable, net of unamortized debt issuance costs of $96,500 and $73,500	28,841,000	19,926,500
Discounted lease rentals	1,121,600	—
Deferred revenue	1,465,500	1,423,800
Other liabilities	845,000	993,600
Deferred income taxes	1,956,500	3,331,900
Total long-term liabilities	69,629,600	49,075,800
Commitments and Contingencies	—	—

Shareholders’ Equity (Deficit):		
Common stock, no par value, 10,000,000 shares authorized, 3,843,078 and 4,165,769 shares issued and outstanding	1,476,200	2,976,100
Accumulated other comprehensive loss	—	(9,900)
Retained earnings (accumulated deficit)	(32,154,400)	(10,818,200)
Total shareholders' equity (deficit)	(30,678,200)	(7,852,000)
	$ 48,404,800	$ 48,581,600

The accompanying notes are an integral part of these consolidated financial statements.

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WINMARK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

	Fiscal Year Ended December 30, 2017	December 31, 2016	December 26, 2015
REVENUE:			
Royalties	$ 45,643,500	$ 43,994,900	$ 41,908,000
Leasing income	18,470,200	17,283,600	21,565,700
Merchandise sales	2,572,200	2,216,900	2,816,900
Franchise fees	1,529,700	1,624,800	1,788,100
Other	1,530,300	1,460,100	1,369,100
Total revenue	69,745,900	66,580,300	69,447,800
COST OF MERCHANDISE SOLD	2,432,600	2,101,400	2,653,100
LEASING EXPENSE	3,269,100	2,323,800	5,759,300
PROVISION FOR CREDIT LOSSES	9,000	18,500	(149,700)
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	25,250,600	23,835,600	24,094,400
Income from operations	38,784,600	38,301,000	37,090,700
INTEREST EXPENSE	(2,366,400)	(2,342,800)	(1,802,200)
INTEREST AND OTHER INCOME (EXPENSE)	12,900	(12,200)	(63,700)
Income before income taxes	36,431,100	35,946,000	35,224,800
PROVISION FOR INCOME TAXES	(11,866,000)	(13,728,400)	(13,425,100)
NET INCOME	$ 24,565,100	$ 22,217,600	$ 21,799,700
EARNINGS PER SHARE - BASIC	$ 6.06	$ 5.39	$ 4.89
EARNINGS PER SHARE - DILUTED	$ 5.66	$ 5.13	$ 4.69
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC	4,056,049	4,122,854	4,458,927
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED	4,339,944	4,330,490	4,651,527

The accompanying notes are an integral part of these consolidated financial statements.

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WINMARK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

	Fiscal Year Ended		
	December 30, 2017	December 31, 2016	December 26, 2015
NET INCOME	$ 24,565,100	$ 22,217,600	$ 21,799,700
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX:			
Unrealized net gains (losses) on marketable securities:			
Unrealized holding net gains (losses) arising during period	15,900	36,900	9,300
Reclassification adjustment for net gains included in net income	—	—	(2,300)
OTHER COMPREHENSIVE INCOME (LOSS), BEFORE TAX	15,900	36,900	7,000
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME:			
Unrealized net gains/losses on marketable securities:			
Unrealized holding net gains/losses arising during period	(6,000)	(13,900)	(3,700)
Reclassification adjustment for net gains included in net income	—	—	900
INCOME TAX (EXPENSE) BENEFIT RELATED TO ITEMS OF OTHER COMPREHENSIVE INCOME	(6,000)	(13,900)	(2,800)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	9,900	23,000	4,200
COMPREHENSIVE INCOME	$ 24,575,000	$ 22,240,600	$ 21,803,900

The accompanying notes are an integral part of these consolidated financial statements.

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WINMARK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity (Deficit)

Fiscal years ended December 30, 2017, December 31, 2016 and December 26, 2015

	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income (Loss)	Total
BALANCE, December 27, 2014	4,998,512	$ 422,400	$ 21,224,200	$ (37,100)	$ 21,609,500
Repurchase of common stock	(881,518)	(2,010,600)	(72,843,100)	—	(74,853,700)
Stock options exercised and related tax benefits	7,773	299,900	—	—	299,900
Compensation expense relating to stock options	—	1,694,800	—	—	1,694,800
Cash dividends	—	—	(1,228,200)	—	(1,228,200)
Comprehensive income	—	—	21,799,700	4,200	21,803,900
BALANCE, December 26, 2015	4,124,767	406,500	(31,047,400)	(32,900)	(30,673,800)
Repurchase of common stock	(17,194)	(1,112,300)	(461,600)	—	(1,573,900)
Stock options exercised and related tax benefits	58,196	1,905,300	—	—	1,905,300
Compensation expense relating to stock options	—	1,776,600	—	—	1,776,600
Cash dividends	—	—	(1,526,800)	—	(1,526,800)
Comprehensive income	—	—	22,217,600	23,000	22,240,600
BALANCE, December 31, 2016	4,165,769	2,976,100	(10,818,200)	(9,900)	(7,852,000)
Repurchase of common stock	(400,000)	(5,766,200)	(44,136,300)	—	(49,902,500)
Stock options exercised	77,309	2,309,700	—	—	2,309,700
Compensation expense relating to stock options	—	1,956,600	—	—	1,956,600
Cash dividends	—	—	(1,765,000)	—	(1,765,000)
Comprehensive income	—	—	24,565,100	9,900	24,575,000
BALANCE, December 30, 2017	3,843,078	$ 1,476,200	$ (32,154,400)	$ —	$ (30,678,200)

The accompanying notes are an integral part of these consolidated financial statements.

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WINMARK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Fiscal Year Ended		
	December 30, 2017	December 31, 2016	December 26, 2015
OPERATING ACTIVITIES:			
Net income	$ 24,565,100	$ 22,217,600	$ 21,799,700
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	355,400	420,500	432,600
Provision for credit losses	9,000	18,500	(149,700)
Compensation expense related to stock options	1,956,600	1,776,600	1,694,800
Deferred income taxes	(1,375,400)	(282,900)	(2,142,100)
(Gain) loss on sale of marketable securities	(1,400)	12,600	22,800
Loss from disposal of property and equipment	—	—	100
Deferred initial direct costs	(416,300)	(535,800)	(416,600)
Amortization of deferred initial direct costs	447,700	471,100	587,300
Tax benefits on exercised stock options	882,300	599,400	26,300
Change in operating assets and liabilities:			
Receivables	(316,800)	(62,300)	(88,700)
Restricted cash	(50,000)	(15,000)	(25,000)
Income tax receivable/payable	(1,371,300)	1,597,700	870,700
Inventories	(9,600)	(42,300)	48,300
Prepaid expenses	235,900	(372,900)	(210,400)
Other assets	—	—	70,000
Accounts payable	381,000	48,700	(312,200)
Accrued and other liabilities	(174,400)	(253,400)	(147,100)
Rents received in advance and security deposits	126,700	759,900	370,600
Deferred revenue	(86,800)	(96,300)	(105,600)
Net cash provided by operating activities	25,157,700	26,261,700	22,325,800
INVESTING ACTIVITIES:			
Proceeds from sale of marketable securities	217,200	52,200	299,000
Purchase of marketable securities	—	—	(75,800)
Purchase of property and equipment	(72,600)	(68,600)	(133,900)
Purchase of equipment for lease contracts	(25,403,200)	(26,211,100)	(22,192,800)
Principal collections on lease receivables	25,343,800	23,006,800	26,603,000
Net cash provided by (used for) investing activities	85,200	(3,220,700)	4,499,500
FINANCING ACTIVITIES:			
Proceeds from borrowings on line of credit	51,900,000	18,800,000	62,300,000
Payments on line of credit	(39,900,000)	(37,800,000)	(38,400,000)
Proceeds from borrowings on notes payable	12,500,000	—	25,000,000
Payments on notes payable	(2,312,500)	(2,000,000)	(1,000,000)
Repurchases of common stock	(49,902,500)	(1,573,900)	(74,853,700)
Proceeds from exercises of stock options	2,309,700	1,305,900	273,600

Dividends paid	(1,765,000)	(1,526,800)	(1,228,200)
Proceeds from discounted lease rentals	1,747,700	—	—
Net cash used for financing activities	(25,422,600)	(22,794,800)	(27,908,300)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(179,700)	246,200	(1,083,000)
Cash and cash equivalents, beginning of period	1,252,900	1,006,700	2,089,700
Cash and cash equivalents, end of period	$ 1,073,200	$ 1,252,900	$ 1,006,700
SUPPLEMENTAL DISCLOSURES:			
Cash paid for interest	$ 2,176,100	$ 2,296,000	$ 1,492,500
Cash paid for income taxes	$ 13,585,200	$ 11,801,400	$ 14,647,400

The accompanying notes are an integral part of these consolidated financial statements.

