

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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, 2006

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number: 001-32320

BUILD-A-BEAR WORKSHOP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

43-1883836

(I.R.S. Employer Identification No.)

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

63114
(Zip Code)

(314) 423-8000

(Registrant's Telephone Number, Including Area Code)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$0.01 per share	New York Stock Exchange

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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, 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 the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There is no non-voting common equity. The aggregate market value of the common stock held by nonaffiliates (based upon the closing price of \$21.51 for the shares on the New York Stock Exchange on June 30, 2006) was approximately \$321,605,000, as of July 1, 2006.

As of March 9, 2007, there were 20,572,126 issued and outstanding shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for its May 10, 2007 Annual Meeting are incorporated herein by reference.

BUILD-A-BEAR WORKSHOP, INC.
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FORWARD-LOOKING STATEMENTS

This annual report on Form 10-K contains certain statements that are, or may be considered to be, “forward-looking statements” for the purpose of federal securities laws, including, but not limited to, statements that reflect our current views with respect to future events and financial performance. We generally identify these statements by words or phrases such as “may,” “might,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “intend,” “predict,” “future,” “potential” or “continue,” the negative or any derivative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include, among other things, projections or statements regarding:

- our future financial performance;
- our anticipated operating and growth strategies;
- our anticipated rate of store openings;
- our franchisees’ anticipated rate of international store openings;
- our anticipated store opening costs; and
- our future capital expenditures.

These statements are only predictions based on our current expectations and projections about future events. Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by these forward-looking statements, including those factors discussed under the caption entitled “Risk Factors” as well as other places in this annual report on Form 10-K.

We operate in a competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all the risk factors, nor can it assess the impact of all the risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, you should not place undue reliance on forward-looking statements, which speak only as of the date of this annual report on Form 10-K, as a prediction of actual results.

You should read this annual report on Form 10-K completely and with the understanding that our actual results may be materially different from what we expect. Except as required by law, we undertake no duty to update these forward-looking statements, even though our situation may change in the future. We qualify all of our forward-looking statements by these cautionary statements.

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PART I

ITEM 1. BUSINESS

Overview

Build-A-Bear Workshop, Inc. is the leading, and only international, company providing a “make your own stuffed animal” interactive retail-entertainment experience. As of December 30, 2006, we operated 271 company-owned retail stores in the United States, Canada, the United Kingdom, and Ireland. Of those stores, 232 are Build-A-Bear Workshop® stores located in the United States and Canada and 38 are located in the United Kingdom and Ireland. We operated one stand-alone Friends 2B Made store and eight Friends 2B Made stores adjacent to or within Build-A-Bear Workshop stores in the United States. Franchisees operated 34 Build-A-Bear Workshop stores in international locations. Our core concept is based on our guests making, personalizing and customizing their stuffed animals, and capitalizes on what we believe is the relatively untapped demand for experience-based shopping as well as the widespread appeal of stuffed animals.

We offer an extensive and coordinated selection of merchandise, including over 30 different styles of animals to be stuffed and a wide variety of clothing, shoes and accessories for the stuffed animals. Our concept appeals to a broad range of age groups and demographics, including children, teens, parents and grandparents. We believe that our stores, which are primarily located in malls, are destination locations and draw guests from a large geographic reach. Our stores average approximately 2,800 square feet in size and have a highly visual and colorful appearance, including custom-designed fixtures featuring teddy bears and other themes relating to the Build-A-Bear Workshop experience.

We also market our products and build our brand through a nationwide multi-media marketing program that targets our core demographic guests, principally parents and children. The program incorporates consistent messaging across a variety of media, and is designed to increase our brand awareness and store traffic and attract more first-time and repeat guests.

Since opening our first store in St. Louis, Missouri in October 1997, we have sold over 47 million stuffed animals. We have grown our store base from 150 stores at the end of fiscal 2003 to 271 as of December 30, 2006 and increased our revenues from \$301.7 million in fiscal 2004 to \$437.1 million in fiscal 2006, for a compound annual revenue growth rate of 20.4%, and increased net income from \$18.5 million in fiscal 2004 to \$29.6 million in fiscal 2006, for a compound annual net income growth rate of 26.5%.

Description of Operations

Guests who visit Build-A-Bear Workshop stores enter a teddy bear-themed environment consisting of eight stuffed animal-making stations: Choose Me, Hear Me, Stuff Me, Stitch Me, Fluff Me, Dress Me, Name Me, and Take Me Home. To attract our target guests, we have designed our stores to provide a “theme park” destination in the mall that is open and inviting with an entryway that spans the majority of our storefront and highly visual and colorful teddy bear themes and displays. The duration of a guest’s experience can vary greatly depending on his or her preferences. While most guests choose to participate in the animal-making stations described above, a process which we believe averages 45 minutes to complete, guests can also visit a Build-A-Bear Workshop store and purchase items such as clothing, accessories, our Bear Bucks gift certificates or pre-made animals in only a few minutes.

We offer an extensive and coordinated selection of merchandise including approximately 30 to 35 varieties of animals to be stuffed, as well as a wide variety of other clothing and accessory items for the animals. We enhance the authentic nature of a number of our products with strategic product licensing relationships with brands that are in demand with our guests such as officially sanctioned NFL, NBA and MLB™ team apparel, SKECHERS® shoes or Limited Too clothing. There are approximately 450 SKUs in our store at any one time and we intend for each item to be highly productive.

Given the unique experience we believe we offer our guests, we historically have not had seasonal or advertised sales events or markdowns. We selectively use coupons and frequent shopper discounts for our most loyal guests, as well as gift-with-purchase promotions.

Growth Strategy

Our growth strategy is to develop and expand the reach of the Build-A-Bear Workshop brand by investing in value-adding marketing programs as well as infrastructure and technology and to offer an authentic and unique merchandise assortment. We expect to grow our business by opening additional stores in the United States, Canada, the United Kingdom and Ireland, by adding additional international stores through existing and new franchise agreements, and through the development of third party licensed products that promote Build-A-Bear Workshop as a lifestyle brand and build overall brand awareness.

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We have increased our company-owned store locations throughout the United States and Canada from 108 at the end of fiscal 2002 to 233 as of December 30, 2006. In April 2006, we acquired Amsbra Limited, our former franchise in the United Kingdom, as well as The Bear Factory Limited, a stuffed animal retailer in the United Kingdom. As of December 30, 2006, we operated 38 stores in the United Kingdom and Ireland all under the Build-A-Bear Workshop brand. We expect to open 37 new stores in North America and 7 to 10 new stores in the UK and Ireland in fiscal 2007 in new and existing markets. We believe there is a market potential for at least 350 Build-A-Bear Workshop stores in the North America and 70 to 75 in the UK and Ireland. In addition, we also currently operate Build-A-Bear Workshop stores in non-traditional retail locations including five Major League Baseball® ballparks and one store located in the St. Louis Zoo. We expect to open our first store in a Science Center at the St. Louis Science Center in 2007.

We believe that there is continued opportunity to grow our Build-A-Bear Workshop concept and brand outside of North America, the United Kingdom and Ireland primarily through franchise agreements. Our franchisees have retail and/or real estate experience and are currently operating 34 Build-A-Bear Workshop stores in several foreign countries under master franchise agreements on a country-by-country basis. We expect our franchisees to open approximately 20 to 25 new stores in fiscal 2007 under existing and anticipated franchise agreements. We believe there is a market potential for approximately 300 franchised stores outside North America, the United Kingdom and Ireland. We may open additional company-owned stores outside of the United States, Canada, the United Kingdom, and Ireland.

We believe there are also growth opportunities in other experiential retail entertainment concepts. We believe that consumer demand for additional experiential retail concepts is relatively untapped and that our expertise in product development and providing a consistent shopping experience can be applied to other experiential retail brands and concepts. We expect to be able to leverage our extensive guest database to market these new brands and concepts.

In fiscal 2003, we began testing in certain markets our initial brand expansion initiative, our proprietary Friends 2B Made® line of make-your-own dolls and related products. We believe this concept brings to dolls what Build-A-Bear Workshop has brought to teddy bears — an opportunity to participate in the creation and customization of the doll. The target customer for Friends 2B Made is a girl age five to twelve. We opened four additional Friends 2B Made locations in 2006 to bring the total number of Friends 2B Made locations to nine as of December 30, 2006. All but one of these locations is in or adjacent to a Build-A-Bear Workshop store and are not considered a separate store. We continue to evaluate the doll market adjusting our merchandise assortments and adding additional product lines as well as determine the optimal real estate strategy as we determine the long term potential of this concept.

In addition, we are consistently evaluating additional retail opportunities and expect to continue our expansion into other concepts and product lines in the future. For example, in 2006, the first Build-A-Dino™ store opened in partnership with T-Rex™ Café, our first store within a third-party restaurant concept. In 2007, we plan to add the Build-A- Dino™ concept to Build-A-Bear Workshop stores in two highly trafficked tourist locations, Myrtle Beach in South Carolina and Manhattan in New York. Also in 2007, in partnership with Retail Entertainment Concepts L.L.C, in which we have a minority interest, we will open the first Ridemakerz™ store, a new concept focused on boys and cars.

Product Development

Through our in-house design and product development team, we have developed a coordinated, creative and broad merchandise assortment, including a variety of animals, clothing, shoes and accessories. We believe our merchandise is an integral part of our concept and that the proprietary design of many of the products we offer is a critical element of our success, while the authentic and fashionable nature of our products greatly enhances our brand's appeal to our guests. Our product development team regularly monitors current fashion and culture trends in order to create products that we believe are most appealing to our guests, often reflecting similar styling to the clothes our guests wear themselves. We test our products on an on going basis to ensure guest demand supports order quantities. Through our focused vendor relationships, we are able to source our merchandise in a manner that is cost-effective, maximizes our speed to market and facilitates rapid reorder of our best-selling items.

The skins for our animals are produced from high quality man-made materials, and the stuffing is made of a high-grade polyester fiber. We believe all of our products meet Consumer Product Safety Commission requirements for toys and American Society for Testing and Materials specifications for toy safety in all material respects. We routinely have samples of all items sold in our stores tested at independent laboratories for compliance with these requirements. Packaging and labels are developed for each product to communicate age grading and any special warnings which may be recommended by the Consumer Product Safety Commission.

Marketing

We believe that the strength of the Build-A-Bear Workshop brand is a competitive advantage and an integral part of our strategy. Unlike other mall based retailers that frequently use markdowns or sale events to drive sales, at Build-A-Bear Workshop we use marketing to raise brand awareness and drive traffic to our stores. Our goal is to continue to build the awareness of our brand and the recognition of our name as a destination retailer that provides experience-based shopping across a broad range of age groups and demographics.

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Since February 2004, we have utilized an integrated marketing program that utilizes national television advertising, direct mail and other components. Our advertising expenditures were \$22.7 million (7.5% of total revenues) in fiscal 2004, \$27.2 million (7.5% of total revenues) in fiscal 2005 and \$31.0 million (7.1% of total revenues) in fiscal 2006, reflecting the rollout and continuation of our marketing initiatives.

We employ several different marketing programs to drive traffic to our stores and grow awareness of our brand. We can benefit from advertising campaigns that run in all four quarters of the year. We use television advertising that targets both children and adults to promote and raise awareness of our Build-A-Bear Workshop brand as well as advertising specific new product introductions. We also advertise on radio and use online advertising to communicate our interactive product and experience. We leverage our database of over 18 million unique households in our direct mail and e-mail programs. Our website, www.buildabear.com, offers e-commerce, information and entertaining games to over 1 million visitors per month. We also incorporate store events, tourism marketing, mobile marketing and public relations into our marketing plans. We integrate the timing and the messaging of the advertising and marketing programs across the various media to maximize our reach to both new and existing guests and drive traffic into our stores.

In July 2006, we introduced our Stuff Fur Stuff® club customer loyalty program in the United States that allows us to track electronically the rewards earned by customers. The program had previously been tested in select markets and replaces our former Buy Stuff program, which was a manual punch card system with limited tracking capability. The reward earned by the new program did not change. After a guest enrolls in the Stuff Fur Stuff® club, they receive one point for every dollar or partial dollar spent and after reaching 100 points and they receive a reward certificate that offers a discount on their future purchase. Since the national roll-out, over 2.8 million members have enrolled.

Following the acquisition of our United Kingdom and Irish operations, we introduced our initial marketing initiatives in those countries including a direct mail and e-mail program, print advertising, store events, tourism marketing and public relations. We expect to continue to expand our marketing initiatives in the UK and Ireland in 2007 in order to grow our brand awareness and grow our store business.

Licensing and Strategic Relationships

We have developed licensing and strategic relationships with some of the leading retail and cultural organizations in the United States and Canada. We believe that our guest base and our position in our industry category makes us an attractive partner and our customer research and insight allows us to focus on strategic relationships with other companies that we believe are appealing to our guests. We plan to continue to add strategic relationships on a selective basis with companies who share our vision for our brand and provide us with attractive brand-awareness, marketing and merchandising opportunities. These relationships for specific products are generally reflected in contractual arrangements for limited terms that are terminable by either party upon specified notice.

Product and Merchandise Licensing. We have key strategic relationships with select companies, including World Wildlife Fund, SKECHERS®, Sanrio, the NBA, the WNBA, MLB™, Limited Too, Disney, NFL, the NHL® and First Book and, in Canada, World Wildlife Fund Canada, in which we use their brands on our products sold in our stores. These strategic relationships allow both parties to generate awareness around their brands. We have relationships with groups that pursue socially responsible causes, as well as companies that have strong consumer brands, in order to respond to our guests' interests. We have also offered selected character-oriented products including Sesame Workshop's Elmo and Big Bird, Disney's Mickey Mouse and Minnie Mouse and Mumble, the feature character in Warner Bros.' animated film, Happy Feet.

Promotional Arrangements. We have also developed promotional arrangements with selected organizations. Our arrangements with Major League Baseball® teams, including the Chicago Cubs™, St. Louis Cardinals™, New York Mets™ and San Francisco Giants™, have featured stuffed animal giveaways at each club's ballpark on a day in which our brand is highly promoted within the stadium. In May 2006, we partnered with McDonalds to feature limited edition, collectible mini Build-A-Bear Workshop animals in Happy Meals. We also have had arrangements featuring product sampling, cross promotions and shared media with companies such as Lego, JC Penney, Hilton Hotels, Mastercard and Macy's as well as targeted promotions with key media brands like *National Geographic Kids* and Radio Disney.

Third Party Licensing. We have entered into a series of licensing arrangements with leading manufacturers to develop a collection of lifestyle Build-A-Bear Workshop branded products including children's furniture, fruit snacks, video and DVD games, a direct-to-home book club, stationary products, infant developmental toys and school fundraising products. We believe that each of these initiatives has the potential to enhance our brand, raise brand awareness, and drive increased revenues and profitability. We select companies for licensing relationships that we believe are leaders in their respective sectors and that understand and share our strategic vision for offering guests exciting and interactive merchandise. We have policies and practices in place intended to ensure that the products manufactured under the Build-A-Bear Workshop brand adhere to our quality, value and usability standards. We have entered into licensing arrangements for our branded products with leading manufacturers including Pulaski Furniture, ConAgra Foods, Scholastic At Home, Game Factory, Extra Large Technology, Snap TV, Creative Designs International and Kids Preferred.

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Industry and Guest Demographics

While Build-A-Bear Workshop offers consumers an interactive and personalized experience, our tangible product is stuffed animals, including our flagship product, the teddy bear, a widely adored stuffed animal for over 100 years. According to data published by the International Council of Toy Industries, worldwide sales of retail plush toys was approximately \$4.4 billion and retail sales of dolls was approximately \$6.6 billion in 2000, which combined represent about 20% of the \$55 billion worldwide toy industry (excluding video games). In addition, a study conducted for the Toy Industry Association reported U.S. sales of retail plush toys were \$1.3 billion and retail sales of dolls were \$2.7 billion in 2006, for a combined total of over \$4.0 billion. In 2006, Playthings Magazine ranked us as the 12th largest toy retailer in the United States for 2005 based on sales.

Our guests are diverse, spanning broad age ranges and socio-economic categories. Major guest segments include families with children, primarily ages three to twelve, grandparents, aunts and uncles, teen girls who occasionally bring along their boyfriends and child-centric organizations looking for interactive entertainment options such as scouting organizations and schools. Based on information compiled from our guest database for 2006, the average age of the recipient of our stuffed animals at the time of purchase is ten years old and children aged one to fourteen are the recipients of approximately 80% of our stuffed animals.

According to the United States Census Bureau, in 2004 there were over 60 million children age 14 and under in the United States. While the size of this population group is projected to remain relatively stable over the next decade, the economic influence of this age group is expected to increase. Based on a recent third-party publication, we believe that children's spending has doubled every ten years for the past three decades, tripling in the 1990s. Direct spending by children aged four to twelve was estimated at \$2.2 billion in 1968, \$4.2 billion in 1984 and \$17.1 billion in 1994 and 2002 estimates placed spending by this demographic at \$40 billion. By 2006, children are expected to directly spend more than \$50 billion as well as influence hundreds of billions of dollars in additional family spending.

Employees and Training

We are committed to providing a great experience for our diverse team of associates as well as our guests. We have a distinctive culture that we believe encourages contribution and collaboration. We take great pride in our culture and feel it is critical in encouraging creativity, communication, and strong store performance. All store managers receive comprehensive training through our Bear University® program, which is designed to promote a friendly and personable environment in our stores and a consistent experience across our stores. We extensively train our associates on the bear-making process and the guest experience. In fiscal 2006, we hired less than 3% of applicants for store manager positions. We focus on employing and retaining people who are friendly and focused on guest service. Our above average employee retention rates, based on 2006 industry data, contribute to the consistency and quality of the guest experience. Our store teams are evaluated and compensated not only on sales results but also the results from our regular guest satisfaction surveys. Each store has a recognition fund so that exceptional guest service can be immediately recognized and rewarded. We are committed to providing compensation structures that recognize individual accomplishments as well as overall team success.

As of December 30, 2006, we employed approximately 1,200 full-time and 5,700 part-time employees. We divide our store base into four geographic regions, with the United Kingdom and Ireland representing one of those regions. The regions are supervised by our Chief Workshop Bear and four Regional Workshop Directors. Bearitory Leaders are responsible for each of our 28 bearitories consisting of between six and twelve stores. Each of our stores generally has a full-time Chief Workshop Manager and two full-time Assistant Workshop Managers in addition to hourly Bear Builder™ associates, most of whom work part-time. The number of part-time employees fluctuates depending on our seasonal needs. In addition to the approximately 6,500 employees at our store locations, we employ approximately 300 associates in general administrative functions at our World Bearquarters in St. Louis, Missouri, approximately 50 associates at our Bearhouse distribution center in Groveport, Ohio, and approximately 25 associates in our U.K. Bearquarters in Windsor, England. We are committed to innovation and invention and generally have confidentiality agreements with our employees and consultants. Store managers and Bearquarters associates pass specific profile assessments. None of our employees are represented by a labor union, and we believe our relationship with our employees is good.

International Franchises

In 2003, we began to expand the Build-A-Bear Workshop brand outside of the United States, opening our own stores in Canada and our first franchised location in the United Kingdom. As of December 30, 2006, there were 34 Build-A-Bear Workshop franchised stores located in the following countries:

Japan	7
Australia	6
Denmark	5
Taiwan	3
Other	13

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On April 2, 2006 we acquired Amsbra Limited, our former franchisee in the United Kingdom, and The Bear Factory Limited, a stuffed animal retailer in the United Kingdom. Amsbra previously operated all of the franchised Build-A-Bear Workshop stores located in the United Kingdom. Upon completion of this acquisition, all of the franchised locations in the United Kingdom became company owned-stores.

All of our non-U.S., Canadian, United Kingdom and Irish stores are currently operated by third party franchisees under separate master franchise agreements covering each country. Master franchise rights are typically granted to a franchisee for an entire country or group of countries for a specified term. The terms of these master franchise agreements vary by country but typically provide that we receive an initial, one-time franchise fee and continuing royalties based on a percentage of sales made by the franchisees' stores. The terms of these agreements range up to ten years with a franchisee option to renew for an additional term if certain conditions are met. All such franchised stores have similar signage, store layout and merchandise characteristics to our stores in the United States and Canada. Our goal is to have well-capitalized franchisees with expertise in retail operations and real estate in their respective country. We work in conjunction with our franchisees in the development of their business and store growth plans. We approve all franchisees' orders for merchandise and have oversight of their operational and business practices in an effort to ensure they are in compliance with our standards. We expect our current and anticipated franchisees to open approximately 20 to 25 new stores in fiscal 2007 in both existing and new countries.

Sourcing and Inventory Management

We do not own or operate any manufacturing facilities. Our animal skins, stuffing, clothing and accessories are produced by factories located primarily in China. We purchased approximately 83% of our inventory in fiscal 2006, approximately 86% in fiscal 2005 and approximately 85% in fiscal 2004 from three vendors. After specifying the details and requirements for our products, our vendors contract orders with multiple manufacturing facilities in Asia that are approved by us in accordance with our quality control and labor standards. Our supplier factories are compliant with the International Council of Toy Industries (ICTI) CARE certification. The CARE (Caring, Awareness, Responsible, Ethical) Process is the ICTI program to promote ethical manufacturing, in the form of fair labor treatment, as well as employee health and safety, in the toy industry supply chain worldwide. Its initial focus is in China, where 70 percent of the world's toy volume is manufactured. In order to obtain this certification each factory completed a rigorous evaluation performed by an accredited ICTI agent. Our suppliers can be used interchangeably as each has a sourcing network for multiple product categories and can expand its factory network as needed. Our relationships with our vendors generally are on a purchase order basis and do not provide a contractual obligation to provide adequate supply, quality or acceptable pricing on a long-term basis.

The average time from the beginning of production to arrival of the products into our stores is approximately 90 to 120 days. Our weekly tracking and reporting tools give us the capabilities to adjust to shifts in demand and help us to negotiate prices with our vendors. Through a regular analysis of selling trends, we periodically update our product assortment by increasing productive styles and eliminating less productive SKUs. Our distribution centers provide further logistical efficiencies for delivering merchandise to our stores.

Distribution and Logistics

Through September 2006, a third-party provider warehoused and distributed a large portion of our merchandise at a distribution center in St. Louis, Missouri. In September 2006, we completed the construction of a new 350,000-square-foot distribution center near Columbus, Ohio which replaced the third-party warehouse as well as a smaller distribution center previously used in Los Angeles, California. We continue to have a third-party distribution center in Toronto, Canada under an agreement that may be terminated with 120-day notice or when no work has been performed for 180 days. In the United Kingdom, we contract with a third-party distribution center in Middlesex, England under a renewable monthly agreement. Store shipments from our third-party distribution centers are scheduled throughout the week in order to smooth workflow and stores that are part of the same shipping route are grouped together to reduce freight costs. All items in our assortment are eligible for distribution, depending on allocation and fulfillment requirements, and we typically distribute merchandise and supplies to each store once a week on a regular schedule, which allows us to consolidate shipments in order to reduce distribution and shipping costs.

Transportation from the warehouses to the stores is managed by several third-party logistics providers. In the United States and Canada, merchandise is ground-shipped to one of 74 third-party pool points, which then deliver merchandise to the stores on a pre-arranged schedule. Back-up supplies, such as Cub Condo carrying cases and stuffing for the animals, are often stored in limited amounts at these local pool points. In the United Kingdom and Ireland, merchandise is shipped directly from the warehouse to the store.

Management Information Systems and Technology

Management information systems are a key component of our business strategy and we are committed to utilizing technology to enhance our competitive position. Our information and operational systems utilize a broad range of both purchased and internally developed applications which support our guest relationships, marketing, financial, retail operations, real estate, merchandising, and

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inventory management processes. Our employees can securely access these systems over a company-wide network. Sales, daily deposit and guest information are automatically collected from the stores' point-of-sale terminals and kiosks on a near real time basis. We have developed proprietary software including domestic and international versions of our Name Me kiosk, Find-A-Bear® identification, and our patented party scheduling systems. Data from these systems are used to support key decisions in all areas of our business, including merchandising, allocation and operations.

In the United States and Canada, we completed the installation of the initial module of our human resources software in April 2006, our General Ledger and Accounts Payable financial software in July 2006, our merchandise planning system in August 2006 as well as installing a warehouse management system as part of our new company-owned distribution center. Additional modules of the human resources and financial systems will be added in fiscal 2007. These new systems are intended to improve our operational efficiency, purchasing and inventory control. Also in 2007, the General Ledger and Accounts Payable financial software will be installed in the United Kingdom.

We regularly evaluate strategic information technology initiatives focused on competitive differentiation, support of corporate strategy and reinforcement of our internal support systems. Our critical systems are reviewed on a regular basis to evaluate disaster recovery plans and the security of our systems.

Competition

We view our Build-A-Bear Workshop experience as a distinctive combination of entertainment and retail. Because we are mall-based, we see our competition as those mall-based retailers that compete for prime mall locations, including various apparel, footwear and specialty retailers. We also compete with toy retailers, such as Wal-Mart, Toys "R" Us, Target, Kmart and Sears and other discount chains, as well as with a number of companies that sell teddy bears in the United States, including, but not limited to, Ty, Fisher Price, Mattel, Ganz, Russ Berrie, Applause, Boyd's, Hasbro, Commonwealth, Gund and Vermont Teddy Bear. Since we sell a product that integrates merchandise and experience, we also view our competition as any company that competes for our guests' time and entertainment dollars, such as movie theaters, amusement parks and arcades, and other mall-based entertainment venues.

We are aware of several small companies that operate "make your own" teddy bear and stuffed animal stores or kiosks in retail locations, but we believe none offer the breadth and depth of the Build-A-Bear Workshop experience or operates as a national retail company.

Intellectual Property and Trademarks

As of December 30, 2006, we had obtained over 200 U.S. trademark registrations, including Build-A-Bear Workshop® for stuffed animals and accessories for the animals, retail store services and other goods and services, over 35 issued U.S. patents with expirations ranging from 2013 through 2024 and over 160 copyright registrations. In addition, we have over 80 U.S. trademark and two U.S. patent applications pending. We also license three patents from third-parties, including a patent for the pre-stitching system used for closing up our stuffed animals after they have been stuffed (U.S. Patent No. 6,109,196). Pursuant to an exclusive patent license agreement with Tonyco, Inc. dated March 12, 2001, we were granted an exclusive license for use of the patent in retail stores similar to ours. While we have the right to sublicense the patent, the licensor has agreed not to grant rights to any of our competitors. In the event that we or the licensor has reason to believe that a third party is infringing upon the patent, the licensor is generally required to bear the expenses required to maintain and defend the patent. The term of the agreement is for the full life of the patent and any improvements thereon. The term will expire in 2019 unless we terminate the agreement, upon notice to the licensor, in the event that the patent lapses due to the licensor's non-payment of maintenance taxes and fees for the patent. We paid the licensor \$760,000 for the license. All payments due under the license have been made and no ongoing payments are required by us.

We believe our copyrights, service marks, trademarks, trade secrets, patents and similar intellectual property are critical to our success, and we intend, directly or indirectly, to maintain and protect these marks and, where applicable, license the intellectual property and the registrations for the intellectual property. We rely on trademark, copyright and other intellectual property law to protect our proprietary rights to the extent available in any relevant jurisdiction. We also depend on trade secret protection through confidentiality and license agreements with our employees, subsidiaries, licensees, licensors and others. We may not have agreements containing adequate protective provisions in every case, and the contractual provisions that are in place may not provide us with adequate protection in all circumstances. Any infringement or misappropriation of our intellectual property rights or breach of our confidentiality or license agreements could result in significant litigation costs, and any failure to adequately protect our proprietary rights could result in our competitors offering similar products, potentially resulting in loss of one or more competitive advantages and decreased revenues. In addition, intellectual property litigation or claims could force us to do one or more of the following: cease selling or using any of our products that incorporate the challenged intellectual property, which would adversely affect our revenue; obtain a license from the holder of the intellectual property right alleged to have been infringed, which license may not be available on reasonable terms, if at all; and redesign or, in the case of trademark claims, rename our products to avoid infringing the intellectual property rights of third parties, which may not be possible and time-consuming if it is possible to do so.

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Despite our efforts to protect our intellectual property rights, intellectual property laws afford us only limited protection. A third party could copy or otherwise obtain information from us without authorization. Accordingly, we may not be able to prevent misappropriation of our intellectual property or to deter others from developing similar products or services. Further, monitoring the unauthorized use of our intellectual property is difficult. Litigation has been and may continue to be necessary to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation of this type could result in substantial costs and diversion of resources, may result in counterclaims or other claims against us and could significantly harm our results of operations. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as do the laws of the United States.

We also conduct business in foreign countries to the extent our merchandise is manufactured or sold outside the United States and we have opened stores outside the United States in the past three years, either directly or indirectly through franchisees. We filed, obtained or plan to file for registration of marks in foreign countries to the degree necessary to protect these marks, although our efforts may not be successful and further there may be restrictions on the use of these marks in some jurisdictions.

Segments and Geographic Areas

We conduct our operations through three reportable segments consisting of retail, international franchising, and licensing and entertainment. The retail segment includes the operating activities of company-owned stores in the United States, Canada, the United Kingdom and Ireland, and other retail delivery operations, including our web-store and non-traditional store locations such as tourist venues and ballpark stores. The international franchising segment includes the licensing activities of our franchise agreements with locations in Europe, Asia, and Australia. The licensing and entertainment segment has been established to market the naming and branding rights of our intellectual properties for third party use. See the financial statements included elsewhere in this annual report on Form 10-K for further discussion and financial information related to our segments.

Our reportable segments are primarily determined by the types of products and services that they offer. Each reportable segment may operate in many geographic areas. See the financial statements included elsewhere in this annual report on Form 10-K for further discussion and financial information related to geographic areas in which we operate.

Availability of Information

We make certain filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments and exhibits to those reports, available free of charge in the Investor Relations section of our corporate website, <http://ir.buildabear.com>, as soon as reasonably practicable after they are filed with the SEC. The filings are also available through the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 or by calling 1-800-SEC-0330. Also, these filings are available on the internet at <http://www.sec.gov>. Our annual reports to shareholders, press releases and recent analyst presentations are also available on our website in the Investor Relations section or by writing to the Investor Relations department at World Bearquarters, 1954 Innerbelt Business Center Dr., St. Louis, MO 63114.

ITEM 1A. RISK FACTORS

We operate in a changing environment that involves numerous known and unknown risks and uncertainties that could materially affect our operations. The risks, uncertainties and other factors set forth below may cause our actual results, performances or achievements to be materially different from those expressed or implied by our forward-looking statements. If any of these risks or events occur, our business, financial condition or results of operations may be adversely affected.

Risks Related to Our Business

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

We believe that our success depends in large part upon our ability to continue to attract guests with our interactive shopping experience and our ability to anticipate, gauge and respond in a timely manner to changing consumer preferences and fashion trends. We cannot assure you that our past success will be sustained or there will continue to be a demand for our "make-your-own stuffed animal" interactive experience, or for our stuffed animals, animal apparel and accessories. A decline in demand for our interactive shopping experience, our animals, animal apparel or accessories, or a misjudgment of consumer preferences or fashion trends, could have a negative impact on our business, financial condition and results of operations. Furthermore, we may be unable to attract guests to and generate demand for our new Friends 2B Made interactive shopping experience. If our Friends 2B Made concept fails to be successful and we determine not to continue it, we may incur charges as a result and it may have an adverse impact on the Build-A-Bear Workshop brand. In addition, if we miscalculate the market for our merchandise or the purchasing preferences of our guests, we may be required to sell a significant amount of our inventory at discounted prices or even below costs, thereby adversely affecting our financial condition and profitability.

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Our future growth and profitability could be adversely affected if our marketing initiatives are not effective in generating sufficient levels of brand awareness and guest traffic.

In February 2004, after development and testing in selected markets, we introduced nationwide a multi-media marketing program targeting our core demographic guests, principally parents and children, which contributed to an increase in our comparable store sales in fiscal 2004. We continue to update and evaluate our marketing initiatives, focusing on brand awareness and rapidly changing consumer preferences. Our future growth and profitability will depend in large part upon the effectiveness and efficiency of this marketing program and future marketing efforts that we undertake, including our ability to:

- create greater awareness of our brand, interactive shopping experience and products;
- identify the most effective and efficient level of spending in each market;
- determine the appropriate creative message and media mix for marketing expenditures;
- effectively manage marketing costs (including creative and media) in order to maintain acceptable operating margins and return on marketing investment;
- select the right geographic areas in which to market; and
- convert consumer awareness into actual store visits and product purchases.

Our planned marketing expenditures may not result in increased total or comparable store sales or generate sufficient levels of product and brand name awareness. We may not be able to manage our marketing expenditures on a cost-effective basis.

If we are not able to generate and maintain comparable store sales growth and continue to have negative comparable store performance, our results of operations could be adversely affected.

Our comparable store sales for fiscal 2006 declined by 6.5%, following a 0.2% decline in fiscal 2005, an 18.1% increase in fiscal 2004. The decrease in 2006 was primarily the result of a changing customer preferences, a decline in customer traffic, and the more difficult macro economic conditions generally impacting customers. In 2005, ongoing programs in advertising were successful in maintaining our comparable store sales levels. The increase in 2004 was principally as a result of the nationwide multi-media marketing program we initiated in February 2004, an improved economy, and the positive impact of being featured in one segment of a nationally syndicated television show in the first quarter of fiscal 2004. We believe the principal factors that will affect comparable store results are the following:

- the continuing appeal of our concept;
- the effectiveness of our marketing efforts to attract new and repeat guests;
- consumer confidence and general economic conditions;
- our ability to anticipate and to respond, in a timely manner, to consumer trends and offer popular characters;
- the continued introduction and expansion of our merchandise offerings;
- the impact of new stores that we open in existing markets;
- mall traffic;
- competition;
- the timing and frequency of national media appearances and other public relations events; and
- weather conditions.

As a result of these and other factors, we may not be able to generate or maintain comparable stores sales growth in the future. If we are unable to do so, our results of operations could be significantly harmed.

A decrease in the customer traffic generated by the shopping malls in which we are located, which we depend upon to attract guests to our stores, could adversely affect our financial condition and profitability.

