

WINMARK CORP
Form 424B3
November 15, 2006

Filed Pursuant to Rule 424(b)(3)
File Number 333-133393

PROSPECTUS SUPPLEMENT NO. 5
to Prospectus declared
effective on June 14, 2006
(Registration No. 333-133393)
WINMARK CORPORATION

This Prospectus Supplement No. 5 supplements our Prospectus declared effective June 14, 2006 (as previously supplemented by the prospectus supplements dated July 13, 2006, August 11, 2006, August 18, 2006 and October 11, 2006, collectively, the Prospectus).

You should read this Prospectus Supplement No. 5 together with the Prospectus.

On November 13, 2006, we filed with the U.S. Securities and Exchange Commission the attached Quarterly Report for the period ended September 30, 2006 on Form 10-Q.

The information contained herein, including the information attached hereto, supplements and supersedes, in part, the information contained in the Prospectus. This Prospectus Supplement No. 5 should be read in conjunction with the Prospectus, and is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 5 supersedes the information contained in the Prospectus.

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

The date of this Prospectus Supplement No. 5 is November 15, 2006.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2006

Commission File Number 000-22012

Winmark Corporation

(Exact Name of Registrant as Specified in Its Charter)

Minnesota

(State or Other Jurisdiction of
Incorporation or Organization)

41-1622691

(I.R.S. Employer
Identification Number)

4200 Dahlberg Drive, Suite 100

Golden Valley, MN 55422-4837

(Address of Principal Executive Offices, Zip Code)

Registrant's Telephone Number, Including Area Code **763-520-8500**

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 registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer: Accelerated filer: Non-Accelerated filer:

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

Yes: No:

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, no par value, 5,644,542 shares outstanding as of November 2, 2006.

WINMARK CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION**ITEM 1: Financial Statements**

WINMARK CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

(unaudited)

	September 30, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 1,301,800	\$ 2,947,700
Receivables, less allowance for doubtful accounts of \$46,500 and \$188,700	2,331,800	1,836,300
Investment in direct finance leases	4,548,400	1,478,200
Income tax receivable	93,500	620,500
Inventories	84,700	67,000
Prepaid expenses and other	1,475,400	804,000
Deferred income taxes	776,800	776,800
Total current assets	10,612,400	8,530,500
Long-term investment in leasing operations	10,881,000	5,492,400
Long-term investments	11,500,000	11,000,000
Long-term receivables, net	76,600	94,300
Property and equipment, net	546,400	448,600
Goodwill	607,500	607,500
Deferred income taxes	375,400	375,400
	\$ 34,599,300	\$ 26,548,700
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Current renewable subordinated notes	\$ 3,294,300	\$
Accounts payable	868,300	1,156,400
Accrued liabilities	1,869,300	1,435,900
Discounted lease rentals	154,500	147,600
Rents received in advance	373,900	167,600
Deferred revenue	976,600	829,100
Total current liabilities	7,536,900	3,736,600
Long-term renewable subordinated notes	12,046,500	
Long-term discounted lease rentals	81,400	185,600
Long-term deferred revenue	412,900	339,600
Shareholders Equity:		
Common stock, no par, 10,000,000 shares authorized, 5,632,042 and 6,049,037 shares issued and outstanding	136,000	3,840,500
Retained earnings	14,385,600	18,446,400
Total shareholders equity	14,521,600	22,286,900
	\$ 34,599,300	\$ 26,548,700