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WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

1. Organization and Business:

Winmark Corporation and subsidiaries (the Company) offers licenses to operate franchises using the service marks Plato's Closet®, Play It Again Sports®, Once Upon A Child®, Style Encore® and Music Go Round®. In addition, the Company sells point-of-sale system hardware to its franchisees and certain merchandise to its Play It Again Sports franchisees. The Company uses its Winmark Franchise Partners™ mark in connection with its strategic consulting and corporate development activities. The Company also operates both middle market and small-ticket equipment leasing businesses under the Winmark Capital® and Wirth Business Credit® marks. The Company has a 52/53-week fiscal year that ends on the last Saturday in December. Fiscal years 2017 and 2015 were 52-week fiscal years, while 2016 was a 53-week fiscal year.

Following is a summary of our franchising activity for the fiscal year ended December 30, 2017:

	12/31/2016	OPENED	CLOSED	12/30/2017
Plato's Closet				
Franchises - US and Canada	468	14	(6)	476
Once Upon A Child				
Franchises - US and Canada	348	18	(6)	360
Play It Again Sports				
Franchises - US and Canada	283	6	(8)	281
Style Encore				
Franchises - US and Canada	52	11	(2)	61
Music Go Round				
Franchises - US	35	—	(2)	33
Total Franchised Stores	1,186	49	(24)	1,211

2. Significant Accounting Policies:

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Winmark Capital Corporation, Wirth Business Credit, Inc. and Grow Biz Games, Inc. All material inter-company transactions have been eliminated in consolidation.

Cash Equivalents

Cash equivalents consist of highly liquid investments with an original maturity of three months or less when purchased. Cash equivalents are stated at cost, which approximates fair value. As of December 30, 2017 and December 31, 2016, the Company had $8,700 and $149,700 of cash located in Canadian banks. The Company holds its cash and cash equivalents with financial institutions and at times, such balances may be in excess of insurance limits.

Receivables

The Company provides an allowance for doubtful accounts on trade receivables. The allowance for doubtful accounts was $400 and $2,100 at December 30, 2017 and December 31, 2016, respectively. If receivables in excess of the provided allowance are determined uncollectible, they are charged to expense in the year the determination is made. Trade receivables are written off when they become uncollectible (which generally occurs when the franchise terminates and there is no reasonable expectation of collection), and payments subsequently received on such receivable are credited to the allowance for doubtful accounts. Historically, receivables balances written off have not exceeded allowances provided.

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Restricted Cash

The Company is required by certain states to maintain initial franchise fees in a restricted bank account until the franchise opens. The use of these funds by the Company is restricted until the franchise opens. Cash held in escrow totaled $90,000 and $40,000 at December 30, 2017 and December 31, 2016, respectively.

Investment in Leasing Operations

The Company uses the direct finance method of accounting to record income from direct financing leases. At the inception of a lease, the Company records the minimum future lease payments receivable, the estimated residual value of the leased equipment and the unearned lease income. Initial direct costs related to lease originations are deferred as part of the investment and amortized over the lease term. Unearned lease income is the amount by which the total lease receivable plus the estimated residual value exceeds the cost of the equipment.

Leasing Income Recognition

Leasing income for direct financing leases is recognized under the effective interest method. The effective interest method of income recognition applies a constant rate of interest equal to the internal rate of return on the lease. Generally, when a lease is more than 90 days delinquent (when more than three monthly payments are owed), the lease is classified as being on non-accrual and the Company stops recognizing leasing income on that date. Payments received on leases in non-accrual status generally reduce the lease receivable. Leases on non-accrual status remain classified as such until there is sustained payment performance that, in the Company's judgment, would indicate that all contractual amounts will be collected in full.

In certain circumstances, the Company may re-lease equipment in its existing portfolio. As this equipment may have a fair value greater than its carrying amount when re-leased, the Company may be required to account for the lease as a sales-type lease. At inception of a sales-type lease, revenue is recorded that consists of the present value of the

future minimum lease payments discounted at the rate implicit in the lease. In subsequent periods, the recording of income is consistent with the accounting for a direct financing lease.

For leases that are accounted for as operating leases, income is recognized on a straight-line basis when payments under the lease contract are due.

Leasing Expense

Leasing expense includes the cost of financing equipment purchases, the cost of equipment sales as well as depreciation expense for operating lease assets. Additionally, at inception of a sales-type lease, cost is recorded that consists of the equipment's book value, less the present value of its residual and is included in leasing expense.

Initial Direct Costs

The Company defers initial direct costs incurred to originate its leases in accordance with applicable accounting guidance. The initial direct costs deferred are part of the investment in leasing operations and are amortized using the effective interest method. Initial direct costs include commissions and costs associated with credit evaluation, recording guarantees and other security arrangements, documentation and transaction closing.

Lease Residual Values

Residual values reflect the estimated amounts to be received at lease termination from sales or other dispositions of leased equipment to unrelated parties. The leased equipment residual values are based on the Company's best estimate.

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Allowance for Credit Losses

The Company maintains an allowance for credit losses at an amount that it believes to be sufficient to absorb losses inherent in its existing lease portfolio as of the reporting dates. Leases are collectively evaluated for potential loss. The Company's methodology for determining the allowance for credit losses includes consideration of the level of delinquencies and non-accrual leases, historical net charge-off amounts and review of any significant concentrations.

A provision is charged against earnings to maintain the allowance for credit losses at the appropriate level. If the actual results are different from the Company's estimates, results could be different. The Company's policy is to charge-off against the allowance the estimated unrecoverable portion of accounts once they reach 121 days delinquent.

Inventories

The Company values its inventories at the lower of cost, as determined by the weighted average cost method, or market. Inventory consists of computer hardware and related accessories.

Impairment of Long-lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the carrying amount of the asset exceeds expected undiscounted future cash flows, the Company measures the amount of impairment by comparing the carrying amount of the asset to its fair value.

Property and Equipment

Property and equipment is stated at cost. Depreciation and amortization for financial reporting purposes is provided on the straight-line method. Estimated useful lives used in calculating depreciation and amortization are: three to five years for computer and peripheral equipment, five to seven years for furniture and equipment and the shorter of the lease term or useful life for leasehold improvements. Major repairs, refurbishments and improvements which significantly extend the useful lives of the related assets are capitalized. Maintenance and repairs, supplies and accessories are charged to expense as incurred.

Goodwill

The Company reviews its goodwill for impairment at its fiscal year end or whenever events or changes in circumstances indicate that there has been impairment in the value of its goodwill. No impairment was noted during the years ended December 30, 2017 and December 31, 2016. Goodwill of $607,500 in the consolidated balance sheets at December 30, 2017 and December 31, 2016 is all attributable to the Franchising segment.