While we invest heavily in integrated marketing efforts and believe we are more of a destination location than traditional retailers, we rely to a great extent on customer traffic in the malls in which our stores are located. In order to generate guest traffic, we generally attempt to locate our stores in prominent locations within high traffic shopping malls. We rely on the ability of the malls' anchor tenants, generally large department stores, and on the continuing popularity of malls as shopping destinations. We cannot control the development of new shopping malls, the addition or loss of anchors and co-tenants, the availability or cost of appropriate locations within existing or new shopping malls or the desirability, safety or success of shopping malls. In addition, customer mall traffic may be reduced due to a loss of consumer confidence because of terrorism or war. If we are unable to generate sufficient guest traffic, our sales and results of operations would be harmed. A significant decrease in shopping mall traffic could have a material adverse effect on our financial condition and profitability.

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A decline in general economic conditions could lead to reduced consumer demand for our products and have an adverse effect on our liquidity and profitability.

Since purchases of our merchandise are dependent upon discretionary spending by our guests, our financial performance is sensitive to changes in overall economic conditions that affect consumer spending. Consumer spending habits are affected by, among other things, prevailing economic conditions, levels of employment, salaries and wage rates, consumer confidence and consumer perception of economic conditions. A general or perceived slowdown in the United States, Canadian or U.K. economies or uncertainty as to the economic outlook could reduce discretionary spending or cause a shift in consumer discretionary spending to other products. Any of these factors would likely cause us to delay or slow our expansion plans, result in lower net sales and could also result in excess inventories, which could, in turn, lead to increased merchandise markdowns and related costs associated with higher levels of inventory and adversely affect our liquidity and profitability.

Our market share may be adversely impacted at any time by a significant number of competitors.

We operate in a highly competitive environment characterized by low barriers to entry. We compete against a diverse group of competitors. Because we are mall-based, we see our competition as those mall-based retailers that compete for prime mall locations, including various apparel, footwear and specialty retailers. We also compete with toy retailers, such as Wal-Mart, Toys “R” Us, Target, Kmart and Sears and other discount chains, as well as with a number of manufacturers that sell plush toys in the United States and Canada, including, but not limited to, Ty, Fisher Price, Mattel, Russ Berrie, Applause, Boyd’s, Hasbro, Commonwealth, Gund and Vermont Teddy Bear. Since we offer our guests an experience as well as merchandise, we also view our competition as any company that competes for our guests’ time and entertainment dollars, such as movie theaters, restaurants, amusement parks and arcades. In addition, there are several small companies that operate “make your own” teddy bear and stuffed animal experiences in retail stores and kiosks. Although we believe that currently none of these companies offers the breadth and depth of the Build-A-Bear Workshop products and experience, we cannot assure you that they will not compete directly with us in the future.

Many of our competitors have longer operating histories, significantly greater financial, marketing and other resources, and greater name recognition. We cannot assure you that we will be able to compete successfully with them in the future, particularly in geographic locations that represent new markets for us. If we fail to compete successfully, our market share and results of operations could be materially and adversely affected.

Our merchandise is manufactured by foreign manufacturers; therefore the availability and costs of our products may be negatively affected by risks associated with international manufacturing and trade.

We purchase our merchandise from domestic vendors who contract with manufacturers in foreign countries, primarily in China. Any event causing a disruption of imports, including the imposition of import restrictions or labor strikes or lock-outs, could adversely affect our business. For example, in fiscal 2002, we experienced disruption to our import of merchandise as well as increased shipping costs associated with a dock-worker labor dispute. The flow of merchandise from our vendors could also be adversely affected by financial or political instability in any of the countries in which the goods we purchase are manufactured, especially China, if the instability affects the production or export of merchandise from those countries. Trade restrictions in the form of tariffs or quotas, or both, applicable to the products we sell could also affect the importation of those products and could increase the cost and reduce the supply of products available to us. In addition, decreases in the value of the U.S. dollar against foreign currencies, particularly the Chinese renminbi, could increase the cost of products we purchase from overseas vendors.

Our distribution vendors may perform poorly, and we may be unable to realize the anticipated benefits from our company-owned distribution center.

The efficient operation of our stores is dependent on our ability to distribute merchandise to locations throughout the United States and Canada in a timely manner. We have in the past relied on third parties to manage all of the warehousing and distribution aspects of our business and continue to rely on them for a portion of our U.K. and Canadian distributions and all of our distributions elsewhere. In 2006, we completed construction of a 350,000-square-foot distribution center in Groveport, Ohio. Although we have added key personnel with experience in the management of warehouses and distribution centers, we do not have extensive experience in this area, and we may not be able to manage these functions as well as our current third party providers, which could disrupt our business. Even if we are able to manage this aspect of our business effectively, we may not realize all of the cost efficiencies and other benefits we currently expect from owning and operating the Groveport distribution center, which would adversely affect our results of operations.

We rely on a few vendors to supply substantially all of our merchandise, and any disruption in their ability to deliver merchandise could harm our ability to source products and supply inventory to our stores.

We do not own or operate any manufacturing facilities. We purchased approximately 83% of our merchandise in fiscal 2006, 86% of our merchandise in fiscal 2005, and approximately 85% in fiscal 2004, from three vendors. These vendors in turn contract for our orders with multiple manufacturing facilities for the production of merchandise. Our relationships with our vendors generally are on a

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purchase order basis and do not provide a contractual obligation to provide adequate supply, quality or acceptable pricing on a long-term basis. Our vendors could discontinue sourcing merchandise for us at any time. If any of our significant vendors were to discontinue their relationship with us, or if the factories with which they contract were to suffer a disruption in their production, we may be unable to replace the vendors in a timely manner, which could result in short-term disruption to our inventory flow as we transition our orders to new vendors or factories which could, in turn, disrupt our store operations and have an adverse effect on our business, financial condition and results of operations.

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

We lease all of our store locations. The majority of our store leases contain provisions for base rent plus percentage rent based on sales in excess of an agreed upon minimum annual sales level. A number of our leases include a termination provision which applies if we do not meet certain sales levels during a specified period, typically in the third to fourth year of the lease. In addition, most of our leases will expire within the next ten years and generally do not contain options to renew. Furthermore, some of these leases contain various restrictions relating to change of control of our company. Our leases also subject us to risks relating to compliance with changing mall rules and the exercise of discretion by our landlords on various matters within the malls. In addition, the lease for our store in the DOWNTOWN DISNEY® District at the DISNEYLAND® Resort in Anaheim, California provides that the landlord may terminate the lease at any time, subject to the payment of an early termination fee. As a result, we cannot assure you that the landlord will not exercise its right to terminate this lease.

Our growth strategy requires us to open a significant number of new stores in the United States, Canada, the United Kingdom, and Ireland each year. If we are not able to open new stores or to effectively manage this growth, it could adversely affect our ability to grow and could significantly harm our profitability.

Our growth will largely depend on our ability to open and operate new stores successfully in the United States, Canada, the United Kingdom, and Ireland. We opened 35, 30 and 21 stores in fiscal 2006, 2005, and 2004, respectively. We plan to open approximately 37 new stores in the United States and Canada in fiscal 2007 and 7 to 10 new stores in the United Kingdom and Ireland and anticipate further store openings in subsequent years. Our ability to identify and open new stores in desirable locations and operate such new stores profitably is a key factor in our ability to grow successfully. We cannot assure you as to when or whether desirable locations will become available, the number of Build-A-Bear Workshop stores that we can or will ultimately open, or whether any such new stores can be profitably operated. We have not always succeeded in identifying desirable locations or in operating our stores successfully in those locations. For example, as of December 30, 2006, we have closed two stores since our inception (not including four stores that we closed in connection with our 2006 acquisition of Amsbra and The Bear Factory). We cannot assure you that we will not have other stores in the future that we may decide to close. In addition, our ability to open new stores and manage our growth will be limited to some extent by market saturation of our stores. Our ability to open new stores and to manage our growth also depends on our ability to:

- negotiate acceptable lease terms, including desired tenant improvement allowances;
- finance the preopening costs, capital expenditures and working capital requirements of the stores;
- manage inventory to meet the needs of new and existing stores on a timely basis;
- hire, train and retain qualified store personnel;
- develop cooperative relationships with our landlords; and
- successfully integrate new stores into our existing operations.

In July 2005, we opened our flagship store in New York City. This store is much larger than our typical mall-based stores and includes additional facilities, such as a restaurant, that we do not operate in our typical mall-based stores. Because we have little experience with this type of store, we may be unable to generate revenues from this store at a level that justifies keeping the store open. Closing this store could not only have an adverse impact on our profitability, as the costs of opening this store were much larger than those for a typical store, but, as our flagship store, it could also have an adverse impact on the Build-A-Bear Workshop brand and consumer perception of our brand.

Increased demands on our operational, managerial and administrative resources as a result of our growth strategy could cause us to operate our business less effectively, which in turn could cause deterioration in our profitability.

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

The success of our business depends upon our senior management closely supervising all aspects of our business, in particular the operation of our stores and the design, procurement and allocation of our merchandise. Also, because guest service is a defining feature of the Build-A-Bear Workshop corporate culture, we must be able to hire and train qualified managers and Bear Builder associates to succeed. The loss of certain key employees, including Maxine Clark, our founder and Chief Executive Bear, or other members of our senior management, our inability to attract and retain other qualified key employees or a labor shortage that reduces

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the pool of qualified store associates could have a material adverse effect on our business, financial condition and results of operations. We generally do not maintain key person insurance with respect to our executives, management or other personnel, except for limited coverage of our Chief Executive Bear, which we do not believe would be sufficient to completely protect us against losses we may suffer if her services were to become unavailable to us in the future.

We may not realize some of the expected benefits of the acquisition of Amsbra and The Bear Factory, including making these operations profitable in light of the substantial costs of these operations.

In April 2006, we acquired The Bear Factory Limited, a stuffed animal retailer in the U.K. owned by The Hamleys Group Limited and Amsbra Limited, our former U.K. franchisee. Both The Bear Factory and Amsbra had losses in 2006, 2005 and prior fiscal years. Although we believe that we can make these operations profitable as part of our larger company through marketing, product and store execution practices, we may be unable to do so. In particular, we may be unable to successfully leverage our purchasing power and know-how, and may be unable to raise sales levels sufficiently to generate profitable operations. In addition, other than Canada, we have not directly operated non-U.S. businesses, and we will face business, regulatory and cultural differences from our domestic business, such as economic conditions in the U.K., changes in foreign government policies and regulations in the U.K. and potential restrictions on the right to convert and repatriate currency, as well as other risks that we may not anticipate. We also face difficulties becoming profitable in the U.K. because we have less brand awareness than in the U.S., face higher labor and rent costs, and have different holiday schedules.

If we are not able to franchise new stores outside of the United States, Canada and the U.K., if we are unable to effectively manage our international franchises or if the laws relating to our international franchises change, our growth and profitability could be adversely affected and we could be exposed to additional liability.

In 2003, we began to expand the Build-A-Bear Workshop brand outside of the United States, opening our own stores in Canada and our first franchised location in the United Kingdom. We intend to continue expanding outside of the United States and Canada through franchising in several countries over the next several years. As of December 30, 2006, there were 34 Build-A-Bear Workshop franchised stores located outside of the United States, Canada and the U.K. We have limited experience in franchising and we may not be successful in maintaining and implementing our international franchising strategy. In addition, we cannot assure you that our franchisees will be successful in identifying and securing desirable locations or in operating their stores. These markets frequently have different demographic characteristics, competitive conditions, consumer tastes and discretionary spending patterns than our existing United States, Canadian and U.K. markets, which may cause these stores to be less successful than those in our existing markets. Additionally, our franchisees may experience merchandising and distribution challenges that are different from those we currently encounter in our existing markets. The operations and results of our franchisees could be negatively impacted by the economic or political factors in the countries in which they operate. These challenges, as well as others, could have a material adverse effect on our business, financial condition and results of operations.

The success of our franchising strategy will depend upon our ability to attract qualified franchisees with sufficient financial resources to develop and grow the franchise operation and upon the ability of those franchisees to develop and operate their franchised stores. Franchisees may not operate stores in a manner consistent with our standards and requirements, may not hire and train qualified managers and other store personnel and may not operate their stores profitably. As a result, our franchising strategy may not be profitable to us. Moreover, our image and reputation may suffer. For example, our initial franchisees in South Korea, the Netherlands and France performed below expectations and we transferred those agreements to other parties. Furthermore, even if our international franchising strategy is successful, the interests of franchisees might sometimes conflict with our interests. For example, whereas franchisees are concerned with their individual business strategies and objectives, we are responsible for ensuring the success of the Build-A-Bear Workshop brand and all of our stores.

The laws of the various foreign countries in which our franchisees operate govern our relationships with our franchisees. These laws, and any new laws that may be enacted, may detrimentally affect the rights and obligations between us and our franchisees and could expose us to additional liability.

We may suffer negative publicity or be sued if the manufacturers of our merchandise violate labor laws or engage in practices that our guests believe are unethical, or if our products are recalled or cause injuries.

We rely on our sourcing personnel to select manufacturers with legal and ethical labor practices, but we cannot control the business and labor practices of our manufacturers. If one of these manufacturers violates labor laws or other applicable regulations or is accused of violating these laws and regulations, or if such a manufacturer engages in labor or other practices that diverge from those typically acceptable in the United States, we could in turn experience negative publicity or be sued.

Many of our products are used by small children and infants who may be injured from usage. We may decide or be required to recall products or be subject to claims or lawsuits resulting from injuries. For example, in January 2003 we voluntarily recalled a product due to a possible safety issue, for which a vendor reimbursed us for certain related expenses. Negative publicity in the event of any recall or if any children are injured from our products could have a material adverse effect on sales of our products and our

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business, and related recalls or lawsuits with respect to such injuries could have a material adverse effect on our financial position. Although we currently have liability insurance, we cannot assure you that it would cover product recalls and we face the risk that claims or liabilities will exceed our insurance coverage. Furthermore, we may not be able to maintain adequate liability insurance in the future.

Portions of our business are subject to privacy and security risks. If we improperly obtain, or are unable to protect, information from our guests, we could be subject to liability and damage to our reputation.

In addition to serving as an online sales portal, our website, www.buildabear.com, features children's games, e-cards and printable party invitations and thank-you notes, and provides an opportunity for children under the age of 13 to sign up, with the consent of their parent or guardian, to receive our online newsletter. We currently obtain and retain personal information about our website users. In addition, we obtain personal information about our guests as part of their registration in our Find-A-Bear® identification system. Federal, state and foreign governments have enacted or may enact laws or regulations regarding the collection and use of personal information, with particular emphasis on the collection of information regarding minors. Such regulations include or may include requirements that companies establish procedures to:

- give adequate notice regarding information collection and disclosure practices;
- allow consumers to have personal information deleted from a company's database;
- provide consumers with access to their personal information and the ability to rectify inaccurate information;
- obtain express parental consent prior to collecting and using personal information from children; and
- comply with the Federal Children's Online Privacy Protection Act.

Such regulation may also include enforcement and redress provisions. While we have implemented programs and procedures designed to protect the privacy of people, including children, from whom we collect information, and our website is designed to be fully compliant with the Federal Children's Online Privacy Protection Act, there can be no assurance that such programs will conform to all applicable laws or regulations.

We have a stringent privacy policy covering the information we collect from our guests and have established security features to protect our guest database and website. However, our security measures may not prevent security breaches. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. If third persons were able to penetrate our network security and gain access to, or otherwise misappropriate, our guests' personal information, it could harm our reputation and, therefore, our business and we could be subject to liability. Such liability could include claims for misuse of personal information or unauthorized use of credit cards. These claims could result in litigation, our involvement in which, regardless of the outcome, could require us to expend significant financial resources. In addition, because our guest database primarily includes personal information of young children and young children frequently interact with our website, we are potentially vulnerable to charges from parents, children's organizations, governmental entities, and the media of engaging in inappropriate collection, distribution or other use of data collected from children. Such charges could adversely impact guest relationships and ultimately cause a decrease in net sales and also expose us to litigation and possible liability.

We may fail to protect our intellectual property and may have infringement, misappropriation or other disputes or litigation with third parties, which could be costly, distract our management and personnel and which could result in the diminution in value of our trademarks and other important intellectual property.

Other parties have asserted in the past, and may assert in the future, trademark, patent, copyright or other intellectual property rights that are important to our business. We cannot assure you that others will not seek to block the use of or seek monetary damages or other remedies for the prior use of our brand names or other intellectual property or the sale of our products or services as a violation of their trademark, patent or other proprietary rights. Defending any claims, even claims without merit, could be time-consuming, result in costly settlements, litigation or restrictions on our business and damage our reputation.

In addition, there may be prior registrations or use of intellectual property in the U.S. or foreign countries for similar or competing marks or other proprietary rights of which we are not aware. In all such countries it may be possible for any third party owner of a national trademark registration or other proprietary right to enjoin or limit our expansion into those countries or to seek damages for our use of such intellectual property in such countries. In the event a claim against us were successful and we could not obtain a license to the relevant intellectual property or redesign or rename our products or operations to avoid infringement, our business, financial condition or results of operations could be harmed. Securing registrations does not fully insulate us against intellectual property claims, as another party may have rights superior to our registration or our registration may be vulnerable to attack on various grounds.

Our profitability could be adversely affected by high petroleum products prices.

The profitability of our business depends to a certain degree upon the price of petroleum products, both as a component of the transportation costs for delivery of inventory from our vendors to our stores and as a raw material used in the production of our animal

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skins. Petroleum prices have recently risen to historic or near historic highs. For example, our results in fiscal 2006 were impacted by fuel surcharges due to higher petroleum products prices. We are unable to predict what the price of crude oil and the resulting petroleum products will be in the future. We may be unable to pass along to our customers the increased costs that would result from higher petroleum prices. Therefore, any such increase could have an adverse impact on our business and profitability.

Risks Related to Owning Our Common Stock

Fluctuations in our quarterly results of operations could cause the price of our common stock to substantially decline.

Retailers generally are subject to fluctuations in quarterly results. Our operating results for one period may not be indicative of results for other periods, and may fluctuate significantly due to a variety of factors, including:

- the timing of new store openings and related expenses;
- the profitability of our stores;
- increases or decreases in comparable store sales;
- the timing and frequency of our marketing initiatives;
- changes in general economic conditions and consumer spending patterns;
- changes in consumer preferences;
- the continued introduction and expansion of merchandise offerings;
- the effectiveness of our inventory management;
- actions of competitors or mall anchors and co-tenants;
- seasonal shopping patterns, including whether the Easter holiday occurs in the first or second quarter and other vacation schedules;
- the timing and frequency of national media appearances and other public relations events; and
- weather conditions.

If our future quarterly results fluctuate significantly or fail to meet the expectations of the investment community, then the market price of our common stock could decline substantially.

The market price of our common stock may be materially adversely affected by market volatility which could result in costly and time-consuming securities litigation.

The market price of our common stock could be subject to significant fluctuations. Among the factors that could affect our stock price are:

- actual or anticipated variations in comparable store sales or operating results;
- changes in financial estimates by the investment community;
- actual or anticipated changes in economic, political or market conditions, such as recessions or international currency fluctuations;
- changes in the retailing environment;
- changes in the market valuations of other specialty retail companies;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives; and
- losses of key members of management.

In addition, we cannot assure you that an active trading market for our common stock will continue which could affect our stock price and the liquidity of any investment in our common stock.

The stock markets in general have experienced substantial volatility that has often been unrelated to the operating performance of individual companies. These broad market fluctuations may adversely affect the trading price of our common stock.

In the past, following periods of volatility in the market price of a company's securities, stockholders have often instituted class action securities litigation against those companies. Such litigation, if instituted, could result in substantial costs and a diversion of management attention and resources, which would significantly harm our profitability and reputation.

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

Our basic corporate documents and Delaware law contain provisions that might enable our management to resist a takeover. These provisions:

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- restrict various types of business combinations with significant stockholders;
- provide for a classified board of directors;
- limit the right of stockholders to remove directors or change the size of the board of directors;
- limit the right of stockholders to fill vacancies on the board of directors;
- limit the right of stockholders to act by written consent and to call a special meeting of stockholders or propose other actions;
- require a higher percentage of stockholders than would otherwise be required to amend, alter, change or repeal our bylaws and certain provisions of our certificate of incorporation; and
- authorize the issuance of preferred stock with any voting rights, dividend rights, conversion privileges, redemption rights and liquidation rights and other rights, preferences, privileges, powers, qualifications, limitations or restrictions as may be specified by our board of directors.

These provisions may:

- discourage, delay or prevent a change in the control of our company or a change in our management, even if such change may be in the best interests of our stockholders;
- adversely affect the voting power of holders of common stock; and
- limit the price that investors might be willing to pay in the future for shares of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Stores

As of December 30, 2006, we operated 233 retail stores located primarily in major malls throughout the United States and Canada and 38 stores located in the United Kingdom and Ireland. Our mall-based stores generally range in size from 2,000 to 4,000 square feet and average approximately 2,800 square feet, while our tourist location stores currently range up to 6,000 square feet and our flagship store in New York City is approximately 20,000 square feet. Our stores are designed to be open and inviting for guests of all ages with an entryway that spans the majority of our storefront with wide aisles to accommodate families or groups. Our typical store has an oversized “sentry bear” at the front entry and features two stuffing machines, five NameMe computer stations, display units and flooring to enhance the guest traffic flow through the store. We select malls and make site selections within the mall based upon demographic analysis, market research, site visits and mall dynamics as well as a forecasting model that projects a potential location’s first year sales. We have identified a significant number of target sites that meet our criteria for new stores in malls and tourist locations. We seek to locate our mall-based stores near major customer entrances to or in the center of malls and adjacent to other children, teen and family retailers. After we approve a site, it typically takes approximately 25 weeks to finalize the lease, design the layout, build out the site, hire and train associates, and stock the store for opening.

We lease all of our store locations. Due to our attraction as a family-oriented entertainment destination concept with average net sales per gross square foot that, in fiscal 2006, generally exceeded the average for the malls in which we operated, we have received numerous requests from mall owners and developers to locate a Build-A-Bear Workshop store in their malls. We believe that we generally have negotiated favorable exclusivity provisions in our leases.

Most of our leases have an initial term of ten years. A number of our leases provide a lease termination or “kick out” option to either party in a pre-determined year or years, typically the third or fourth year of the lease, if we do not meet certain agreed upon minimum sales levels. In addition, our leases typically require us to pay personal property taxes, our pro rata share of real property taxes of the shopping mall, our own utilities, repairs and maintenance in our store, a pro rata share of the malls’ common area maintenance and, in some instances, merchant association fees and media fund contributions. Most of our leases also require the payment of a fixed minimum rent as well as percentage rent based on sales in excess of agreed upon minimum annual sales levels.

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Following is a list of our 271 company-owned stores in the United States, Canada, the United Kingdom and Ireland as of December 30, 2006:

State	Number of Stores
Alabama	2
Arizona	4
Arkansas	3
California	23
Colorado	6
Connecticut	5
Delaware	1
Florida	12
Georgia	7
Hawaii	1
Idaho	1
Illinois	7
Indiana	6
Iowa	3
Kansas	2
Kentucky	3
Louisiana	3
Maine	1
Maryland	4
Massachusetts	9
Michigan	4
Minnesota	2
Mississippi	1
Missouri	6
Nebraska	1
Nevada	3
New Hampshire	2
New Jersey	12
New Mexico	1
New York	12
North Carolina	7
Ohio	10
Oklahoma	2
Oregon	3
Pennsylvania	8
Rhode Island	1
South Carolina	3
Tennessee	6
Texas	16
Utah	3
Virginia	6
Washington	4
West Virginia	1
Wisconsin	3
Canadian Province	
Alberta	2
British Columbia	2
Manitoba	1
Nova Scotia	1
Ontario	7
United Kingdom	
England	32
Scotland	4
Wales	1
Ireland	1

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Non-Store Properties

In addition to leasing all of our store locations, we lease approximately 52,000 square feet for our web fulfillment site and corporate headquarters, or World Bearquarters, in St. Louis, Missouri. Our World Bearquarters houses our corporate staff, our call center and our on-site training facilities. The lease commenced on January 1, 2005 with a four-year term, and may be extended for two additional five-year terms. In 2007, our web fulfillment site will be moving to our company-owned warehouse and distribution center.

In the United Kingdom, we lease approximately 2,000 square feet for our regional headquarters, or U.K. Bearquarters, in Windsor, England. The lease commenced on August 2003. The lease can be terminated at any time by either party giving notice of termination six months prior to cancellation.

In September 2006, we completed construction of a company-owned warehouse and distribution center, or Bearhouse, in Groveport, Ohio. The facility is approximately 350,000 square feet.

ITEM 3. LEGAL PROCEEDINGS

From time to time we are involved in ordinary routine litigation common to companies engaged in our line of business. We are involved in several court actions seeking to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. As of the date of this annual report on Form 10-K, we are not involved in any pending legal proceedings that we believe would be likely to have a material adverse effect on our financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of security holders in the fourth quarter of fiscal 2006.

PART II

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

Our common stock is listed on the New York Stock Exchange (NYSE) under the symbol "BBW." Our common stock commenced trading on the NYSE on October 28, 2004. The following table sets forth the high and low closing sale prices of our common stock for the periods indicated.

	Fiscal 2006		Fiscal 2005	
	High	Low	High	Low
First Quarter	\$32.35	\$26.89	\$36.90	\$29.44
Second Quarter	\$32.30	\$21.31	\$31.08	\$20.31
Third Quarter	\$24.12	\$19.79	\$24.49	\$19.86
Fourth Quarter	\$32.00	\$22.00	\$31.97	\$21.44

As of March 9, 2007, there were approximately 930 holders of record of the Company's common stock.

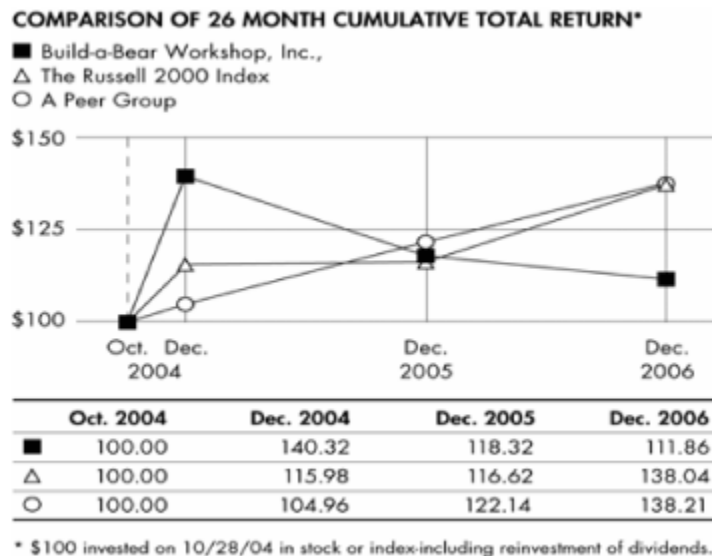
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PERFORMANCE GRAPH

The following performance graph compares the 14-month cumulative total stockholder return of the Company’s common Stock, with the cumulative total return on the Russell 2000® Index and an SEC-defined peer group of companies identified as SIC Code 5600-5699 (the “Peer Group”). The Peer Group consists of companies whose primary business is the operation of apparel and accessory retail stores. Build-A-Bear Workshop is not strictly a merchandise retailer and there is a strong interactive, entertainment component to the Company’s business which differentiates it from retailers in the Peer Group. However, in the absence of any other readily identifiable peer group, we believe the use of the Peer Group is appropriate.

The performance graph starts with the Company’s initial public offering on October 28, 2004 and ends on December 29, 2006, the last trading day prior to December 30, 2006, the end of the Company’s fiscal 2006. The graph assumes that \$100 was invested on October 28, 2004 in each of the Company’s common stock, the Russell 2000® Index and the Peer Group, and that all dividends were reinvested.

These indices are included only for comparative purposes as required by Securities and Exchange Commission rules and do not necessarily reflect management’s opinion that such indices are an appropriate measure of the relative performance of the Common Stock. They are not intended to forecast the possible future performance of the Common Stock.



Stock Repurchase Program

On February 20, 2007, we announced a \$25 million share repurchase program of our outstanding common stock over the next twelve months. The program was authorized by our board of directors. Purchases may be made in the open market or in privately negotiated transactions, with the level and timing of activity depending on market conditions, other investment opportunities, and other factors. Purchases may be increased, decreased or discontinued at any time without notice. As of March 9, 2007, approximately 160,000 shares at an average price of \$26.48 per share have been repurchased under this program. Future repurchases will be reported in our quarterly and annual reports under Item 5 on a monthly basis.

Recent Sales of Unregistered Securities

There were no sales of unregistered securities during the fourth quarter of fiscal 2006.

Dividend Policy

We paid a special \$10.0 million cash dividend to our stockholders in August 2004. We anticipate that we will retain any future earnings to support operations and to finance the growth and development of our business, and we do not expect, at this time, to pay cash dividends in the future. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including future earnings, capital requirements, financial conditions, future prospects and other factors that the board of directors may deem relevant. Additionally, under our credit agreement, we are prohibited from declaring dividends without the prior consent of our lender, subject to certain exceptions, as described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources.”

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ITEM 6. SELECTED FINANCIAL DATA

Throughout this annual report on Form 10-K, we refer to our fiscal years ended December 30, 2006, December 31, 2005, January 1, 2005, January 3, 2004, and December 28, 2002 as fiscal years 2006, 2005, 2004, 2003, and 2002, respectively. Our fiscal year consists of 52 or 53 weeks, and ends on the Saturday nearest December 31 in each year. Fiscal years 2006, 2005, 2004, and 2002 included 52 weeks and fiscal year 2003 included 53 weeks. All of our fiscal quarters presented in this annual report on Form 10-K included 13 weeks. When we refer to our fiscal quarters, or any three month period ending as of a specified date, we are referring to the 13-week period prior to that date.

The following table sets forth, for the periods and dates indicated, our selected consolidated financial and operating data. The balance sheet data as of December 30, 2006 and December 31, 2005 and the statement of operations and other financial data for our fiscal years ended December 30, 2006, December 31, 2005, and January 1, 2005 are derived from our audited financial statements included elsewhere in this annual report on Form 10-K. The balance sheet data as of January 1, 2005, January 3, 2004, and December 28, 2002 and the statement of operations and other financial data for our fiscal years ended January 3, 2004 and December 28, 2002 are derived from our audited financial statements that are not included in this annual report on Form 10-K. You should read our selected consolidated financial and operating data in conjunction with our consolidated financial statements and related notes and with "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this annual report on Form 10-K.

See the notes to our consolidated financial statements for an explanation of the method used to determine the numbers of shares used in computing basic and diluted net earnings per common share.

	Fiscal Year				
	2006	2005	2004	2003	2002
	(Dollars in thousands, except share, per share and per gross square foot data)				
Statement of operations data:					
Total revenues	\$ 437,072	\$ 361,809	\$ 301,662	\$ 213,672	\$ 169,138
Costs and expenses:					
Cost of merchandise sold	227,509	180,373	150,903	115,845	90,215
Selling, general and administrative	158,712	133,921	115,939	81,533	66,068
Store preopening	3,958	4,812	2,186	3,859	3,949
Interest expense (income), net	(1,530)	(1,710)	(299)	(58)	(88)
Total costs and expenses	388,649	317,396	268,729	201,179	160,144
Income before income taxes	48,423	44,413	32,933	12,493	8,994
Income tax expense	18,933	17,099	12,934	4,875	3,557
Net income	29,490	27,314	19,999	7,618	5,437
Cumulative dividends and accretion of redeemable preferred stock	—	—	1,262	1,970	1,971
Cumulative dividends on nonredeemable preferred stock	—	—	263	455	455
Net income available to common and participating preferred stockholders	\$ 29,490	\$ 27,314	\$ 18,474	\$ 5,193	\$ 3,011
Net income allocated to common stockholders	\$ 29,490	\$ 27,314	\$ 8,519	\$ 116	\$ 67
Net income allocated to participating preferred stockholders	\$ —	\$ —	\$ 9,955	\$ 5,077	\$ 2,944
Earnings per common share:					
Basic	\$ 1.46	\$ 1.38	\$ 2.30	\$ 0.53	\$ 0.31
Diluted	\$ 1.44	\$ 1.35	\$ 1.07	\$ 0.43	\$ 0.29
Shares used in computing common per share amounts:					
Basic	20,169,814	19,735,067	3,702,365	217,519	217,519
Diluted	20,468,256	20,229,978	18,616,435	17,546,348	12,055,458

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	Fiscal Year				
	2006	2005	2004	2003	2002
(Dollars in thousands, except share, per share and per gross square foot data)					
Other financial data:					
Gross margin (\$) (1)	\$205,063	\$178,528	\$149,566	\$ 97,582	\$ 78,908
Gross margin (%) (1)	47.4%	49.7%	49.8%	45.7%	46.7%
Capital expenditures (2)	\$ 52,577	\$ 31,083	\$ 16,494	\$ 24,917	\$ 24,017
Depreciation and amortization	22,394	17,592	14,948	12,840	8,990
Cash flow data:					
Cash flows provided by operating activities	\$ 53,035	\$ 54,642	\$ 48,527	\$ 31,770	\$ 23,963
Cash flows used in investing activities	(93,772)	(37,077)	(17,732)	(27,035)	(25,531)
Cash flows provided by (used in) financing activities	3,537	6,058	15,931	—	(121)
Cash dividends declared per common share	\$ —	\$ —	\$ 0.55	\$ —	\$ —
Store data (3):					
Number of stores at end of period					
North America	233	200	170	150	108
United Kingdom and Ireland	38	—	—	—	—
Total Stores	271	200	170	150	108
Square footage at end of period					
North America	712,299	615,194	514,341	461,982	344,503
United Kingdom and Ireland (4)	56,701	—	—	—	—
Total square footage	769,000	615,194	514,341	461,982	344,503
Average net retail sales per store (5) (6)	\$ 1,761	\$ 1,864	\$ 1,857	\$ 1,605	\$ 1,904
Net retail sales per gross square foot (6) (7)	\$ 573	\$ 615	\$ 602	\$ 502	\$ 582
Comparable store sales change (%) (8)	(6.5)%	(0.2)%	18.1%	(15.9)%	(9.7)%
Balance sheet data:					
Cash and cash equivalents	\$ 53,109	\$ 90,950	\$ 67,327	\$ 20,601	\$ 15,866
Working capital	27,952	66,646	48,000	10,463	7,376
Total assets	299,770	246,108	189,237	128,210	105,893
Redeemable preferred stock	—	—	—	37,890	35,920
Total stockholders' equity	164,263	130,357	95,510	19,845	14,192

- (1) Gross margin represents net retail sales less cost of merchandise sold. Gross margin percentage represents gross margin divided by net retail sales.
- (2) Capital expenditures consist of leasehold improvements, furniture and fixtures and computer equipment and software purchases.
- (3) Excludes our webstore and seasonal and event-based locations.
- (4) Square footage in the United Kingdom and Ireland is estimated selling square footage.
- (5) Average net retail sales per store represents net retail sales from stores open throughout the entire period divided by the total number of such stores.
- (6) When we refer to average net retail sales per store and net retail sales per gross square foot for any period, we include in those calculations only those stores that have been open for that entire period.
- (7) Net retail sales per gross square foot represents net retail sales from stores open throughout the entire period divided by the total gross square footage of such stores.
- (8) Comparable store sales percentage changes are based on net retail sales and stores are considered comparable beginning in their thirteenth full month of operation.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "Risk Factors" and elsewhere in this annual report on Form 10-K. The following section is qualified in its entirety by the more detailed information, including our financial statements and the notes thereto, which appears elsewhere in this annual report on Form 10-K.