The accompanying notes are an integral part of these financial statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 24, 2005	September 30, 2006	September 24, 2005
REVENUE:				
Royalties	\$ 4,800,000	\$ 4,230,300	\$ 14,320,500	\$ 12,953,400
Merchandise sales	1,452,600	1,446,100	3,533,300	5,393,700
Franchise fees	305,000	330,000	980,700	745,000
Leasing income	523,100	119,500	1,209,800	273,800
Other	158,900	163,800	441,900	432,300
Total revenue	7,239,600	6,289,700	20,486,200	19,798,200
COST OF MERCHANDISE SOLD	1,381,900	1,144,900	3,378,600	4,465,200
LEASING EXPENSE	84,500	600	131,200	600
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	4,206,300	3,645,700	12,934,600	11,678,100
Income from operations	1,566,900	1,498,500	4,041,800	3,654,300
LOSS FROM EQUITY INVESTMENTS		(5,500)		(188,800)
GAIN ON SALE OF INVESTMENTS				17,400
INTEREST EXPENSE	(307,900)		(429,300)	
INTEREST AND OTHER INCOME	145,300	90,100	746,600	224,100
Income before income taxes	1,404,300	1,583,100	4,359,100	3,707,000
PROVISION FOR INCOME TAXES	(566,100)	(657,000)	(1,757,200)	(1,538,400)
NET INCOME	\$ 838,200	\$ 926,100	\$ 2,601,900	\$ 2,168,600
EARNINGS PER SHARE BASIC	\$.15	\$.15	\$.45	\$.36
EARNINGS PER SHARE DILUTED	\$.14	\$.14	\$.43	\$.34
WEIGHTED AVERAGE SHARES OUTSTANDING BASIC	5,632,042	6,012,463	5,841,047	6,024,700
WEIGHTED AVERAGE SHARES OUTSTANDING DILUTED	5,853,968	6,424,990	6,056,690	6,452,359

The accompanying notes are an integral part of these financial statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2006	September 24, 2005
OPERATING ACTIVITIES:		
Net income	\$ 2,601,900	\$ 2,168,600
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	141,200	135,500
Allowance for doubtful accounts	(143,300)	
Provision for credit losses	228,900	62,900
Gain on sale of investment	(360,000)	
Compensation expense related to stock options	588,900	467,700
Gain on sale of marketable securities		(17,400)
Deferred initial direct costs, net of amortization	(181,800)	(48,400)
Loss from disposal of property and equipment	1,400	
Loss from equity investments		188,800
Tax benefit on exercised options		306,300
Change in operating assets and liabilities:		
Receivables	(334,500)	(3,200)
Income tax receivable	527,000	368,100
Inventories	(17,700)	223,000
Prepaid expenses and other	(671,400)	(230,400)
Accounts payable	(288,100)	(63,800)
Income tax payable		108,300
Accrued liabilities	433,400	73,600
Additions to advance and security deposits	597,900	105,000
Deferred revenue	220,800	333,900
Net cash provided by operating activities	3,344,600	4,178,500
INVESTING ACTIVITIES:		
Proceeds from sale of marketable securities		1,475,000
Purchase of marketable securities		(196,200)
Proceeds from sale of long-term investment	360,000	
Purchase of long-term investments	(500,000)	(1,500,000)
Purchases of property and equipment	(240,400)	(265,900)
Additions to other assets		(25,300)
Proceeds from discounted lease rentals		381,800
Proceeds from sale of property and equipment		23,300
Purchase of equipment for lease contracts	(11,622,300)	(2,641,900)
Principal collections on lease receivables	2,627,500	381,300
Net cash used for investing activities	(9,375,200)	(2,367,900)
FINANCING ACTIVITIES:		
Proceeds from issuance of unsecured notes	15,340,800	
Repurchase of common stock	(12,177,200)	(3,541,400)
Proceeds from exercises of options and warrants	613,800	828,200
Tax benefit on exercised options	607,300	
Net cash provided by (used for) financing activities	4,384,700	(2,713,200)
DECREASE IN CASH AND CASH EQUIVALENTS	(1,645,900)	(902,600)
Cash and cash equivalents, beginning of period	2,947,700	5,983,500
Cash and cash equivalents, end of period	\$ 1,301,800	\$ 5,080,900
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	\$ 499,300	\$

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Cash paid for income taxes	\$	533,600	\$	712,100
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The accompanying notes are an integral part of these financial statements

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WINMARK CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. Management's Interim Financial Statement Representation:

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

Revenues and operating results for the nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year.

2. Organization and Business:

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

3. Long-Term Investments:

The Company has an investment in Tomsten, Inc. (Tomsten), the parent company of Archiver's retail chain. Archiver's is a retail concept created to help people preserve and enjoy their photographs. The Company has invested a total of \$7.5 million in the purchase of common stock of Tomsten. The Company's investment currently represents 18.29% of the outstanding common stock of Tomsten and is accounted for by the cost method. The Company has entered into a voting agreement with Tomsten appointing officers of Tomsten as the Company's proxy with the right to vote the Tomsten shares held by the Company consistent with the two largest shareholders of Tomsten (or in case of their disagreement, consistent with a majority of the remaining shareholders) as long as the Company owned such shares. No officers or directors of the Company serve as officers or directors of Tomsten.