Use of Estimates

The preparation of financial statements in conformity with generally accepted U.S. accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The ultimate results could differ from those estimates. The most significant estimates relate to allowance for credit losses. These estimates may be adjusted as more current information becomes available, and any adjustment could be significant.

Advertising

Advertising costs are charged to operating expenses as incurred. Advertising costs were $307,700, $200,300 and $199,300 for fiscal years 2017, 2016 and 2015, respectively.

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Accounting for Stock-Based Compensation

The Company recognizes the cost of all share-based payments to employees, including grants of employee stock options, in the consolidated financial statements based on the grant date fair value of those awards. This cost is recognized over the period for which an employee is required to provide service in exchange for the award.

The Company estimates the fair value of options granted using the Black-Scholes option valuation model. The Company estimates the volatility of its common stock at the date of grant based on its historical volatility rate. The Company's decision to use historical volatility was based upon the lack of actively traded options on its common stock. The Company estimates the expected term based upon historical option exercises. The risk-free interest rate assumption is based on observed interest rates for the expected term. The Company uses historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For options granted, the Company amortizes the fair value on a straight-line basis. All options are amortized over the vesting periods, which are generally four years beginning from the date of grant.

Revenue Recognition - Franchising

The Company collects royalties from each retail franchise based on a percentage of retail store gross sales. The Company recognizes royalties as revenue when earned. The Company collects initial franchise fees when franchise agreements are signed and recognizes the initial franchise fees as revenue when the franchise is opened, which is when the Company has performed substantially all initial services required by the franchise agreement. The Company had deferred franchise fee revenue of $1,267,100 and $1,545,900 at December 30, 2017 and December 31, 2016, respectively. The Company recognizes deferred software license fees over the 10-year life of the initial franchise agreement. The Company had deferred software license fees of $1,779,600 and $1,672,500 at December 30, 2017 and December 31, 2016, respectively. Merchandise sales are recognized when the product has been shipped to the franchisee.

Sales Tax

The Company’s accounting policy is to present taxes collected from customers and remitted to government authorities on a net basis.

Discounted Lease Rentals

The Company may utilize its lease rentals receivable and underlying equipment as collateral to borrow from financial institutions at fixed rates on a non-recourse basis. In the event of a default by a customer, the financial institution has a first lien on the underlying leased equipment, with no further recourse against the Company. Proceeds from discounting are recorded on the balance sheet as discounted lease rentals. As customers make payments, lease income and interest expense are recorded and discounted lease rentals are reduced by the effective interest method.

Earnings Per Share

The Company calculates earnings per share by dividing net income by the weighted average number of shares of common stock outstanding to arrive at the Earnings Per Share — Basic. The Company calculates Earnings Per Share — Diluted by dividing net income by the weighted average number of shares of common stock and dilutive stock equivalents from the potential exercise of stock options using the treasury stock method.

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The following table sets forth the presentation of shares outstanding used in the calculation of basic and diluted earnings per share ("EPS"):

	Year Ended December 30, 2017	December 31, 2016	December 26, 2015
Denominator for basic EPS — weighted average common shares	4,056,049	4,122,854	4,458,927
Dilutive shares associated with option plans	283,895	207,636	192,600
Denominator for diluted EPS — weighted average common shares and dilutive potential common shares	4,339,944	4,330,490	4,651,527
Options excluded from EPS calculation — anti-dilutive	24,516	31,590	22,459

Fair Value Measurements

The Company defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company uses three levels of inputs to measure fair value:

- Level 1 — quoted prices in active markets for identical assets and liabilities.
- Level 2 — observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3 — unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The Company's marketable securities were valued based on Level 1 inputs using quoted prices.

Due to their nature, the carrying value of cash equivalents, receivables, payables and debt obligations approximates fair value.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, which provides guidance for revenue recognition that supersedes existing revenue recognition guidance (but does not apply to nor supersede accounting guidance for lease contracts). The ASU's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The ASU should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. The new standard will become effective for the Company beginning with the first quarter of fiscal 2018. During 2016, the FASB issued four clarifications on specific topics within the new revenue recognition guidance that did not change the core principles of the guidance originally issued in May 2014.

The adoption of this guidance is not expected to impact the Company's recognition of leasing revenues or revenue from royalties that are based on a percentage of franchisee sales. Upon adoption, initial franchise fees, which are currently recognized upon the opening of a franchise, are expected to be deferred and recognized over the term of the underlying franchise agreement. The effect of the required deferral of initial franchise fees received in a given year will be mitigated by the recognition of revenue from fees retrospectively deferred from prior years. The Company presently expects to use the retrospective method of adoption when the new guidance is adopted in the first quarter of 2018. Upon adoption, the Company expects to recognize the deferral on its balance sheet of approximately $7 million in revenue from franchise fees, with a corresponding adjustment to retained earnings, net of deferred taxes.

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In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which provides guidance on accounting for leases that supersedes existing lease accounting guidance. The ASU's core principle is that a lessee should recognize lease assets and lease liabilities for those leases classified as operating leases under existing lease accounting guidance. The new standard also makes targeted changes to lessor accounting. This guidance is effective for reporting periods beginning after December 15, 2018, with early adoption permitted. The provisions of this guidance are to be applied using a modified retrospective approach, with elective reliefs, which requires application of the guidance for all periods presented. The Company is currently in the process of evaluating the impact of the adoption of this ASU on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments, which changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. This guidance will be effective for reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently in the process of evaluating the impact of the adoption of this ASU on the Company's consolidated financial statements.

Recently Adopted Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of accounting for stock based compensation, including excess tax benefits and deficiencies, forfeiture estimates and classification in the statements of cash flows. Upon adoption, any future excess tax benefits or deficiencies are recorded to the provision for income taxes in the consolidated statements of operations instead of recorded to equity in the consolidated balance sheets. This reclassification can have a material impact on the Company's provision for income taxes and effective tax rate, depending in part on whether significant stock option exercises occur. In addition, when applying the treasury stock method for computing diluted weighted average common shares, the assumed proceeds available for hypothetical repurchase of shares do not include any windfall tax benefits under the new ASU. As a result, outstanding option awards have a more dilutive effect on earnings per share. The Company adopted ASU 2016-09 in the first quarter of 2017, using a prospective approach. As a result of adopting the ASU, for the year ended December 30, 2017, the Company recognized $793,400 of excess tax benefits as a discrete tax benefit. The treatment of forfeitures has not changed as the Company will continue to estimate the number of forfeitures at the time of the option grant; therefore, there is no cumulative effect on retained earnings. The Company has elected to present the cash flows on a retrospective transition method with prior periods adjusted, which resulted in a reclassification of excess tax benefits for the years ended December 31, 2016 and December 26, 2015 of $599,400 and $26,300, respectively, from cash

flows from financing activities to cash flows from operating activities.

Reclassifications

Certain reclassifications of previously reported amounts have been made to conform to the current year presentation. Such reclassifications did not impact net income or shareholders' equity (deficit) as previously reported.

3. Investments:

Marketable Securities

The following is a summary of marketable securities classified as available-for-sale securities:

	December 30, 2017		December 31, 2016	
	Cost	Fair Value	Cost	Fair Value
Equity securities	$ —	$ —	$ 215,800	$ 199,900

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The Company's unrealized gains and losses for marketable securities classified as available-for-sale securities in accumulated other comprehensive income (loss) are as follows:

	Year Ended		
	December 30, 2017	December 31, 2016	December 26, 2015
Unrealized gains	$ —	$ —	$ —
Unrealized losses	—	(15,900)	(52,800)
Net unrealized losses	$ —	$ (15,900)	$ (52,800)

The Company's realized gains and losses recognized on sales of available-for-sale marketable securities are as follows:

	Year Ended		
	December 30, 2017	December 31, 2016	December 26, 2015
Realized gains	$ 10,300	$ —	$ 13,400
Realized losses	(8,900)	(12,600)	(36,200)
Net realized gains (losses)	$ 1,400	$ (12,600)	$ (22,800)

Amounts reclassified out of accumulated other comprehensive income (loss) into earnings is determined by using the average cost of the security when sold. Gross realized gains (losses) reclassified out of accumulated other comprehensive loss into earnings are included in Interest and Other Income (Expense) and the related tax benefits (expenses) are included in the Provision for Income Taxes lines of the Consolidated Statements of Operations.