Overview

We are the leading, and only international, company providing a "make your own stuffed animal" interactive entertainment experience under the Build-A-Bear Workshop brand, in which our guests stuff, fluff, dress, accessorize and name their own teddy bears and other stuffed animals. Our concept, which we developed for mall-based retailing, capitalizes on what we believe is the relatively untapped demand for experience-based shopping as well as the widespread appeal of stuffed animals. The Build-A-Bear Workshop experience appeals to a broad range of age groups and demographics, including children, teens, their parents and grandparents. As of December 30, 2006, we operated 233 stores in the United States and Canada, 38 stores in the United Kingdom and Ireland, and had 34 franchised stores operating in international locations under the Build-A-Bear Workshop brand. In addition to our stores, we market our products and build our brand through our website, which simulates our interactive shopping experience, as well as our non-traditional store locations in Major League Baseball® ballparks, a location in a zoo, and our presence at event-based locations through our mobile store.

On April 2, 2006, we acquired all of the outstanding shares of The Bear Factory Limited, a stuffed animal retailer in the United Kingdom, and Amsbra Limited, our former U.K. franchisee. The results of this acquisition's operations have been included in the consolidated financial statements since that date. In conjunction with those transactions, we obtained 40 retail locations in the United Kingdom and Ireland. Four of those locations closed during 2006. Of those four locations, two closed due to overlapping store locations in the Amsbra and Bear Factory portfolios, and the other two locations are concessions within department stores, which is a format that we have chosen not to continue at this point in the United Kingdom. We converted and rebranded 25 Bear Factory stores to Build-A-Bear Workshop stores in time for the 2006 holiday season, resulting in a unified company brand throughout the U.K. and Ireland. During the store conversion and rebranding process, stores were temporarily closed on average for 22 days while many of the costs to operate the stores continue. Therefore, the acquisition was dilutive to earnings during fiscal 2006. The Company hopes to improve sales performance and adopt best practices in the areas of merchandising, marketing, purchasing and store operations, across the acquired store base, and to realize earnings accretion from the acquisition in fiscal 2007.

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

- Company-owned retail stores located in the United States, Canada, the United Kingdom and Ireland, a webstore and seasonal, event-based locations;
- International stores operated under franchise agreements; and
- License arrangements with third parties which manufacture and sell to other retailers merchandise carrying the Build-A-Bear Workshop brand.

Selected financial data attributable to each segment for fiscal 2006, 2005, and 2004 are set forth in note 18 to our consolidated financial statements included elsewhere in this annual report on Form 10-K.

For a discussion of the key trends and uncertainties that have affected our revenues, income and liquidity, see the "— Revenues," "— Costs and Expenses" and "— Expansion and Growth Potential" subsections of this Overview.

We believe that we have developed an appealing retail store concept that, for stores open for the entire year, averaged \$1.8 million in fiscal 2006 and \$1.9 million in both fiscal 2005 and fiscal 2004 in net retail sales per store. For a discussion of the changes in comparable store sales in fiscal years 2006, 2005 and 2004, see "— Revenues." Store contribution, which consists of income before income tax expense, interest, store depreciation and amortization, store preopening expense and general and administrative expense, excluding franchise fees, income from licensing activities and contribution from our webstore and seasonal event-based locations, as a percentage of net retail sales, excluding revenue from our webstore and seasonal and event-based locations, was 24.7% for 2006 and 26.8% for fiscal 2005, and total company net income as a percentage of total revenues was 6.8% for fiscal 2006, and 7.5% for fiscal 2005. See "— Non-GAAP Financial Measures" for a reconciliation of store contribution to net income. The store contribution of our

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average store, coupled with the fact that we have opened 198 stores in the United States and Canada since the beginning of fiscal 2001 have been the primary reasons for our net income increasing during each of the last five fiscal years. Additionally, as we have added stores and grown our sales volume, the quantities of merchandise and supplies we purchase have increased which has created economies of scale for our vendors allowing us to obtain reduced costs for these items and increase our profitability.

The increase in total store contribution has been partially offset by the increase in our central office general and administrative expenses required to support an expanding store base and international franchise operations. These expenses have grown at a slower rate, in percentage terms, than our number of stores and net retail sales.

We expect to grow our business primarily through the continued opening of new stores. Further, we expect to increase our net retail sales, including comparable store sales, as a result of the continuation of national television and online advertising which we added to our marketing mix in fiscal 2004. We also plan to increase our revenues through increasing the number of international franchised stores, as well as the addition of new licensees and sales of licensed products for which we receive license revenue.

We expect to realize leverage on our national advertising programs as we expand and open stores in new markets. We have been running national advertising since 2004 and believe that our brand awareness is higher and our entry into new markets is stronger as a result of the advertising and we expect to leverage these programs on an ongoing basis. We expect to improve our store productivity as a result of comparable store sales improvement and thereby improve our store contribution as a percentage of net retail sales by better leveraging our store level operating expenses, primarily those which are fixed such as occupancy, over increased net retail sales per store. As we grow our total revenues, we also expect to decrease our general and administrative expenses as a percentage of revenues by leveraging these expenses, primarily those which are largely fixed such as management payroll and occupancy, over an increased revenue amount. This decrease will be partially offset by some increases in general and administrative expenses, including marketing such as direct mail to support more stores and our growing international franchise business.

Following is a description and discussion of the major components of our statement of operations:

Revenues

Net retail sales: Net retail sales are revenues from retail sales (including our webstore and seasonal and event-based locations), are net of discounts, exclude sales tax, include shipping and handling costs billed to customers, and are recognized at the time of sale. Revenues from gift cards are recognized at the time of redemption. Our guests use cash, checks and third party credit cards to make purchases. We classify stores as new or comparable stores and do not include our webstore or seasonal, event-based locations in our store count or in our comparable store calculations. Stores enter the comparable store calculation in their thirteenth full month of operation. We opened four additional Friends 2B Made locations in 2006 to bring the total number of Friends 2B Made locations to nine as of December 30, 2006. All but one of these locations are within or adjacent to a Build-A-Bear Workshop store and share common store management, employees and infrastructure. Other than our stand-alone store in Ontario, California, these locations are considered expansions of the existing Build-A-Bear Workshop store and are not considered an addition to our total store count. The net retail sales of these expanded Build-A-Bear Workshop stores are excluded from comparable store sales calculations until the thirteenth full month of operation after the date of the expansion.

We have an automated frequent shopper program in the United States, the Stuff Fur Stuff® club, whereby guests enroll in the program and receive one point for every dollar or partial dollar spent and after reaching 100 points receive a \$10 discount on a future purchase. This program was automated in July 2006 and replaced our former Buy Stuff Program, which was a manual punch card system with limited tracking capability. The reward earned under the new program did not change. An estimate of the obligation related to the program, based on historical redemption rates, is recorded as deferred revenue and a reduction of net retail sales at the time of purchase. The deferred revenue obligation is reduced, and a corresponding amount is recognized in net retail sales, in the amount of and at the time of redemption of the \$10 discount. We account for changes in the deferred revenue account at the total company level only. This is due to the fact that the frequent buyer discount can be earned or redeemed at any of our store locations. Therefore, when we refer to net retail sales by location, such as comparable stores or new stores, these amounts do not include any changes in the deferred revenue amount. See “— Critical Accounting Policies” for additional details on the accounting for the deferred revenue program.

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We use net retail sales per gross square foot and comparable store sales as performance measures for our business. The following table details net retail sales per gross square foot by age of store for the periods presented:

	Fiscal 2006	Fiscal 2005	Fiscal 2004
Net retail sales per gross square foot (1) (2)			
Store Age > 5 years (66 stores in 2006, 34 stores in 2005, 13 stores in 2004)	\$577	\$623	\$691
Store Age 3-5 years (80 stores in 2006, 69 stores in 2005, 55 stores in 2004)	\$556	\$593	\$576
Store Age < 3 years (54 stores in 2006, 66 stores in 2005, 79 stores in 2004)	\$592	\$637	\$608
All comparable stores	\$573	\$615	\$602

- (1) Net retail sales per gross square foot represents net retail sales from stores open throughout the entire period divided by the total gross square footage of such stores. As such, stores in the UK are excluded from the calculation. Calculated on an annual basis only.
- (2) Excludes our webstore and seasonal and event-based locations.

The percentage increase (or decrease) in comparable store sales for the periods presented below is as follows:

	Fiscal 2006	Fiscal 2005	Fiscal 2004
Comparable store sales change (%) (1) (2)			
Store Age > 5 years (66 stores in 2006, 34 stores in 2005, 13 stores in 2004)	(5.2)%	4.0%	24.0%
Store Age 3-5 years (80 stores in 2006, 69 stores in 2005, 55 stores in 2004)	(6.3)%	(0.2)%	19.7%
Store Age < 3 years (54 stores in 2006, 66 stores in 2005, 79 stores in 2004)	(9.4)%	(3.3)%	15.1%
Total comparable store sales change	(6.5)%	(0.2)%	18.1%

- (1) Comparable store sales percentage changes are based on net retail sales and stores are considered comparable beginning in their thirteenth full month of operation.
- (2) Excludes our webstore and seasonal and event-based locations.

Our net retail sales per gross square foot are among the highest for specialty retailers. Historically, as a group our younger stores have performed at the highest sales per square foot level, above the chain-wide average, despite experiencing comparable store sales pressures. Often our stores open with strong sales performance in their first year of operation and show comparable store sales declines in years two and three. Our older stores consistently perform the best on a comparable store sales basis and younger stores consistently generate the highest sales per square foot. New stores typically pay for themselves in their first year of operation.

Comparable store sales decreased by 6.5% in fiscal 2006 following a decrease of 0.2% in fiscal 2005. We believe these changes can be attributed primarily to the following factors:

- Changing customer preferences in 2006 contributed to the decline in comparable store sales. Our repeat customers, many of whom have built a sizable collection of Build-A-Bear Workshop stuffed animals, have become more product discriminating. Additionally, in the fourth quarter of 2006, inventory shortfalls on products, specifically our special holiday animal Mumble, impacted store performance. Demand was greater than we had anticipated and coupled with our customer's changing preferences contributed to a fourth quarter negative comparable store sales decrease of 10.4%.
- In 2006, we saw improvement in our average transaction value per guest. However, there was a decline in customer traffic during fiscal 2006 compared to 2005.
- Due to the discretionary nature of our products, we believe that during much of 2006 comparable store sales were impacted by the more difficult macro economic conditions generally impacting customers.

Comparable store sales decreased by 0.2% in fiscal 2005 following an increase of 18.1% in fiscal 2004. We believe these changes can be attributed primarily to the following factors:

- Our ongoing programs in advertising. During the fourth quarter of fiscal 2003, we tested in a limited number of markets the use of television and online advertising and determined that it was successful in attracting a higher number of new and repeat guests. In the first quarter of fiscal 2004, we implemented this marketing strategy on a national basis and quickly began achieving

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comparable store sales increases. We continued this marketing approach throughout fiscal 2005. This approach was successful in maintaining our comparable store sales levels, but did not produce the increases that were achieved in fiscal 2004 when the change in the marketing program was an incremental addition to the prior year.

- Following an improved economy in 2004, with higher levels of consumer confidence and a better retail climate, the economy showed mixed results in 2005 with varying levels of consumer confidence, record levels of crude oil prices and significant weather activity, particularly during the hurricane season.

Franchise fees: We receive an initial, one-time franchise fee for each master franchise agreement which is amortized to revenue over the life of the respective franchise agreement, which extend for periods up to 10 years.

Master franchise rights are typically granted to a franchisee for an entire country or countries. Continuing franchise fees are based on a percentage of sales made by the franchisees' stores and are recognized as revenue at the time of those sales.

As of December 30, 2006, we had 34 stores, including 15 opened in fiscal 2006, operating under franchise arrangements in the following countries:

Japan	7
Australia	6
Denmark	5
Taiwan	3
Other	13

On April 2, 2006, we acquired all of the outstanding shares Amsbra Limited, our former U.K. franchisee. Amsbra operated all 11 of the franchised Build-A-Bear Workshop stores located in the United Kingdom. Upon completion of the acquisition, all of the franchised locations in the United Kingdom became company-owned stores.

Licensing revenue: Licensing revenue is based on a percentage of sales made by licensees to third parties and is recognized at the time the product is shipped by the licensee or at the point of sale. We have entered into a number of licensing arrangements whereby third parties manufacture and sell to other retailers merchandise carrying the Build-A-Bear Workshop trademark.

Costs and Expenses

Cost of merchandise sold and gross margin: Cost of merchandise sold includes the cost of the merchandise, royalties paid to licensors of third party branded merchandise, store occupancy cost, including store depreciation, freight costs from the manufacturer to the store, cost of warehousing and distribution, packaging, damages and shortages, and shipping and handling costs incurred in shipment to customers. Gross margin is defined as net retail sales less the cost of merchandise sold.

We have been able to reduce the unit costs of our merchandise and packaging through economies of scale realized as our sales volume has grown. The increase in sales volume has also allowed us to reduce our freight, cost of warehousing and distribution costs as a percentage of net retail sales as a result of the cost efficiencies of shipping higher volumes of merchandise. We expect to maintain these efficiencies in the future.

Selling, general and administrative expense: These expenses include store payroll and benefits, advertising, credit card fees, and store supplies, as well as central office general and administrative expenses, including management payroll, benefits, stock-based compensation, travel, information systems, accounting, insurance, legal and public relations. These expenses also include depreciation and amortization of central office leasehold improvements, furniture, fixtures and equipment as well as the amortization of intellectual property costs.

Central office general and administrative expenses have grown over time in order to support the increased number of stores in operation and we believe will continue to grow as we add stores, but we expect this increase to be at a lower rate than the percentage increase in total revenues. Advertising increased significantly with the introduction in fiscal 2004 of our national television and online advertising campaign. We maintained the level of advertising expense as a percentage of net retail sales in fiscal 2006 as compared to fiscal 2005 and fiscal 2004, and anticipate continuing this level of advertising expenditures in the future. Other store expenses such as credit card fees and supplies historically have increased or decreased proportionately with net retail sales.

We granted options during fiscal 2004 at an exercise price of \$8.78 per share, which had been determined to be the fair value of our common stock at the time based on an independent appraisal. Subsequent to such grants, we determined that the fair value of the underlying common stock should have been deemed to be approximately \$15.00 per share. As a result of this determination, this option issuance generated stock-based compensation of \$1.9 million to be recognized over the vesting period of the 302,234 underlying options issued. These options became fully vested upon the completion of our initial public offering on October 28, 2004. Accordingly, all unrecognized compensation expense related to this grant was recognized at that time and is reflected in the consolidated statement of operations for fiscal 2004 as a component of selling, general and administrative expense.

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On January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). The provisions of SFAS 123R require that all share-based payments to employees be recognized in the financial statements based on the fair value of the instruments issued. SFAS 123R requires the recognition of compensation expense related to instruments issued following adoption as well as to the non-vested portion of instruments issued prior to adoption of the standard. After the adoption of SFAS 123R, we anticipate that our share-based employee compensation will primarily consist of the granting of non-vested stock which vests over a pre-determined period of time assuming continued employment. In the past, our share-based employee compensation consisted primarily of stock option awards which vested over a pre-determined period of time assuming continued employment. In 2006 we recorded stock-based compensation of approximately \$2.1 million (\$1.4 million net of taxes) in fiscal 2006 following the adoption of SFAS 123R. Of this amount, \$0.2 million (\$0.2 after tax) is attributable to the Company's adoption of SFAS 123R. This incremental expense from the adoption of SFAS 123R did not reduce basic or diluted earnings per share based upon the insignificance of the expense. The additional stock-based compensation expense not related to the adoption of SFAS 123R was related to the vesting of restricted stock awards. In 2005, we recorded stock based compensation of approximately \$0.8 million (\$0.5 million net of tax).

Store preopening: Preopening costs are expensed as incurred and include store set-up, certain labor and hiring costs, and rental charges incurred prior to a store's opening.

Expansion and Growth Potential

Company-Owned Stores:

The number of Build-A-Bear Workshop stores in the United States, Canada, United Kingdom, and Ireland for the last three fiscal years can be summarized as follows:

	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>	<u>Fiscal 2004</u>
Beginning of period	200	170	150
U.K. Acquisition	40	—	—
Opened	35	30	21
Closed	(4)	—	(1)
End of period	271	200	170

On April 2, 2006 the Company acquired all of the outstanding shares of The Bear Factory Limited (Bear Factory), a stuffed animal retailer in the United Kingdom, and Amsbra Limited (Amsbra), the Company's former U.K. franchisee (collectively, the U.K. Acquisition). In conjunction with those transactions, we obtained 40 retail locations in the United Kingdom and Ireland. Four of those locations closed during 2006. Of those four locations, two closed due to overlapping store locations in the Amsbra and Bear Factory portfolios, and the other two locations are concessions within department stores, which is a format that we have chosen not to continue at this point in the United Kingdom. We opened two new store locations in the United Kingdom in fiscal 2006.

In fiscal 2007, we anticipate opening 37 Build-A-Bear Workshop stores in the United States and Canada and 7 to 10 stores in the United Kingdom and Ireland. We believe there is a market potential for at least 350 Build-A-Bear Workshop stores in the United States and Canada and 70 to 75 stores in the United Kingdom and Ireland. In fiscal 2003, we began testing in certain markets our initial brand expansion initiative, our proprietary "Friends 2B Made" line of make-your-own dolls and related products. In fiscal 2004, we opened two Friends 2B Made locations within or adjacent to existing Build-A-Bear Workshop stores. In fiscal 2005, we opened three additional locations in or adjacent to new or existing Build-A-Bear Workshop stores. In fiscal 2006, we opened three additional locations in or adjacent to new or existing Build-A-Bear Workshop stores and one stand alone Friends 2B Made store in Ontario, California. Other than the one stand alone store, the Friends 2B Made stores are not included in the number of store openings in fiscal 2006, 2005 or 2004 as noted above but rather are considered expansions of Build-A-Bear Workshop stores. The Friends 2B Made merchandise is also offered from a separate display fixture in select Build-A-Bear Workshop stores.

Non-Store Locations:

In 2004 we began offering merchandise in seasonal, event-based locations such as Major League Baseball® ballparks, as well as at temporary locations such as at the NBA All-Star Jam Session. We expect to expand our future presence at select seasonal, event-based locations contingent on their availability. As of the end of December 30, 2006 we had a total of five ballpark locations. We also opened up our first store in a zoo during fiscal 2006.

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International Franchise Revenue:

Our first franchisee location was opened in November 2003. The number of international, franchised stores opened and closed for the periods presented below can be summarized as follows:

	Fiscal 2006	Fiscal 2005	Fiscal 2004
Beginning of period	30	12	1
U.K. Acquisition	(11)	—	—
Opened	15	18	12
Closed	—	—	(1)
End of period	34	30	12

As of December 30, 2006, we had 13 master franchise agreements, which typically grant franchise rights for a particular country or countries, covering 15 countries. We anticipate signing additional master franchise agreements in the future. We expect our current and future franchisees to open 20 to 25 stores in fiscal 2007. We believe there is a market potential for approximately 300 franchised stores outside of the United States, Canada, the United Kingdom, and Ireland.

In April 2006, we acquired Amsbra Limited, our former franchisee in the United Kingdom. Amsbra owned all 11 franchised Build-A-Bear Workshop stores in the United Kingdom. Upon completion of the transaction, all of the franchised locations in the United Kingdom became company-owned stores.

Licensing Revenue:

In fiscal 2004, we began entering into license agreements pursuant to which we receive royalties on Build-A-Bear Workshop brand products. These agreements generated revenue of approximately \$1.0 million in 2006, \$0.9 million in fiscal 2005, and \$0.3 million in 2004. We anticipate entering into additional license agreements in the future.

Results of Operations

The following table sets forth, for the periods indicated, selected statement of operation data expressed as a percentage of total revenues, except where otherwise indicated. Percentages will not total due to cost of merchandise sold being expressed as a percentage of net retail sales and rounding:

	Fiscal 2006	Fiscal 2005	Fiscal 2004
Revenues:			
Net retail sales	99.0%	99.2%	99.6%
Franchise fees	0.8	0.5	0.3
Licensing revenues	0.2	0.3	0.1
Total revenues	100.0	100.0	100.0
Costs and expenses:			
Cost of merchandise sold (1)	52.6	50.3	50.2
Selling, general and administrative	36.3	37.0	38.4
Store preopening	0.9	1.3	0.7
Interest expense (income), net	(0.4)	(0.5)	(0.1)
Total costs and expenses	88.9	87.7	89.1
Income before income taxes	11.1	12.3	10.9
Income tax expense	4.3	4.7	4.3
Net income	6.8%	7.5%	6.6%
Gross margin (%) ⁽²⁾	47.4%	49.7%	49.8%

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

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

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Fiscal Year Ended December 30, 2006 (52 weeks) Compared to Fiscal Year Ended December 31, 2005 (52 weeks)

Total revenues. Net retail sales increased to \$432.6 million for fiscal 2006 from \$358.9 million for fiscal 2005, an increase of \$73.7 million, or 20.5%. Sales from new stores contributed a \$55.0 million increase in net retail sales. Sales from our acquisition of Amsbra and The Bear Factory contributed \$32.7 million and sales from non-store locations and non-comparable stores resulted in a \$3.0 million increase in net retail sales. Included in net retail sales in fiscal 2006 is an adjustment to deferred revenue of \$3.6 million, effective at the beginning of fiscal 2006, related to the most recent assessment of redemption rates on our customer loyalty program. Offsetting these increases, comparable store sales decreased \$22.2 million, or 6.5%.

Revenue from international franchise fees increased to \$3.5 million for fiscal 2006 from \$2.0 million for fiscal 2005, an increase of \$1.5 million. This increase was primarily due to the addition of new franchisees and new franchised stores in fiscal 2006. Licensing revenue was \$1.0 million in fiscal 2006 compared to \$0.9 million in fiscal 2005.

Gross margin. Gross margin increased to \$205.1 million for fiscal 2006 from \$178.5 million for fiscal 2005, an increase of \$26.6 million, or 14.9%. As a percentage of net retail sales, gross margin decreased to 47.4% for fiscal 2006 from 49.7% for fiscal 2005, a decrease of 2.3%. This decrease was anticipated and resulted primarily from higher occupancy costs as a percentage of net retail sales in the U.K. Higher occupancy costs in the U.S. and Canada as a percentage of net retail sales resulting from the decline in comparable store sales, and higher shipping and transportation costs primarily related to the transition to our company-owned distribution center, also contributed to the decline in gross margin as a percentage of net retail sales. Improved merchandise margins partially offset the decrease in gross margin percentage.

Selling, general and administrative. Selling, general and administrative expenses were \$158.7 million for fiscal 2006 as compared to \$133.9 million for fiscal 2005, an increase of \$24.8 million, or 18.5%. As a percentage of total revenues, selling, general and administrative expenses decreased to 36.3% for fiscal 2006 as compared to 37.0% for fiscal 2005, a decrease of 0.7%. The dollar increase was primarily due to 71 more stores, which includes the acquired U.K. stores, in operation at December 30, 2006 as compared to December 31, 2005 with the increased salaries at the stores and central office to support the larger store base. Selling, general and administrative expense as a percentage of total revenues was lower primarily due to a reduction in the percentage of advertising expense as compared to total revenues, the leveraging of store payroll over a larger revenue base, and a decline in the central office management payroll resulting primarily from a reduction in performance-based bonus expense. These decreases were partially offset by increased stock-based compensation expense.

Store preopening. Store preopening expense was \$4.0 million for fiscal 2006 as compared to \$4.8 million for fiscal 2005. These amounts include preopening rent expense of \$0.6 million in fiscal 2006 and \$1.5 million in fiscal 2005. The decrease was primarily due to preopening costs of \$1.8 million related to our flagship store and café in New York City. Offsetting the impact of the flagship store, five more new stores were opened in fiscal 2006 than in fiscal 2005 (35 in fiscal 2006, including two U.K. stores, as compared to 30 in fiscal 2005). Preopening expenses include expenses for stores that have opened as well as some expenses incurred for stores that will be opened at a later date.

Interest expense (income), net. Interest income, net of interest expense, was \$1.5 million for fiscal 2006 as compared to \$1.7 million for fiscal 2005. This decrease was the result of lower cash balances throughout fiscal 2006 due to capital expenditures for our distribution center and cash used for the acquisition of Amsbra and The Bear Factory.

Provision for income taxes. The provision for income taxes was \$18.9 million for fiscal 2006 as compared to \$17.1 million for fiscal 2005. The effective tax rate was 39.1% for fiscal 2006 and 38.5% for fiscal 2005. The increase in the effective tax rate was principally due to the impact of the U.K. acquisition and the inability to record a benefit for net operating losses generated by the U.K. operations in the current year.

Fiscal Year Ended December 31, 2005 (52 weeks) Compared to Fiscal Year Ended January 1, 2005 (52 weeks)

Total revenues. Net retail sales increased to \$358.9 million for fiscal 2005 from \$300.5 million for fiscal 2004, an increase of \$58.4 million, or 19.4%. Sales from new stores contributed a \$54.8 million increase in net retail sales. Sales over the Internet increased by \$2.4 million, or 38.8%, and sales from non-store locations and non-comparable stores resulted in a \$0.7 million increase in net retail sales. Comparable store sales decreased \$0.5 million, or 0.2%. Revenue deferrals under our frequent shopper program decreased to \$1.6 million in fiscal 2005 compared to \$2.6 million in fiscal 2004 and resulted in a \$1.0 million increase in net retail sales.

Revenue from international franchise fees increased to \$2.0 million for fiscal 2005 from \$0.8 million for fiscal 2004, an increase of \$1.2 million. This increase was primarily due to the addition of new franchisees and new franchised stores in fiscal 2005. Licensing revenue was \$0.9 million in fiscal 2005 compared to \$0.3 million in fiscal 2004.

Gross margin. Gross margin increased to \$178.5 million for fiscal 2005 from \$149.6 million for fiscal 2004, an increase of \$28.9 million, or 19.3%. As a percentage of net retail sales, gross margin decreased to 49.7% for fiscal 2005 from 49.8% for fiscal

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2004, a decrease of 0.1%. Higher shipping costs related to increased fuel surcharges accounted for 0.3% of the decrease in gross margin. Higher occupancy cost as a percentage of net retail sales, resulting from flat comparable store sales, accounted for 0.2% of this decrease. These decreases were partially offset by lower product and supply costs, as a percentage of net retail sales, resulting from purchasing cost efficiencies related to higher sales volumes, which accounted for a 0.3% increase in gross margin. Reduced inventory damages and shortages also offset the decrease in gross margin by 0.1%.

Selling, general and administrative. Selling, general and administrative expenses were \$133.9 million for fiscal 2005 as compared to \$115.9 million for fiscal 2004, an increase of \$18.0 million, or 15.5%. As a percentage of total revenues, selling, general and administrative expenses decreased to 37.0% for fiscal 2005 as compared to 38.4% for fiscal 2004, a decrease of 1.4%. The dollar increase was primarily due to 30 more stores in operation at December 31, 2005 as compared to January 1, 2005. Selling, general and administrative expense as a percentage of total revenues was 1.5% lower due to the leveraging of central office and store payroll costs, primarily as a result of lower performance-based bonuses in 2005 as compared to 2004. Lower stock-based compensation also decreased selling, general and administrative expenses by 0.4% as a percentage of total revenues. These decreases were partially offset by higher legal, accounting and insurance costs primarily associated with being a public company for the entire period in fiscal 2005 which resulted in a 0.4% increase as a percentage of total revenues.

Store preopening. Store preopening expense was \$4.8 million for fiscal 2005 as compared to \$2.2 million for fiscal 2004. These amounts include preopening rent expense of \$1.5 million in fiscal 2005 and \$0.4 million in fiscal 2004. Approximately \$2.0 million of this increase, including approximately \$0.9 million of preopening rent expense, was due to the preopening costs related to our flagship store and café in New York City. Excluding our flagship store, eight more new stores were opened in fiscal 2005 than in fiscal 2004 (29 in fiscal 2005 as compared to 21 in fiscal 2004). Preopening expenses include expenses for stores that have opened as well as some expenses incurred for stores that will be opened at a later date.

Interest expense (income), net. Interest income, net of interest expense, was \$1.7 million for fiscal 2005 as compared to \$0.3 million for fiscal 2004. This increase was the result of higher cash balances throughout fiscal 2005.

Provision for income taxes. The provision for income taxes was \$17.1 million for fiscal 2005 as compared to \$12.9 million for fiscal 2004. The effective tax rate was 38.5% for fiscal 2005 and 39.3% for fiscal 2004. The decrease in the effective tax rate was principally due to non-deductible stock compensation charges incurred in fiscal 2004.

Non-GAAP Financial Measures

We use the term “store contribution” throughout this annual report on Form 10-K. Store contribution consists of income before income tax expense, interest, store depreciation and amortization, store preopening expense and general and administrative expense, excluding franchise fees, income from licensing activities and contribution from our webstore and seasonal and event-based locations. This term, as we define it, may not be comparable to similarly titled measures used by other companies and is not a measure of performance presented in accordance with U.S. generally accepted accounting principles (GAAP).

We use store contribution as a measure of our stores’ operating performance. Store contribution should not be considered a substitute for net income, net income per store, cash flows provided by operating activities, cash flows provided by operating activities per store, or other income or cash flow data prepared in accordance with GAAP.

We believe store contribution is useful to investors in evaluating our operating performance because it, along with the number of stores in operation, directly impacts our profitability. Historically, central office general and administrative expenses and preopening expenses have increased at a rate less than our total net retail sales increases. Therefore, as we have opened additional new stores and leveraged our central office general and administrative and preopening expenses over this larger store base and sales volume, we have been able to increase our net income each year.

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The following table sets forth a reconciliation of store contribution to net income for our company-owned stores located in the United States and Canada (North America), stores located the U.K. and Ireland (United Kingdom) and for our consolidated store base:

	Fiscal 2006			Fiscal 2005		
	North America	United Kingdom	Total	North America	United Kingdom	Total
Net income (1)	\$ 30,942	\$ (1,452)	\$ 29,490	\$ 27,314	\$ —	\$ 27,314
Income tax expense	18,933	—	18,933	17,099	—	17,099
Interest expense (income)	(1,530)	—	(1,530)	(1,710)	—	(1,710)
Store depreciation and amortization (2)	15,986	1,655	17,641	13,985	—	13,985
Store preopening expense	3,209	749	3,958	4,812	—	4,812
General and administrative expense (3)	38,596	2,010	40,606	34,000	—	34,000
Franchising and licensing contribution (4)	(2,409)	(90)	(2,499)	(1,107)	—	(1,107)
Non-store activity contribution (5)	(3,464)	—	(3,464)	(1,499)	—	(1,499)
Store contribution	<u>\$100,263</u>	<u>\$ 2,872</u>	<u>\$103,135</u>	<u>\$ 92,894</u>	<u>\$ —</u>	<u>\$ 92,894</u>
Total revenues	\$404,109	\$32,717	\$436,826	\$361,809	\$ —	\$361,809
Franchising and licensing revenues	(4,410)	—	(4,410)	(2,907)	—	(2,907)
Revenues from non-store activities (5)	(15,191)	—	(15,191)	(12,131)	—	(12,131)
Store location net retail sales	<u>\$384,508</u>	<u>\$32,717</u>	<u>\$417,225</u>	<u>\$346,771</u>	<u>\$ —</u>	<u>\$346,771</u>
Store contribution as a percentage of store location net retail sales	<u>26.1%</u>	<u>8.8%</u>	<u>24.7%</u>	<u>26.8%</u>	<u>0.0%</u>	<u>26.8%</u>
Total net income as a percentage of total revenues	<u>7.7%</u>	<u>-4.4%</u>	<u>6.8%</u>	<u>7.5%</u>	<u>0.0%</u>	<u>7.5%</u>

- (1) Includes a change in estimate to deferred revenue related to our customer loyalty program of \$2.2 million.
- (2) Store depreciation and amortization includes depreciation and amortization of all capitalized assets in store locations, including leasehold improvements, furniture and fixtures, and computer hardware and software.
- (3) General and administrative expenses consist of non-store, central office general and administrative functions such as management payroll and related benefits, travel, information systems, accounting, purchasing and legal costs as well as the depreciation and amortization of central office leasehold improvements, furniture and fixtures, computer hardware and software and intellectual property. General and administrative expenses also include a central office marketing department, primarily payroll and related benefits expense, but exclude advertising expenses, such as direct mail catalogs and television advertising, which are included in store contribution.
- (4) Franchising and licensing contribution includes franchising and licensing revenues and all expenses attributable to the franchising and licensing segments other than depreciation, amortization and interest expense/income. Depreciation and amortization related to franchising and licensing is included in the general and administrative expense caption. Interest expense/income related to franchising and licensing is included in the interest expense (income) caption.
- (5) Non-store activities include our webstore, seasonal and event-based locations and franchising and licensing activities.

Seasonality and Quarterly Results

The following is a summary of certain unaudited quarterly results of operations data for each of the last two fiscal years.