On October 8, 2004, the Company agreed to make a \$2.0 million preferred stock investment in Commercial Credit Group, Inc. (CCG), a newly formed equipment leasing company specializing in construction, transportation and waste management equipment. At closing, the Company paid \$1.5 million for approximately 21.5% of the outstanding equity of CCG. The Company made the remaining \$500,000 investment on May 20, 2005. In August 2005, CCG raised an additional \$3.0 million of preferred stock. Subsequent to that financing, the Company owned approximately 17.7% of the outstanding equity of CCG. This investment was accounted for by the cost method.

On February 15, 2006, the Company entered into two separate transactions with CCG whereby CCG (i) redeemed its 20,000 shares of Series A-1 preferred stock at face value of \$100 per share and, (ii) issued \$2,000,000 of five-year senior subordinated notes that carry an interest rate of 14.75%, which is compounded quarterly. In connection with the redemption, a \$360,000 transaction fee was received by the Company. The Company recorded the \$360,000 fee as additional consideration for the redemption for its preferred stock which, when combined with the \$2,000,000 redemption proceeds, resulted in a gain of \$360,000 on the transaction. The gain is included in interest and other income for the nine month period ended September 30, 2006.

On October 13, 2004, the Company made a commitment to lend \$2.0 million to BridgeFunds Limited at an annual rate of 12% pursuant to several senior subordinated promissory notes. BridgeFunds Limited advances funds to claimants involved in civil litigation to cover litigation expenses. The proceeds of the loans are used to fund these advances. On October 13, 2004, February 9, 2005, May 24, 2005 and May 15, 2006, Winmark Corporation funded \$500,000, \$500,000, \$500,000 and \$500,000, respectively, of such \$2.0 million commitment. In addition, Winmark Corporation has received a warrant to purchase approximately 257,000 shares of BridgeFunds which currently represents 14.7% of the equity of BridgeFunds on a fully diluted basis. BridgeFunds is currently in the process of raising capital which, if successful, will reduce Winmark's fully diluted ownership.

4. Investment in Leasing Operations:

Investment in leasing operations consists of the following:

	September 30, 2006	December 31, 2005
Minimum lease payments receivable	\$ 15,844,200	\$ 5,742,000
Estimated residual value of equipment	587,300	69,900
Unearned lease income net of initial direct costs deferred	(2,723,200)	(967,000)
Security deposits	(536,900)	(145,000)
Allowance for credit losses	(332,100)	(103,200)
Total investment in leasing operations	12,839,300	4,596,700
Less: current investment in direct finance leases	(4,548,400)	(1,478,200)
Long-term investment in direct financing leases	8,290,900	3,118,500
Equipment installed on leases not yet commenced	2,590,100	2,373,900
Total long-term investment in leasing operations	\$ 10,881,000	\$ 5,492,400

During the third quarter and nine months ended September 30, 2006, the Company had \$7,800 in write-offs, compared with \$0 for the third quarter and nine months ended September 24, 2005.

Minimum lease payments receivable under lease contracts and the amortization of unearned lease income, net of initial direct costs and fees is as follows for the remainder of fiscal 2006 and the full fiscal years thereafter as of September 30, 2006:

Fiscal Year	Minimum Lease Payments Receivable	Income Amortization
2006	\$ 1,494,500	\$ 433,500
2007	6,140,400	1,330,400
2008	4,989,000	674,700
2009	2,307,900	216,200
2010	729,700	63,500
Thereafter	182,700	4,900
	\$ 15,844,200	\$ 2,723,200

5. Other Comprehensive Income (Loss):

The Company reports other comprehensive income (loss) in accordance with Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS No. 130). SFAS No. 130 establishes standards for reporting in the financial statements all changes in equity during a period. For the Company, other comprehensive income (loss) consists of unrealized holding gains and losses, net of tax, from investments classified as available-for-sale. In the three and nine months ended September 24, 2005, the Company recognized tax benefits directly to shareholders equity of \$1,400 and \$11,500, respectively, relating to mark-to-market adjustment on our investments. There were no recognized tax benefits directly to shareholders equity in the first nine months of 2006.