4. Investment in Leasing Operations:

Investment in leasing operations consists of the following:

	December 30, 2017	December 31, 2016
Direct financing and sales-type leases:		
Minimum lease payments receivable	$ 36,119,700	$ 37,839,800
Estimated residual value of equipment	4,762,700	4,754,200
Unearned lease income net of initial direct costs deferred	(5,371,900)	(5,844,500)
Security deposits	(4,526,000)	(4,424,400)
Equipment installed on leases not yet commenced	10,989,700	9,961,600
Total investment in direct financing and sales-type leases	41,974,200	42,286,700
Allowance for credit losses	(711,200)	(896,000)
Net investment in direct financing and sales-type leases	41,263,000	41,390,700
Operating leases:		
Operating lease assets	1,045,400	800,700
Less accumulated depreciation and amortization	(1,030,800)	(775,900)
Net investment in operating leases	14,600	24,800
Total net investment in leasing operations	$ 41,277,600	$ 41,415,500

As of December 30, 2017, the $41.3 million total net investment in leases consists of $15.3 million classified as current and $26.0 million classified as long-term. As of December 31, 2016, the $41.4 million total net investment in leases consists of $17.0 million classified as current and $24.4 million classified as long-term.

As of December 30, 2017, leased assets with one customer approximated 26% of the Company’s total assets. As of December 31, 2016, leased assets with two customers approximated 19% and 17%, respectively, of the Company’s total assets.

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Future minimum lease payments receivable under lease contracts and the amortization of unearned lease income, net of initial direct costs deferred, is as follows as of December 30, 2017:

	Direct Financing and Sales-Type Leases	
Fiscal Year	Minimum Lease Payments Receivable	Income Amortization
2018	$ 20,679,500	$ 3,946,100
2019	12,413,200	1,296,900
2020	2,982,900	124,700
2021	18,000	2,300
2022	13,700	1,300
Thereafter	12,400	600
	$ 36,119,700	$ 5,371,900

The activity in the allowance for credit losses for leasing operations during 2017, 2016 and 2015, respectively, is as follows:

	December 30, 2017	December 31, 2016	December 26, 2015
Balance at beginning of period	$ 896,000	$ 859,100	$ 386,000
Provisions charged to expense	9,000	18,500	(149,700)
Recoveries	8,600	47,700	632,200
Deductions for amounts written-off	(202,400)	(29,300)	(9,400)
Balance at end of period	$ 711,200	$ 896,000	$ 859,100

The Company’s investment in direct financing and sales-type leases (“Investment In Leases”) and allowance for credit losses by loss evaluation methodology are as follows:

	December 30, 2017		December 31, 2016	
	Investment In Leases	Allowance for Credit Losses	Investment In Leases	Allowance for Credit Losses
Collectively evaluated for loss potential	$ 41,974,200	$ 711,200	$ 42,286,700	$ 896,000
Individually evaluated for loss potential	—	—	—	—
Total	$ 41,974,200	$ 711,200	$ 42,286,700	$ 896,000

The Company's key credit quality indicator for its investment in direct financing and sales-type leases is the status of the lease, defined as accruing or non-accrual. Leases that are accruing income are considered to have a lower risk of loss. Non-accrual leases are those that the Company believes have a higher risk of loss. The following table sets forth information regarding the Company's accruing and non-accrual leases. Delinquent balances are determined based on the contractual terms of the lease.

	December 30, 2017				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 40,657,500	$ 133,700	$ —	$ —	$ 40,791,200
Small-Ticket	1,183,000	—	—	—	1,183,000
Total Investment in Leases	$ 41,840,500	$ 133,700	$ —	$ —	$ 41,974,200

	December 31, 2016				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 41,299,600	$ —	$ —	$ —	$ 41,299,600
Small-Ticket	987,100	—	—	—	987,100
Total Investment in Leases	$ 42,286,700	$ —	$ —	$ —	$ 42,286,700

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5. Receivables:

The Company's current receivables consisted of the following:

	December 30, 2017	December 31, 2016
Trade	$ 9,800	$ 12,200
Royalty	1,574,500	1,302,700
Other	211,700	164,300
	$ 1,796,000	$ 1,479,200

The activity in the allowance for doubtful accounts for trade receivables is as follows:

	December 30, 2017	December 31, 2016	December 26, 2015
Balance at beginning of year	$ 2,100	$ 200	$ 1,600
Provisions charged to expense	(1,600)	2,800	1,500
Deductions for amounts written-off	(100)	(900)	(2,900)
Balance at end of year	$ 400	$ 2,100	$ 200

As part of its normal operating procedures, the Company requires Standby Letters of Credit as collateral for a portion of its trade receivables.

6. Shareholders' Equity (Deficit):

Dividends

In 2017, the Company declared and paid quarterly cash dividends totaling $0.43 per share ($1.8 million).

In 2016, the Company declared and paid quarterly cash dividends totaling $0.37 per share ($1.5 million).

In 2015, the Company declared and paid quarterly cash dividends totaling $0.27 per share ($1.2 million).

Repurchase of Common Stock

In July 2017, the Company's Board of Directors authorized the repurchase of up to 400,000 shares of our common stock for a price of $124.48 per share through a tender offer (the "2017 Tender Offer"). The 2017 Tender Offer began on the date of the announcement, July 19, 2017 and expired on August 16, 2017. Upon expiration, the Company accepted for payment 400,000 shares for a total purchase price of approximately $49.9 million, including fees and expenses related to the 2017 Tender Offer. The 2017 Tender Offer was financed by net borrowings under the Line of Credit and Notes Payable. (See Note 7 – "Debt").

In 2016 the Company purchased 17,194 shares of our common stock for an aggregate purchase price of $1.6 million or $91.54 per share.

In April 2015, the Company's Board of Directors authorized the repurchase of up to 875,000 shares of our common stock for a price of $84.72 per share through a tender offer (the "2015 Tender Offer"). The 2015 Tender Offer began on the date of the announcement, April 15, 2015 and expired on May 13, 2015. Upon expiration, the Company accepted for payment 875,000 shares for a total purchase price of approximately $74.3 million, including fees and expenses related to the 2015 Tender Offer. The 2015 Tender Offer was financed by a combination of cash on hand as well as net borrowings under the Line of Credit and Notes Payable. (See Note 7 – "Debt").

In addition to the 2015 Tender Offer, during 2015, the Company repurchased 6,518 shares for an aggregate purchase price of $0.6 million or $90.85 per share.

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Under a previous Board of Directors' authorization, as of December 30, 2017 the Company has the ability to repurchase an additional 142,988 shares of its common stock. Repurchases may be made from time to time at prevailing prices, subject to certain restrictions on volume, pricing and timing.

Stock Option Plans and Stock-Based Compensation

The Company had authorized up to 750,000 shares of common stock be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2001 Stock Option Plan (the "2001 Plan"). The 2001 Plan expired on February 20, 2011. At the April 26, 2017 Annual Shareholders meeting, the Company's shareholders approved an increase in the shares of common stock available for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2010 Stock Option Plan (the "2010 Plan") by 200,000 shares, from 500,000 to 700,000.

Grants under the 2001 Plan and 2010 Plan are made by the Compensation Committee of the Board of Directors at a price of not less than 100% of the fair market value on the date of grant. If an incentive stock option is granted to an individual who owns more than 10% of the voting rights of the Company's common stock, the option exercise price may not be less than 110% of the fair market value on the date of grant. The term of the options may not exceed 10 years, except in the case of nonqualified stock options, whereby the terms are established by the Compensation Committee. Options may be exercisable in whole or in installments, as determined by the Compensation Committee.