	Fiscal 2006				Fiscal 2005			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in millions, except per share data)							
Total revenues	\$98.6	\$93.7	\$101.5	\$143.3	\$86.1	\$73.7	\$84.0	\$118.0
Gross margin(1)	47.9	40.8	42.4	74.0	43.3	34.5	40.0	60.8
Net income	8.4	3.0	2.7	15.4	8.0	3.5	5.3	10.6
Net income allocated to common stockholders	8.4	3.0	2.7	15.4	8.0	3.5	5.3	10.6
Earnings per common share:								
Basic	0.42	0.15	0.13	0.76	0.41	0.18	0.26	0.53
Diluted	0.41	0.15	0.13	0.75	0.40	0.17	0.26	0.52
Number of stores (end of quarter)	202	256	264	271	173	186	193	200

- (1) Gross margin represents net retail sales less cost of merchandise sold.

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Our operating results for one period may not be indicative of results for other periods, and may fluctuate significantly because of a variety of factors, including those discussed under “Risk Factors — Fluctuations in our quarterly results of operations could cause the price of our common stock to substantially decline.”

The timing of new store openings may result in fluctuations in quarterly results as a result of the revenues and expenses associated with each new store location. We typically incur most preopening costs for a new store in the three months immediately preceding the store’s opening. We expect our growth, operating results and profitability to depend in some degree on our ability to increase our number of stores.

For accounting purposes, the quarters of each fiscal year consist of 13 weeks, although we will have a 14-week quarter approximately once every six years. Quarterly fluctuations and seasonality may cause our operating results to fall below the expectations of securities analysts and investors, which could cause our stock price to fall.

Liquidity and Capital Resources

Our cash requirements are primarily for the opening of new stores, information systems and working capital. Historically, we have met these requirements through capital generated from the sale and issuance of our securities to private investors and through our initial public offering, cash flow provided by operations and our revolving line of credit. From our inception to December 2001, we raised at various times a total of \$44.9 million in capital from several private investors. In 2004, we raised \$25.7 million from the initial public offering of our common stock. From fiscal 2002 to fiscal 2005, cash flows provided by operating activities have exceeded cash flows used in investing activities.

Operating Activities. Cash flows provided by operating activities were \$53.0 million in fiscal 2006, \$54.6 million in fiscal 2005 and \$48.5 million in fiscal 2004. Cash flow from operating activities decreased in fiscal 2006 from fiscal 2005 primarily due to increased cash outflows for inventories offset by the timing of cash payments on accounts payable and accrued expenses. Additionally, the adoption of SFAS 123R led to the reclassification of the tax benefit from the exercise of stock options from operating activities to financing activities. This caused the impact of this line item on cash flows to decrease by \$4.4 million. Cash flow from operating activities increased in fiscal 2005 from fiscal 2004 primarily due to increases in net income adjusted for the impact of depreciation and amortization.

Investing Activities. Cash flows used in investing activities were \$93.8 million in fiscal 2006, \$37.1 million in fiscal 2005 and \$17.7 million in fiscal 2004. Cash used in investing activities during fiscal 2006 relates primarily to the U.K. acquisition for \$39.1 million, the construction of our company-owned distribution center for approximately \$22 million, and 35 new stores. Cash used in investing activities during fiscal 2005 and 2004 relates primarily to 30 new stores in fiscal 2005 and 21 in fiscal 2004. In fiscal 2005, a loan made to one of our franchisees used cash of \$4.4 million. No loans were made in fiscal 2004.

Financing Activities. Cash flows provided by financing activities were \$3.5 million in fiscal 2006, \$6.1 million in fiscal 2005, and \$15.9 million in fiscal 2004. In fiscal 2006, exercises of employee stock options and employee stock purchases and related tax benefits provided cash of \$3.4 million, as compared to \$4.4 million in fiscal 2005 and \$0.1 million in fiscal 2004. The collection of a note receivable from an officer of the Company provided cash of \$1.6 million in fiscal 2005. A similar note collection in fiscal 2004 provided cash of \$0.1 million. In fiscal 2004, we completed our initial public offering which resulted in cash inflows, net of offering costs, of \$25.7 million. The financing cash inflows from the initial public offering were partially offset by the payment of a special cash dividend in August 2004 of \$10.0 million.

Capital Resources. As of December 30, 2006, we had a cash balance of \$53.1 million. We also have a line of credit, which we can use to finance capital expenditures and seasonal working capital needs throughout the year. The credit agreement is with U.S. Bank, National Association and was amended effective June 30, 2006 to include a seasonal overline from July 1 to December 31 each year during which the line availability increases from \$15 million to \$30 million. Borrowings under the credit agreement are not collateralized, but availability under the credit agreement can be limited by the vendor based on our level of accounts receivable, inventory, and property and equipment. The credit agreement expires on September 30, 2007 and contains various restrictions on indebtedness, liens, guarantees, redemptions, mergers, acquisitions or sale of assets, loans, transactions with affiliates, and investments. It also prohibits us from declaring dividends without the bank’s prior consent, unless such payment of dividends would not violate any terms of the loan agreement. Borrowings bear interest at our option of prime minus 1.0% or LIBOR plus 1.5%. Financial covenants include maintaining a minimum tangible net worth, maintaining a minimum fixed charge cover ratio (as defined in the credit agreement) and not exceeding a maximum funded debt to earnings before interest, depreciation and amortization ratio. As of December 30, 2006, we were in compliance with these covenants. There were no borrowings under our line of credit as of December 30, 2006. There was a standby letter of credit of approximately \$1.1 million outstanding under the credit agreement as of December 30, 2006. Accordingly, there was approximately \$28.9 million available for borrowing under the line of credit as of December 30, 2006.

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

Our leases in the U.K. typically have terms of 10-15 years and generally contain a provision whereby every fifth year the rental rate can be adjusted to reflect the current market rates. The leases typically provide the lessee with the first right for renewal at the end of the lease. We may also be required to make deposits and rent guarantees to secure new leases as we expand. Real estate taxes also change according to government time schedules to reflect current market rental rates for the locations we lease.

In fiscal 2007, we expect to spend a total of \$35 to \$40 million on capital expenditures. Capital spending in fiscal 2006 totaled \$52.6 million. Capital spending in fiscal 2006 was primarily for the construction of our new distribution center, the opening of 35 new stores (33 in North America and two in the United Kingdom), the re-branding of 25 stores in the United Kingdom, and the continued installation and upgrades of central office information technology systems. In fiscal 2006, the average investment per new store, which includes leasehold improvements, fixtures, equipment and inventory, was approximately \$0.5 million. We anticipate the investment per store in fiscal 2007 will be approximately the same as fiscal 2006.

On February 20, 2007, we announced a \$25 million share repurchase program of our outstanding common stock over the next twelve months. The program was authorized by our board of directors. Purchases may be made in the open market or in privately negotiated transactions, with the level and timing of activity depending on market conditions, other investment opportunities, and other factors. Purchases may be increased, decreased or discontinued at any time without notice. As of March 9, 2007, approximately 160,000 shares at an average price of \$26.48 per share have been repurchased under this program. Future repurchases will be reported in our quarterly and annual reports under Item 5 on a monthly basis.

We believe that cash generated from operations and borrowings under our credit agreement will be sufficient to fund our working capital and other cash flow requirements for at least the next 18 months. Our credit agreement expires on September 30, 2007.

Off-Balance Sheet Arrangements

We do not have any arrangements classified as off-balance sheet arrangements.

Contractual Obligations and Commercial Commitments

Our contractual obligations and commercial commitments include future minimum obligations under operating leases and purchase obligations. Our purchase obligations primarily consist of purchase orders for merchandise inventory, construction commitments related to our new distribution center and obligations associated with building out our stores. The future minimum payments for these obligations as of December 30, 2006 for periods subsequent to this date are as follows:

	Total	2007	Payments Due by Fiscal Period as of December 30, 2006				2011	Beyond
			2008	2009	2010			
				(In thousands)				
Operating lease obligations	347,886	42,222	44,106	43,432	42,016	38,590	137,520	
Purchase obligations	44,719	44,421	228	60	5	4	—	
Total	\$392,605	\$86,644	\$44,334	\$43,492	\$42,021	\$38,594	\$137,520	

Inflation

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

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Critical Accounting Policies

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

We believe application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

Our accounting policies are more fully described in note 2 to our consolidated financial statements, which appear elsewhere in this annual report on Form 10-K. We have identified certain critical accounting policies which are described below.

Inventory

Inventory is stated at the lower of cost or market, with cost determined on an average cost basis. Historically, we have not conducted sales whereby we offer significant discounts or markdowns, nor have we experienced significant occurrences of obsolete or slow moving inventory. However, future changes in circumstances, such as changes in guest merchandise preference, could cause reclassification of inventory as obsolete or slow-moving inventory. The effect of this reclassification would be the recording of a reduction in the value of inventory to realizable values.

Throughout the year we record an estimated cost of shortage based on past historical results. Periodic physical inventories are taken and any difference between the actual physical count of merchandise and the recorded amount in our records are adjusted and recorded as shortage. Historically, the timing of the physical inventory has been near the end of the fiscal year so that no material amount of shortage was required to be estimated on activity between the date of the physical count and year-end. However, future physical counts of merchandise may not be at times at or near the end of a fiscal quarter or fiscal year-end, and our estimate of shortage for the intervening period may be material based on the amount of time between the date of the physical inventory and the date of the fiscal quarter or year-end.

Long-Lived Assets

If facts and circumstances indicate that a long-lived asset, including property and equipment, may be impaired, the carrying value is reviewed. If this review indicates that the carrying value of the asset will not be recovered as determined based on projected undiscounted cash flows related to the asset over its remaining life, the carrying value of the asset is reduced to its estimated fair value. No long-lived assets were impaired in fiscal 2006, 2005, or 2004. In fiscal 2004, we determined that one store which had been designated for closure would remain open. This determination resulted in the reversal of \$0.1 million in impairment charges taken in fiscal 2001 for costs to be incurred upon the closing of the store. Impairment losses in the future are dependent on a number of factors such as site selection and general economic trends, and thus could be significantly different than historical results. To the extent our estimates for net sales, gross profit and store expenses are not realized, future assessments of recoverability could result in additional impairment charges.

Goodwill and Other Intangibles

The Company has adopted SFAS No. 142. Under the provisions of this standard, intangible assets deemed to have indefinite lives and goodwill are not subject to amortization. All other intangible assets are amortized over their estimated useful lives. Goodwill and other intangible assets not subject to amortization are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. This testing requires comparison of carrying values to fair values, and when appropriate, the carrying value of impaired assets is reduced to fair value. We reviewed our goodwill and other intangible assets as of December 30, 2006 and determined that no impairment existed.

Revenue Recognition

Revenues from retail sales, net of discounts and excluding sales tax, are recognized at the time of sale. Guest returns have not been significant. Revenues from gift certificates are recognized at the time of redemption. Unredeemed gift cards are included in current liabilities on the consolidated balance sheets.

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We have an automated frequent shopper program in the United States, the Stuff Fur Stuff® club, whereby guests enroll in the program and receive one point for every dollar or partial dollar spent and after reaching 100 points receive a \$10 discount on a future purchase. This program was automated in July 2006 and replaced our former Buy Stuff Program, which was a manual punch card system with limited tracking capability. The reward earned under the new program did not change. An estimate of the obligation related to the program, based on historical redemption rates, is recorded as deferred revenue and a reduction of net retail sales at the time of purchase. The deferred revenue obligation is reduced, and a corresponding amount is recognized in net retail sales, in the amount of and at the time of redemption of the \$10 discount.

Under the previous Buy Stuff Program, the first card had no expiration date. Beginning in June 2002, and continuing each summer up to July 1, 2006, a series of cards was issued that had an expiration date of December 31 of the year following the year in which that series of cards was first issued. Beginning in July 2006, the automated Stuff Fur Stuff® club was introduced which provides greater visibility to the rewards earned by our guests and the historical redemption rates. We track redemptions of these various cards and use actual redemption rates by card series and historical results to estimate how much revenue to defer. We review these redemption rates and assess the adequacy of the deferred revenue account at the end of each fiscal quarter. Due to the estimates involved in these assessments, adjustments to the deferral rate are generally made no more often than bi-annually in order to allow time for more definite trends to emerge.

Based upon an assessment at the end of fiscal 2003, the deferred revenue account was adjusted downward by \$1.1 million with a corresponding increase to net retail sales, an increase in net income of \$0.7 million. Additionally, the amount of revenue being deferred beginning in fiscal 2004 was decreased by 0.2%, and by another 0.5% beginning with the third quarter of 2004, to give effect to the change in redemption experience. The changes made to the deferral rate in fiscal 2004 were prospective in nature with no impact on previously reported results of operations. Beginning with the second quarter of fiscal 2005, the amount of revenue being deferred was reduced by 0.1% on a prospective basis from its then current level due to further changes in the Company's redemption experience.

Based on the most recent assessment at the end of fiscal 2006, the deferred revenue account was adjusted downward by \$3.6 million, effective at the beginning of fiscal 2006, with a corresponding increase to net sales, and a \$2.2 million increase in net income. Additionally, the amount of revenue being deferred for future periods has been decreased by 0.6%, to give effect to the change in redemption experience and the increased visibility of the redemptions with the automated system. An additional 0.1% adjustment of the ultimate redemption rate at the end of fiscal 2006 for the current cards expiring on December 30, 2006 and December 29, 2007 would have an approximate impact of \$0.5 million on the deferred revenue balance and net retail sales.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 establishes threshold and measurement attributes for financial statement measurement and recognition of tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We will adopt FIN 48 on December 31, 2006. We do not expect the adoption of FIN 48 will have a significant impact on the financial results of the Company and will not result in a significant cumulative effect adjustment to the December 31, 2006 balance of retained earnings.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. We are required to adopt SFAS 157 in the first quarter of 2008. We are currently assessing the financial impact of SFAS 157 on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risks relate primarily to changes in interest rates, and we bear this risk in two specific ways. First, our revolving credit facility carries a variable interest rate that is tied to market indices and, therefore, our results of operations and our cash flows can be impacted by changes in interest rates. Outstanding balances under our credit facility bear interest at our option of prime minus 1.0% or LIBOR plus 1.5%. We had no borrowings outstanding during fiscal 2006. Accordingly, a 100 basis point change in interest rates would result in no material change to our annual interest expense. The second component of interest rate risk involves the short term investment of excess cash in short term, investment grade interest-bearing securities. These investments are considered to be cash equivalents and are shown that way on our balance sheet. If there are changes in interest rates, those changes would affect the investment income we earn on these investments and, therefore, impact our cash flows and results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and schedules are listed under Item 15(a) and filed as part of this annual report on Form 10-K.

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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

Our management, with the participation of our Chief Executive Bear and Chief Financial Bear, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this report. Our management, with the participation of our Chief Executive Bear and Chief Financial Bear also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on this evaluation, our management, including the Chief Executive Bear and Chief Financial Bear, concluded that our disclosure controls and procedures were effective as of December 30, 2006, the end of the period covered by this annual report.

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

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. With the participation of our Chief Executive Bear and our Chief Financial Bear, management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 30, 2006.

In conducting our evaluation of the effectiveness of our internal control over financial reporting, we have excluded the acquisition of The Bear Factory Limited and Amsbra Limited (collectively, the U.K. Acquisition). Total revenues of these entities for the period from the respective acquisitions through December 30, 2006 were \$32.8 million. These entities were acquired for total consideration of \$39.4 million, subject to certain contingent purchase price adjustments. Refer to Note 3 to our consolidated financial statements for further discussion of the U.K. acquisition and the impact on our consolidated financial results.

The Company’s independent registered public accounting firm has audited and issued their report on management’s assessment of the Company’s internal control over financial reporting. That report appears in this Item 9A.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Build-A-Bear Workshop, Inc.:

We have audited management’s assessment, included in the accompanying Management’s Report on Internal Control over Financial Reporting that Build-A-Bear Workshop, Inc. and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). 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. Our responsibility is to express an opinion on management’s assessment and an opinion on the effectiveness of the Company’s internal control over financial

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reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by COSO. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by COSO.

The Company acquired The Bear Factory Limited and Amsbra Limited, during the fiscal year ended December 30, 2006. Management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, these entities' internal control over financial reporting associated with total revenues of \$32.8 million, included in the consolidated financial statements of the Company for the periods from the respective acquisitions through December 30, 2006. These entities were acquired for total consideration of \$39.4 million, subject to certain contingent purchase price adjustments. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of these entities.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 30, 2006, and December 31, 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2006, and our report dated March 15, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

St. Louis, Missouri
March 15, 2007

Changes in Internal Controls

There were no changes in internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fourth quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information concerning directors, appearing under the caption “Board of Directors” in our Proxy Statement (the “Proxy Statement”) to be filed with the SEC in connection with our Annual Meeting of Shareholders scheduled to be held on May 10, 2007 is incorporated by reference in response to this Item 10.

The information appearing under the caption “Section 16(a) Beneficial Ownership reporting Compliance” in the Proxy Statement is incorporated by reference in response to this Item 10.

Business Conduct Policy

The Board of Directors has adopted a Business Conduct Policy applicable to our directors, officers and employees, including all executive officers. The Business Conduct Policy has been posted in the Investor Relations section of our corporate web site at <http://ir.buildabear.com>. We intend to satisfy the amendment and waiver disclosure requirements under applicable securities regulations by posting any amendments of, or waivers to, the Business Conduct Policy on our web site.

The information appearing under the caption “Code of Ethics” in the Proxy Statement is incorporated by reference in response to this Item 10.

Executive Officers and Key Employees

Set forth below is the name, age, position and a brief account of the business experience of each of our executive officers and key employees as of March 9, 2007.

Name	Age	Position(s)
Maxine Clark	58	Chief Executive Bear and Chairman of the Board
Scott Seay	44	President and Chief Operating Officer Bear
Tina Klocke	47	Chief Financial Bear, Treasurer and Secretary
Teresa Kroll	52	Chief Marketing Bear
Paul Bundonis	45	Chief Workshop Bear

Maxine Clark has been our Chief Executive Bear since our inception in 1997, our President from our inception in 1997 to April 2004 and has served as Chairman of our board of directors since our conversion to a corporation in April 2000. From November 1992 until January 1996, Ms. Clark was the President of Payless ShoeSource, Inc. Prior to joining Payless, Ms. Clark spent over 19 years in various divisions of The May Department Stores Company in areas including merchandise development, merchandise planning, merchandise research, marketing and product development. Ms. Clark is a member of the Board of Directors of The J.C. Penney Company, Inc. and Chairman of its Corporate Governance Committee. She also serves on the Board of Trustees of the International Council of Shopping Centers and Washington University in St. Louis and on the Board of Directors of Barnes Jewish Hospital. Ms. Clark is Chairman of the Board of Directors of Teach for America St. Louis. She is also a member of the Committee of 200, an organization for women entrepreneurs around the world.

Scott Seay joined Build-A-Bear Workshop in May 2002 as Chief Workshop Bear and was named President and Chief Operating Bear in January 2007. Prior to joining us, Mr. Seay was Chief of Field Operations for Kinko’s Inc., a national chain of copy centers, from April 1999 to May 2002. From April 1991 to April 1999, Mr. Seay held several operational roles including Senior Vice President of Operations West for CompUSA Inc., a computer retailer. From April 1983 to April 1991, Mr. Seay held several operational positions for The Home Depot, Inc.

Tina Klocke has been our Chief Financial Bear since November 1997, our Treasurer since April 2000, and Secretary since February 2004. Prior to joining us, she was the Controller for Clayton Corporation, a manufacturing company, where she supervised all accounting and finance functions as well as human resources. Prior to joining Clayton in 1990, she was the controller for Love Real Estate Company, a diversified investment management and development firm. She began her career in 1982 with Ernst & Young LLP.

Teresa Kroll has been our Chief Marketing Bear since September 2001. Prior to joining us Ms. Kroll was Vice President-Advertising for The WIZ, a unit of Cablevision, from 1999 to 2001. From 1995 to 1999, Ms. Kroll was Director of Marketing for Montgomery Ward Holding Corp., a department store retailer. From 1980 to 1994 Ms. Kroll held various administrative and marketing positions for Venture Stores, Inc.

Paul Bundonis joined Build-A-Bear Workshop in May 2006 as Managing Director, Western Region and was named Chief Workshop Bear in January 2007. Prior to joining us, Mr. Bundonis was President and Chief Operating Officer at Olly Shoes, a

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children’s shoe retailer, from 2003 to 2006. From 2000 to 2003, Mr. Bundonis was Director Store Operations Planning and Development at Express (Limited Brands), a specialty retailer. From 1998 to 2000, he was Vice President Merchandise Planning and Replenishment at Zany Brainy, Inc., a specialty retailer. From 1979 to 1998, Mr. Bundonis held various operations positions at Eddie Bauer, Inc. and R.H. Macy, Inc.

Barry Erdos served as our President and Chief Operating Officer Bear during the 2006 fiscal year and until January 5, 2007. On January 5, 2007, Mr. Erdos resigned as President and Chief Operating Officer Bear. Also effective on January 5, 2007, Scott Seay was appointed President and Chief Operating Bear and Paul Bundonis assumed the role of Chief Workshop Bear.

ITEM 11. EXECUTIVE COMPENSATION

The information contained in the sections titled “Executive Compensation” and “Information About the Board of Directors — Board of Directors Compensation” in the Proxy Statement is incorporated herein by reference in response to this Item 11.

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

The information contained in the section titled “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement is incorporated herein by reference in response to this Item 12.

Equity Compensation Plan Information

Plan category	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (1)
Equity compensation plans approved by security holders	529,200	\$ 16.10	2,530,420
Equity compensation plans not approved by security holders	—	—	—
Total	529,200	\$ 16.10	2,530,420

- (1) The number of securities remaining available for future issuance under equity compensation plans includes 880,689 shares available for issuance under our Associate Stock Purchase Plan (ASPP). Shares sold under our ASPP can be obtained from treasury stock, authorized but unissued shares or open market purchases of our common stock.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information contained in the section titled “Certain Relationships and Related Party Transactions” in the Proxy Statement is incorporated herein by reference in response to this Item 13.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information contained in the section titled “Principal Accountant Fees” and “Policy Regarding Pre-Approval of Services Provided by the Independent Auditor” in the Proxy Statement is incorporated herein by reference in response to Item 14.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) *Financial Statements*

The financial statements and schedules set forth below are filed on the indicated pages as part of this annual report on Form 10-K.

	Page
<u>Report of Independent Registered Public Accounting Firm</u>	41
<u>Consolidated Balance Sheets as of December 30, 2006 and December 31, 2005</u>	42
<u>Consolidated Statements of Operations for the fiscal years ended December 30, 2006, December 31, 2005, and January 1, 2005</u>	43
<u>Consolidated Statements of Stockholders' Equity for the fiscal years ended December 30, 2006, December 31, 2005, and January 1, 2005</u>	44
<u>Consolidated Statements of Cash Flows for the fiscal years ended December 30, 2006, December 31, 2005, and January 1, 2005</u>	45
<u>Notes to Consolidated Financial Statements</u>	46

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Build-A-Bear Workshop, Inc.:

We have audited the accompanying consolidated balance sheets of Build-A-Bear Workshop, Inc. and subsidiaries (the Company) as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 30, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards No. 123R "Shared Based Payment", effective January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

St. Louis, Missouri
March 15, 2007

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BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share data)

	December 30,	December 31,
	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 53,109	\$ 90,950
Inventories	50,905	40,157
Receivables	7,389	6,629
Prepaid expenses and other current assets	11,805	6,839
Deferred tax assets	2,388	3,232
Total current assets	125,596	147,807
Property and equipment, net	130,347	89,973
Note receivable from franchisee	—	4,518
Goodwill	36,927	—
Other intangible assets, net	2,873	1,454
Other assets, net	4,027	2,356
Total Assets	<u>\$ 299,770</u>	<u>\$ 246,108</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 46,761	\$ 34,996
Accrued expenses	16,301	15,792
Gift cards and customer deposits	28,128	22,865
Deferred revenue	6,454	7,508
Total current liabilities	97,644	81,161
Deferred franchise revenue	2,297	2,306
Deferred rent	34,754	30,687
Other liabilities	352	586
Deferred tax liabilities	459	1,011
Commitments and contingencies — See Note 12		
Stockholders' equity:		
Preferred stock, par value \$0.01. Shares authorized: 15,000,000; No shares issued or outstanding	—	—
Common stock, par value \$0.01. Shares authorized: 50,000,000; Issued and outstanding: 20,537,421 and 20,120,655 shares, respectively	205	201
Additional paid-in capital	88,866	85,259
Other comprehensive income	(997)	—
Retained earnings	76,190	46,700
Notes receivable from officers	—	(151)
Unearned compensation	—	(1,652)
Total stockholders' equity	164,264	130,357
Total Liabilities and Stockholders' Equity	<u>\$ 299,770</u>	<u>\$ 246,108</u>

See accompanying notes to consolidated financial statements.

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BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except share and per share data)

	Fiscal Year		
	2006	2005	2004
Revenues:			
Net retail sales	\$ 432,572	\$ 358,901	\$ 300,469
Franchise fees	3,521	1,976	846
Licensing revenue	979	932	347
Total revenues	<u>437,072</u>	<u>361,809</u>	<u>301,662</u>
Costs and expenses:			
Cost of merchandise sold	227,509	180,373	150,903
Selling, general, and administrative	158,712	133,921	115,939
Store reopening	3,958	4,812	2,186
Interest expense (income), net	(1,530)	(1,710)	(299)
Total costs and expenses	<u>388,649</u>	<u>317,396</u>	<u>268,729</u>
Income before income taxes	48,423	44,413	32,933
Income tax expense	18,933	17,099	12,934
Net income	29,490	27,314	19,999
Cumulative dividends and accretion of redeemable preferred stock	—	—	1,262
Cumulative dividends of nonredeemable preferred stock	—	—	263
Net income available to common and participating preferred stockholders	<u>\$ 29,490</u>	<u>\$ 27,314</u>	<u>\$ 18,474</u>
Net income allocated to common stockholders	<u>\$ 29,490</u>	<u>\$ 27,314</u>	<u>\$ 8,519</u>
Net income allocated to participating preferred stockholders	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,955</u>
Earnings per common share:			
Basic	<u>\$ 1.46</u>	<u>\$ 1.38</u>	<u>\$ 2.30</u>
Diluted	<u>\$ 1.44</u>	<u>\$ 1.35</u>	<u>\$ 1.07</u>
Shares used in computing common per share amounts:			
Basic	20,169,814	19,735,067	3,702,365
Diluted	20,468,256	20,229,978	18,816,435

See accompanying notes to consolidated financial statements.

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BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in thousands)

	Nonredeemable preferred stock			Common stock	Additional paid-in capital	Other comprehensive income	Retained earnings	Notes receivable from officers	Unearned compensation	Total
	Class A	Class B	Class C							
Balance, January 3, 2004	24	20	50	5	10,918	—	10,649	(1,821)	—	19,845
Interest on notes receivable from officers	—	—	—	—	93	—	—	(93)	—	—
Collection of notes receivable from officers	—	—	—	—	—	—	—	144	—	144
Cumulative dividends and accretion of redeemable preferred stock	—	—	—	—	—	—	(1,262)	—	—	(1,262)
Payment of cash dividend	—	—	—	—	—	—	(10,000)	—	—	(10,000)
Exercise of stock options and exchange of outstanding shares, net of tax benefit	—	—	(1)	4	460	—	—	—	—	463
Shares withheld in lieu of tax withholdings	—	—	—	(1)	(539)	—	—	—	—	(540)
Stock-based compensation related to stock options and restricted stock	—	—	—	—	1,984	—	—	—	(10)	1,974
Initial public offering, net of offering expenses	—	—	—	15	25,720	—	—	—	—	25,735
Conversion of redeemable and non-redeemable preferred stock to common stock	(24)	(20)	(49)	173	39,072	—	—	—	—	39,152
Net income	—	—	—	—	—	—	19,999	—	—	19,999
Balance, January 1, 2005	—	—	—	196	77,708	—	19,386	(1,770)	(10)	95,510
Interest on notes receivable from officers	—	—	—	—	26	—	—	(26)	—	—
Collection of notes receivable from officers	—	—	—	—	—	—	—	1,645	—	1,645
Issuance of restricted common stock	—	—	—	1	2,436	—	—	—	(2,437)	—
Employee stock purchases	—	—	—	1	1,670	—	—	—	—	1,671
Exercise of stock options, net of tax benefit	—	—	—	4	5,829	—	—	—	—	5,833
Shares withheld in lieu of tax withholdings	—	—	—	(1)	(2,410)	—	—	—	—	(2,411)
Stock-based compensation related to restricted stock	—	—	—	—	—	—	—	—	795	795
Net income	—	—	—	—	—	—	27,314	—	—	27,314
Balance, December 31, 2005	\$ —	\$ —	\$ —	\$ 201	\$ 85,259	\$ —	\$ 46,700	\$ (151)	\$ (1,652)	\$130,357
Reclassification of unearned compensation upon adoption of SFAS 123R	—	—	—	—	(1,652)	—	—	—	1,652	—
Interest on notes receivable from officers	—	—	—	—	4	—	—	(4)	—	—
Collection of notes receivable from officers	—	—	—	—	—	—	—	155	—	155
Issuance of restricted common stock	—	—	—	2	(2)	—	—	—	—	—
Employee stock purchases	—	—	—	1	478	—	—	—	—	479
Exercise of stock options, net of tax benefit	—	—	—	2	2,780	—	—	—	—	2,782
Shares withheld in lieu of tax withholdings	—	—	—	(1)	(140)	—	—	—	—	(141)
Stock-based compensation related to restricted stock	—	—	—	—	2,139	—	—	—	—	2,139
Other comprehensive income	—	—	—	—	—	(997)	—	—	—	(997)
Net income	—	—	—	—	—	—	29,490	—	—	29,490
Balance, December 30, 2006	\$ —	\$ —	\$ —	\$ 205	\$ 88,866	\$ (997)	\$ 76,190	\$ —	\$ —	\$164,264

See accompanying notes to consolidated financial statements.

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

	Fiscal Year		
	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 29,490	\$ 27,314	\$ 19,999
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	22,394	17,592	14,948
Deferred taxes	(1,130)	(2,035)	(1,875)
Tax benefit from stock option exercises	(1,269)	3,091	410
Loss on disposal of property and equipment	82	526	533
Impairment of goodwill	—	—	97
Impairment charge (credit)	—	—	(54)
Stock-based compensation	2,139	795	1,974
Change in assets and liabilities:			
Inventories	(8,368)	(9,366)	(8,218)
Receivables	(1,826)	(2,804)	(1,629)
Prepaid expenses and other assets	(1,021)	(1,612)	(1,105)
Accounts payable	3,419	9,229	3,998
Accrued expenses and other liabilities	9,125	11,912	19,449
Net cash provided by operating activities	<u>53,035</u>	<u>54,642</u>	<u>48,527</u>
Cash flows from investing activities:			
Purchases of property and equipment	(52,577)	(31,083)	(16,494)
Purchases of other assets and other intangible assets	(2,063)	(1,569)	(1,238)
Loan to franchisee	—	(4,425)	—
Purchase of business, net of cash acquired	(39,132)	—	—
Net cash used in investing activities	<u>(93,772)</u>	<u>(37,077)</u>	<u>(17,732)</u>
Cash flows from financing activities:			
Exercise of employee stock options and employee stock purchases	2,112	4,413	52
Collection of notes receivable from officers	155	1,645	144
Payment of cash dividend	—	—	(10,000)
Tax benefit from stock option exercises	1,270	—	—
Proceeds from initial public offering, net of offering costs	—	—	25,735
Net cash provided by financing activities	<u>3,537</u>	<u>6,058</u>	<u>15,931</u>
Effect of exchange rates on cash	(641)		
Net (decrease) increase in cash and cash equivalents	<u>(37,841)</u>	<u>23,623</u>	<u>46,726</u>
Cash and cash equivalents, beginning of year	<u>90,950</u>	<u>67,327</u>	<u>20,601</u>
Cash and cash equivalents, end of year	<u>\$ 53,109</u>	<u>\$ 90,950</u>	<u>\$ 67,327</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	<u>\$ 11</u>	<u>\$ 79</u>	<u>\$ 15</u>
Income taxes	<u>\$ 18,969</u>	<u>\$ 11,562</u>	<u>\$ 13,578</u>
Noncash transaction:			
Cumulative dividends and accretion of redeemable preferred stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,262</u>

See accompanying notes to consolidated financial statements.

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(1) Description of Business

Build-A-Bear Workshop, Inc. (the Company) is a specialty retailer of plush animals and related products. At December 30, 2006, the Company operated 271 stores (unaudited) located in the United States, Canada, the United Kingdom, and Ireland. The Company was formed in September 1997 and began operations in October 1997. The Company changed to a Delaware C Corporation on April 3, 2000. The Company previously operated as a Missouri Limited Liability Company.

During 2001, the Company and a third party formed Build-A-Bear Entertainment, LLC (BABE) for the purpose of promoting the Build-A-Bear Workshop brand and characters of the Company through certain entertainment media. Prior to February 2003, the Company owned 51% and was the managing member. BABE had no active operations for the period from December 29, 2001 through February 10, 2003. On February 10, 2003, the Company purchased, for \$200,000, the 49% minority interest in BABE, which then became a wholly-owned subsidiary.

During 2002, the Company formed Build-A-Bear Workshop Franchise Holdings, Inc. (Holdings) for the purpose of entering into franchise agreements with companies in foreign countries other than Canada. Holdings is a wholly-owned subsidiary of the Company. Since 2002, Holdings has signed franchise agreements with third parties to open Build-A-Bear Workshop stores in various countries throughout the world. For each of the franchise agreements, Holdings received a one-time, nonrefundable fee that has been deferred and is being amortized over the life of the respective franchise agreement. Holdings also receives a percentage of all sales by the franchisees. As of December 30, 2006, the number of Build-A-Bear Workshop franchise stores that are open and operating in these countries is as follows (unaudited):

Japan	7
Australia	6
Denmark	5
Taiwan	3
Other	13

On April 2, 2006, Holdings acquired all of the outstanding shares of The Bear Factory Limited, a stuffed animal retailer in the United Kingdom, and Amsbra Limited, our former U.K. franchisee. During 2006, the Company formed Build-A-Bear Workshop UK Holdings, Ltd (UK Holdings) as the parent company to The Bear Factory and Amsbra. UK Holdings is a wholly-owned subsidiary of Holdings. The results of the acquisition's operations have been included in the consolidated financial statements since the date of acquisition. In conjunction with those transactions, we obtained 40 (unaudited) retail locations in the United Kingdom and Ireland. Amsbra operated 11 (unaudited) franchised Build-A-Bear Workshop stores located in the United Kingdom. Upon completion of the acquisition, all of the franchised locations in the United Kingdom became company-owned stores. Also during 2006, the Company formed Build-A-Bear Workshop Ireland and Build-A-Bear Workshop France as wholly-owned subsidiaries of Holdings.