Comprehensive income and the components of other comprehensive income (loss) were as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 24, 2005	September 30, 2006	September 24, 2005
Net income	\$ 838,200	\$ 926,100	\$ 2,601,900	\$ 2,168,600
Other comprehensive income (loss)		2,300		(18,400)
Total comprehensive income	\$ 838,200	\$ 928,400	\$ 2,601,900	\$ 2,150,200

6. Accounting for Stock-Based Compensation:

In 2002, the Company adopted the fair value method recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (Statement No. 123) using the prospective method as provided by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Historically, the Company had applied the intrinsic value method permitted under Statement 123, as defined in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, in accounting for our stock-based compensation plans. Accordingly, no compensation cost has been recognized for stock options issued prior to 2002. Compensation expense of \$136,100 and \$143,500 and \$588,900 and \$467,700 relating to the vested portion of the fair value of stock options granted subsequent to adoption of the fair value method has been included in Selling, General and Administration Expenses in the third quarter and nine months of 2006 and 2005, respectively.

Financial Accounting Standards Board (FASB) Statement No. 123, *Share-Based Payment* (revised 2004) requires the cost of all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated financial statements based on the grant date fair value of those awards. In accordance with Statement No. 123R, this cost is recognized over the period for which an employee is required to provide service in exchange for the award. For awards outstanding as of January 1, 2006, Statement No. 123R requires the Company to recognize compensation expense for the unvested portion of outstanding share-based payments based on the fair value of the award on the grant date. It also requires that the benefits associated with tax deductions in excess of recognized compensation expense be reported as a financing cash flow rather than as an operating cash flow. The Company adopted Statement No. 123R, effective January 1, 2006, utilizing the modified prospective method, and, therefore, did not restate the prior-period results. The Company uses the straight-line method of expensing graded vesting awards.

The impact of adopting Statement No. 123R did not increase compensation expense over the amount the Company would have recorded under Statement No. 123 during the three and nine months ended September 30, 2006 given that we adopted Statement No. 123 in November 2002.

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

Year Granted	Option Fair Value	Risk Free Interest Rate	Expected Life (Years)	Expected Volatility	Dividend Yield
2006					
2005	\$6.81/\$10.66	4.44%/4.47%	5/7	28.1%/43.5%	none

The Company did not modify any outstanding options to minimize the impact of 123R. The Company is using the same valuation model and assumptions under 123R that it used before and the adoption of 123R will not affect our option granting practices.

7. Recent Accounting Pronouncements:

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. FIN 48 prescribes a comprehensive financial statement model of how a company should recognize, measure, present, and disclose uncertain tax positions that the Company has taken or expects to take in its income tax returns. FIN 48 requires that only income tax benefits that meet the more likely than not recognition threshold be recognized or continue to be recognized on the effective date. Initial derecognition amounts would be reported as a cumulative effect of a change in accounting principle. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is assessing the impact of the new guidance on all of our open tax positions.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Company is currently assessing the impact, if any, the adoption of SAB No. 108 will have on its financial statements. The cumulative effect, if any, of applying the provisions of SAB No. 108 will be reported as an adjustment to beginning-of-year retained earnings.

8. Reclassifications:

Certain amounts in the prior period financial statements have been reclassified to conform with the current year presentation. These reclassifications have no effect on net income or shareholders' equity as previously reported.

9. Earnings Per Share:

The Company calculates earnings per share in accordance with SFAS No. 128 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 - Dilutive by dividing net income by the weighted average number of shares of common stock and dilutive stock equivalents from the exercise of stock options and warrants using the treasury stock method. The weighted average diluted outstanding shares is computed by adding the weighted average basic shares outstanding with the dilutive effect of 221,926 and 412,527 stock options and warrants for the three months ended and 215,643 and 427,659 for the nine months ended September 30, 2006 and September 24, 2005, respectively.

Options totaling 53,305 and 23,746 and 64,324 and 17,810 shares for the three and nine months ended September 30, 2006 and September 24, 2005, respectively, were outstanding but were not included in the calculation of Earnings Per Share - Diluted because their exercise prices were greater than the average market price of the common shares and, therefore, including the options in the denominator would be anti-dilutive, or decrease the number of weighted average shares.