The Company also sponsors a Stock Option Plan for Nonemployee Directors (the "Nonemployee Directors Plan"), and has reserved a total of 350,000 shares for issuance to directors of the Company who are not employees.

Stock option activity under the 2001 Plan, 2010 Plan and Nonemployee Directors Plan (collectively, the "Option Plans") as of December 30, 2017 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Intrinsic Value
Outstanding, December 27, 2014	597,700	$ 48.50	6.93	$ 20,973,700
Granted	79,400	91.46		
Exercised	(8,360)	38.46		
Outstanding, December 26, 2015	668,740	53.73	6.41	25,582,300
Granted	69,600	112.07		
Exercised	(61,169)	26.21		
Forfeited	(3,501)	80.31		
Outstanding, December 31, 2016	673,670	62.11	6.11	43,139,100
Granted	69,500	128.00		
Exercised	(80,236)	33.41		
Forfeited	(4,750)	95.28		
Outstanding, December 30, 2017	658,184	$ 72.33	5.87	$ 37,723,800
Exercisable, December 30, 2017	476,780	$ 58.41	4.84	$ 33,845,900

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The fair value of options granted under the Option Plans during 2017, 2016 and 2015 were estimated on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions and results:

	Year Ended December 30, 2017	December 31, 2016	December 26, 2015
Risk free interest rate	2.05 %	1.80 %	1.71 %
Expected life (years)	6	6	6
Expected volatility	25.64 %	27.13 %	30.15 %
Dividend yield	1.10 %	1.23 %	1.36 %
Option fair value	$ 32.07	$ 28.54	$ 24.88

The total intrinsic value of options exercised during 2017, 2016 and 2015 was $7.7 million, $4.8 million and $0.4 million, respectively. The total fair value of shares vested during 2017, 2016 and 2015 was $7.3 million, $6.9 million and $6.2 million, respectively.

During 2017, 2016 and 2015, option holders surrendered 2,927 shares, 2,973 shares and 587 shares, respectively, of previously owned common stock as payment for option shares exercised as provided for by the Option Plans. All unexercised options at December 30, 2017 have an exercise price equal to the fair market value on the date of the grant.

Compensation expense of $1,956,600, $1,776,600 and $1,694,800 relating to the vested portion of the fair value of stock options granted was expensed to “Selling, General and Administrative Expenses” in 2017, 2016 and 2015, respectively. As of December 30, 2017, the Company had $4.3 million of total unrecognized compensation expense related to stock options that is expected to be recognized over the remaining weighted average vesting period of approximately 2.6 years.

7. Debt:

Line of Credit

As of December 30, 2017 there was $35.4 million in borrowings outstanding under the Company's revolving credit facility with CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) and BMO Harris Bank N.A. (the "Line of Credit") bearing interest ranging from 3.42% to 4.50%.

In April 2015, the Line of Credit was amended to, among other things:

- Provide the consent of the lenders for the 2015 Tender Offer;
- Increase the aggregate commitments to partially fund the 2015 Tender Offer;
- Extend the termination date from February 28, 2018 to May 14, 2019;
- Amend certain financial covenant calculations to remove the effect of the 2015 Tender Offer; and
- Permit the Company to sell up to $30 million in term notes to Prudential Investment Management, Inc., its affiliates and managed accounts ("Prudential") to partially fund the 2015 Tender Offer.

In July 2017, the Line of Credit was amended to, among other things:

- Provide the consent of the lenders for the 2017 Tender Offer;
- Extend the termination date from May 14, 2019 to July 19, 2021;
- Amend the tangible net worth covenant calculation to remove the effect of the 2017 Tender Offer;
- Reduce the applicable margin on interest rate options in connection with LIBOR loans under the Line of Credit; and
- Permit the Company to sell up to $15.0 million in term notes to one or more affiliates or managed accounts of Prudential to partially fund the 2017 Tender Offer.

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December 30, 2017, December 31, 2016 and December 26, 2015

The Line of Credit has been and will continue to be used for general corporate purposes. During 2017 and 2015, the Line of Credit was used to finance in part the 2017 and 2015 Tender Offers (as indicated above). Borrowings under the Line of Credit are subject to certain borrowing base limitations, and the Line of Credit is secured by a lien against substantially all of the Company's assets, contains customary financial conditions and covenants, and requires maintenance of minimum levels of debt service coverage and tangible net worth and maximum levels of leverage (all as defined within the Line of Credit). In July 2019 and each subsequent July thereafter through the term of the facility, the aggregate commitments under the Line of Credit automatically reduce by $5.0 million. As of December 30, 2017, the Company was in compliance with all of its financial covenants and the Company's additional borrowing availability under the Line of Credit was $14.6 million.

The Line of Credit allows the Company to choose between two interest rate options in connection with its borrowings. The interest rate options are the Base Rate (as defined) and the LIBOR Rate (as defined) plus an applicable margin of 0% and 2.0%, respectively. Interest periods for LIBOR borrowings can be one, two, three, six or twelve months, as selected by the Company. The Line of Credit also provides for non-utilization fees of 0.25% per annum on the daily average of the unused commitment.

Notes Payable

In May 2015, the Company entered into a $25.0 million Note Agreement (the "Note Agreement") with Prudential. Proceeds from the Note Agreement of $25.0 million were used to finance in part the 2015 Tender Offer (as indicated above).

In July 2017, the Note Agreement was amended to, among other things:

- Provide the consent of Prudential for the 2017 Tender Offer:
- Amend the tangible net worth covenant calculation to remove the effect of the 2017 Tender Offer:
- Provide for a new $12.5 million term loan to partially fund the 2017 Tender offer.

In August 2017, the Company issued $12.5 million of Series B notes to finance in part the 2017 Tender Offer. As of December 30, 2017, with the $20.0 million in principal outstanding from the $25.0 million of Series A notes issued in

May 2015, the aggregate principal outstanding under the Note Agreement was $32.2 million.

The final maturity of the Series A and Series B notes is 10 years from the issuance date. For the Series A notes, interest at a rate of 5.50% per annum on the outstanding principal balance is payable quarterly, along with required prepayments of the principal of $500,000 quarterly for the first five years, and $750,000 quarterly thereafter until the principal is paid in full. For the Series B notes, interest at a rate of 5.10% per annum on the outstanding principal balance is payable quarterly, along with required prepayments of the principal of $312,500 quarterly until the principal is paid in full. The Series A and Series B notes may be prepaid, at the option of the Company, in whole or in part (in a minimum amount of $1.0 million), but prepayments require payment of a Yield Maintenance Amount, as defined in the Note Agreement.

The Company’s obligations under the Note Agreement are secured by a lien against substantially all of the Company’s assets (as the notes rank pari passu with the Line of Credit), and the Note Agreement contains customary financial conditions and covenants, and requires maintenance of minimum levels of fixed charge coverage and tangible net worth and maximum levels of leverage (all as defined within the Note Agreement). As of December 30, 2017, the Company was in compliance with all of its financial covenants.

In connection with the Note Agreement, the Company incurred debt issuance costs, of which unamortized amounts are presented as a direct deduction from the carrying amount of the related liability.

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WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

8. Accrued Liabilities:

Accrued liabilities at December 30, 2017 and December 31, 2016 are as follows:

	December 30, 2017	December 31, 2016
Accrued compensation and benefits	$ 970,200	$ 1,011,900
Deferred rent	241,400	234,000
Accrued interest	357,100	253,500
Other	268,600	311,700
	$ 1,837,300	$ 1,811,100

9. Discounted Lease Rentals

The Company utilized certain lease receivables and underlying equipment as collateral to borrow from financial institutions at a weighted average rate of 6.00% at December 30, 2017 on a non-recourse basis. As of December 30, 2017, $0.6 million of the $1.7 million liability balance is current.