During 2003, the Company formed Build-A-Bear Retail Management, Inc. (BABRM) for the purpose of providing purchasing, legal, information technology, accounting, and other general management services for Build-A-Bear Workshop stores. BABRM is a wholly-owned subsidiary of the Company.

(2) Summary of Significant Accounting Policies

A summary of the Company's significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows:

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Build-A-Bear Workshop, Inc. and its wholly-owned subsidiaries: Holdings, BAB Canada, BABE, and BABRM. All significant intercompany accounts are eliminated in consolidation.

(b) Fiscal Year

The Company operates on a 52- or 53-week fiscal year ending on the Saturday closest to December 31. The periods presented in these financial statements are the fiscal years ended December 30, 2006 (fiscal 2006), December 31, 2005 (fiscal 2005), and January

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1, 2005 (fiscal 2004). All fiscal years presented included 52 weeks. References to years in these financial statements relate to fiscal years or year ends rather than calendar years.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash and short-term highly liquid investments with an original maturity of three months or less.

The majority of the Company's cash and cash equivalents exceed federal deposit insurance limits. The Company has not experienced any losses in such accounts and management believes that the Company is not exposed to any significant credit risk on cash and cash equivalents.

(d) Inventories

Inventories are stated at the lower of cost or market, with cost determined on an average-cost basis.

(e) Receivables

Receivables consist primarily of amounts due to the Company in relation to tenant allowances, corporate product sales, franchisee royalties and product sales, and licensing revenue. The Company assesses the collectibility of all receivables on an ongoing basis by considering its historical credit loss experience, current economic conditions, and other relevant factors. Based on this analysis, the Company has determined that no material allowance for doubtful accounts was necessary at either December 30, 2006 or December 31, 2005.

(f) Property and Equipment

Property and equipment consist of leasehold improvements, furniture and fixtures, and computer equipment and software and are stated at cost. Leasehold improvements are depreciated using the straight-line method over the shorter of the useful life of the assets or the life of the lease which is generally ten years. Furniture and fixtures and computer equipment are depreciated using the straight-line method over the estimated service lives ranging from three to seven years. Computer software is amortized using the straight-line method over a period of three years. New store construction deposits are recorded at the time the deposit is made as construction-in-progress and reclassified to the appropriate property and equipment category at the time of completion of construction, when operations of the store commence. Maintenance and repairs are expensed as incurred and improvements are capitalized. Gains or losses on the disposition of fixed assets are recorded upon disposal.

(g) Note Receivable from Franchisee

The 2005 note receivable from franchisee consists of principal and accrued interest related to a loan made to one of the Company's international franchisees. The note is stated at face value plus accrued interest. The note receivable was included in the purchase price of the U.K. acquisition on April 2, 2006.

(h) Goodwill

The Company has adopted SFAS No. 142. Under the provisions of this standard, goodwill is not subject to amortization. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. This testing requires comparison of carrying values to fair values, and when appropriate, the carrying value of impaired assets is reduced to fair value. We reviewed our goodwill as of December 30, 2006 and determined that no impairment existed.

(i) Other Intangible Assets

Other intangible assets consist primarily of costs related to trademarks and other intellectual property. Trademarks and other intellectual property represent third-party costs that are capitalized and amortized over their estimated lives ranging from one to ten years using the straight-line method.

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(j) Other Assets

Other assets consist primarily of deferred leasing fees and deferred costs related to franchise agreements. Deferred leasing fees are initial, direct costs related to the Company's operating leases and are amortized over the term of the related leases. Amortization expense related to other assets was \$0.5 million, \$0.3 million, and \$0.3 million for 2006, 2005, and 2004, respectively.

(k) Long-lived Assets

Whenever facts and circumstances indicate that the carrying value of a long-lived asset may not be recoverable, the carrying value is reviewed. If this review indicates that the carrying value of the asset will not be recovered, as determined based on projected undiscounted cash flows related to the asset over its remaining life, the carrying value of the asset is reduced to its estimated fair value.

(l) Deferred Rent

Certain of the Company's operating leases contain predetermined fixed escalations of minimum rentals during the original lease terms. For these leases, the Company recognizes the related rental expense on a straight-line basis over the life of the lease and records the difference between the amounts charged to operations and amounts paid as deferred rent. The Company also receives certain lease incentives in conjunction with entering into operating leases. These lease incentives are recorded as deferred rent at the beginning of the lease term and recognized as a reduction of rent expense over the lease term. In addition, certain of the Company's leases contain future contingent increases in rentals. Such increases in rental expense are recorded in the period that it is probable that store sales will meet or exceed the specified target that triggers contingent rental expense.

(m) Franchises

The Company defers initial, one-time nonrefundable franchise fees and amortizes them over the life of the respective franchise agreements, which extend for periods up to 10 years. Continuing franchise fees are recognized as revenue as the fees are earned. The Company defers direct and incremental costs incurred with third parties when entering into franchise agreements and amortizes them over the life of the respective franchise agreements.

(n) Retail Revenue Recognition

Net retail sales are net of discounts, exclude sales tax, and are recognized at the time of sale. Shipping and handling costs billed to customers are included in net retail sales.

Revenues from the sale of gift cards are recognized at the time of redemption. Unredeemed gift cards are included in gift cards and customer deposits on the consolidated balance sheets. The company escheats a portion of unredeemed gift cards according to Delaware escheatment regulations that require remittance of the cost of merchandise portion of unredeemed gift cards over five years old. The difference between the value of gift cards and the amount escheated is recorded as a reduction in selling, general, and administrative expenses in the consolidated statement of operations.

The Company has an automated frequent shopper program in the United States, the Stuff Fur Stuff® club, whereby guests enroll in the program and receive one point for every dollar or partial dollar spent and after reaching 100 points receive a \$10 discount on a future purchase. This program was automated in July 2006 and replaced the former Buy Stuff Program, which was a manual punch card system with limited tracking capability. The reward earned under the new program did not change. An estimate of the obligation related to the program, based on historical redemption rates, is recorded as deferred revenue and a reduction of net retail sales at the time of purchase. The deferred revenue obligation is reduced, and a corresponding amount is recognized in net retail sales, in the amount of and at the time of redemption of the \$10 discount.

Under the previous Buy Stuff Program, the first card had no expiration date. Beginning in June 2002, and continuing each summer up to July 1, 2006, a series of cards was issued that had an expiration date of December 31 of the year following the year in which that series of cards was first issued. Beginning in July 2006, the automated Stuff Fur Stuff® club was introduced which provides greater visibility to the rewards earned by our guests and the historical redemption rates. Management tracks redemptions of these various cards and uses actual redemption rates by card series and historical results to estimate how much revenue to defer. Management reviews these redemption rates and assesses the adequacy of the deferred revenue account at the end of each fiscal quarter. Due to the estimates involved in these assessments, adjustments to the deferral rate are generally made no more often than bi-annually in order to allow time for more definite trends to emerge.

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Based upon an assessment at the end of fiscal 2003, the deferred revenue account was adjusted downward by \$1.1 million with a corresponding increase to net retail sales, an increase in net income of \$0.7 million. Additionally, the amount of revenue being deferred beginning in fiscal 2004 was decreased by 0.2%, and by another 0.5% beginning with the third quarter of 2004, to give effect to the change in redemption experience. The changes made to the deferral rate in fiscal 2004 were prospective in nature with no impact on previously reported results of operations. Beginning with the second quarter of fiscal 2005, the amount of revenue being deferred was reduced by 0.1% on a prospective basis from its then current level due to further changes in the Company's redemption experience.

Based on the most recent assessment at the end of fiscal 2006, the deferred revenue account was adjusted downward by \$3.6 million, effective at the beginning of fiscal 2006, with a corresponding increase to net sales, and a \$2.2 million increase in net income. Additionally, the amount of revenue being deferred for future periods has been decreased by 0.6%, to give effect to the change in redemption experience and the increased visibility of the redemptions with the automated system. An additional 0.1% adjustment of the ultimate redemption rate at the end of fiscal 2006 for the current cards expiring on December 30, 2006 and December 29, 2007 would have an approximate impact of \$0.5 million on the deferred revenue balance and net retail sales.

(o) Cost of Merchandise Sold

Cost of merchandise sold includes the cost of the merchandise, royalties paid to licensors of third party branded merchandise, store occupancy cost, including store depreciation, freight costs from the manufacturer to the store, cost of warehousing and distribution, packaging, damages and shortages, and shipping and handling costs incurred in shipment to customers.

(p) Selling, General, and Administrative Expenses

Selling, general, and administrative expenses include store payroll and related benefits, advertising, credit card fees, and store supplies, as well as central office management payroll and related benefits, travel, information systems, accounting, insurance, legal, and public relations. It also includes depreciation and amortization of central office leasehold improvements, furniture, fixtures, and equipment, as well as amortization of trademarks and intellectual property.

(q) Store Preopening Expenses

Store preopening expenses, including store set-up, certain labor and hiring costs, and rental charges incurred prior to store openings are expensed as incurred.

(r) Advertising

Production costs of commercials and programming are charged to operations in the period during which the production is first aired. The costs of other advertising, promotion and marketing programs are charged to operations in the period the program takes place. Advertising expense was \$31.0 million, \$27.2 million, and \$22.7 million for fiscal years 2006, 2005 and 2004, respectively.

(s) Income Taxes

Income taxes are accounted for using a balance sheet approach known as the asset and liability method. The asset and liability method accounts for deferred income taxes by applying the statutory tax rates in effect at the date of the consolidated balance sheets to differences between the book basis and the tax basis of assets and liabilities.

(t) Earnings Per Share

Certain classes of preferred stock were entitled to participate in cash dividends on common stock prior to their conversion. For purposes of calculating basic earnings per share, undistributed earnings were allocated to common and participating preferred shares on a pro rata basis. Basic earnings per share is determined by dividing net income allocated to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if options to issue common stock or conversion rights of preferred stocks were exercised. In periods in which the inclusion of such instruments is anti-dilutive, the effect of such securities is not given consideration.

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All outstanding classes of preferred stock were converted to common stock in conjunction with the completion of the Company's initial public offering on October 28, 2004.

(u) Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R requires companies to recognize the cost of awards of equity instruments, such as stock options and restricted stock, based on the fair value of those awards at the date of grant and eliminates the choice to account for employee stock options under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). The Company adopted SFAS 123R effective January 1, 2006 using the modified prospective method and, as such, results for prior periods have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro forma disclosures in prior periods. Prior to January 1, 2006, the fair value of restricted stock awards was expensed by the Company over the vesting period, while compensation expense for stock options was recognized over the vesting period only to the extent that the grant date market price of the stock exceeded the exercise price of the options.

For 2006, selling, general and administrative expense includes \$2.1 million (\$1.4 million after tax) of stock-based compensation expense which had a \$0.07 impact on both basic and diluted earnings per share. Of this amount, \$0.2 million (\$0.2 after tax) is attributable to the Company's adoption of SFAS 123R. This incremental expense from the adoption of SFAS 123R did not reduce basic or diluted earnings per share based upon the insignificance of the expense. The additional stock-based compensation expense not related to the adoption of SFAS 123R was related to the vesting of restricted stock awards.

As of December 30, 2006, there was \$4.4 million of total unrecognized compensation expense related to nonvested restricted stock awards and options which is expected to be recognized over a weighted-average period of 2.75 years.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value method of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), prior to January 1, 2006 (in thousands except per share amounts):

	<u>2005</u>	<u>2004</u>
Net income:		
As reported	\$ 27,314	\$ 19,999
Add stock-based employee compensation expense recorded, net of related tax effects	489	1,446
Deduct stock-based employee compensation expense under fair value-based method, net of related tax effects	(2,758)	(2,643)
Pro Forma	<u>\$ 25,045</u>	<u>\$ 18,802</u>
Basic earnings per common share:		
As reported	<u>\$ 1.38</u>	<u>\$ 2.30</u>
Pro forma	<u>\$ 1.27</u>	<u>\$ 2.03</u>
Diluted earnings per common share:		
As reported	<u>\$ 1.35</u>	<u>\$ 1.07</u>
Pro forma	<u>\$ 1.24</u>	<u>\$ 1.02</u>

The fair value of each option was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: (a) dividend yield of 0%; (b) expected volatility of 50%; (c) risk-free interest rate of 3.5%; and (d) a weighted average expected life of 6.3 years for 2005 and 9.4 years for 2004. The weighted average grant date fair value of options granted during fiscal 2005 and fiscal 2004 was \$17.23 and \$8.63, respectively. There were no new options granted in fiscal 2006. The pro forma disclosures above utilize the accelerated expense attribution method under FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans — An Interpretation of APB Opinions No. 15 and 25*. Upon adoption of SFAS 123R, the Company made a policy decision that the straight-line expense attribution method would be utilized for all future stock-based compensation awards with graded vesting.

On October 21, 2005, the Compensation Committee of the Board of Directors of the Company approved accelerated vesting of all unvested stock options which were granted prior to March 9, 2005. These options have exercise prices ranging from \$20.00 to \$34.65 per share. Options to purchase 174,056 shares of the Company's stock became exercisable on October 21, 2005 as a result of this acceleration, including 71,000 shares held by the Company's named executive officers. Of these options, 173,056 had exercise prices in excess of the current market value at the time of the acceleration of vesting.

The Compensation Committee's decision to accelerate the vesting of the accelerated options was based upon the issuance of SFAS 123R. The acceleration of the vesting of these stock options enabled the Company to avoid compensation charges related to these options in subsequent periods of the effective date under the provisions of SFAS 123R.

The aggregate compensation expense that would have been recorded subsequent to the adoption of SFAS 123R, but is eliminated as a result of the acceleration of the vesting of these options, is approximately \$1.8 million (\$1.1 million net of tax). This amount is instead reflected in the above pro forma disclosures for 2005.

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Prior to the adoption of SFAS 123R, the Company presented the benefit of all tax deductions resulting from the exercise of stock options and restricted stock awards as operating cash flows in the consolidated statements of cash flows. SFAS 123R requires the benefits of tax deductions in excess of grant-date fair value be reported as a financing cash flow, rather than as an operating cash flow. Excess tax benefits of \$1.3 million, which were classified as a financing cash inflow in fiscal 2006, would have been classified as an operating cash inflow if the Company had not adopted SFAS 123R.

(v) Fair Value of Financial Instruments

For purposes of financial reporting, management has determined that the fair value of financial instruments, including cash and cash equivalents, receivables, accounts payable, and accrued expenses, approximates book value at December 30, 2006 and December 31, 2005.

(w) Use of Estimates

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment and intangibles, inventories, the valuation of assets and liabilities in the purchase price allocation for business combinations and deferred income tax assets and the determination of deferred revenue under the Company's frequent shopper program.

(x) Sales Tax Policy

The Company's revenues in the consolidated statement of operations are net of sales taxes.

(y) Foreign Currency Translation

Assets and liabilities of the Company's foreign operations are translated at the exchange rate in effect at the balance sheet date, while revenues and expenses are translated at average rates prevailing during the years. Translation adjustments are reported in other comprehensive income, a separate component of stockholders' equity.

(z) Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 establishes threshold and measurement attributes for financial statement measurement and recognition of tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 on December 31, 2006. Management does not expect the adoption of FIN 48 will have a significant impact on the financial results of the Company and will not result in a significant cumulative effect adjustment to the December 31, 2006 balance of retained earnings.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. The Company is required to adopt SFAS 157 in the first quarter of 2008. The Company is currently assessing the financial impact of SFAS 157 on its consolidated financial statements.

(3) Business Acquisition

On April 2, 2006, the Company acquired all of the outstanding shares of The Bear Factory Limited (Bear Factory), a stuffed animal retailer in the United Kingdom, and Amsbra Limited (Amsbra), the Company's former U.K. franchisee (collectively, the U.K. Acquisition). The results of the U.K. Acquisition operations have been included in the consolidated financial statements since that date. In conjunction with those transactions, we obtained 40 (unaudited) retail locations in the United Kingdom and Ireland. The aggregate cash purchase price for the U.K. Acquisition was \$39.4 million, excluding cash acquired of \$0.3 million. In addition to the cash purchase price, the Company had previously advanced \$4.5 million to Amsbra as a note receivable. The amount of this note receivable and the related accrued interest is a non-cash component of the purchase price.

The Company has not completed its assessment of the U.K. Acquisition assets and liabilities. Until that assessment is complete, the allocation of the purchase price is preliminary and may be subject to revisions.

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	\$ 6,497
Property and equipment	6,192
Goodwill	31,727
Intangibles	1,824
Total assets acquired	<u>46,240</u>
Current liabilities assumed	(8,607)
Loan previously advanced	<u>4,517</u>
Total purchase price	<u>\$ 42,150</u>

The following unaudited pro forma summary presents the Company's revenue, net income, basic earnings per share and diluted earnings per share as if the U.K. Acquisition had occurred on January 2, 2005 (in thousands, except per share data):

	<u>Fiscal 2006</u>	<u>Fiscal 2005</u>
Revenue	\$ 446,140	\$ 404,057
Net Income	27,735	21,189
Basic earnings per common share:	\$ 1.38	\$ 1.07
Diluted earnings per common share:	\$ 1.36	\$ 1.05

Pro forma adjustments have been made to reflect depreciation and amortization using estimated asset values recognized after applying purchase accounting adjustments.

This pro forma information is presented for informational purposes only and is not necessarily indicative of actual results had the acquisition been effected at the beginning of the respective periods presented, and is not necessarily indicative of future results.

(4) Comprehensive Income

Comprehensive income for fiscal 2006 and fiscal 2005 was \$30.1 million and \$27.3 million, respectively. The difference between comprehensive income and net income resulted from foreign currency translation adjustments.

(5) Property and Equipment

Property and equipment consist of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Land	\$ 2,261	\$ —
Furniture and fixtures	33,938	19,727
Computer hardware	15,649	12,655
Building	14,970	—
Leasehold improvements	122,043	98,991
Computer software	12,988	7,250
Construction in progress	2,200	5,853
	<u>204,049</u>	<u>144,476</u>
Less accumulated depreciation	<u>73,702</u>	<u>54,503</u>
	<u>\$130,347</u>	<u>\$ 89,973</u>

For 2006, 2005, and 2004, depreciation expense was \$20.5 million, \$16.4 million, and \$13.8 million, respectively.

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(6) Goodwill

On April 2, 2006, the Company acquired all of the outstanding shares of The Bear Factory Limited (Bear Factory), a stuffed animal retailer in the United Kingdom, and Amsbra Limited (Amsbra), the Company's former U.K. franchisee (collectively, the U.K. Acquisition). The purchase was recorded in accordance with SFAS No. 141, "Business Combinations" and is reported as a component of the Company's retail segment. The following table summarizes the Company's goodwill (in thousands):

U.K. Acquisition	\$ 31,727
Acquisition costs	1,005
Severance costs	785
	<u>33,517</u>
Effect of foreign currency translation	<u>3,410</u>
Goodwill, as of December 30, 2006	<u>\$ 36,927</u>

There was no tax-deductible goodwill as of December 30, 2006.

(7) Other Intangible Assets

Other intangible assets consist of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Trademarks and other intellectual property at cost	\$ 8,897	\$ 6,026
Less accumulated amortization	6,024	4,572
Total, net	<u>\$ 2,873</u>	<u>\$ 1,454</u>

Trademarks and intellectual property are amortized over three to ten years. Amortization expense related to trademarks and intellectual property was \$1.4 million in 2006 and \$0.9 million each year for 2005 and 2004. Estimated amortization expense related to other intangible assets as of December 30, 2006, for each of the years in the subsequent five year period and thereafter is: 2007- \$1.3 million; 2008 — \$0.8 million; 2009 — \$0.4 million; 2010 — \$0.1 million; 2011 — \$0.1 million and all remaining years — \$0.2 million.

Trademarks and intellectual property acquired in the U.K. Acquisition were \$2.0 million at cost and had \$0.5 million in amortization in fiscal 2006.

(8) Accrued Expenses

Accrued expenses consist of the following (in thousands):

	<u>2006</u>	<u>2005</u>
Accrued wages, bonuses and related expenses	\$ 3,559	\$ 3,926
Sales tax payable	5,384	4,217
Current income taxes payable	6,482	6,653
Accrued rent and related expenses	876	996
	<u>\$ 16,301</u>	<u>\$ 15,792</u>

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(9) Income Taxes

The components of the provision for income taxes are as follows (in thousands):

	2006	2005	2004
Current:			
Federal	\$ 15,660	\$ 15,770	\$ 12,432
State	2,156	2,584	2,035
Foreign	2,220	780	342
Deferred:			
Federal	(1,282)	(1,757)	(1,617)
State	(119)	(278)	(258)
Foreign	298	—	—
Income tax expense	<u>\$ 18,933</u>	<u>\$ 17,099</u>	<u>\$ 12,934</u>

The income tax expense is different from the amount computed by applying the U.S. statutory Federal income tax rates to income before income taxes. The reasons for these differences are as follows (in thousands):

	2006	2005	2004
Net income before taxes	\$48,421	\$44,413	\$32,933
UK net operating loss — no tax benefit	1,452	—	—
Income before income taxes	49,873	44,413	32,933
U.S. statutory Federal income tax rate	35%	35%	35%
Computed income taxes	17,456	15,545	11,527
State income taxes, net of Federal tax benefit	1,325	1,498	1,155
Other	152	56	252
Income tax expense	<u>\$18,933</u>	<u>\$17,099</u>	<u>\$12,934</u>
Effective tax rate	39.1%	38.5%	39.3%

Temporary differences that gave rise to deferred income tax assets and liabilities are as follows (in thousands):

	2006	2005
Deferred income tax assets:		
Deferred revenue	\$ 3,529	\$ 4,240
Accrued rents	3,409	3,210
Deferred compensation	829	380
Intangible assets	1,283	1,173
Stock compensation	234	350
Accrued severance	207	—
Net operating loss carryovers	435	—
Other	223	211
	<u>10,149</u>	<u>9,564</u>
Less: valuation allowance	(435)	—
Total deferred income tax assets	<u>9,714</u>	<u>9,564</u>
Deferred income tax liabilities:		
Depreciation	(6,001)	(6,963)
Other	(389)	(380)
Total deferred income tax liabilities	<u>(6,390)</u>	<u>(7,343)</u>
Net deferred income tax asset	<u>\$ 3,324</u>	<u>\$ 2,221</u>

As of December 30, 2006, the Company has recognized a net operating loss for its wholly-owned U. K. subsidiaries of \$1.5 million. The tax impact of that loss is \$0.4 million based on a local tax rate in the U. K. of 30%. The entire benefit of that loss has been reduced by a valuation allowance. At the time when the loss is utilized, that valuation allowance will be relieved. There are no statutory expiration limits on net operating loss carryforwards in the U.K. The Company had no valuation allowance at December 31, 2005.

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(10) Long-Term Debt

On June 30, 2006, the Company amended its previous line of credit with a bank increasing their borrowing capacity from \$15 million to \$30 million. The amended line of credit has an effective date of June 30, 2006 with a maturity date of September 30, 2007. Borrowings under the amended line of credit (the credit agreement) are not collateralized, but availability under the credit agreement can be limited by the lender based on the Company's levels of accounts receivable, inventory, and property and equipment. The credit agreement requires the Company to comply with certain financial covenants, including maintaining a minimum tangible net worth, maintaining a minimum fixed charge coverage ratio (as defined in the credit agreement) and not exceeding a maximum funded debt to earnings before interest, depreciation and amortization ratio. The credit agreement also places certain restrictions on indebtedness, liens, guarantees, redemptions, mergers, acquisitions or sale of assets, loans, transactions with affiliates, and investments. It also prohibits the Company from declaring dividends without the bank's prior consent, unless such payment of dividends would not violate any terms of the loan agreement. Borrowings bear interest at the Company's option of prime minus 1.0% or LIBOR plus 1.5%.

There was no outstanding balance under the credit agreement at December 30, 2006 or December 31, 2005 other than a standby letter of credit for \$1.1 million. Giving effect to this standby letter of credit, there was \$28.9 million available for borrowing under the credit agreement at December 30, 2006 and December 31, 2005.

(11) Commitments and Contingencies

(a) Operating Leases

The Company leases its retail stores, web fulfillment site, and corporate offices under agreements which expire at various dates through 2023. The majority of leases contain provisions for base rent plus contingent payments based on defined sales. Total office and retail store base rent expense was \$40.5 million, \$23.8 million, and \$19.9 million, and contingent rents were \$1.5 million, \$1.8 million, and \$1.2 million for 2006, 2005, and 2004, respectively.

Future minimum lease payments at December 30, 2006, were as follows (in thousands):

2007	\$ 42,222
2008	44,106
2009	43,432
2010	42,016
2011	38,590
Subsequent to 2011	<u>137,520</u>
	<u>\$347,886</u>

(b) Litigation

In the normal course of business, the Company is subject to certain claims or lawsuits. Management is not aware of any claims or lawsuits that will have a material adverse effect on the consolidated financial position or results of operations of the Company.

(12) Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share date):

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	2006	2005	2004
Net income	\$ 29,490	\$ 27,314	\$ 19,999
Cumulative dividends and accretion of redeemable preferred stock	—	—	1,262
Cumulative dividends of nonredeemable preferred stock	—	—	263
Net income available to common and participating preferred stockholders	29,490	27,314	18,474
Dividends and accretion related to dilutive preferred stock:			
Series A-1	—	—	113
Series A-2	—	—	20
Series A-3	—	—	101
Series A-4	—	—	29
Series A-5	—	—	293
Series B-4	—	—	41
Series D	—	—	928
Total dividends and accretion	—	—	1,525
	<u>\$ 29,490</u>	<u>\$ 27,314</u>	<u>\$ 19,999</u>
Net income allocated to common stockholders	<u>\$ 29,490</u>	<u>\$ 27,314</u>	<u>\$ 8,519</u>
Net income allocated to participating preferred stockholders	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,955</u>
Weighted average number of common shares outstanding	<u>20,169,814</u>	<u>19,735,067</u>	<u>3,702,365</u>
Weighted average number of participating preferred shares outstanding	<u>—</u>	<u>—</u>	<u>7,805,238</u>
Weighted average number of common shares outstanding	20,169,814	19,735,067	3,702,365
Effect of dilutive securities:			
Stock options	236,316	420,280	556,545
Restricted stock	62,125	74,631	205,845
	<u>20,468,256</u>	<u>20,229,978</u>	<u>4,464,755</u>
Convertible preferred shares:			
Series A-1	—	—	1,203,221
Series A-2	—	—	148,017
Series A-3	—	—	1,016,444
Series A-4	—	—	217,641
Series A-5	—	—	1,122,950
Series B-1	—	—	226,182
Series B-2	—	—	1,193,595
Series B-3	—	—	255,467
Series B-4	—	—	1,318,130
Series C	—	—	4,084,723
Series D	—	—	3,365,310
Total dilutive convertible preferred shares	—	—	14,151,680
Weighted average number of common shares — dilutive	<u>20,468,256</u>	<u>20,229,978</u>	<u>18,616,435</u>
Earnings per share:			
Basic:			
Per common share	<u>\$ 1.46</u>	<u>\$ 1.38</u>	<u>\$ 2.30</u>
Per participating preferred share	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1.28</u>
Diluted	<u>\$ 1.44</u>	<u>\$ 1.35</u>	<u>\$ 1.07</u>

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In calculating diluted earnings per share for fiscal 2006, options to purchase 166,588 shares of common stock were outstanding at the end of the period, but were not included in the computation of diluted earnings per share due to their anti-dilutive effect.

In calculating diluted earnings per share for fiscal 2005, options to purchase 173,560 shares of common stock were outstanding at the end of the period, but were not included in the computation of diluted earnings per share due to their anti-dilutive effect. An additional 51,750 shares of restricted common stock were outstanding at the end of the period, but excluded from the calculation of diluted earnings per share due to their anti-dilutive effect under provisions of Statement of Financial Accounting Standards No. 128, *Earnings per Share*.

No options were excluded from the diluted earnings per share calculation for fiscal 2004.

(13) Stock Incentive Plans

On April 3, 2000, the Company adopted the 2000 Stock Option Plan (the Plan). In 2003, the Company adopted the Build-A-Bear Workshop, Inc. 2002 Stock Incentive Plan, and, in 2004, the Company adopted the Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (collectively, the Plans).

Under the Plans, as amended, up to 3,700,000 shares of common stock were reserved and may be granted to employees and nonemployees of the Company. The Plan allows for the grant of incentive stock options, nonqualified stock options, and restricted stock. Options granted under the Plan expire no later than 10 years from the date of the grant. The exercise price of each incentive stock option shall not be less than 100% of the fair value of the stock subject to the option on the date the option is granted. The exercise price of the nonqualified options shall be determined from time to time by the compensation committee of the board of directors (the Committee). The vesting provision of individual options is at the discretion of the Committee and generally ranges from one to four years.

(a) Stock Options

The following table is a summary of the balance and activity for the Plans related to stock options for the periods presented:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding, January 3, 2004	1,067,549	\$ 4.82		
Granted:				
Exercise price less than fair market value	302,234	8.78		
Exercise price equal to fair market value	2,000	20.00		
Exercised	268,912	2.05		
Forfeited	63,463	8.05		
Outstanding, January 1, 2005	1,039,408	6.52		
Granted:				
Exercise price less than fair market value	218,292	32.73		
Exercised	475,970	5.76		
Forfeited	13,107	28.87		
Outstanding, December 31, 2005	768,623	14.06		
Exercised	208,951	7.23		
Forfeited	30,472	25.46		
Outstanding, December 30, 2006	529,200	\$ 16.10	6.0	\$ 6,310

Options Exercisable As Of:

December 30, 2006	525,450	16.05	5.9	\$ 6,291
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The total intrinsic value of options exercised in fiscal 2006 and fiscal 2005 was approximately \$4.3 million and \$10.5 million, respectively. The Company generally issues new shares to satisfy option exercises.

The Company granted options during 2004 at an exercise price of \$8.78 per share, which had been determined to be the fair value of its common stock at the time based on an independent appraisal. Subsequent to such grants, the Company determined that the fair value of the underlying common stock should have been deemed to be approximately \$15.00 per share. As a result of this

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determination, this option issuance generated stock-based compensation of \$1.9 million to be recognized over the vesting period of the 302,234 underlying options. These options became fully vested upon completion of the Company's initial public offering on October 28, 2004. Accordingly, all unrecognized compensation expense related to this grant was recognized at that time and is reflected in the consolidated statement of operations for the fiscal year ended January 1, 2005.

In May of 2004, a former officer of the Company surrendered 48,964 shares of Class C preferred stock in exchange for the exercise of 255,600 stock options with exercise prices ranging from \$0.47 to \$6.10 per share. In conjunction with this transaction, the vesting of 9,400 options with an exercise price of \$6.04 per share was accelerated by one calendar month. Stock compensation costs of \$26,000 are reflected in the consolidated statements of operations for the modification of the terms of these options. The Company also extended the due date of a loan made to the same former officer. The loan was originally due upon the earlier of the officer's separation date from the Company or September 19, 2006. The officer separated from the Company during 2004. On the date of separation, the due date of the loan was extended until September 19, 2006. The loan was collected in full on November 24, 2004.

In May of 2004, the Company accelerated the vesting of 5,625 options with an exercise price of \$9.10 per share. The options were held by a former member of the Company's board of directors. The options were originally scheduled to vest at a rate of 1,875 per year on April 24 of each year through April 24, 2007. Simultaneously with this acceleration, the Company allowed the former director to exercise 7,500 options with an exercise price of \$9.10 per share for no consideration. The 7,500 options consisted of the 5,625 accelerated options plus 1,875 previously vested options. At the time of this modification, the fair value of the Company's common stock was \$8.78 per share. Accordingly, the Company recognized \$66,000 in compensation expense at the time of this modification, which is reflected in the consolidated statements of operations.

Shares available for future option, non-vested stock and restricted stock grants were 1,649,731 and 1,796,166 at the end of 2006 and 2005, respectively.

(b) Restricted Stock

The following table is a summary of the balance and activity for the Plans related to unvested restricted stock granted as compensation to employees and directors for the periods presented:

	Number of Shares	Weighted Average Grant Date Fair Value per Award
Outstanding, January 1, 2005 and January 3, 2004	—	\$ —
Granted	82,946	32.37
Outstanding, December 31, 2005	82,946	32.37
Granted	230,702	29.18
Vested	42,705	30.60
Forfeited	43,490	29.27
Outstanding, December 30, 2006	<u>227,453</u>	\$ 30.06

On April 3, 2000, the Company issued 274,815 shares of restricted common stock to an officer of the Company in exchange for a promissory note of \$1,236,667 that bore interest at 6.60% per annum. Both principal and interest were collected in full in April 2005.

On September 19, 2001, the Company issued 40,982 shares of contractually restricted common stock to two officers of the Company in exchange for nonrecourse promissory notes totaling \$249,990 that bear interest at 4.82% per annum. Both principal and interest are due September 2006. On November 24, 2004, the Company collected all outstanding principal and interest related to 20,491 shares of this restricted stock. On September 19, 2006, the Company collected all outstanding principal and interest on the remaining 20,291 shares of this restricted stock. The collection of these funds removed all remaining restrictions from those shares.

On November 17, 2004, the Company granted 330 shares of non-vested common stock to a member of its board of directors as compensation for services. The shares were issued subject to a restriction of continued service on the board of directors, and all restrictions lapsed one year from the grant date. The fair value of the non-vested stock at the date of grant was \$30.33 per share.