10. Shareholders Equity:

Repurchase of Common Stock

Under the Board of Directors' authorization, the Company has the ability to repurchase up to 4,000,000 shares of its common stock, of which all but 500,458 shares have been repurchased. Repurchases may be made from time to time at prevailing prices, subject to certain restrictions on volume, pricing and timing. Since November 1995 through September 30, 2006, the Company has repurchased 3,499,542 of its stock at an average price of \$13.73 per share. In the first nine months of 2006, the Company repurchased 519,000 shares for an aggregate purchase price of \$12,177,200 or \$23.46 per share.

Dilutive Securities

As of September 30, 2006, the Company had options and warrants outstanding to purchase a total of 678,000 shares of its common stock with an average exercise price of \$13.33 per share. Of these, 437,400 were exercisable as of September 30, 2006.

Stock Option Plans

The Company had authorized up to 1,530,000 shares of common stock to be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 1992 Stock Option Plan (the 1992 Plan). The 1992 Plan expired on April 21, 2002.

The Company's shareholders had approved the Company's 2001 Stock Option Plan (the 2001 Plan) under which 500,000 shares had been reserved for granting either nonqualified or incentive stock options to officers and key employees. At the regularly scheduled Annual Meeting of Shareholders held on May 3, 2006, the Company's shareholders approved a resolution to amend the 2001 Plan to increase the number of approved and reserved shares of common stock under the 2001 Plan from 500,000 to 750,000.

Grants under the 2001 Plan are made by the Board of Directors or a Board-designated committee 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 Board of Directors or a Board-designated committee. Options may be exercisable in whole or in installments, as determined by the Board of Directors or a Board-designated committee.

The Company also sponsors a Stock Option Plan for Nonemployee Directors (the Nonemployee Directors Plan) and has reserved a total of 200,000 shares for issuance to directors of the Company who are not employees. Each option granted under the Nonemployee Directors Plan vests and becomes exercisable in five equal increments, beginning one year after the date of grant.

Stock options granted and exercised under the 1992 Plan, 2001 Plan and Nonemployee Directors Plan as of September 30, 2006 were as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Remaining Intrinsic Value
Outstanding at December 31, 2005	582,000	\$ 14.56		
Granted				
Exercised	(104,000)	6.35		
Forfeited				
Outstanding at September 30, 2006	478,000	16.40	7.02	\$ 3,479,600
Exercisable at September 30, 2006	237,400	\$ 12.77	5.57	\$ 2,732,000

The total intrinsic value of options exercised during the first nine months of 2006 and 2005 was \$1,858,900 and \$3,894,800, respectively. The total fair value of shares vested during the first nine months of 2006 and 2005 was \$82,100 and \$877,900, respectively.

All unexercised options at September 30, 2006 have an exercise price equal to the fair market value on the date of the grant.

As of September 30, 2006, the Company had \$1.55 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 2.5 years.

Other Options

On March 22, 2000, Sheldon Fleck, a former consultant to the Company, was granted a warrant to purchase 200,000 shares of common stock at an exercise price of \$6 per share. This warrant will expire on March 22, 2008 if unexercised. Such warrant remains unexercised.

11. Line of Credit and Subordinated Debt:

On March 31, 2006, the Company entered into a Second Amendment (the **Second Amendment**) to its \$15,000,000 line of credit with LaSalle Bank National Association (as amended, the **Credit Facility**). The Credit Facility allows the Company various interest rate options, including fixed rate, LIBOR plus 2% and the bank's base rate plus 200 basis points. The Second Amendment, among other things, extends the term of the Credit Facility until March 31, 2010, and allows the Company to increase its obligations under the Credit Facility over time to up to \$25,000,000 provided that certain conditions are met. As a result of the Second Amendment, certain financial covenants in the Credit Facility have changed, including (i) minimum tangible net worth; (ii) minimum interest coverage ratio; and (iii) maximum senior leverage ratio.

On May 19, 2006, the Company entered into a Third Amendment (the **Third Amendment**) to the Credit Facility. The Third Amendment, among other things, affirms the Lender's consent to the repurchase of Rush River's 420,000 shares of Winmark common stock (**Repurchase**). The Third Amendment also amends the definition of tangible net worth in the Credit Facility to add into the Company's tangible net worth the amount paid by Winmark for the Repurchase, \$9.891 million, until December 31, 2006.