10. Income Taxes:

A reconciliation of the expected federal income tax expense based on the federal statutory tax rate to the actual income tax expense is provided below:

	Year Ended December 30, 2017	December 31, 2016	December 26, 2015
Federal income tax expense at statutory rate (35%)	$ 12,750,900	$ 12,581,100	$ 12,328,700
Change in valuation allowance	7,500	13,800	(4,400)
State and local income taxes, net of federal benefit	1,056,500	1,021,600	956,000
Permanent differences, including stock option expenses	(628,400)	84,300	158,100
Adjustment to uncertain tax positions	77,800	2,900	10,400
Rate change	(1,540,300)	—	—
Other, net	142,000	24,700	(23,700)
Actual income tax expense	$ 11,866,000	$ 13,728,400	$ 13,425,100

Components of the provision for income taxes are as follows:

	Year Ended December 30, 2017	December 31, 2016	December 26, 2015
Current:			
Federal	$ 11,143,400	$ 12,016,000	$ 13,486,500
State	1,732,100	1,598,700	1,654,800
Foreign	365,900	396,600	425,900
Current provision	13,241,400	14,011,300	15,567,200
Deferred:			
Federal	(1,405,000)	(274,600)	(1,983,200)
State	29,600	(8,300)	(158,900)
Deferred provision	(1,375,400)	(282,900)	(2,142,100)
Total provision for income taxes	$ 11,866,000	$ 13,728,400	$ 13,425,100

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WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

The tax effects of temporary differences that give rise to the net deferred income tax assets and liabilities are presented below:

	December 30, 2017	December 31, 2016
Deferred tax assets:		
Accounts receivable and lease reserves	$ 179,800	$ 347,400
Non-qualified stock option expense	1,800,600	2,370,700
Deferred franchise and software license fees	561,800	817,500
Trademarks	44,300	76,800
Lease deposits	1,110,000	1,674,300
Loss from and impairment of equity and note investments	2,634,500	4,065,200
Valuation allowance	(2,634,500)	(4,065,200)
Other	190,600	413,100
Total deferred tax assets	3,887,100	5,699,800
Deferred tax liabilities:		
Lease revenue and initial direct costs	(5,707,000)	(8,802,800)
Depreciation and amortization	(136,600)	(228,900)
Total deferred tax liabilities	(5,843,600)	(9,031,700)
Total net deferred tax liabilities	$ (1,956,500)	$ (3,331,900)

On December 22, 2017, the Tax Cut and Jobs Act (the “Tax Act”) was signed into law. The Tax Act makes changes to the U.S. tax code that affected our income tax rate in 2017, notably the reduction of the U.S. federal corporate income tax rate from 35% to 21% beginning in 2018. Accounting guidance applicable to income taxes requires us to recognize the impact of the change in tax rate on our existing deferred tax assets and liabilities as of the date that the Tax Act was signed into law. We recorded a reduction in our 2017 income tax expense of $1.5 million and a corresponding reduction in our net deferred income tax liabilities as a result of the decrease in the federal income tax rate.

During the years ended December 30, 2017, December 31, 2016 and December 26, 2015, $0, $599,400 and $26,300, respectively, was directly credited to stockholders’ equity to account for excess tax benefits related to stock option exercises. (See Note 2 – “Recently Adopted Accounting Pronouncements”)

The Company has assessed its taxable earnings history and prospective future taxable income. Based upon this assessment, the Company has determined that it is more likely than not that its deferred tax assets will be realized in future periods and no valuation allowance is necessary, except for the deferred tax assets related to the loss from and impairment of equity and note investments (which are capital losses for tax purposes). As a result, valuation allowances of $2.6 million and $4.1 million as of December 30, 2017 and December 31, 2016, respectively, have been recorded.

The amount of unrecognized tax benefits, including interest and penalties, as of December 30, 2017 and December 31, 2016, was $583,100 and $502,000, respectively, primarily for potential state taxes.

The Company recognizes interest accrued related to unrecognized tax benefits and penalties as income tax expense for all periods presented. The Company had accrued approximately $32,000 and $22,500 for the payment of interest and penalties at December 30, 2017 and December 31, 2016, respectively.

WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

The following table summarizes the activity related to the Company's unrecognized tax benefits:

	Total
Balance at December 26, 2015	$ 469,900
Increases related to current year tax positions	128,500
Subtractions for tax positions of prior years	(5,300)
Expiration of the statute of limitations for the assessment of taxes	(113,600)
Balance at December 31, 2016	479,500
Increases related to current year tax positions	192,900
Subtractions for tax positions of prior years	(8,300)
Expiration of the statute of limitations for the assessment of taxes	(113,000)
Balance at December 30, 2017	$ 551,100

The Company and its subsidiaries file income tax returns in the U.S. federal, numerous state and certain foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2013. The Internal Revenue Service concluded its examination of our U.S. federal tax return for the fiscal year ended 2014 in 2017. We expect various statutes of limitation to expire during the next 12 months. Due to the uncertain response of taxing authorities, a range of outcomes cannot be reasonably estimated at this time.

11. Commitments and Contingencies:

Employee Benefit Plan

The Company provides a 401(k) Savings Incentive Plan which covers substantially all employees. The plan provides for matching contributions and optional profit-sharing contributions at the discretion of the Board of Directors. Employee contributions are fully vested; matching and profit sharing contributions are subject to a five-year service vesting schedule. Company contributions to the plan for 2017, 2016 and 2015 were $319,700, $309,800 and $324,600, respectively.

Operating Leases

As of December 30, 2017, the Company rents its corporate headquarters in a facility with a lease that expires in August 2019 as well as satellite office space in California with a lease that expires in January 2019. These leases require the Company to pay maintenance, insurance, taxes and other expenses in addition to minimum annual rent. Total rent expense under operating leases, inclusive of maintenance, insurance, taxes and other expenses, was $1,102,000 in 2017, $1,066,500 in 2016 and $1,063,900 in 2015. As of December 30, 2017, minimum rental commitments under noncancelable operating leases, exclusive of maintenance, insurance, taxes and other expenses, are as follows:

2018	$ 718,800
2019	451,100
2020	—
2021	—
2022	—
Thereafter	—
Total	$ 1,169,900

For leases that contain predetermined fixed escalations of the minimum rent, we recognize the related rent expense on a straight-line basis from the date we take possession of the property to the end of the initial lease term. We record any difference between the straight-line rent amounts and amounts payable under the leases as part of deferred rent, in accrued liabilities or other liabilities, as appropriate.

WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

Cash or lease incentives received upon entering into certain leases ("tenant allowances") are recognized on a straight-line basis as a reduction to rent from the date we take possession of the property through the end of the initial lease term. We record the unamortized portion of tenant allowances as a part of deferred rent, in accrued liabilities or other liabilities, as appropriate.

At December 30, 2017 and December 31, 2016, total deferred rent included in our consolidated balance sheets was $0.4 million and $0.6 million, respectively, of which $0.2 million and $0.4 million, respectively was included in other liabilities.

Litigation

The Company is exposed to a number of asserted and unasserted legal claims encountered in the normal course of business. Management believes that the ultimate resolution of these matters will not have a material adverse effect on the consolidated financial position or results of operations of the Company.