In March 2005, the Company granted 51,750 shares of restricted, non-vested stock to certain executives of the Company. The shares vest ratably over a four year period from the date of grant if a certain net income level is achieved by the Company in fiscal 2005 and the executives remain employed by the Company over the vesting period. The executives are entitled to vote these restricted shares and will be eligible for participation in any dividends declared during the vesting period. The net income level required for vesting was achieved in fiscal 2005. Under the provisions of APB Opinion No. 25 and related interpretations, the compensation

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related to these shares was adjusted to the market value (\$29.64 per share) of the Company's common stock as of December 31, 2005, the date the performance condition was satisfied. During 2005, 1,000 shares of the non-vested stock were forfeited by an executive due to the cessation of the executive's employment with the Company. In July 2005, 1,000 shares of non-vested stock were issued under the same terms as the March 2005 grant noted above to a new executive who joined the Company. At December 31, 2005, the total fair value of these restricted stock grants was approximately \$1.5 million. During fiscal 2005, the Company recorded compensation expense of approximately \$0.6 million related to these restricted stock grants. The 51,750 shares of non-vested stock were excluded from the calculation of diluted earnings per share because the achievement of the specified net income level was not known until the end of fiscal 2005. These non-vested shares will be included in the calculation of diluted earnings per share beginning January 1, 2006.

During 2005, an additional 31,196 shares of non-vested stock were granted to various members of the Company's board of directors as compensation for services. The shares were issued subject to a restriction of continued service on the board of directors, and all restrictions lapse over a period from one to three years from the grant date. The weighted average grant date fair value of these non-vested shares was \$28.95 per share.

During 2006, 195,040 of non-vested restricted stock were granted to employees of the Company. The shares vest over a period of 4 years from the grant date at a grant date fair value of \$29.14. An additional 28,321 shares of non-vested stock were granted to various members of the Company's board of directors as compensation for services. The shares were issued subject to a restriction of continued service on the board of directors and all restrictions lapse over a period of one to three year from the grant date. In September 2006, a one time discretionary grant of 4,941 shares of restricted stock were granted to an executive of the Company for continued valued contributions to the Company and vest over a period of one year from the grant date. In May 2006, 2,400 shares of restricted stock were granted to a newly hired employee. The shares vest over a period of 4 years from the grant date.

The aggregate unearned compensation expense related to restricted stock was \$4.3 million as of December 30, 2006. Based on the vesting provisions of the underlying equity instruments, future compensation expense related to previously issued restricted stock at December 30, 2006 was as follows (in thousands):

2007	\$ 1,887
2008	1,190
2009	1,035
2010	237
	<u>\$ 4,349</u>

The outstanding restricted and non-vested stock is included in the number of outstanding shares on the face of the consolidated balance sheets, but is treated as outstanding stock options for accounting purposes. The shares of restricted and non-vested stock, accounted for as options, are included in the calculation of diluted earnings per share using the treasury stock method, with the proceeds equal to the sum of unrecognized compensation cost and amounts to be collected from the outstanding loans related to the restricted stock, where applicable.

(c) Associate Stock Purchase Plan

In October 2004, the Company adopted an Associate Stock Purchase Plan (ASPP). Under the ASPP, substantially all full-time employees are given the right to purchase shares of the Company's common stock, subject to certain limitations, at 85% of the lesser of the fair market value on the purchase date or the beginning of each purchase period. Up to 1,000,000 shares of the Company's common stock are available for issuance under the ASPP. The employees of the Company purchased 34,488 shares at \$20.00 per share through the ASPP during fiscal 2006. The expense recorded related to the ASPP during fiscal 2006 was determined using the Black-Scholes option pricing model and the provision of FASB Technical Bulletin 97-1, *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option* (FTB 97-1), as amended by SFAS 123R. The assumptions used in the option pricing model for fiscal 2006 were: (a) dividend yield of 0%; (b) volatility of 20%; (c) risk-free interest rate of 6.0%; and (d) an expected life of 0.25 years. Prior to the adoption of SFAS 123R, the ASPP was considered noncompensatory and no expense was recorded in the consolidated statement of operations.

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(14) Stockholders' Equity

(a) Reorganization and Preferred Stock Sales

Effective April 3, 2000, the Company reorganized from an LLC to a C Corporation. The existing LLC members received a total of 9,482,482 shares of Series A, B, and C convertible nonredeemable preferred stock and 217,519 shares of common stock in exchange for their member units.

On April 5, 2000, the Company issued a total of 2,666,666 shares of Series A and B convertible redeemable preferred stock in exchange for \$9,837,876 in cash and \$1,934,485 in a promissory note from a related party. The note was subsequently collected in full within 30 days of issuance. The proceeds are net of the costs associated with the preferred stock sales of \$227,632.

From September through December 2001, the Company issued a total of 3,467,337 shares of Series D convertible redeemable preferred stock in exchange for \$21,024,016 in cash. The cash proceeds are net of the costs associated with the preferred stock sales of \$141,911.

(b) Preferred Stock

Prior to the Company's initial public offering, 25,000,000 shares of preferred stock were authorized. Preferred stock consisted of various series of Class A, B, C, and D preferred stock. Each class had various dividend, liquidation, and redemption rights as summarized below:

Series of Preferred Stock	Defined Liquidation Rights	Defined Cumulative Dividends	Shares Issued and Outstanding as of January 3, 2004	Liquidation Preference as of January 3, 2004 (in thousands)
A-1	\$ 2.451890	0.171632	1,137,898	\$ 3,522
A-2	3.556556	0.248959	139,981	629
A-3	2.600746	0.182052	961,263	3,156
A-4	3.484283	0.243900	205,824	905
A-5	5.649780	0.395485	1,061,986	7,575
B-1	1.808051	0.000000	275,352	498
B-2	1.720493	0.000000	1,453,072	2,500
B-3	2.305925	0.000000	311,003	717
B-4	3.739067	0.000000	1,604,680	6,000
C-1	0.105315	0.000000	3,418,306	360
C-2	0.973290	0.000000	1,385,507	1,349
C-3	0.720934	0.000000	194,276	140
D	6.100000	0.427000	3,467,337	24,471
			<u>15,616,485</u>	<u>\$ 51,822</u>

During 2004, \$1.3 million was recorded to increase the carrying value of the Series A-5, B-4, and D redeemable preferred stock to its redemption value. This includes cumulative dividends of \$1.1 million and accretion of equity issuance costs of \$0.2 million for 2004 for the redeemable preferred stock. Cumulative dividends in arrears for the nonredeemable preferred stock totaled approximately \$1.7 million at January 3, 2004 and approximately \$2.0 million at the date of conversion in conjunction with the initial public offering.

As of August 10, 2004, the Certificate of Incorporation was amended primarily with respect to the liquidation and redemption preferences of the Series A and Series D preferred stock as well as the dividend rights for all series of preferred stock. Previously, Series A and Series D preferred stock accrued a dividend and any accrued and unpaid dividends were added to the original liquidation preference and redemption amounts for these series. Additionally, these series had certain dividend preference rights over other classes of stock.

The amended Certificate of Incorporation effectively set the liquidation preferences and redemption amounts for the Series A and Series D stock to be equal to the original amounts plus the amounts of accrued and unpaid dividends as of July 31, 2004. Additionally, any dividend preferences or restrictions on all series of preferred stock were removed and all series of preferred stock participate on an as converted basis ratably with common stock for any declared dividends.

In August 2004, following the amendment of the Certificate of Incorporation, the Company paid a cash dividend of \$10.0 million to the common and preferred stockholders. The dividend equated to \$0.55 per share for all classes of stock.

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All shares of preferred stock, including shares of preferred stock issuable in exchange for accrued but unpaid dividends, were converted into 17,316,689 shares of common stock upon the completion of the Company's initial public offering.

(c) Initial Public Offering

On October 28, 2004, the Company completed an initial public offering (the "offering") of 7,482,000 shares of common stock, of which 5,982,000 shares were sold by selling shareholders, at a price of \$20.00 per share. The proceeds to the Company from the offering, after underwriting discounts and offering costs, were approximately \$25.7 million. In conjunction with the offering, all shares of preferred stock, including shares of preferred stock issuable in exchange for accrued but unpaid dividends, were converted into 17,316,689 shares of common stock.

As a result of the initial public offering, the Company's charter was amended to authorize 50,000,000 shares of \$0.01 par value common stock and 15,000,000 shares of \$0.01 par value preferred stock.

(d) Share Activity

The following table summarizes the changes in outstanding shares of all series of common and preferred stock for fiscal 2004, 2005 and 2006:

	Redeemable Preferred Stock			Nonredeemable Preferred Stock			Common Stock
	Class A	Class B	Class D	Class A	Class B	Class C	
Shares as of December January 3, 2004	1,061,986	1,604,680	3,467,337	2,444,966	2,039,427	4,998,089	533,316
Exercise of stock options and exchange of outstanding shares	—	—	—	—	—	(48,964)	268,912
Shares withheld in lieu of tax withholdings	—	—	—	—	—	—	(61,463)
Issuance of restricted common stock	—	—	—	—	—	—	330
Conversion of preferred stock to common stock	(1,061,986)	(1,604,680)	(3,467,337)	(2,444,966)	(2,039,427)	(4,949,125)	17,316,689
Additional shares issued in the offering	—	—	—	—	—	—	1,500,000
Shares as of January 1, 2005	—	—	—	—	—	—	19,557,784
Employee stock purchases	—	—	—	—	—	—	84,823
Exercise of stock options	—	—	—	—	—	—	475,970
Shares withheld in lieu of tax withholdings	—	—	—	—	—	—	(80,868)
Issuance of restricted common stock	—	—	—	—	—	—	82,946
Shares as of December 31, 2005	—	—	—	—	—	—	20,120,655
Employee stock purchases	—	—	—	—	—	—	34,488
Exercise of stock options	—	—	—	—	—	—	208,621
Shares withheld in lieu of tax withholdings	—	—	—	—	—	—	(13,683)
Forfeiture of restricted common stock	—	—	—	—	—	—	(43,362)
Issuance of restricted common stock	—	—	—	—	—	—	230,702
Shares as of December 30, 2006	—	—	—	—	—	—	20,537,421

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(15) Employee Benefit Plans

(a) 401(k) Savings Plan

During 2000, the Company established a defined contribution plan that conforms to IRS provisions for 401(k) plans. The Build-A-Bear Workshop, Inc. Employees Savings Trust covers associates who work 1,000 hours or more in a year and have attained age 21. The Company, at the discretion of its board of directors, can provide for a Company match on the first 6% of employee deferrals. For 2006, 2005, and 2004, the Company provided a match of 30% on the first 6% of employee deferrals totaling \$0.3 million, \$0.3 million, and \$0.2 million, respectively. The Company match vests over a five-year period.

(16) Related-Party Transactions

The Company bought fixtures for new stores and furniture for the corporate offices from a related party. The total payments to this related party for fixtures and furniture amounted to \$2.7 million, \$3.3 million, and \$1.9 million in 2006, 2005, and 2004, respectively. The Company leased part of its corporate office from the same related party in 2004. Rent under this lease amounted to \$0.1 million 2004. As of December 30, 2005 nothing was due to this related party. The total due to this related party as of December 31, 2005 was \$0.1 million.

The Company paid \$0.8 million in 2004 for construction management services to an entity controlled by a stockholder holding in excess of 5% of one class of the Company's capital stock prior to the initial public offering. The Company leased one of its retail stores from this same related party in fiscal 2003. Subsequent to the initial public offering, this stockholder no longer owns in excess of 5% of any class of the Company's capital stock. As a result, the entity controlled by this stockholder is no longer considered a related party. The Company plans to continue to use the same entity for construction management services in the future.

The Company paid \$0.4 million 2004 for design and other creative services to a stockholder holding in excess of 5% of one class of the Company's capital stock prior to the initial public offering. Subsequent to the initial public offering, this stockholder no longer owns in excess of 5% of any class of the Company's capital stock. As a result, the stockholder is no longer considered a related party. The Company plans to continue to use this stockholder for design and other creative services in the future.

The Company made charitable contributions of \$1.0 million, \$0.8 million and \$0.2 million in 2006, 2005 and 2004, respectively, to charitable foundations controlled by the executive officers of the Company. The total due to the charitable foundations as of December 30, 2006 and December 31, 2005 was \$0.2 million.

(17) Major Vendors

Three vendors accounted for approximately 83%, 86%, and 85% of inventory purchases in 2006, 2005, and 2004, respectively.

(18) Segment Information

The Company's operations are conducted through three reportable segments consisting of retail, international franchising, and licensing and entertainment. The retail segment includes the operating activities of company-owned stores in the United States, Canada, the United Kingdom and Ireland, and other retail delivery operations, including the Company's web store and non-traditional store locations such as baseball ballparks. The international franchising segment includes the licensing activities of the Company's franchise agreements with store locations in Europe, Asia, and Australia. The licensing and entertainment segment has been established to market the naming and branding rights of the Company's intellectual properties for third party use. These operating segments represent the basis on which the Company's chief operating decision-maker regularly evaluates the business in assessing performance, determining the allocation of resources and the pursuit of future growth opportunities. The operating segments have discrete sources of revenue, different capital structures and different cost structures. The reporting segments follow the same accounting policies used for the Company's consolidated financials statements.

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

	<u>Retail</u>	<u>International Franchising</u>	<u>Licensing & Entertainment</u>	<u>Total</u>
Fiscal 2004				
Net sales to external customers	\$300,469	\$ 846	\$ 347	\$301,662
Net income (loss) before income taxes	33,796	(990)	127	32,933
Capital expenditures	16,545	49	—	16,594
Depreciation and amortization	14,438	510	—	14,948
Fiscal 2005				
Net sales to external customers	358,901	1,976	932	361,809
Net income (loss) before income taxes	43,764	119	530	44,413
Capital expenditures	30,987	46	50	31,083
Depreciation and amortization	17,039	552	1	17,592
Fiscal 2006				
Net sales to external customers	432,571	3,521	979	437,071
Net income before income taxes	27,609	1,794	86	29,489
Capital expenditures	52,525	34	18	52,577
Depreciation and amortization	21,683	699	12	22,394
Total Assets as of:				
December 30, 2006	\$295,337	\$ 2,683	\$ 1,750	\$299,770
December 31, 2005	\$235,754	\$ 9,279	\$ 1,075	\$246,108

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

	<u>North America</u>	<u>United Kingdom & Ireland</u>	<u>Other</u>	<u>Total</u>
Fiscal 2004				
Net sales to external customers	\$300,781	\$ 169	\$ 712	\$301,662
Property and equipment, net	75,815	—	—	75,815
Fiscal 2005				
Net sales to external customers	359,615	471	1,723	361,809
Property and equipment, net	89,924	—	49	89,973
Fiscal 2006				
Net sales to external customers	400,832	32,717	3,522	437,071
Property and equipment, net	\$115,779	\$ 14,549	\$ 19	\$130,347

(19) Subsequent Event

On February 20, 2007 the Company announced a \$25 million share repurchase program of outstanding common stock over the next twelve months. The program was authorized by the Company's board of directors. Purchases may be made in the open market or in privately negotiated transactions, with the level and timing of activity depending on market conditions, other investment opportunities, and other factors. Purchases may be increased, decreased or discontinued at any time without notice.

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(a)(2) *Financial Statement Schedules*

No additional Financial Statement Schedules are filed as a part of this report pursuant to Item 8 and Item 15(d).

(a)(3) *Exhibits.*

The following is a list of exhibits filed as a part of the Annual Report on Form 10-K:

<u>Exhibit Number</u>	<u>Description</u>
2.1	Agreement and Plan of Merger dated April 3, 2000 between Build-A-Bear Workshop, L.L.C. and the Registrant (incorporated by reference from Exhibit 2.1 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
3.1	Third Amended and Restated Certificate of Incorporation (incorporated by reference from Exhibit 3.1 of our Current Report on Form 8-K, filed on November 11, 2004)
3.2	Amended and Restated Bylaws (incorporated by reference from Exhibit 3.4 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
4.1	Specimen Stock Certificate (incorporated by reference from Exhibit 4.1 to Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
4.2	Stock Purchase Agreement by and among the Registrant, Catterton Partners IV, L.P., Catterton Partners IV Offshore, L.P. and Catterton Partners IV Special Purpose, L.P. and the Purchasers named therein dated as of April 3, 2000 (incorporated by reference from Exhibit 4.2 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
4.3	Stock Purchase Agreement by and among the Registrant and the other Purchasers named therein dated as of September 21, 2001 (incorporated by reference from Exhibit 4.3 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
4.4	Amended and Restated Registration Rights Agreement, dated September 21, 2001 by and among Registrant and certain stockholders named therein (incorporated by reference from Exhibit 4.5 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.1*	Build-A-Bear Workshop, Inc. 2000 Stock Option Plan (incorporated by reference from Exhibit 10.1 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.1.1*	Form of Incentive Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2000 Stock Option Plan (incorporated by reference from Exhibit 10.1.1 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.1.2*	Form of Nonqualified Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2000 Stock Option Plan (incorporated by reference from Exhibit 10.1.2 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.2*	Build-A-Bear Workshop, Inc. 2002 Stock Incentive Plan, as amended (incorporated by reference from Exhibit 10.2 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.2.1*	Form of Manager-Level Incentive Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2002 Stock Option Plan (incorporated by reference from Exhibit 10.2.1 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.2.2*	Form of Nonqualified Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2002 Stock Option Plan (incorporated by reference from Exhibit 10.2.2 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.3*	Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.3 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.3.1*	Form of Incentive Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.3.1 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.3.2*	Form of Director Nonqualified Stock Option Agreement under the Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.3.2 to Pre-Effective Amendment No. 3 to our Registration Statement on Form S-1, filed on October 1, 2004, Registration No. 333-118142)
10.3.3*	Model Incentive Stock Option Agreement Under the Registrant's 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.3.3 to Pre-Effective Amendment No. 5 to our Registration Statement on Form S-1, filed on October 12, 2004, Registration No. 333-118142)
10.3.4*	Form of Employee Nonqualified Stock Option Agreement under the Registrant's 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.3.4 to Pre-Effective Amendment No. 5 to our Registration Statement on Form S-1, filed on October 12, 2004, Registration No. 333-118142)
10.3.5*	Form of the Restricted Stock Agreement under the Registrant's 2004 Stock Incentive Plan (incorporated by

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<u>Exhibit Number</u>	<u>Description</u>
	reference from Exhibit 10.3.5 to Pre-Effective Amendment No. 5 to our Registration Statement on Form S-1, filed on October 12, 2004, Registration No. 333-118142)
10.3.6*	Amended and Restated Build-A-Bear Workshop, Inc 2004 Stock Incentive Plan (incorporated by reference from Exhibit 10.1 on our Current Report on Form 8-K, filed on August 1, 2006)
10.4*	Employment, Confidentiality and Noncompete Agreement dated May 1, 2004 between Maxine Clark and the Registrant (incorporated by reference from Exhibit 10.4 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.4.1*	First Amendment dated February 22, 2006 to the Employment, Confidentiality and Noncompete Agreement dated May 1, 2004 between Maxine Clark and the Registrant (incorporated by reference from Exhibit 10.4.1 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.5*	Employment, Confidentiality and Noncompete Agreement dated April 13, 2004 between Barry Erdos and the Registrant (incorporated by reference from Exhibit 10.5 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.5.1*	First Amendment dated February 22, 2006 to the Employment, Confidentiality and Noncompete Agreement dated April 13, 2004 between Barry Erdos and the Registrant (incorporated by reference from Exhibit 10.5.1 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.5.2*	Separation Agreement and General Release dated January 5, 2007 between Barry Erdos and the Registrant (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K, filed on January 5, 2007)
10.6*	Employment, Confidentiality and Noncompete Agreement dated March 7, 2004 between Tina Klocke and the Registrant (incorporated by reference from Exhibit 10.6 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.6.1*	First Amendment dated February 22, 2006 to the Employment, Confidentiality and Noncompete Agreement dated March 7, 2004 between Tina Klocke and the Registrant (incorporated by reference from Exhibit 10.6.1 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.7*	Employment, Confidentiality and Noncompete Agreement dated July 9, 2001 between John Burtelow and the Registrant (incorporated by reference from Exhibit 10.7 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.7.1*	First Amendment dated March 28, 2005 to Employment, Confidentiality and Noncompete Agreement dated July 9, 2001 between John Burtelow and the Registrant (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K, filed on April 1, 2005)
10.8*	Employment, Confidentiality and Noncompete Agreement dated as of March 7, 2004 between Scott Seay and the Registrant (incorporated by reference from Exhibit 10.8 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.8.1*	First Amendment dated February 22, 2006 to the Employment, Confidentiality and Noncompete Agreement dated March 7, 2004 between Scott Seay and the Registrant (incorporated by reference from Exhibit 10.8.1 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.8.2*	Second Amendment dated January 5, 2007 to the Employment, Confidentiality and Noncompete Agreement dated March 7, 2004 between Scott Seay and the Registrant (incorporated by reference from Exhibit 10.2 to our Current Report on Form 8-K, filed on January 5, 2007)
10.9*	Employment, Confidentiality and Noncompete Agreement dated September 10, 2001 between Teresa Kroll and the Registrant (incorporated by reference from Exhibit 10.9 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.9.1*	First Amendment dated February 22, 2006 to the Employment, Confidentiality and Noncompete Agreement dated September 10, 2001 between Teresa Kroll and the Registrant (incorporated by reference from Exhibit 10.9.1 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.10*	Form of Indemnification Agreement between the Registrant and its directors and executive officers (incorporated by reference from Exhibit 10.11 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.11	Third Amendment to Loan Documents among the Registrant, Shirts Illustrated, LLC, Build-A-Bear Workshop Franchise Holdings, Inc., Build-A-Bear Entertainment, LLC, Build-A-Bear Retail Management, LLC (incorporated by reference from Exhibit 10.12 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.11.1	Fifth Amendment to Loan Documents among the Registrant, Shirts Illustrated, LLC, Build-A-Bear Workshop Franchise Holdings, Inc., Build-A-Bear Entertainment, LLC, Build-A-Bear Retail Management, LLC (incorporated by reference from Exhibit 10.1 of our Current Report on Form 8-K, filed on July 10, 2006)
10.12	Third Amended and Restated Loan Agreement between the Registrant, Shirts Illustrated, LLC, Build-A-Bear Workshop Franchise Holdings, Inc., Build-A-Bear Entertainment, LLC, and Build-A-Bear Retail Management, Inc., as borrowers, and U.S. Bank National Association, as Lender, entered into on September 27, 2005 with an effective date of May 31, 2005

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Exhibit Number	Description
10.13	Second Amended and Restated Revolving Credit Note dated May 31, 2005 by the Registrant, Shirts Illustrated, LLC, Build-A-Bear Workshop Franchise Holdings, Inc., Build-A-Bear Entertainment, LLC, and Build-A-Bear Retail Management, Inc., as Borrowers, in favor of U.S. Bank National Association (incorporated by reference from Exhibit 10.2 to our Current Report on Form 8-K, filed on October 3, 2005)
10.13.1	Third Amended and Restated Revolving Credit Note dated June 30, 2006 by the Registrant, Build-A-Bear Workshop Franchise Holdings, Inc., Build-A-Bear Entertainment, LLC, Build-A-Bear Retail Management, Inc., and Build-A-Bear UK Holdings Ltd., as Borrowers, in favor of U.S. Bank National Association (incorporated by reference from Exhibit 10.2 to our Current Report on Form 8-K, filed on July 10, 2006)
10.14*	Restricted Stock Purchase Agreement dated April 3, 2000 by and between Maxine Clark and the Registrant (incorporated by reference from Exhibit 10.16 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.15*	Secured Promissory Note of Maxine Clark in favor of the Registrant, dated April 3, 2000 (incorporated by reference from Exhibit 10.17 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.16*	Repayment and Stock Pledge Agreement dated April 3, 2000 by and between Maxine Clark and the Registrant (incorporated by reference from Exhibit 10.18 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.17*	Restricted Stock Purchase Agreement dated September 19, 2001 by and between Tina Klocke and the Registrant (incorporated by reference from Exhibit 10.22 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.18*	Secured Promissory Note of Tina Klocke in favor of the Registrant, dated September 19, 2001 (incorporated by reference from Exhibit 10.23 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.19*	Repayment and Stock Pledge Agreement dated September 19, 2001 by and between Tina Klocke and the Registrant (incorporated by reference from Exhibit 10.24 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.20	Public Warehouse Agreement dated April 5, 2002 between the Registrant and JS Logistics, Inc., as amended (incorporated by reference from Exhibit 10.25 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.20.1	Second Amendment dated June 16, 2005 to the Public Warehouse Agreement dated April 5, 2002 between the Registrant and JS Warehousing, Inc. (incorporated by reference from Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended on April 2, 2005)
10.20.2†	Second Amendment dated June 16, 2005 to the Public Warehouse Agreement dated April 5, 2002 between the Registrant and JS Warehousing, Inc. (incorporated by reference from Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended July 2, 2005)
10.21	Agreement for Logistics Services dated as of February 24, 2002 by and among the Registrant and HA Logistics, Inc. (incorporated by reference from Exhibit 10.26 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.21.1	Letter Agreement extending Agreement for Logistics Services between HA Logistics, Inc. and the Registrant dated March 22, 2005 (incorporated by reference from Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended April 2, 2005)
10.21.2	Letter Agreement extending Agreement for Logistics Services between HA Logistics, Inc. and the Registrant dated May 3, 2005 (incorporated by reference from Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended April 2, 2005)
10.21.3†	Letter Agreement dated June 7, 2005 amending the Agreement for Logistics Services dated February 24, 2002 by and among the Registrant and HA Logistics, Inc. (incorporated by reference from Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended July 2, 2005)
10.22†	Lease Agreement dated as of June 21, 2001 between the Registrant and Walt Disney World Co. (incorporated by reference from Exhibit 2.1 of our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.23	Amendment and Restatement of Sublease dated as of June 14, 2000 by and between NewSpace, Inc. and the Registrant (incorporated by reference from Exhibit 10.28 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.24	Lease dated May 5, 1997 between Smart Stuff, Inc. and Hycel Partners I, L.P. (incorporated by reference from Exhibit 10.29 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.25	Agreement dated October 16, 2002 between the Registrant and Hycel Properties Co., as amended (incorporated by reference from Exhibit 10.30 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.26	Letter Agreement dated September 30, 2003 between the Registrant and Hycel Properties Co. (incorporated by reference from Exhibit 10.30.1 to Pre-Effective Amendment No. 5 to our Registration Statement on Form S-1, filed on October 12, 2004, Registration No. 333-118142)

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<u>Exhibit Number</u>	<u>Description</u>
	Properties Co. (incorporated by reference from Exhibit 10.31 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.28	Agreement dated July 19, 2001 between the Registrant and Adrienne Weiss Company (incorporated by reference from Exhibit 10.32 to our Registration Statement on Form S-1, filed on August 12, 2004, Registration No. 333-118142)
10.29	Lease between 5th Midtown LLC and the Registrant dated July 21, 2004 (incorporated by reference from Exhibit 10.33 to Pre-Effective Amendment No. 1 to our Registration Statement on Form S-1, filed on September 10, 2004, Registration No. 333-118142)
10.30	Exclusive Patent License Agreement dated March 12, 2001 by and between Tonyco, Inc. and the Registrant (incorporated by reference from Exhibit 10.34 to Pre-Effective Amendment No. 2 to our Registration Statement on Form S-1, filed on September 20, 2004, Registration No. 333-118142)
10.31	Standard Form Industrial Building Lease dated August 28, 2004 between First Industrial, L.P. and the Registrant (incorporated by reference from Exhibit 10.35 to Pre-Effective Amendment No. 4 to our Registration Statement on Form S-1, filed on October 5, 2004, Registration No. 333-118142)
10.32	Loan Agreement by and between Amsbra, Ltd., as Borrower, and Build-A-Bear Workshop Franchise Holdings, Inc., as Lender, entered into on October 4, 2005 with an effective date of September 26, 2005 (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K, filed on October 11, 2005)
10.33	Revolving Credit Note by Amsbra, Ltd., as Borrower, in favor of Build-A-Bear Workshop Franchise Holdings, Inc., dated as of September 26, 2005 (incorporated by reference from Exhibit 10.2 to our Current Report on Form 8-K, filed on October 11, 2005)
10.34	Debenture dated October 11, 2005 by and between Amsbra, Ltd. and Build-A-Bear Workshop Franchise Holdings, Inc. (incorporated by reference from Exhibit 10.3 to our Current Report on Form 8-K, filed on October 11, 2005)
10.35	Facility Construction Agreement dated December 22, 2005 between the Registrant and Duke Construction Limited Partnership (incorporated by reference from Exhibit 10.35 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.36	Real Estate Purchase Agreement dated December 19, 2005 between Duke Realty Ohio and the Registrant (incorporated by reference from Exhibit 10.36 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.37*	Description of Board Compensation for Non-Management Directors effective November 10, 2005 (incorporated by reference from Exhibit 10.1 from our Current Report on Form 8-K, filed on November 16, 2005)
10.38	Share Purchase Agreement dated March 3, 2006 between the Hamleys Group Limited, Build-A-Bear Workshop UK Holdings Limited and The Bear Factory Limited (incorporated by reference from Exhibit 10.38 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.39	Sale and Purchase Agreement dated March 3, 2006 between the Registrant, Build-A-Bear Workshop UK Holdings Limited, the selling shareholders of Amsbra, Ltd. and Andrew Mackay (incorporated by reference from Exhibit 10.39 to our Annual Report on Form 10-K for the year ended December 31, 2005)
10.40*	Employment, Confidentiality and Noncompete Agreement dated January 16, 2007 between Paul Bundonis and the Registrant (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K, filed on January 18, 2007)
10.41*	Rules of the Build-A-Bear Workshop, Inc. Share Option Scheme (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K, filed on February 9, 2007)
10.42*	Nonqualified Deferred Compensation Plan
11.1	Statement regarding computation of earnings per share (incorporated by reference from Note 12 of the Registrant's audited consolidated financial statements included herein)
13.1	Annual Report to Shareholders for the Fiscal Year Ended December 30, 2006 (The Annual Report, except for those portions which are expressly incorporated by reference in the Form 10-K, is furnished for the information of the Commission and is not deemed filed as part of the Form 10-K)
21.1	List of Subsidiaries of the Registrant
23.1	Consent of KPMG LLP
31.1	Rule 13a-14(a)/15d-14(a) certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by the Chief Executive Bear)
31.2	Rule 13a-14(a)/15d-14(a) certification (pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by the Chief Financial Bear)
32.1	Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the Chief Executive Bear)
32.2	Section 1350 Certification (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by the Chief Financial Bear)

* Management contract or compensatory plan or arrangement.

† Confidential treatment requested as to certain portions filed separately with the Securities and Exchange Commission.

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BUILD-A-BEAR WORKSHOP, INC.

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.

BUILD-A-BEAR WORKSHOP, INC.

(Registrant)

Date: March 15, 2007

By: /s/ Maxine Clark
Maxine Clark
Chief Executive Bear

By: /s/ Tina Klocke
Tina Klocke
Chief Financial Bear, Treasurer and Secretary

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Maxine Clark and Tina Klocke, and each of them, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities to sign the Annual Report on Form 10-K of Build-A-Bear Workshop, Inc. (the "Company") for the fiscal year ended December 30, 2006 and any other documents and instruments incidental thereto, together with any and all amendments and supplements thereto, to enable the Company to comply with the Securities Act of 1934, as amended, and any rules, regulations and requirements of the Securities and Exchange Commission in respect thereof, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents and/or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Signatures	Title	Date
<u>/s/ Mary Lou Fiala</u> Mary Lou Fiala	Director	March 15, 2007
<u>/s/ James M. Gould</u> James M. Gould	Director	March 15, 2007
<u>/s/ Louis M. Mucci</u> Louis M. Mucci	Director	March 15, 2007
<u>/s/ William Reisler</u> William Reisler	Director	March 15, 2007
<u>/s/ Coleman Peterson</u> Coleman Peterson	Director	March 15, 2007

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Signatures	Title	Date
<u>/s/ Joan Ryan</u> Joan Ryan	Director	March 15, 2007
<u>/s/ Maxine Clark</u> Maxine Clark	Chief Executive Bear and Chairman of the Board (Principal Executive Officer)	March 15, 2007
<u>/s/ Tina Klocke</u> Tina Klocke	Chief Financial Bear, Treasurer and Secretary (Principal Financial and Accounting Officer)	March 15, 2007

**NONQUALIFIED
DEFERRED COMPENSATION PLAN
BASIC PLAN DOCUMENT**
(Including Code §409A provisions)

**NONQUALIFIED
DEFERRED COMPENSATION PLAN
BASIC PLAN DOCUMENT**

By execution of the Adoption Agreement associated with this Basic Plan Document, the Employer establishes this Nonqualified Deferred Compensation Plan (“Plan”) for the benefit of certain Employees and Contractors the Employer designates in its Adoption Agreement. The primary purpose of the Plan is to provide additional compensation to Participants upon termination of employment or service with the Employer. The Employer will pay benefits under the Plan only in accordance with the terms and conditions set forth in the Plan.

PREAMBLE

Plan Type. The Employer in its Adoption Agreement will specify whether it establishes the Plan as a nonqualified deferred compensation plan or as an ineligible Code §457(f) plan. A nonqualified deferred compensation plan is an unfunded plan that may be: (i) an “excess benefit plan”; (ii) a plan maintained “primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees” (“top-hat plan”); or (iii) a plan for Contractors. A top-hat plan includes a supplemental executive retirement plan (“SERP”).

Possible Nonuniformity. The Employer in its Adoption Agreement will specify such Plan terms as will apply to all Participants uniformly or as may apply to a given Participant. The Employer need not provide the same Plan benefits or apply the same Plan terms and conditions to all Participants, even as to Participants who are of similar pay, title and other status with the Employer. The elections the Employer makes in its Adoption Agreement apply uniformly to all Participants, except to the extent the Employer adopts inconsistent provisions with respect to one or more Participants in a separate attachment designated as “Exhibit A” and attached to the Adoption Agreement. The Employer may create a separate Exhibit A for one or more Participants, specifying such terms and conditions as are applicable to a given Participant. The Employer, in Exhibit A, may modify any Plan provision or any Adoption Agreement election as to one or more Participants.

I. DEFINITIONS

1.01 **“Account”** means the account the Employer establishes under the Plan for each Participant and, as applicable, means a Participant’s Elective Deferral Account, Nonelective Contribution Account or Matching Contribution Account.

1.02 **“Accrued Benefit”** means the total dollar amount credited to a Participant’s Account.

1.03 **“Adoption Agreement”** means the document the Employer executes to establish the Plan and includes all Exhibits and other documents referenced therein.