The Credit Facility has a borrowing base that is equal to two times the Earnings Before Interest, Taxes, Depreciation and Amortization (**EBITDA**) of the Company's franchising and corporate segments plus 90% of the amount of eligible leased assets. The line of credit will be used for growing the Company's leasing business, stock repurchases and general corporate purposes. The Credit Facility is secured by a lien against substantially all of the Company's assets.

As of September 30, 2006, the Company has no amount outstanding on its Credit Facility.

Renewable Unsecured Subordinated Notes

In May 2006, the Company filed a public offering of up to \$50 million of Renewable Unsecured Subordinated Notes that was declared effective in June 2006. Through September 30, 2006, the Company has issued \$15,340,800 in renewable unsecured subordinated notes. The table below presents the Company's outstanding notes payable as of September 30, 2006:

	Original Term	Principal Amount	Weighted Average Interest Rate	
Renewable unsecured subordinated notes	3 months	\$ 135,000	5.68	%
	6 months	2,065,000	6.60	%
	1 year	1,094,300	7.33	%
	2 years	1,383,000	8.33	%
	3 years	3,852,500	9.34	%
	4 years	1,162,500	9.84	%
	5 years	5,543,000	10.10	%
	10 years	105,500	10.33	%
Total		\$ 15,340,800	9.02	%

The Company made interest payments of \$259,400 on the above-mentioned unsecured subordinated notes during the first nine months of 2006. The weighted average term of the outstanding unsecured subordinated notes is 39 months.

12. Other Contingencies:

In addition to the operating lease obligations disclosed in footnote 12 of the Company's Form 10-K for the year ended December 31, 2005, the Company has remained a guarantor on Company-owned retail stores that have been either sold or closed. At September 30, 2006 and September 24, 2005, \$110,000 and \$112,000, respectively, is included in accrued liabilities relating to these obligations. These leases have various expiration dates through 2008. The Company believes it has adequate accruals for any future liability.

[THIS SECTION IS INTENTIONALLY BLANK]

13. 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. The leasing segment includes (i) Winmark Capital Corporation, a middle-market equipment leasing business and (ii) Wirth Business Credit, Inc., a small ticket equipment leasing 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. Segment contribution less other expenses is equal to operating income. 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, long-term investments, 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:

	Three Months Ended September 30, 2006	September 24, 2005	Nine Months Ended September 30, 2006	September 24, 2005
Revenue:				
Franchising	\$ 6,716,500	\$ 6,170,200	\$ 19,276,400	\$ 19,524,400
Leasing	523,100	119,500	1,209,800	273,800
Total revenue	\$ 7,239,600	\$ 6,289,700	\$ 20,486,200	\$ 19,798,200
Reconciliation to operating income:				
Franchising segment contribution	\$ 3,021,300	\$ 2,985,900	\$ 8,983,200	\$ 8,363,400
Leasing segment contribution	(436,400)	(357,300)	(1,510,700)	(1,232,800)
Other contribution(1)	(1,018,000)	(1,130,100)	(3,430,700)	(3,476,300)
Total operating income	\$ 1,566,900	\$ 1,498,500	\$ 4,041,800	\$ 3,654,300
Depreciation and amortization:				
Franchising	\$	\$	\$	\$ 18,800
Leasing	8,200	500	24,600	1,700
Unallocated	41,200	46,300	116,600	115,000
Total depreciation and amortization	\$ 49,400	\$ 46,800	\$ 141,200	\$ 135,500

	As of September 30, 2006	December 31, 2005
Identifiable assets:		
Franchising	\$ 3,807,700	\$ 3,932,500
Leasing	17,302,700	9,041,700
Unallocated	13,488,900	13,574,500
Total	\$ 34,599,300	\$ 26,548,700

Notes:

(1) Other contribution represents unallocated shared-service costs such as corporate executive management, occupancy, management information services, account services, telephone expense and human resources.

14. Related Party Transactions:

On May 16, 2006, in connection with the Company's existing stock repurchase plan, Winmark repurchased 420,000 shares of common stock from Rush River Group, LLC (Rush River) for aggregate consideration of \$9.891 million, or \$23.55 per share, pursuant to a stock purchase agreement. The purchase price was based upon a 5% discount to the 30-day average closing price of Winmark's common stock as reported on Nasdaq, set on May 11, 2006. The 420,000 shares represent 100% of the shares of Winmark common stock held by Rush River, an entity owned and controlled by Winmark's Chairman and Chief Executive Officer, John L. Morgan, Vice-Chairman Kirk A. MacKenzie, and Jack A. Norqual. The repurchase from Rush River was approved by Winmark's Audit Committee and the independent directors of the Board of Directors.