12. Segment Reporting:

The Company currently has two reportable business segments, franchising and leasing. The franchising segment franchises value-oriented retail store concepts that buy, sell, trade and consign merchandise as well as provides strategic consulting services related to franchising. The leasing segment includes (i) Winmark Capital Corporation, a middle-market equipment leasing business and (ii) Wirth Business Credit, Inc., a small-ticket financing business. Segment reporting is intended to give financial statement users a better view of how the Company manages and evaluates its businesses. The Company's internal management reporting is the basis for the information disclosed for its business segments and includes allocation of shared-service costs. Segment assets are those that are directly used in or identified with segment operations, including cash, accounts receivable, prepaids, inventory, property and equipment and investment in leasing operations. Unallocated assets include corporate cash and cash equivalents, marketable securities, long-term investments, current and deferred tax amounts and other corporate assets. Inter-segment balances and transactions have been eliminated. The following tables summarize financial information by segment and provide a reconciliation of segment contribution to operating income:

	Year ended December 30, 2017	December 31, 2016	December 26, 2015
Revenue:			
Franchising	$ 51,275,700	$ 49,296,700	$ 47,882,100
Leasing	18,470,200	17,283,600	21,565,700
Total revenue	$ 69,745,900	$ 66,580,300	$ 69,447,800
Reconciliation to operating income:			
Franchising segment contribution	$ 29,493,500	$ 28,650,400	$ 26,891,000
Leasing segment contribution	9,291,100	9,650,600	10,199,700
Total operating income	$ 38,784,600	$ 38,301,000	$ 37,090,700
Depreciation and amortization:			
Franchising	$ 271,300	$ 325,200	$ 341,600
Leasing	84,100	95,300	91,000
Total depreciation and amortization	$ 355,400	$ 420,500	$ 432,600

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WINMARK CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 30, 2017, December 31, 2016 and December 26, 2015

	As of December 30, 2017	December 31, 2016
Identifiable assets:		
Franchising	$ 3,614,200	$ 3,141,300
Leasing	42,153,600	42,735,600
Unallocated	2,637,000	2,704,700
Total	$ 48,404,800	$ 48,581,600

Revenues are all generated from United States operations other than franchising revenues from Canadian operations of $3.8 million, $3.3 million and $2.9 million in each of fiscal 2017, 2016 and 2015, respectively. All long-lived assets are located within the United States.

13. Quarterly Financial Data (Unaudited):

The Company's unaudited quarterly results for the years ended December 30, 2017 and December 31, 2016 were as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2017					
Total Revenue	$ 17,623,800	$ 16,749,500	$ 17,567,900	$ 17,804,700	$ 69,745,900
Income from Operations	9,135,400	9,134,200	9,852,000	10,663,000	38,784,600
Net Income	5,416,400	5,773,200	5,719,000	7,656,500	24,565,100
Net Income Per Common Share — Basic	$ 1.30	$ 1.37	$ 1.42	$ 2.00	$ 6.06
Net Income Per Common Share — Diluted	$ 1.22	$ 1.29	$ 1.33	$ 1.86	$ 5.66
2016					

Total Revenue	$ 16,180,300	$ 16,299,800	$ 16,734,300	$ 17,365,900	$ 66,580,300
Income from Operations	8,038,600	9,323,100	10,438,000	10,501,300	38,301,000
Net Income	4,562,900	5,394,300	6,094,200	6,166,200	22,217,600
Net Income Per Common Share — Basic	$ 1.11	$ 1.31	$ 1.48	$ 1.49	$ 5.39
Net Income Per Common Share — Diluted	$ 1.06	$ 1.25	$ 1.41	$ 1.41	$ 5.13

The total of basic and diluted earnings per common share by quarter may not equal the totals for the year as there are changes in the weighted average number of common shares outstanding each quarter and basic and diluted earnings per common share are calculated independently for each quarter.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Winmark Corporation

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of Winmark Corporation (a Minnesota corporation) and subsidiaries (the "Company") as of December 30, 2017 and December 31, 2016, the related consolidated statements of operations, comprehensive income, shareholders' equity (deficit), and cash flows for each of the three years in the period ended December 30, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 30, 2017 and December 31, 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 30, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 30, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report dated March 9, 2018 expressed an unqualified opinion.

Basis for opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to

those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2006.

/s/ GRANT THORNTON LLP

Minneapolis, Minnesota
March 9, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Winmark Corporation

Opinion on internal control over financial reporting

We have audited the internal control over financial reporting of Winmark Corporation (a Minnesota corporation) and subsidiaries (the "Company") as of December 30, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 30, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company as of and for the year ended December 30, 2017, and our report dated March 9, 2018 expressed an unqualified opinion on those financial statements.

Basis for opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and limitations of internal control over financial reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have

a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ GRANT THORNTON LLP

Minneapolis, Minnesota
March 9, 2018

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ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on that evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective as of December 30, 2017.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control — Integrated Framework (2013), our management concluded that our internal control over financial reporting was effective as of December 30, 2017.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The effectiveness of our internal control over financial reporting as of December 30, 2017 has been audited by Grant Thornton LLP, our independent registered public accounting firm, as stated in their report, which is included under Item 8 of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

During the most recent fiscal quarter ended December 30, 2017, there was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B: OTHER INFORMATION

All information required to be reported in a report on Form 8-K during the fourth quarter covered by this Form 10-K has been reported.

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PART III

ITEM 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The sections entitled “Election of Directors,” “Executive Officers,” “Audit Committee,” “Majority of Independent Directors; Committees of Independent Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Code of Ethics and Business Conduct,” appearing in our proxy statement for the annual meeting of stockholders to be held on April 25, 2018 are incorporated herein by reference.

ITEM 11: EXECUTIVE COMPENSATION

The sections entitled “Executive Compensation,” “2017 Director Compensation,” “Compensation Committee Report” and “Compensation Committee Interlocks and Insider Participation” appearing in our proxy statement for the annual meeting of stockholders to be held on April 25, 2018 are incorporated herein by reference.

ITEM 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The sections entitled “Security Ownership of Certain Beneficial Owners, Directors and Executive Officers” and “Securities Authorized for Issuance Under Equity Compensation Plans” appearing in our proxy statement for the annual meeting of stockholders to be held on April 25, 2018 are incorporated herein by reference.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The sections entitled “Transactions with Related Persons, Promoters and Certain Control Persons,” “Review, Approval or Ratification of Transactions with Related Persons” and “Majority of Independent Directors; Committees of Independent Directors” appearing in our proxy statement for the annual meeting of stockholders to be held on April 25, 2018 is incorporated herein by reference.

ITEM 14: PRINCIPAL ACCOUNTING FEES AND SERVICES

The section entitled "Principal Accounting Fees and Services" appearing in our proxy statement for the annual meeting of stockholders to be held April 25, 2018 is incorporated herein by reference.

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PART IV

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as a part of this Report:

1. Financial Statements

The financial statements filed as part of this report are listed on the Index to Consolidated Financial Statements on page 24.

2. Financial Statement Schedules

All schedules for which provision is made in the applicable accounting regulations of the SEC have been omitted as not required or not applicable, or the information required has been included elsewhere by reference in the consolidated financial statements and related items.

3. Exhibits

Exhibits that are not filed herewith have been previously filed with the Securities and Exchange Commission and are incorporated herein by reference.