1.04 **“Aggregated Plans”** means this Plan and any other like-type plan or arrangement (account balance plan or separation pay arrangement) of the Employer in which a Participant participates and as to which the Plan or Applicable Guidance requires the aggregation of all such nonqualified deferred compensation in applying Code §409A.

1.05 **“Applicable Guidance”** means as the context requires Code §§83, 409A and 457, Treas. Reg. §1.83, Prop. Treas. Reg. §1.409A, Treas. Reg. §1.457-11, or other written Treasury or IRS guidance regarding or affecting Code §§83, 409A or 457(f). Applicable Guidance also includes, through December 31, 2006, or other applicable date, Notice 2005-1.

1.06 **“Base Salary”** means a Participant’s Compensation consisting only of regular salary and excluding any other Compensation.

1.07 **“Basic Plan Document”** means this Nonqualified Deferred Compensation Plan document.

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1.08 **“Beneficiary”** means the person or persons entitled to receive Plan benefits in the event of a Participant’s death.

1.09 **“Bonus”** means a Participant’s Compensation consisting only of bonus and excluding any other Compensation. A Bonus also may be Performance-Based Compensation under Section 1.36.

1.10 **“Change in Control”** means, as to an Employer which is a corporation, a change: (i) in the ownership of the Employer; (ii) in the effective control of the Employer; or (iii) in the ownership of a substantial portion of the assets of the Employer, within the meaning of Prop. Treas. Reg. §1.409A-3(g)(5) or in Applicable Guidance. The Employer in its Adoption Agreement will elect whether a Change in Control includes any or all the events described in clauses (i), (ii) or (iii) and also may elect to increase the percentage change required under any such event to constitute a Change in Control. Pending the issuance of Applicable Guidance as to the application of the Change in Control provisions to partnerships (or to other unincorporated Employers), if the Employer elects in its Adoption Agreement to permit Change in Control as a payment event, the Employer will apply clauses (i) and (iii) by analogy.

1.11 **“Change in the Employer’s Financial Health”** means an adverse change in the Employer’s financial condition as described in Applicable Guidance.

1.12 **“Code”** means the Internal Revenue Code of 1986, as amended.

1.13 **“Commissions”** means Compensation or portions of Compensation a Participant earns if: (i) a substantial portion of Participant’s services to the Employer consists of the direct sale of a product or a service to a customer; (ii) the Compensation the Employer pays to the Participant consists either of a portion of the purchase price for the product or service or of an amount calculated solely by reference to volume of sales; and (iii) payment is contingent upon the Employer receiving payment for the product or services from a customer who is unrelated to the Employer or to the Participant. A customer is related if treated as related under Prop. Treas. Reg. §§1.409A-1(f)(3)(ii) or -1(f)(3)(iv).

“Compensation” with respect to any Participant means such Participant’s wages, salaries, fees for professional services and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the Employer maintaining the Plan to the extent that the amounts are includible in gross income (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, regular bonuses as described in the Employer’s payroll records, fringe benefits, and reimbursements or other expense allowances under a nonaccountable plan as described in Regulation 1.62-2(c)) for a Plan Year.

Compensation shall exclude (a)(1) contributions made by the Employer to a plan of deferred compensation to the extent that, the contributions are not includible in the gross income of the Participant for the taxable year in which contributed, (2) Employer contributions made on behalf of an Employee to a simplified employee pension plan described in Code Section 408(k) to the extent such contributions are excludable from the Employee’s gross income, (3) any distributions from a plan of deferred compensation; (b) amounts realized from the exercise of a non-qualified stock option, or when restricted stock (or property) held by an Employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture; (c) amounts realized from the sale, exchange or other disposition of stock acquired under a qualified stock option; and (d) other amounts which receive special tax benefits, or contributions made by the Employer (whether or not under a salary reduction agreement) towards the purchase of any annuity contract described in Code Section 403(b) (whether or not the contributions are actually excludable from the gross income of the Employee); and (e) any bonuses, other than regular bonuses (as described in the Employer’s payroll records).

For purposes of this Section, the determination of Compensation shall be made by including amounts which are contributed by the Employer pursuant to a salary reduction agreement and which are not includible in the gross income of the Participant under Code Sections 125, 132(f)(4), 402(e)(3), 402(h)(1)(B), 403(b) or 457(b), and Employee contributions described in Code Section 414(h)(2) that are treated as Employer contributions.

For a Participant’s initial year of participation, Compensation shall be recognized for the entire Plan Year.

The Employer, in its Adoption Agreement, may modify the definition of Compensation or may specify a different definition of Compensation either as to Employees, as to Contractors or both.

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1.15 **“Contractor”** means a person or entity (as described in Prop. Treas. Reg. §1.409A-1(f)(1), and which is not on the accrual method of accounting for Federal income tax purposes) providing services to the Employer and who is not an Employee. For this Plan, a Contractor excludes a Contractor providing significant services to the Employer and to at least two unrelated entities as described in Prop. Treas. Reg. §1.409A-1(f)(3) or other Applicable Guidance.

1.16 **“Disability”** means a physical or mental condition of a Participant resulting from bodily injury, disease, or mental disorder which renders such Participant incapable of continuing any gainful occupation and which condition constitutes total disability under the federal Social Security Acts.

1.17. **“Deferred Compensation”** means the Participant’s Account Balance attributable to Elective Deferrals and Employer Contributions and includes Earnings on such amounts. “Compensation Deferred” is Compensation that the Participant or the Employer has deferred under this Plan. Compensation is Deferred Compensation if: (i) under the terms of the Plan and the relevant facts and circumstances, the Participant has a Legally Binding Right to Compensation during a Taxable Year that the Participant has not actually or constructively received and included in gross income; and (ii) pursuant to the Plan terms, the Compensation is payable to or on behalf of the Participant in a later Taxable Year. Deferred Compensation includes Separation Pay paid pursuant to a Separation Pay Arrangement except as otherwise described in Prop. Treas. Reg. §1.409A-1(b)(9) which excludes: (i) certain collectively bargained Separation Pay Arrangements; (ii) payments based upon an involuntary Separation from Service or pursuant to a Window Program where the payments do not exceed certain dollar limitations and are paid no later than December 31 of the second calendar year which follows the calendar year in which the Separation from Service occurs; and (iii) certain reimbursements, in-kind benefits, direct payments to the provider of goods and services on behalf of the Participant, or de minimis payments where the expenses incurred and the reimbursements are paid no later than December 31 of the second calendar year following the calendar year in which the Separation from Service occurs. Deferred Compensation for purposes of this Plan does not include: (i) Compensation payable after the last day of the Participant’s Taxable Year pursuant to the normal timing of the Employer’s payroll period as provided in Prop. Treas. Reg. §1.409A-1(b)(3); (ii) certain short-term deferrals as provided in Prop. Treas. Reg. §1.409A-1(b)(4); (iii) certain restricted property as described in Prop. Treas. Reg. §1.409A-1(b)(6); (iv) certain foreign arrangements as described in Prop. Treas. Reg. §1.409A-1(b)(8); and (v) any other amounts which under Applicable Guidance are not a Grandfathered Amount or a 409A Amount under Article VII.

1.18 **“Earnings”** means Trust earnings, gain or loss applicable to a Participant’s Account. In the absence of a Trust, Earnings means the Plan’s actual or notional earnings, gain and loss applicable to a Participant’s Account as described in Section 5.02.

1.19 **“Effective Date”** of the Plan is the date the Employer specifies in the Adoption Agreement.

1.20 **“Elective Deferral”** means Compensation a Participant elects to defer into the Participant’s Account under the Plan.

1.21 **“Elective Deferral Account”** means the portion of a Participant’s Account attributable to Elective Deferrals and Earnings thereon.

1.22 **“Employee”** means a person or entity (as described in Prop. Treas. Reg. §1.409A-1(f)(1), and which is not on the accrual method of accounting for Federal income tax purposes) providing services to the Employer in the capacity of a common law employee of the Employer.

1.23 **“Employer”** means the person or entity: (i) receiving the services of the Participant; (ii) with respect to whom the Legally Binding Right to Compensation arises; and (iii) who or which executes an Adoption Agreement establishing the Plan. The Employer includes all persons with whom the Employer would be considered a single employer under Code §§414(b) or (c). In the case of an Ineligible 457 Plan, Employer means a State or a Tax-Exempt Organization.

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1.24 **“Employer Contribution”** means amounts the Employer contributes or credits to an Account under the Plan, including Nonelective Contributions and Matching Contributions but not including Elective Deferrals.

1.25 **“Employer Contribution Account”** means the portion of a Participant’s Account attributable to Employer Contributions and Earnings thereon.

1.26 **“ERISA”** means the Employee Retirement Income Security Act of 1974, as amended.

1.27 **“409A Amount”** means: (i) any Compensation Deferred prior to January 1, 2005, unless such Deferred Compensation is a Grandfathered Amount; and (ii) any Compensation Deferred in Taxable Years beginning after December 31, 2004. In determining 409A Amounts, the rules of Section 1.04 regarding Aggregated Plans apply.

1.28 **“Grandfathered Amount”** means prior to January 1, 2005, a Participant: (i) had a Legally Binding Right to be paid Deferred Compensation; and (ii) such Deferred Compensation is Vested, unless the Employer after October 3, 2004, materially modifies the Plan (within the meaning of Section 7.04). For purposes of determining whether Deferred Compensation is Vested, the conditioning of payment of the Deferred Compensation on the completion of services in 2005 for a payroll period that includes December 31, 2004, does not constitute a requirement to render additional services or a Substantial Risk of Forfeiture. If the Plan is a Separation Pay Arrangement, the Employer will determine any Grandfathered Amount in accordance with the Preamble to the Prop. Treas. Reg. §1.409A and Applicable Guidance. In determining Grandfathered Amounts, the rules of Section 1.04 regarding Aggregated Plans apply.

1.29 **“Ineligible 457 Plan”** means this Plan which is subject to Code §457(f) and that is not an eligible 457 plan under Code §457(b).

1.30 **“Legally Binding Right”** means, in reference to Compensation, the grant by the Employer to the Participant of a right to Compensation where, after the Participant has performed the services which created the Legally Binding Right, the Compensation is not subject to unilateral reduction or elimination by the Employer or any other person. The Employer, based on the facts and circumstances and in accordance with Prop. Treas. Reg. §1.409A-1(b)(1), will determine: (i) whether a Legally Binding Right exists; or (ii) whether a Legally Binding Right does not exist on account of the existence of negative discretion which has substantive significance to reduce or eliminate the Compensation.

1.31 **“Matching Contribution”** means a fixed or discretionary Employer contribution made with respect to a Participant’s Elective Deferral.

1.32 **“Matching Contribution Account”** means the portion of a Participant’s Account attributable to Matching Contributions and Earnings thereon.

1.33 **“Nonelective Contribution”** means a fixed or discretionary Employer Contribution that is unrelated to a Participant’s Elective Deferrals.

1.34 **“Nonelective Contribution Account”** means the portion of a Participant’s Account attributable to Nonelective Contributions and Earnings thereon.

1.35 **“Participant”** means an Employee or Contractor the Employer designates under Adoption Agreement Section 2.01 to participate in the Plan.

1.36 **“Performance-Based Compensation”** means Compensation (including a Bonus) where the amount of, or entitlement to, the Compensation is contingent on satisfaction of preestablished organizational or individual performance criteria relating to a performance period of at least 12 consecutive months during which the Participant performs services. The Employer must establish the organizational or individual performance criteria in writing not later than 90 days after commencement of the performance period and the outcome must be substantially uncertain at the time that the Employer establishes the performance criteria. The Employer may establish performance criteria without the necessity of action by its shareholders, board of directors, compensation committee or similar entities. Performance-Based Compensation may be based on

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subjective performance criteria provided: (i) the criteria relate the Participant's performance, a group of service providers that includes the Participant or a business unit for which the Participant provides services which may include the Employer; and (ii) the person who decides whether the subjective performance criteria have been met is someone other than the Participant, the Participant's family member (within the meaning of Code §267(c)(4) applied as if the family of an individual includes the spouse of any member of the family), a person under the supervision of the Participant or such a family member, or where the compensation of the decision maker is controlled in whole or in part by the Participant or such a family member. The Employer will determine the status of Compensation as Performance-Based Compensation in accordance with Prop. Treas. Reg. §1.409A-1(e) and Applicable Guidance.

1.37 **"Plan"** means the Nonqualified Deferred Compensation Plan of the Employer established by and including the Adoption Agreement, the Basic Plan Document and the Trust, if any. The Employer will set forth the name of the Plan in its Adoption Agreement. For purposes of applying Code §409A requirements: (i) this Plan is an account balance plan under Prop. Treas. Reg. §1.409A-1(c)(2)(i)(A) or is a separation pay arrangement under Prop. Treas. Reg. §1.409A-1(c)(2)(i)(C); and (ii) this plan constitutes a separate plan for each Participant. This Plan does not constitute: (i) a Code §401(a) plan with and exempt trust under Code §501(a); (ii) a Code §403(a) annuity plan; (iii) a Code §403(b) annuity; (iv) a Code §408(k) SEP; (v) a Code §408(p) Simple IRA; (vi) a Code §501(c)(18) trust to which an active participant makes deductible contributions; (vii) a Code §457(b) plan; or (viii) a Code §415(m) plan.

1.38 **"Retirement Age"** means the date the Employer elects in the Adoption Agreement. A Participant is not entitled to distribution of his/her Vested Accrued Benefit based solely on attainment of Retirement Age, unless the Employer elects in the Adoption Agreement to permit such distributions.

1.39 **"Separation from Service"** means in the case of an Employee, the Employee's termination of employment with the Employer whether on account of death, retirement or otherwise.

(A) **Effect of Leave.** An Employee does not incur a Separation from Service if the Employee is on military leave, sick leave, or other bona fide leave of absence (such as temporary employment by the government), if such leave does not exceed a period of six months, or if longer, the period for which a statute or contract provides the Employee with the right to reemployment with the Employer. If a Participant's leave exceeds six months but the Participant is not entitled to reemployment under a statute or contract, the Participant incurs a Separation from Service on the next day following the expiration of six months.

(B) **Insignificant Service.** If an Employee continues to perform services for the Employer, but the services are not more than insignificant, the Employee incurs a Separation from Service. For this purpose, an Employee will be deemed to provide more than insignificant service (and no Separation from Service occurs) if the Employee provides service at an annual rate and receives annual remuneration from the Employer which are equal to at least 20% of the average annual service performed and to at least 20% of the average annual remuneration earned during the immediately preceding 3 full calendar years of employment, or if less, the period the Employer employed the Employee.

(C) **Significant Non-Employee Service.** In addition, a former Employee who continues to render significant services to the Employer in a non-Employee capacity is not deemed to have incurred a Separation from Service. For this purpose a former Employee is deemed to render significant service if the former Employee provides service at an annual rate and receives annual remuneration from the Employer which are equal to at least 50% of the average annual service performed and to at least 50% of the average annual remuneration earned during the immediately preceding 3 full calendar years of employment, or if less, the period the Employer employed the Employee.

(D) **Contractor.** Separation from Service, in the case of a Contractor, means the expiration of the contract or contracts under which the Contractor performs services for the Employer provided that the expiration constitutes a good-faith and complete termination of the contractual relationship between the Contractor and the Employer. A good-faith and complete termination does not occur if: (i) the Employer anticipates a renewal of the service contract for the services provided under the expired contract or the Employer anticipates the Contractor becoming an Employee; and (ii) neither the Employer nor the Contractor has eliminated the Contractor as a possible provider of such additional services. The Employer is deemed to intend renewal of the Contractor's expired contract if renewal is conditioned only upon the need for services,

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the Employer's ability to pay for the services, or both. See Section 4.01(B) as to Contractor "deemed" Separation from Service provisions.

(E) **Employer Determination.** The Employer will determine whether an Employee has incurred a Separation from Service: (i) based on the facts and circumstances; (ii) subject to the provisions of this Section 1.39; and (iii) without application of the "same desk rule" under Rev. Rul. 79-336 and Rev. Rul. 80-229. The Employer will determine whether an Employee or Contractor has incurred a Separation from Service in accordance with Prop. Treas. Reg. §1.409A-1(h) and Applicable Guidance.

1.40 "**Separation Pay**" means any Compensation where one of the conditions to a right to the Compensation is Separation from Service, whether voluntary or involuntary. Separation Pay includes: (i) payments in the form of reimbursements for expenses incurred and the provision of other taxable benefits; (ii) payments due on account of Separation from Service, regardless of whether such payments are conditioned on the Participant's execution of a release of claims, noncompetition or nondisclosure provisions or other similar requirements; and (iii) such other amounts as are described in Prop. Treas. Reg. §1.409A-1(m) or in Applicable Guidance.

1.41 "**Separation Pay Arrangement**" means any arrangement that provides for Separation Pay, including the portion of any arrangement that provides for Separation Pay.

1.42 "**Service Year**" means a Participant's Taxable Year in which the Participant performs services which give rise to Compensation.

1.43 "**Specified Employee**" means a Participant who is a key employee as described in Code §416(i), disregarding paragraph (5) thereof. However, a Participant is not a Specified Employee unless any stock of the Employer is publicly traded on an established securities market or otherwise. If a Participant is a key employee at any time during the 12 months ending on the identification date, the Participant is a Specified Employee for the 12 month period commencing on the first day of the fourth month following the identification date. The Employer in its Adoption Agreement will elect the identification date which may be any date in the calendar year and the same identification date must apply as to all deferred compensation arrangements of the Employer. The Employer may amend its Adoption Agreement to change the identification date but any such amendment is not effective for 12 months after the adoption of the amendment. If the Employer fails to elect an identification date in its Adoption Agreement, the identification date is December 31. The Employer's election of an identification date on or before December 31, 2006, applies to any Separation from Service occurring on or after January 1, 2005. The Employer, in determining whether this Section 1.43 and all related Plan provisions apply, will determine whether the Employer has any publicly traded stock as of the date of a Participant's Separation from Service. In the case of a spin-off or merger, or in the case of nonresident alien Employees, the Employer will apply the Specified Employee provisions of the Plan in accordance with Prop. Treas. Reg. §1.409A-1(i) and other Applicable Guidance.

1.44 "**Specified Time or Fixed Schedule**" means, in reference to a payment of Deferred Compensation, the Employer at the time of the deferral of the Compensation can objectively determine: (i) the amount payable; and (ii) the payment date or dates. An amount is objectively determinable if the deferral election specifically identifies the amount or if the Employer can determine the amount pursuant to a nondiscretionary formula. For this purpose, the Participant's or the Employer's designation of a calendar year or years for payment without more is deemed to mean payment on January 1 in such years. A Specified Time or Fixed Schedule also means as described in Prop. Treas. Reg. §1.409A-3(g)(1) and other Applicable Guidance.

1.45 "**State**" means: (i) one of the fifty states of the United States or the District of Columbia, or (ii) a political subdivision of a State, or any agency or instrumentality of a State or its political subdivision. A State does not include the federal government or an agency or instrumentality thereof.

1.46 "**Substantial Risk of Forfeiture**" means as to 409A Amounts, and other than for purposes of application of Code §457(f), Compensation which is payable conditioned: (i) on the performance of substantial future services by any person including the Participant; or (ii) on the occurrence of a condition related to a purpose of the Compensation, and where under clause (i) or (ii) the possibility of forfeiture is substantial. A condition related to the purpose of the Compensation relates to the Participant's performance

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for the Employer or to the Employer's business activities or organizational goals. A Substantial Risk of Forfeiture does not include any addition of a condition after a Legally Binding Right to the Compensation arises or any extension of a period during which the Compensation is subject to a Substantial Risk of Forfeiture. Compensation is not subject to a Substantial Risk of Forfeiture merely because payment is conditioned on the Participant's refraining from performing services. Compensation is not subject to a Substantial Risk of forfeiture beyond the date or time that the Participant otherwise could have elected to receive the Compensation unless the amount of Compensation (disregarding Earnings) is materially greater than the amount of Compensation that the Participant otherwise could have elected to receive. As such, a Participant's Elective Deferrals generally may not be made subject to a Substantial Risk of Forfeiture. In determining whether the possibility of forfeiture is substantial in the case of rights to Compensation granted to a Participant who owns significant voting power or value in the Employer, the Employer will apply Prop. Treas. Reg. §1.409A-1(d)(3) and Applicable Guidance. A Substantial Risk of Forfeiture for Grandfathered Amounts means as defined in Treas. Reg. §1.83-3(c) and in Notice 2005-1, Q/A-16(b) or in Applicable Guidance. A Substantial Risk of Forfeiture for purposes of application of Code §457(f) under an Ineligible 457 Plan means as described in Code §457(f)(3)(B), Treas. Reg. §1.83-3(c) and Applicable Guidance.

1.47 **"Tax-Exempt Organization"** means any tax-exempt organization other than a governmental unit or a church or a qualified church-controlled organization within the meaning of Code §§3121(w)(3)(A) and 3121(w)(3)(B).

1.48 **"Taxable Year"** means the 12 consecutive month period ending each December 31.

1.49 **"Trust"** means the trust described in Section 5.01 of the Basic Plan Document and created under Section 5.01 of the Adoption Agreement.

1.50 **"Unforeseeable Emergency"** means: (i) a severe financial hardship of the Participant or Beneficiary resulting from an illness or accident of the Participant or Beneficiary, of the Participant's spouse or of the Beneficiary's spouse, or the Participant's or Beneficiary's dependent (as defined in Code §152(a)); (ii) loss of the Participant's or Beneficiary's property due to casualty; or (iii) other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the Participant's or Beneficiary's control. The Employer will determine whether a Participant or Beneficiary incurs an Unforeseeable Emergency based on the relevant facts and circumstances and in accordance with Prop. Treas. Reg. §1.409A-3(g)(3) or Applicable Guidance, but in any case, the Plan may not make payment to the extent that the Unforeseeable Emergency may be relieved: (i) through reimbursement or compensation by insurance or otherwise; (ii) by liquidation of the Participant's assets to the extent that such liquidation of assets would not itself cause severe financial hardship; or (iii) by the Participant's cessation of Elective Deferrals under the Plan. The Plan must limit the amount of any payment based on Unforeseeable Emergency to the amount that is reasonably necessary to satisfy the emergency need, which may include amounts necessary to pay any Federal, state or local income taxes or penalties reasonably anticipated to result from the payment. The Employer in making the determination as to the amount of payment must take into account any additional Compensation available to the Participant if he/she cancels an Elective Deferral election under Section 4.03(D)(vii). If the Employer in its Adoption Agreement elects to permit payment based on Unforeseeable Emergency, the Employer further will elect whether to permit payment based on all events that will constitute an Unforeseeable Emergency or to limit such events to a subset of specific events which will so qualify.

1.51 **"Valuation Date"** means the last day of each Taxable Year and such other dates as the Employer may determine.

1.52 **"Vested"** means Deferred Compensation which is not subject to a Substantial Risk of Forfeiture, or to a requirement to perform further services for the Employer. For purposes of determining whether an amount satisfies the vesting requirement for Grandfathered Amounts under Article VII, Substantial Risk of Forfeiture means as described in Treas. Reg. §1.83-3(c) and does not mean as defined in Section 1.46 for purposes of application of Code §409A.

1.53 **"Window Program"** means a program the Employer establishes to provide, for a limited period of time not exceeding one year, Separation Pay in connection with Separation from Service, or in connection with Separation from Service under prescribed circumstances, and otherwise as described in Prop. Treas. Reg. §1.409A-1(b)(9)(v) or in Applicable Guidance.

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1.54 **“Wraparound Election”** means as to a Participant who also is a participant in a 401(k) plan of the Employer, an election (or elections, if made separately) to defer compensation under both plans with the result that the Participant will achieve under the 401(k) plan, the maximum amount of elective deferrals and matching contributions, if any, as is permissible under Code §§402(g), 401(k)(3), 401(m), 415 and 414(v). For a Taxable Year as to any Participant, the maximum amount of Elective Deferrals the Plan will transfer may not exceed the Code §402(g) limit and the maximum amount of Matching Contributions the Plan will transfer may not exceed the Code §402(g) limit, applying such limit separately as to each contribution type. Under a Wraparound Election, the Plan promptly following completion of 401(k) plan testing and within any time required under Applicable Guidance, will transfer from the Participant’s Account such Elective Deferrals and related Matching Contributions for the Taxable Year (but without Earnings thereon) as are consistent with the Wraparound Election, to the Participant’s account under the 401(k) plan to be held and administered in accordance with the 401(k) plan. Any remaining amounts not transferred to the 401(k) plan will remain in and be administered in accordance with this Plan. The Employer in its Adoption Agreement will specify whether a participant may make a Wraparound Election. A Participant will make a Wraparound Election subject to any timing requirements of Applicable Guidance and on a form the Employer provides for this purpose.

1.55 **“Year of Service”** means the computation period of twelve (12) consecutive months, herein set forth, during which the Employee has at least 1,000 hours of service. For vesting purposes, the computation periods shall be the Plan Year, including periods prior to the Effective Date. The computation period shall be the Plan Year.

Notwithstanding the foregoing, for any short Plan Year, the determination of whether an Employee has completed a Year of Service shall be made in accordance with Department of Labor regulation 2530.203-2[©]. However, in determining whether an Employee has completed a Year of Service for benefit accrual purposes in the short Plan Year, the number of hours of service shall be proportionately reduced based on the number of full months in the short Plan Year.

Years of Service with any affiliated employer shall be recognized.

II. PARTICIPATION

2.01 Participant Designated. The Employer will designate from time to time in its Adoption Agreement those Employees or Contractors (by name, job title or other classification) who are Participants in the Plan.

2.02 Elective Deferrals. The Employer will specify in its Adoption Agreement whether Participants may elect to make Elective Deferrals to their Accounts.

(A) Limitations. The Employer will specify in its Adoption Agreement any amount limitations or conditions applicable to Elective Deferrals.

(B) Election Form and Timing. A Participant must make his/her Elective Deferral election on an election form the Employer provides for that purpose. The Participant must make the election no later than the latest of the applicable times specified below. The Employer in its Adoption Agreement will elect that a Participant must make and deliver his/her election to the Employer no later than: (i) such applicable time; or (ii) the number of days prior to such applicable time as the Employer sets forth in its Adoption Agreement. The Employer will disregard any election which is not timely under this Section 2.02(B).

(1) General Timing Rule. Except as otherwise provided in this Section 2.02(B), a Participant must deliver his/her election to the Employer no later than the end of the Taxable Year prior to the Service Year.

(2) New Participant/New Plan. If the Plan becomes effective, or an Employee or Contractor first becomes a Participant, on a date which is not the first day of a Taxable Year, the Participant must make and deliver his/her Elective Deferral election for that Taxable Year not later than 30 days after the Plan goes into effect or the Participant becomes a Participant. The election may apply only to Compensation for services

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the Participant performs subsequent to the date the Participant delivers the election to the Employer. For Compensation that is earned for a specified performance period, including an annual bonus, and where the new Participant makes an Elective Deferral election after the service period commences, the Employer will pro rate the election by multiplying the Compensation by the ratio of the number of days left in the performance period at the time of the election, over the total number of days in the entire performance period.

(3) Certain Forfeitable Rights. If payment of Deferred Compensation is subject to a forfeiture condition requiring the Participant to perform services for the Employer for at least 12 months after the Participant obtains the Legally Binding Right to the Compensation, the Participant may make an Elective Deferral election no later than 30 days after the Participant obtains the Legally Binding Right to the Compensation, provided the Participant makes the election at least 12 months prior to the earliest date on which the service forfeiture condition could lapse.

(4) Performance-Based Compensation. As to any Performance-Based Compensation based on services performed over a period of at least 12 months, a Participant may elect no later than 6 months before the end of the service period to defer such Compensation, provided that the Participant: (i) continuously must perform services from a date no later than the date the Employer establishes the performance criteria and at least through the date of the Participant's election; and (ii) may not make an election after the Compensation has become substantially certain to be paid and is readily ascertainable.

(5) Commissions. For purposes of election timing under this Section 2.02(B), if Compensation consists of Commissions, the Participant is treated as providing the services giving rise to the Commissions in the Taxable Year in which the customer remits payment to the Employer.

(6) Final Payroll Period. As the Employer elects in its Adoption Agreement, if Compensation is payable after the last day of the Participant's Taxable Year, but is Compensation for the Participant's services during the final payroll period within the meaning of Code §3401 (b) which contains the last day of the Taxable Year, the Compensation is treated for purposes of an election under this Section 2.02(B), as Compensation for the current Taxable Year in which the final payroll period commenced or for the subsequent Taxable Year in which the Employer pays the Compensation. This Section 2.02(B)(6) does not apply to Compensation for services performed over any period other than the final payroll period as described herein and the Employer will apply this Section 2.02(B)(6) in accordance with Prop. Treas. Reg. §1.409A-2(a)(11) and Applicable Guidance. If the Employer amends its plan after December 31, 2006, to alter the timing rule of this Section 2.02(B)(6), any such amendment may not take effect until 12 months after the later of the date the amendment is adopted and is effective.

(7) Separation Pay/Window Program. If the Participant's election relates to Separation Pay and the Separation Pay: (i) is due to an actual involuntary Separation from Service; and (ii) is the result of bona-fide, arm's length negotiations, then the Participant may make an election under this Section 2.02(B) at any time up to the time that the Participant has a Legally Binding Right to the Separation Pay. If the Separation Pay results from a Window Program, the Participant may make the election at any time up to the time that the Participant's election to participate in the Window Program becomes irrevocable.

(8) Wraparound Elections. A Participant's Wraparound Election under Section 1.54 is not an election under this Section 2.02(B) even if as a result of the election the amount of the Participant's Elective Deferrals under this Plan increases, provided that the Wraparound Election does not affect the timing and form of payment of Deferred Compensation under this Plan.

(9) Fiscal Year Employer. In the event that the Employer's taxable year is a non-calendar year, a Participant may elect to defer Compensation which is co-extensive with the Employer's fiscal year by making an election no later than the end of the Employer's fiscal year which precedes the Employer's fiscal year in which the Participant performs the service for which the Compensation is payable and in accordance with Prop. Treas. Reg. §1.409A-2(a)(5) and Applicable Guidance.

(C) Early Elections/Changes. The Employer in its Adoption Agreement will elect whether a Participant's election made prior to the Section 2.02(B) deadline becomes irrevocable as to a Taxable Year: (i) following the last day on which a Participant may make an election under Section 2.02(B) for such Taxable Year; or (ii) if earlier, when the Participant makes the election for a Taxable Year. If the Employer elects to

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permit changes to an election up to the Section 2.02(B) election deadline, a Participant may make any number of changes to his/her Elective Deferral election during the period prior to the election becoming irrevocable. If the Employer elects in its Adoption Agreement and under Section 2.02(D) that a Participant's election is continuing, the Participant is deemed to have made an election as to each Taxable Year on the last day that the Participant could have made an election under Section 2.02(B). As such, the Participant may revoke or modify a continuing election for a Taxable Year up to the date that such election is deemed made for that Taxable Year. A change payment election under Section 4.03(B) does not render an Elective Deferral election and an accompanying initial payment election under Section 4.03(A), revocable within the meaning of this Section 2.02(C).

(D) Election Duration. As the Employer elects in its Adoption Agreement, a Participant's Elective Deferral election remains in effect: (i) only for the duration of the Taxable Year for which the Participant makes the election; or (ii) for the duration of the Taxable Year for which the Participant makes the election and for all subsequent Taxable Years unless the Participant executes a subsequent timely election, modification or revocation. A Participant, subject to Plan requirements regarding election timing, including those in Article VII, may make a new election, or may revoke or modify an existing election effective no earlier than for the next Taxable Year, provided that a Participant may cancel an existing and otherwise irrevocable election for a Taxable Year at any time following the Participant's receipt of an Unforeseeable Emergency distribution or of a distribution from the Employer's 401(k) plan based upon hardship within the meaning of Treas. Reg. §1.401(k)-1(d)(3).

2.03 Nonelective Contributions. The Employer will specify in its Adoption Agreement whether the Employer will or may make Nonelective Contributions to the Plan, and the terms and conditions applicable to any Nonelective Contributions.

2.04 Matching Contributions. The Employer will specify in its Adoption Agreement whether the Employer will or may make Matching Contributions to the Plan, and the terms and conditions applicable to any Matching Contributions.

2.05 Actual or Notional Contribution. The Employer will specify in its Adoption Agreement whether it will make any Employer Contribution as a notional contribution or as an actual contribution to an Account. If the Employer establishes the Trust, any Employer Contributions to the Trust will be actual contributions.

2.06 Allocation Conditions. The Employer will specify in its Adoption Agreement any employment or other condition applicable to the allocation of Employer Contributions for a Taxable Year.

2.07 Timing. The Employer may elect to make any Employer Contribution for a Taxable Year at such times as Code §409A or Applicable Guidance may permit. The Employer is not required to contribute any actual contribution (or to post any notional contribution) to an Account at the time that the Employer makes its contribution election.

2.08 Administration. The Employer will administer all Employer Contributions in the same manner as Elective Deferrals, except as the Plan otherwise provides. If the Employer establishes the Trust, the Employer will remit any Elective Deferrals to the Trust and will make any Employer Contributions to the Trust. Any Employer Contribution is not subject to an immediate Participant right to elect a cash payment in lieu of the Employer Contribution and such amounts are payable only in accordance with the Plan terms.

III. VESTING AND SUBSTANTIAL RISK OF FORFEITURE

3.01 Vesting Schedule or other Substantial Risk of Forfeiture. The Employer will specify in its Adoption Agreement any vesting schedule or other Substantial Risk of Forfeiture applicable to Participant Accounts. If the Plan is an Ineligible 457 Plan, the Employer must specify a Substantial Risk of Forfeiture.

3.02 Immediate Vesting on Specified Events. The Employer will specify in its Adoption Agreement whether a Participant's Account is Vested without regard to Years of Service if the Participant Separates from Service on or following Retirement Age, or as a result of death, Disability, or other events.

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3.03 Application of Forfeitures. A Participant will forfeit any non-Vested Accrued Benefit upon Separation from Service. The Employer will specify in its Adoption Agreement how it will apply Participant forfeitures under the Plan.