On June 6, 2006, in connection with the Company's existing stock repurchase plan, the Company repurchased 44,000 shares of common stock from K. Jeffrey Dahlberg for aggregate consideration of \$1.0362 million, or \$23.55 per share.

On June 29, 2006, John L. Morgan, Chief Executive Officer and Chairman of the Board of Directors of Winmark Corporation, purchased approximately \$1.5 million in unsecured subordinated notes of various maturities (\$250,000 of two year maturity, \$500,000 of three year maturity, \$500,000 of four year maturity, and \$250,000 of five year maturity notes, all on a monthly interest payment schedule at the rates described in the Interest Rate Supplement filed with the Securities and Exchange Commission on June 16, 2006 (Interest Rate Supplement)) offered by Winmark pursuant to a prospectus and related documents declared effective on June 14, 2006 (Prospectus). In connection with his investment, Mr. Morgan agreed that his notes would be voted consistent with the majority of the remaining noteholders in an event of default.

On July 14, 2006, Rush River subscribed for and purchased approximately \$10 million in unsecured subordinated notes of various maturities (\$2 million of six month maturity, \$1 million of one year maturity, \$1 million of two year maturity, \$2 million of three year maturity and \$4 million of five year maturity notes) all on a monthly interest payment schedule at the rates described in the Interest Rate Supplement offered by Winmark pursuant to the Prospectus. In connection with their investment, Rush River agreed that their notes would be voted consistent with the majority of the remaining noteholders in an event of default.

In addition, Kirk A. MacKenzie, Vice-Chairman of the Board of Directors, subscribed for and purchased \$500,000 of three year maturity unsecured subordinated notes, on a monthly interest payment schedule at the rates described in the Interest Rate Supplement, offered by Winmark pursuant to the Prospectus. In connection with his investment, Mr. MacKenzie agreed that his notes would be voted consistent with the majority of the remaining noteholders in an event of default.

The Company used the proceeds of the sale to pay down its revolving Line of Credit.

15. Subsequent Events:

On October 4, 2006, Stephen M. Briggs announced his resignation from his position of President and Chief Operating officer, as well as his resignation as a member of the Company's Board of Directors. On October 25, 2006, Winmark executed a Separation Letter and Agreement with Mr. Briggs.

ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.**Overview**

As of September 30, 2006, we had 829 franchises operating under the following brands: Play it Again Sports®, Once Upon a Child®, Plato's Closet®, Music Go Round® and Wirth Business Credit. Management closely tracks the following criteria to evaluate current business operations and future prospects: royalties, franchise fees, leasing activity, selling, general and administrative expenses, franchise openings and closings and franchise renewals.

Our most profitable sources of franchising revenue are royalties earned from our franchise partners and franchise fees for new openings and transfers.

During the first nine months of 2006, our royalties increased \$1,367,100 or 10.6% compared to the first nine months of 2005. Franchise fees increased \$235,700 or 31.6% compared to the same period last year and primarily reflect consistent new openings in established brands and the addition of the new Wirth Business Credit franchise system. During the first nine months of 2006, revenue generated from the Company's leasing activities was \$1,209,800 compared to \$273,800 in the same period last year. (See Note 13 Segment Reporting.) The Company's leasing portfolio was \$15.4 million at September 30, 2006. (Investment in direct finance leases plus long-term investment in leasing operations.)

Management 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 first nine months ended September 30, 2006:

				NINE MONTHS ENDING 9/30/06		
	TOTAL			TOTAL	FOR	COMPLETED
	12/31/05	OPENED	CLOSED	9/30/06	RENEWAL	RENEWALS
Play It Again Sports®						
Franchised Stores - US and Canada	396	12	(15)	393	7	7
Once Upon A Child®						
Franchised Stores - US and Canada	206	8	(4)	210	12	12
Plato's Closet®						
Franchised Stores	159	19	(2)	176	0	0
Music Go Round®						
Franchised Stores	42	0	(1)	41	7	7
Total Franchised Stores	803	39	(22)	820	26	26
Wirth Business Credit						
Franchises	0	9	(0)	9	0	0
Total Franchises	803	48	(22)	829	26	26

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. During the nine months ended September 30, 2006, the Company renewed 26 franchise agreements of the 26 franchise agreements that were available for renewal.