Exhibit Number	Description
3.1	Articles of Incorporation, as amended (Exhibit 3.1)(1)
3.2	By-laws, as amended and restated to date (Exhibit 3.2)(2)
10.1	Asset Purchase Agreement dated January 24, 1992 with Sports Traders, Inc. and James D. Van Buskirk ("Van Buskirk") concerning acquisition of wholesale business, including amendment dated March 11, 1992 (Exhibit 10.6 (a))(1)

10.2	Retail store agreement dated January 24, 1992 with Van Buskirk (Exhibit 10.6 (b))(1)
10.3	Amended and Restated Stock Option Plan for Nonemployee Directors (Exhibit 10.3)(3)(4)
10.4	Employment Agreement with John L. Morgan, dated March 22, 2000 (Exhibit 10.1)(3)(5)
10.5	First Amendment to Employment Agreement with John L. Morgan dated February 18, 2001 (Exhibit 10.26)(3)(6)
10.6	2001 Stock Option Plan, including forms of stock option agreements (Exhibit 10.27)(3)(6)
10.7	Second Amendment to Employment Agreement with John L. Morgan dated March 23, 2006 (Exhibit 10.16)(3)(7)
10.8	Third Amendment to Employment Agreement with John L. Morgan dated December 15, 2006 (Exhibit 10.1)(3)(8)
10.9	Amendment No. 1 to the 2001 Stock Option Plan (Exhibit 10.13)(3) (2)
10.10	Multi-Tenant Office Lease with Utah State Retirement Investment Fund for Corporate Headquarters dated September 28, 2008 (Exhibit 10.1)(9)
10.11	2010 Stock Option Plan, including forms of stock option agreements (Exhibit 10.18)(3) (10)
10.12	Credit Agreement, dated July 13, 2010, among Winmark Corporation and its subsidiaries and CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) (Exhibit 10.2)(11)
10.13	Amendment No. 1 to Credit Agreement, among Winmark Corporation and its subsidiaries, CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), and BMO Harris Bank N.A., dated January 30, 2012 (Exhibit 10.1)(12)

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Exhibit Number	Description
10.14	Amendment No. 2 to Credit Agreement, among Winmark Corporation and its subsidiaries, CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), and BMO Harris Bank N.A., dated February 29, 2012 (Exhibit 10.1)(13)
10.15	Lease Amending Agreement No. 1 to Multi-Tenant Office Lease by and between Winmark Corporation and AX Waterford L.P. dated October 21, 2013 (Exhibit 10.1)(14)
10.16	Amendment No. 3 to Credit Agreement, among Winmark Corporation and its subsidiaries, CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), and BMO Harris Bank N.A., dated February 21, 2014 (Exhibit 10.1)(15)
10.17	First Amendment to the 2010 Stock Option Plan (Exhibit 10.1)(3)(16)
10.18	First Amendment to the Amended and Restated Stock Option Plan for Nonemployee Directors (Exhibit 10.2)(3)(16)
10.19	Non-Competition Agreement, dated January 26, 2015, by and among Steven C. Zola, Winmark Corporation and Winmark Capital Corporation (Exhibit 10.1)(3)(17)
10.20	Amendment No. 4 to Credit Agreement, among Winmark Corporation and its subsidiaries, CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), and BMO Harris Bank N.A., dated April 14, 2015 (Exhibit (b)(2))(18)
10.21	Amended and Restated Security Agreements, dated May 14, 2015, among Winmark Corporation, each of its subsidiaries and CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) (Exhibit 10.4)(19)
10.22	Amended and Restated Pledge Agreement, dated May 14, 2015, among Winmark Corporation and CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) (Exhibit 10.5)(19)
10.23	Trademark Security Agreement, dated May 14, 2015, among Winmark Corporation and its subsidiaries and CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company) (Exhibit 10.6)(19)
10.24	Intercreditor and Collateral Agency Agreement, dated May 14, 2015, among CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), BMO Harris Bank N.A. and Prudential Investment Management, Inc., its affiliates and managed accounts (Exhibit 10.7)(19)
10.25	Note Agreement, dated May 14, 2015, among Winmark Corporation and its subsidiaries and Prudential Investment Management, Inc., its affiliates and managed accounts (Exhibit 10.8)(19)
10.26	Amendment No. 5 to Credit Agreement, among Winmark Corporation and its subsidiaries, CIBC Bank USA (as successor by merger to The PrivateBank and Trust Company), and BMO Harris Bank N.A., dated July 18, 2017 (Exhibit (b)(7)) (20)
10.27	Amendment No. 1 to Note Agreement dated July 19, 2017 among Winmark Corporation and its subsidiaries and Prudential Investment Management, Inc., its affiliates and managed accounts (Exhibit (b)(8))(20)
10.28	Amendment No. 1 to Intercreditor and Collateral Agency Agreement dated July 19, 2017 (Exhibit (b)(9))(20)
10.29	Second Amendment to the 2010 Stock Option Plan (Exhibit (d)(7))(20)
21.1	Subsidiaries: Grow Biz Games, Inc., a Minnesota corporation; Winmark Capital Corporation, a Minnesota corporation and Wirth Business Credit, Inc., a Minnesota corporation
23.1*	Consent of GRANT THORNTON LLP; Independent Registered Public Accounting Firm
24.1	Power of Attorney (Contained on signature page to this Form 10-K)
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002

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Exhibit Number	Description
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: Financial statements from the annual report on Form 10-K of Winmark Corporation and Subsidiaries for the year ended December 30, 2017, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Shareholders' Equity (Deficit), (v) Consolidated Statements of Cash Flows, and (vi) Notes to the Consolidated Financial Statements.

*Filed Herewith

(1) Incorporated by reference to the specified exhibit to the Registration Statement on Form S-1, effective August 24, 1993 (Reg. No. 33-65108).
(2) Incorporated by reference to the specified exhibit to the Annual Report on Form 10-K for the fiscal year ended December 30, 2006.
(3) Indicates management contracts, compensation plans or arrangements required to be filed as exhibits.
(4) Incorporated by reference to the specified exhibit to the Quarterly Report on Form 10-Q for the fiscal quarter ended June 27, 2009.
(5) Incorporated by reference to the specified exhibit to the Quarterly Report on Form 10-Q for the fiscal quarter ended March 25, 2000.
(6) Incorporated by reference to the specified exhibit to the Annual Report on Form 10-K for the fiscal year ended December 30, 2000.
(7) Incorporated by reference to the specified exhibit to the Annual Report on Form 10-K for the fiscal year ended December 31, 2005.
(8) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on December 20, 2006.
(9) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on October 2, 2008.
(10) Incorporated by reference to the specified exhibit to the Annual Report on Form 10-K for the fiscal year ended December 26, 2009.
(11) Incorporated by reference to the specified exhibit to the Quarterly Report on Form 10-Q for the fiscal quarter ended June 26, 2010.
(12) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on January 31, 2012.
(13) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on March 1, 2012.
(14) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on October 23, 2013.
(15) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on February 21, 2014.
(16) Incorporated by reference to the specified exhibit to the Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 2014.
(17) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on January 26, 2015.
(18) Incorporated by reference to the specified exhibit to the Schedule TO filed on April 15, 2015.
(19) Incorporated by reference to the specified exhibit to the Current Report on Form 8-K filed on May 18, 2015.
(20) Incorporated by reference to the specified exhibit to the Schedule TO filed on July 19, 2017.

ITEM 16: FORM 10-K SUMMARY

Not Applicable.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

WINMARK CORPORATION

By:	/s/ BRETT D. HEFFES Brett D. Heffes Chief Executive Officer	Date: March 9, 2018

KNOWN TO ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Brett D. Heffes and Anthony D. Ishaug and each of them, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any amendments to this Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorney-in-fact or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ BRETT D. HEFFES Brett D. Heffes	Chief Executive Officer and Director (principal executive officer)	March 9, 2018
/s/ Anthony D. Ishaug	Executive Vice President,	March 9, 2018

Anthony D. Ishaug	Chief Financial Officer and Treasurer (principal financial and accounting officer)	
/s/ JOHN L. MORGAN John L. Morgan	Executive Chairman of the Board	March 9, 2018
/s/ STEVEN C. ZOLA Steven C. Zola	Vice Chairman and Director	March 9, 2018
/s/ LAWRENCE A. BARBETTA Lawrence A. Barbetta	Director	March 9, 2018
/s/ JENELE C. GRASSLE Jenele C. Grassle	Director	March 9, 2018
/s/ KIRK A. MACKENZIE Kirk A. MacKenzie	Director	March 9, 2018
/s/ PAUL C. REYELTS Paul C. Reyelts	Director	March 9, 2018
/s/ MARK L. WILSON Mark L. Wilson	Director	March 9, 2018