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 the nine months ended September 30, 2006, selling, general and administrative expense increased due to salaries and infrastructure costs in connection with our leasing activities, partially offset by decreases due to our 2005 sale of all Company-owned stores and the elimination of the related costs.

	Nine Months Ended September 30, 2006	September 24, 2005
Selling, general and administrative expenses	\$ 12,934,600	\$ 11,678,100

Our ability to grow our profits 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 of Wirth Business Credit, Inc. and Winmark Capital Corporation and (iv) control our selling, general and administrative expenses.

Results of Operations

The following table sets forth for the periods indicated, certain income statement items as a percentage of total revenue:

	Three Months Ended September 30, 2006		September 24, 2005		Nine Months Ended September 30, 2006		September 24, 2005	
Revenue:								
Royalties	66.3	%	67.3	%	69.9	%	65.4	%
Merchandise sales	20.1		23.0		17.2		27.2	
Franchise fees	4.2		5.2		4.8		3.8	
Leasing income	7.2		1.9		5.9		1.4	
Other	2.2		2.6		2.2		2.2	
Total revenues	100.0	%	100.0	%	100.0	%	100.0	%
Cost of merchandise sold	(19.1	)	(18.2	)	(16.5	)	(22.5)
Leasing expense	(1.2	)			(0.7)		
Selling, general and administrative expenses	(58.1	)	(58.0	)	(63.1	)	(59.0)
Income from operations	21.6		23.8		19.7		18.5	
Loss from equity investments							(0.9)
Gain on sale of investments								
Interest expense	(4.2	)			(2.1)		
Interest and other income	2.0		1.4		3.7		1.1	
Income before income taxes	19.4		25.2		21.3		18.7	
Provision for income taxes	(7.8	)	(10.5	)	(8.6	)	(7.8)
Net income	11.6	%	14.7	%	12.7	%	10.9	%

Comparison of Three Months Ended September 30, 2006 to Three Months Ended September 24, 2005

Revenue

Revenue for the quarter ended September 30, 2006 totaled \$7.24 million compared to \$6.29 million for the comparable period in 2005.

Royalties increased to \$4.8 million for the third quarter of 2006 from \$4.2 million for the same period in 2005, a 13.5% increase. The increase was due to higher Plato's Closet® (\$256,000), Once Upon A Child® (\$206,000) and Play It Again Sports® (\$108,000) royalties. The increase in Plato's Closet®, Once Upon A Child® and Play It Again Sports® royalties is primarily due to having 26 additional Plato's Closet® franchise stores in the third quarter of 2006 compared to the same period last year and higher franchisee retail sales in these brands.

Merchandise sales include the sale of product to franchisees either through the Play It Again Sports® buying group, or through our Computer Support Center (Direct Franchisee Sales) and retail sales at the Company-owned stores. For the third quarter of 2006 and 2005, they were as follows:

	2006	2005
Direct Franchisee Sales	\$ 1,452,600	\$ 943,700
Retail		502,400
	\$ 1,452,600	\$ 1,446,100

Direct Franchisee Sales revenues increased \$508,900, or 53.9%, for the three months ended September 30, 2006 compared to the same period last year. This is a result of adding two large name brand vendors that required billing through our Play It Again Sports buying group. Retail store sales decreased \$502,400, or 100%, as a result of selling all Company-owned stores in 2005.

Franchise fees decreased to \$305,000 for the third quarter of 2006 compared to \$330,000 for the third quarter of 2005. The decrease is due to opening 15 franchises in the third quarter of 2006, compared to 18 in the same period of 2005.

Leasing income increased to \$523,100 for the third quarter of 2006 compared to \$119,500 for the same period in 2005. The increase is due to a larger lease portfolio in 2006 compared to 2005.

Other revenues decreased to \$158,900 for the third quarter of 2006 compared to \$163,800 for the third quarter of 2005.

Cost of Merchandise Sold

Cost of merchandise sold increased \$237,000 or 20.7% for the third quarter of 2006 compared to the same period last year. The increase was primarily due to an increase in Direct Franchisee Sales discussed in the revenue section, partially offset by a \$236,000 decrease in retail cost of goods sold due to selling all Company-owned stores in 2005.