IV. BENEFIT PAYMENTS

4.01 Separation from Service or Death. The Plan will pay to the Participant the Vested Accrued Benefit held in the Participant's Account following the earlier of the Participant's Separation from Service or death. Payment will commence at the time and payment will be made in the form and method specified under Section 4.03. In the event of the Participant's death, the Plan will pay to the Participant's Beneficiary the Participant's Vested Accrued Benefit or any remaining amount thereof if benefits to the Participant already have commenced, in accordance with the Participant's election or otherwise as the Plan permits.

(A) Payment to Specified Employees. Notwithstanding anything to the contrary in the Plan or in a Participant or Employer payment election, the Plan may not make payment to a Specified Employee, based on Separation from Service, earlier than 6 months following Separation from Service (or if earlier, upon the Specified Employee's death), except as permitted under this Section 4.01(A). The Employer in its Adoption Agreement will elect whether any payments that otherwise would be payable to the Specified Employee during the foregoing 6 month period: (i) will be accumulated and payment delayed until a date specified in the Adoption Agreement that is after the 6 month period; or (ii) will be delayed by 6 months as to each installment otherwise payable during the 6 month period. The Employer may amend its Adoption Agreement to change the method of treating payments otherwise payable within the 6 month period, provided that any change in method may not be effective for 12 months after the adoption of the amendment unless the Employer makes such an amendment prior to the Employer's stock first becoming readily tradable on an established securities market. This Section 4.01(A) does not apply to payments made on account of a domestic relations order under Section 4.03(D)(i), payments made because of a conflict of interest under Section 4.03(D)(ii), or payment of employment taxes under Section 4.03(D)(v).

(B) Deemed Separation of Contractor. The Employer in its Adoption Agreement may elect to apply the special payment timing rules in this Section 4.01(B) as to Contractors. Compliance with this Section 4.01(B) results in the Contractor being deemed to have incurred a Separation from Service under Section 1.39. Under this Section 4.01(B): (i) the Plan will not pay a Contractor's Account, or any portion thereof, before a date that is at least 12 months after the expiration of the contract or contracts under which the Contractor performs services for the Employer; and (ii) no amount payable under clause (i) will be paid to the Contractor if the Contractor (whether as a Contractor or an Employee) performs significant services for the Employer after the contract(s)' expiration and before the payment date.

4.02 Other Payment Events. The Employer will specify in the Adoption Agreement whether, in addition to the payment events under Section 4.01, the Plan may pay to a Participant all or any part of the Participant's Account: (i) upon the Participant's Disability; (ii) at a Specified Time or pursuant to a Fixed Schedule; (iii) upon a Change in Control; or (iv) based upon an Unforeseeable Emergency. Payment will commence at the time and payment will be made in the form and method specified under Section 4.03.

4.03 Form, Timing and Method/ Payment Election. The Employer will specify in its Adoption Agreement: (i) the permissible forms of payment (cash or property), the timing of payment and methods of payment applicable to Plan Accounts (collectively, "payment elections"); and (ii) whether a Participant or the Employer may make an initial payment election under Section 4.03(A) or change payment election under Section 4.03(B). Until the Plan pays a Participant's entire Vested Accrued Benefit, the Plan will continue to credit the Participant's Account with Earnings, in accordance with Section 5.02. As to the permissible forms of payment (cash or property), the Participant or the Employer may, but is not required to, elect the form of payment as part of and at the same time as the initial payment election or change payment election.

(A) Initial Payment Election. The Employer will specify in its Adoption Agreement: (i) whether a Participant or the Employer may make an initial payment election or whether there are no initial payment elections and the form, timing and method of payment are controlled by the Employer's Adoption Agreement elections; and (ii) whether any Participant payment election applies to all Account types or only applies to a Participant's Elective Deferral Account. In the event the Employer elects in its Adoption Agreement not to

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provide any Participant or Employer initial payment elections, the Plan provisions constitute an initial payment election under the Plan. A Participant must make an initial payment election at the time of the Participant's Elective Deferral election under Section 2.02(B). The Employer must make an initial payment election as to a Participant at the time that the Employer grants a Legally Binding Right to Deferred Compensation to the Participant. A payment election may apply only to the Deferred Compensation that is the subject of the Elective Deferral election or the Employer Contribution or may apply to such Deferred Compensation and to all future Deferred Compensation, as the payment election indicates. A Participant must make any permissible initial payment election on a form the Employer provides for that purpose. If the Participant or the Employer as applicable have the right to make an initial payment election but fail to do so, the Plan will pay the affected Participant's Vested Accrued Benefit attributable to the non-election under this default provision, in a lump-sum cash payment 13 months following the earliest event permitting payment of the Participant's Account under Sections 4.01 or 4.02. If this default provision applies, the default payment is deemed to be an initial payment election under the Plan.

(B) **Change Payment Election.** The Employer will specify in its Adoption Agreement whether a Participant's or the Employer's initial payment election under Section 4.03(A) or first change payment election under this Section 4.03(B) is irrevocable or whether a Participant or the Employer may change the elections. If the Plan permits Participants or the Employer to change existing payment elections (initial or change elections) as to any or all Deferred Compensation, including any Plan default payment applicable in the absence of an actual initial payment election, any such change payment election must comply with this Section 4.03(B). The Employer in its Adoption Agreement will elect whether a Beneficiary following a Participant's death may make a change payment election under this Section 4.03(B). A Participant or Beneficiary must make any change payment election on a form the Employer provides for such purpose.

(1) **Conditions on Change Payment Elections.** Any Participant or Employer change payment election: (i) may not take effect until at least 12 months following the date of the change payment election; (ii) if the change payment election relates to a payment based on Separation from Service or on Change in Control, or if the payment is at a Specified Time or pursuant to a Fixed Schedule, the change payment election must result in payment being made not earlier than 5 years following the date upon which the payment otherwise would have been made (or, in the case of a life annuity or installment payments treated as a single payment, 5 years from the date the first amount was scheduled to be paid); and (iii) if the change payment election relates to payment at a Specified Time or pursuant to a Fixed Schedule, the Participant or Employer must make the change payment election not less than 12 months prior to the date the payment is scheduled to be made (or, in the case of a life annuity or installment payments treated as a single payment, 12 months prior to the date the first amount was scheduled to be paid).

(2) **Definition of "Payment."** Except as otherwise provided in Section 4.03(B)(3), a "payment" for purposes of applying Section 4.03(B)(1) is each separately identified amount the Plan is obligated to pay to a Participant on a determinable date and includes amounts paid for the benefit of the Participant. An amount is "separately identified" only if the Employer can objectively determine the amount. A payment includes the provision of any taxable benefit, including payment in cash or in-kind. A payment includes, but is not limited to, the transfer, cancellation or reduction of an amount of Deferred Compensation in exchange for benefits under a welfare benefit plan, fringe benefits excludible under Code §§119 or 132, or any other benefit that is excluded from gross income.

(3) **Installment Payments and Life Annuities.** A life annuity is treated as a single payment. For purposes of this Section 4.03(B)(3), a "life annuity" is a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the Participant, or the joint lives (or life expectancies) of the Participant and of his/her Beneficiary. A change in the form of payment from one type of life annuity to another before any annuity payment has been made is not subject to the change payment election requirements provided that the annuities are actuarially equivalent applying reasonable actuarial assumptions. The Employer in its Adoption Agreement will elect whether to treat a series of installment payments which are not a life annuity as a single payment or as a series of separate payments. If the Employer fails to so elect, the Employer must treat the installments as a single payment. For purposes of this Section 4.03(B)(3), a "series of installment payments" means payment of a series of substantially equal periodic amounts to be paid over a predetermined number of years, except to the extent that any increase in the payment amounts reflects reasonable Earnings through the date of payment.

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(4) Coordination with Anti-Acceleration Rule. In applying Section 4.03(C), “payment” means as described in Sections 4.03(B)(2) and (3). A Participant under a change payment election may change the form of payment to a more rapid schedule (including a change from installments to a lump-sum payment) without violating Section 4.03(C), provided any such change remains subject to the change payment election provisions under this Section 4.03(B). Accordingly, if the Participant’s payment change election modifies the payment method from installments to a lump-sum payment, and if the Plan treats an installment payment as a single payment, a change payment election must satisfy Section 4.03(B)(1) measured from the first installment payment. Conversely, if the plan treats an installment payment as a series of payments, a change payment election must satisfy Section 4.03(B)(1) measured from the last installment payment. If a change payment election only modifies the timing of an installment payment, and the Plan treats the installments as a single payment, the change payment election must apply to each installment and must satisfy Section 4.03(B) measured from each installment payment. If in the latter case, the Plan treats installments as a series of payments, the change payment election may apply to any or all installments and must satisfy Section 4.03(B) separately as to each payment the change payment election affects.

(5) Multiple Payment Events. If the Plan permits multiple payment events, the change payment election provisions of Section 4.03(B)(1) apply separately as to each payment due upon each payment event. The addition of a permissible payment event to Deferred Compensation previously deferred is subject to the change election provisions of Section 4.03(B)(1) where the additional event may cause a change in the time or form of payment. The addition of a payment event is not an impermissible acceleration under Section 4.03(C) provided that the change complies with this Section 4.03(B)(5).

(6) Certain Payment Delays not Subject to Change Payment Election Rules. The Employer in its Adoption Agreement will elect whether to apply the some or all of the following payment delay provisions. If applicable, these provisions do not result in the Plan failing to provide for payment upon a permissible event as Code §409A requires nor are the delays treated as a change payment election under this Section 4.03(B).

(a) Non-deductible Payment. The Plan may delay payment to a Participant if the Employer reasonably anticipates that the Employer’s deduction for payment of the Participant’s Deferred Compensation will be limited or eliminated under Code §162(m). As the Employer elects in its Adoption Agreement, the Plan will pay such Deferred Compensation at the earliest date at which the Employer reasonably anticipates that Code §162(m) will not apply or in the calendar year in which the affected Participant Separates from Service.

(b) Loan Covenants/Contract Terms. The Plan may delay payment to a Participant if the Employer reasonably anticipates that the payment will violate the terms of a loan agreement or other similar contract to which the Employer is a party, provided that the Employer entered into the agreement or contract for legitimate business reasons and that such violation will cause material harm to the Employer. The Plan will pay such Deferred Compensation at the earliest date at which the Employer reasonably anticipates that the payment will not cause a violation of the agreement or contract or that such a violation will not result in material harm to the Employer.

(c) Securities or Other Laws. The Plan may delay payment to a Participant if the Employer reasonably anticipates that the payment will violate Federal securities law or other applicable law. The Plan will pay such Deferred Compensation at the earliest date at which the Employer reasonably anticipates that the payment will not cause a violation of such laws. For purposes of this Section 4.03(B)(6)(c), a violation of “other applicable law” does not include a payment which would cause inclusion of the Deferred Compensation in the Participant’s gross income or which would subject the Participant to any Code penalty or other Code provision.

(d) Other. The Plan may delay payment to a Participant upon such other events as Applicable Guidance may permit.

(e) Amendment. If the Employer amends its Adoption Agreement to add any or all of payment delays described in this Section 4.03(B)(6), any such amendment may not be effective for at least 12 months following the Employer’s adoption of the amendment. As required under Section 4.03(C), the

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Employer may not amend its Adoption Agreement to remove any or all payment delays described in this Section 4.03(B)(6) as to any previous Deferred Compensation.

(C) No Acceleration-General Rule. Neither the Employer nor a Participant may accelerate the time or schedule of any Plan payment or amount scheduled to be paid under the Plan. For this purpose, the following are not an acceleration: (i) payment made in accordance with Plan provisions or pursuant to an initial payment election under Section 4.03(A) or a change payment election under Section 4.03(B) under which payment on an accelerated schedule is required on account of an intervening event which includes Separation from Service, Disability, death, Change in Control or Unforeseeable Emergency; (ii) The Employer's waiver or acceleration of the satisfaction of any condition constituting a Substantial Risk of Forfeiture provided that payment is made only upon a permissible payment event and the Employer's action otherwise does not violate Code §409A; and (iii) a choice between a distribution of cash or property if the timing and the amount of income inclusion to the Participant are the same.

(D) Permissible Accelerations. Notwithstanding Section 4.03(C), the Employer in its Adoption Agreement may elect to permit any or all of the following accelerations of the time or schedule of payment: (i) a payment to an individual other than the Participant required under a domestic relations order under Code §414(p)(1)(B); (ii) a payment required under a certificate of divestiture under Code §1043(b)(2) relating to conflicts of interest; (iii) a payment from a 457(f) plan to a Participant for the purpose of payment of the Participant's Federal, state local or foreign income tax due upon a vesting event under the 457(f) plan, provided that the payment does not exceed the income tax withholding the Employer would have remitted if it had paid wages equal to the amount of 457(f) income includible at the time of vesting; (iv) a Plan amendment to permit certain cash-out payments described in Sections 4.03(E) and (F); (v) as it relates to the Deferred Compensation, a payment to pay the FICA tax under Code §§3101, 3121(a) and 3121(v)(2) and to pay income taxes at source on wages under Code §3401 or under corresponding provisions of state, local or foreign tax laws related to payment of the FICA and to pay additional income tax at source on wages attributable to pyramiding Section §3401 wages and taxes, but the total of all such payments may not exceed the aggregate of the FICA amount and the income tax withholding related to the FICA amount; (vi) a payment to any affected Participant at any time that the Plan fails to meet the requirements of Code §409A and the regulations thereunder, provided that such payment may not exceed the amount required to be included in income as a result of such failure; (vii) cancellation of a Participant's Elective Deferral election on account of a payment based on Unforeseeable Emergency or a hardship distribution under Treas. Reg. §1.401(k)-1(d)(3) provided that the election is fully cancelled and that any subsequent election is subject to Sections 2.02 and 4.03(A); (viii) payment upon Plan termination in accordance with Section 6.03(B); (ix) payment to prevent the occurrence of a "nonallocation year" under Code §409(p) in accordance with Prop. Treas. Reg. §1.409A-3(h)(2)(ix) or other Applicable Guidance; and (x) a decrease in the amounts deferred under the Plan as a result of a formula which links Deferred Compensation under this Plan to benefits paid by or contributions made to a qualified plan of the Employer, including Wraparound Elections, in accordance with Prop. Treas. Reg. §1.409A-3(h)(3) or other Applicable Guidance.

(E) Cash-Out Upon Separation. The Employer in its Adoption Agreement will elect whether (notwithstanding a Participant's or the Employer's payment election or any contrary Plan terms) the Plan will pay in a single cash payment the entire Vested Accrued Benefit of a Participant who has Separated from Service (including Grandfathered and 409A Amounts) where the Participant's Vested Accrued Benefit does not exceed \$10,000. A payment under this Section 4.03(E) must terminate the Participant's entire interest in the Plan and in all similar deferred compensation arrangements within the meaning of Prop. Treas. Reg. §1.409A-1(c) or other Applicable Guidance. The Employer will make any payment under this Section 4.03(E) on or before the later of: (i) December 31 of the Taxable Year in which the Participant Separates from Service; or (ii) the 15th day of the third month following the Participant's Separation from Service.

(F) Cash-out of 409A Amount. The Employer in its Adoption Agreement will elect whether the Plan will pay in the form of a single cash payment the entire Vested Accrued Benefit of any Participant attributable to 409A Amounts upon the occurrence of any Plan payment event affecting the Participant, provided: (i) the Vested Accrued Benefit attributable to 409A Amounts does not exceed an amount the Employer designates in the Adoption Agreement; and (ii) "409A Amounts" for purposes of this cash-out provision only includes Compensation Deferred on and following the date the Employer elects this cash-out provision in the Adoption Agreement. If the Employer elects to apply this Section 4.03(F), any subsequent

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amendment to change or eliminate this feature is subject to the rules regarding payment change elections under Section 4.03(B).

4.04 Withholding. The Employer will withhold from any payment made under the Plan and from any amount taxable under Code §409A, all applicable taxes, and any and all other amounts required to be withheld under Federal, state or local law, including Notice 2005-1 and other Applicable Guidance.

4.05 Beneficiary Designation. A Participant may designate a Beneficiary (including one or more primary and contingent Beneficiaries) to receive payment of any Vested Accrued Benefit remaining in the Participant's Account at death. The Employer will provide each Participant with a form for this purpose and no designation will be effective unless made on that form and delivered to the Employer. A Participant may modify or revoke an existing designation of Beneficiary by executing and delivering a new designation to the Employer. In the absence of a properly designated Beneficiary, the Employer will pay a deceased Participant's Vested Accrued Benefit to the Participant's surviving spouse and if none, to the Participant's estate. If a Beneficiary is a minor or otherwise is a person whom the Employer reasonably determines to be legally incompetent, the Employer may cause the Plan or Trust to pay the Participant's Vested Accrued Benefit to a guardian, trustee or other proper legal representative of the Beneficiary. The Plan's or Trust's payment of the deceased Participant's Vested Accrued Benefit to the Beneficiary or proper legal representative of the Beneficiary completely discharges the Employer, the Plan and Trust of all further obligations under the Plan.

4.06 Administration of Payment Date(s).

(A) Objective Payment Date(s). The Employer in its Adoption Agreement, or the Participant or the Employer in an initial payment election or change payment election made pursuant to the Adoption Agreement must provide for a payment date that the Employer, at the time of the payment event, objectively can determine. Such payment date may, but need not, coincide with a payment event, but any payment must be on or following and must relate to a Plan payment event. If the Adoption Agreement or any such election provides for payment only in a designated calendar year, the payment date is deemed to be January 1 of that year.

(B) Multiple Payment Events/Fixed Schedule Linked to Payment Events. The Employer in its Adoption Agreement, or a Participant or the Employer in a payment election under Sections 4.03(A) or (B): (i) may provide for payment upon the earliest or latest of more than one permissible payment event under Sections 4.01 and 4.02; (ii) may provide that a payment based on Separation from Service, death, Disability, Change in Control or Unforeseeable Emergency is to be made in accordance with a Fixed Schedule that the Employer objectively can determine at the time of the applicable payment event; or (iii) may provide for an alternative payment schedule if the payment event to which the payment schedule is linked occurs prior to a single specified date.

(C) Treatment of Payment as Made on Designated Payment Date. The Plan's payment of Deferred Compensation is deemed made on the Plan required payment date or payment election required payment date even if the Plan makes payment after such date, provided the payment is made by the latest of: (i) the end of the calendar year in which the payment is due; (ii) the 15th day of the third calendar month following the payment due date; (iii) in case the Employer cannot calculate the payment amount on account of administrative impracticality which is beyond the Participant's control (or the control of the Participant's estate), in the first calendar year in which payment is practicable; (iv) in case the Employer does not have sufficient funds to make the payment without jeopardizing the Employer's solvency, in the first calendar year in which the Employer's funds are sufficient to make the payment. The Employer may cause the Plan or Trust to pay a Participant's Vested Accrued Benefit on any date which satisfies this Section 4.06(C) and that is administratively practicable following any Plan specified payment date or the date specified in any valid payment election.

(D) Disputed Payments. In the event of a dispute between the Employer and a Participant as to whether Deferred Compensation is payable to the Participant or as to the amount thereof, the Plan is deemed to make timely payment on any Plan required payment date or payment election required payment date if: (i) the Participant accepts any portion of the payment that the Employer is willing to make (unless such acceptance results in a forfeiture of the Participant's claim to the remaining amount); (ii) the Participant

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makes prompt, reasonable and good-faith efforts to collect the payment; and (iii) the Plan makes payment in the first calendar year in which the Employer and the Participant enter into a legally binding settlement of the dispute, the Employer concedes that the amount is payable or the Employer is required to cause the Plan to make payment under a final and nonappealable judgment or other binding decision. This Section 4.06 (D) does not apply if the Plan's failure to make payment on a required date is on account of: (i) the Participant's failure to request payment, to provide information or to take any other action necessary for the Plan to make payment; or (ii) the Participant or a member of the Participant's family (as defined in Code §267(c)(4) applied to include the spouse of any family member), any person or group of persons over whom the Participant or the Participant's family has effective control or any person whose compensation (or any portion thereof) is controlled by the Participant or the Participant's family members, makes the decision to not pay.

4.07 Employer Approval of Participant Elections. A Participant's or the Employer's initial payment elections or change payment elections must be consistent with the Plan and with the Adoption Agreement. The Employer at the time of the election must approve any Participant payment election as to form, timing and method, where the Adoption Agreement does not expressly authorize the elected form, timing or method. The Employer, in its absolute discretion, may withhold approval for any reason, including, but not limited to non-compliance with Plan terms. If the Employer does not approve a Participant's initial payment election or change payment election, the Employer will pay the Participant's Vested Accrued Benefit under Section 4.03 as though the Participant did not make such payment election.

V. TRUST ELECTION AND PLAN EARNINGS

5.01 Unfunded Plan/Trust Election. The Employer as it elects in its Adoption Agreement intends this Plan to be an unfunded plan that is wholly or partially exempt under ERISA. No Participant, Beneficiary or successor thereto has any legal or equitable right, interest or claim to any property or assets of the Employer, including assets held in any Account under the Plan except as the Plan otherwise permits. The Employer's obligation to pay Plan benefits is an unsecured promise to pay. Except as provided in the Adoption Agreement, this Plan does not create a trust for the benefit of any Participant. If the Employer elects to create the Trust, the applicable provisions of the Basic Plan Document continue to apply, including those of this Section 5.01. The Trustee will pay Plan benefits in accordance with the Plan terms or upon the Employer's direction consistent with Plan terms. Unless the Employer establishes the Trust: (i) the Employer may elect to make notional contributions in lieu of actual contributions to the Plan; and (ii) the Employer may elect not to invest any actual Plan contributions. If the Employer elects to invest any actual Plan contributions, such investments may be held for the Employer's benefit in providing for the Employer's obligations under the Plan or for such other purposes as the Employer may determine. Any assets held in Plan Accounts remain subject to claims of the Employer's general creditors and no Participant's or Beneficiary's claim to Plan assets has any priority over any general unsecured creditor of the Employer.

(A) Restriction on Trust Assets. If an Employer establishes, directly or indirectly, the Trust (or any other arrangement Applicable Guidance may describe), the Trust and the Trust assets must be and must remain located within the United States, except with respect to a Participant who performs outside the United States substantially all services giving rise to the Deferred Compensation. The Trust may not contain any provision limiting the Trust assets to the payment of Plan benefits upon a Change in the Employer's Financial Health, even if the assets remain subject to claims of the Employer's general creditors. For this purpose, the Employer, upon a Change in the Employer's Financial Health, may not transfer Deferred Compensation to the Trust. Any Trust the Employer establishes under this Plan shall be further subject to Applicable Guidance, compliance with which is necessary to avoid the transfer of assets to the Trust being treated as a transfer of property under Code § 83.

(B) Transitional Relief for Grace Period Assets. As to any Grace Period Assets that otherwise would violate Section 5.01(A) and Code §409 (A)(b), not later than December 31, 2007, or such other date as Applicable Guidance may specify, the Plan or the Employer will eliminate Grace Period Assets or otherwise cause such assets to not violate Code §409A(b) by: (i) making payment of Deferred Compensation in accordance with the Plan terms; (ii) making payment of Deferred Compensation upon the Employer's termination of the Plan under Section 6.03(b); (iii) dissolving the Trust in accordance with the Trust terms; (iv) desegregating the Grace Period Assets such that they no longer are associated with the payment of Deferred Compensation; or (v) taking such other action to come into conformity with Code §409A(b) and Applicable Guidance issued before December 31, 2007, as Applicable guidance may specify. Under clause

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(iv), even if the Employer takes no other prior action, the Grace Period Assets as of December 31, 2007, are by this provision desegregated and no longer are associated with the payment of Deferred Compensation. Under clauses (i) and (ii), if payment consists of both Grace Period Assets and other assets, the payment is treated for purposes of this Section 5.01(B) as consisting first of Grace Period Assets.

(1) Grace Period Assets. For purposes of this Section 5.01(B), Grace Period Assets means assets which on or before March 21, 2006, were set aside, transferred or restricted under Code §§409(A)(b)(1) or 409A(b)(2) so as to become subject to income inclusion under such Code sections. Grace Period Assets includes actual Earnings on the Grace Period Assets (whether held in the Trust or otherwise), including such Earnings credited after March 21, 2006. The Employer will determine Grace Period Assets in accordance with Notice 2006-33 and other Applicable Guidance.

5.02 Actual or Notional Earnings. If the Employer establishes the Trust under Section 5.01, the Trust earnings provisions apply to all Plan contributions and constitute Earnings for purposes of the Plan. If the Employer does not establish the Trust, the Employer will elect in its Adoption Agreement whether the Plan periodically will credit actual or notional Plan contributions with a determinable amount of notional Earnings (at a specified fixed or floating interest rate or other specified index) or will credit or charge each Participant's Account with net investment earnings, gain and loss actually incurred by the Account. If the Account is credited and charged with actual Earnings, the Employer will specify in the Adoption Agreement whether the Employer, the Trustee (subject to the Trust terms) or the Participant has the right to direct the investment of the Participant's Account and also may specify any limitations on the Participant's right of investment direction. If the Adoption Agreement provides for Employer investment direction, the Employer may make any investment of Plan assets it deems reasonable or appropriate. If the Adoption Agreement provides for Participant investment direction, this right is limited strictly to investment direction and the Participant will not be entitled to the distribution of any Account asset except as the Plan otherwise permits. Except as otherwise provided in the Plan or Trust, all Plan assets, including all incidents of ownership thereto, at all times will be the sole property of the Employer.

VI. MISCELLANEOUS

6.01 No Assignment. No Participant or Beneficiary has the right to anticipate, alienate, assign, pledge, encumber, sell, transfer, mortgage or otherwise in any manner convey in advance of actual receipt, the Participant's Account. Prior to actual payment, a Participant's Account is not subject to the debts, judgments or other obligations of the Participant or Beneficiary and is not subject to attachment, seizure, garnishment or other process applicable to the Participant or Beneficiary.

6.02 Not Employment Contract. This Plan is not a contract for employment between the Employer and any Employee who is a Participant. This Plan does not entitle any Participant to continued employment with the Employer, and benefits under the Plan are limited to payment of a Participant's Vested Accrued Benefit in accordance with the terms of the Plan.

6.03 Amendment and Termination.

(A) Amendment. The Employer reserves the right to amend the Plan at any time to comply with Code §409A, Notice 2005-1, Prop. Treas. Reg. §1.409A and other Applicable Guidance or for any other purpose, provided that such amendment will not result in taxation to any Participant under Code §409A. Except as the Plan and Applicable Guidance otherwise may require, the Employer may make any such amendments effective immediately.

(B) Termination. The Employer may terminate, but is not required to terminate, the Plan and distribute Plan Accounts under the following circumstances:

(1) Dissolution/Bankruptcy. The Employer may terminate the Plan within 12 months following a dissolution of a corporate Employer taxable under Code §331 or with approval of a Bankruptcy court under 11 U.S.C. §503(b)(1)(A), provided that the Deferred Compensation is paid to the Participants and is included in the Participants' gross income in the latest calendar year: (i) in which the plan termination occurs; (ii) in which the amounts no longer are subject to a Substantial Risk of Forfeiture; or (iii) in which the payment is administratively practicable.

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(2) **Change in Control.** The Employer may terminate the Plan within the 30 days preceding or the 12 months following a Change in Control provided the Employer distributes all Plan Accounts (and must distribute the accounts under any substantially similar Employer plan which plan the Employer also must terminate) within 12 months following the Plan termination.

(3) **Other.** The Employer may terminate the Plan for any other reason in the Employer's discretion provided that: (i) the Employer also terminates all Aggregated Plans in which any Participant also is a participant; (ii) the Plan makes no payments in the 12 months following the Plan termination date other than payments the Plan would have made irrespective of Plan termination; (iii) the Plan makes all payments within 24 months following the Plan termination date; and (iv) the Employer within 5 years following the Plan termination date does not adopt a new plan covering any Participant that would be an Aggregated Plan.

(4) **Applicable Guidance.** The Employer may terminate the Plan under such other circumstances as Applicable Guidance may permit.

(C) **Effect on Vesting.** Any Plan amendment or termination will not reduce the Vested Accrued Benefit held in any Participant Account at the date of the amendment or termination and also may not accelerate vesting except as may be permitted without subjecting any Participant to taxation under Code §409A.

(D) **Cessation of Future Contributions.** The Employer in its Adoption Agreement may elect at any time to amend the Plan to cease future Elective Deferrals, Nonelective Contributions or Matching Contributions as of a specified date. In such event, the Plan remains in effect (except those provisions permitting the frozen contribution type) until all Accounts are paid in accordance with the Plan terms, or, if earlier, upon the Employer's termination of the Plan.

6.04 **Severability.** If the Employer or any proper authority determines any provision of the Plan will cause taxation under Code §409A or is otherwise invalid, the remaining portions of the Plan will continue in effect and will be interpreted consistent with the elimination of the invalid provision.

6.05 **Notice and Elections.** Any notice given or election made under the Plan must be in writing and must be delivered or mailed by certified mail, to the Employer or to the Participant or Beneficiary as appropriate. The Employer will prescribe the form of any Plan notice or election to be given to or made by Participants. Any notice or election will be deemed given or made as of the date of delivery, or if given or made by certified mail, as of 3 business days after mailing.

6.06 **Administration.** The Employer will administer and interpret the Plan, including making a determination of the Vested Accrued Benefit due any Participant or Beneficiary under the Plan. As a condition of receiving any Plan benefit to which a Participant or Beneficiary otherwise may be entitled, a Participant or Beneficiary will provide such information and will perform such other acts as the Employer reasonably may request. The Employer may cause the Plan to forfeit any or all of a Participant's Vested Accrued Benefit, if the Participant fails to cooperate reasonably with the Employer in the administration of the Participant's Plan Account, provided that this provision does not apply to a bona fide dispute under Section 4.06(D). The Employer may retain agents to assist in the administration of the Plan and may delegate to agents such duties as it sees fit. The decision of the Employer or its designee concerning the administration of the Plan is final and is binding upon all persons having any interest in the Plan. The Employer will indemnify, defend and hold harmless any Employee designated by the Employer to assist in the administration of the Plan from any and all loss, damage, claims, expense or liability with respect to this Plan (collectively, "claims") except claims arising from the intentional acts or gross negligence of the Employee.

6.07 **Account Statements.** The Employer from time to time will provide each Participant with a statement of the Participant's Vested Accrued Benefit as of the most recent Valuation Date. The Employer also will provide Account statements to any Beneficiary of a deceased Participant with a Vested Accrued Benefit remaining in the Plan.

6.08 **Accounting.** The Employer will maintain for each Participant as is necessary for proper administration of the Plan, an Elective Deferral Account, a Matching Contribution Account, a Nonelective

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Contribution Account, and separate sub-accounts reflecting 409A Amounts and Grandfathered Amounts in accordance with Section 7.03.

6.09 Costs and Expenses. Except for investment charges, which will be borne by the Account to which they pertain, the Employer will pay the costs, expenses and fees associated with the operation of the Plan, excluding those incurred by Participants or Beneficiaries. The Employer will pay costs, expenses or fees charged by or incurred by the Trustee only as provided in the Trust or other agreement between the Employer and the Trustee.

6.10 Reporting. The Employer will report Deferred Compensation for Employee Participants on Form W-2 for and on Form 1099-MISC for Contractor Participants in accordance with Notice 2005-1 and Applicable Guidance.

6.11 ERISA Claims Procedure. If this Plan is established as a “top-hat plan” within the meaning of DOL Reg. §2520.104-23, the following claims procedure under DOL Reg. §2560.503-1 applies. For purposes of the Plan’s claims procedure under this Section 6.11, the “Plan Administrator” means the Employer. A Participant or Beneficiary may file with the Plan Administrator a written claim for benefits, if the Participant or Beneficiary disputes the Plan Administrator’s determination regarding the Participant’s or Beneficiary’s Plan benefit. However, the Plan Administrator will cause the Plan to pay only such benefits as the Plan Administrator in its discretion determines a Participant or Beneficiary is entitled to receive. The Plan Administrator under this Section 6.11 will provide a separate written document to affected Participants and Beneficiaries which explains the Plan’s claims procedure and which by this reference is incorporated into the Plan. If the Plan Administrator makes a final written determination denying a Participant’s or Beneficiary’s claim, the Participant or Beneficiary must file an action with respect to the denied claim within 180 days following the date of the Plan Administrator’s final determination.

VII. 2005 AND 2006 TRANSITION RULES AND PROVISIONS APPLICABLE IF PLAN WAS EFFECTIVE BEFORE 2005

7.01 409A Amounts. The terms of this Plan control as to any 409A Amount.

7.02 Grandfathered Amounts. A Grandfathered Amount remains subject to the terms of the Plan as in effect before January 1, 2005, unless the Employer makes a material modification to the Plan under Section 7.04. Notwithstanding the preceding sentence, the restrictions of Section 5.01(A) and the transition relief of Section 5.01(B) as to Grace Period Assets apply to Grandfathered Amounts.

7.03 Separate Accounting/Earnings. The Employer will account separately for 409A Amounts and for Grandfathered Amounts within each Participant’s Account. The Employer also will account separately for Earnings on the 409A Amounts and Earnings on the Grandfathered Amounts. Post-2004 Earnings on Grandfathered Amounts are included in the Grandfathered Amount.

7.04 Material Modification. The Employer makes a material modification to the Plan if at any time the Employer amends the Plan or exercises discretion under the Plan to enhance materially a benefit or right existing as of October 3, 2004, or to add a new material benefit or right not existing as of October 3, 2004, and such actions affect amounts which otherwise would be Grandfathered Amounts. The Employer’s adoption of this Plan as a new plan or grant of an additional benefit under an existing Plan after October 3, 2004, and before January 1, 2005, is a material modification unless: (i) the adoption or grant is consistent with the Employer’s historical compensation practices; and (ii) the Plan treats such additional Deferred Compensation as a 409A Amount. The Employer’s amendment of the Plan to permit Participants with the option to terminate participation in the Plan is a material modification.

(A) Not a Material Modification. A material modification does not include: (i) the Employer’s amendment of the Plan to comply with Code §409A (except to add one or more provisions permitted by Code §409A that the Plan did not include as of October 3, 2004, and which would enhance materially an existing benefit or add a new material benefit); (ii) the Employer’s amendment of the Plan to reduce or eliminate any benefit existing as of October 3, 2004; (iii) the Employer’s exercise of Plan discretion existing as of October 3, 2004, over the time and manner of payment (except for the right to accelerate vesting to a date on or before

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December 31, 2004, or otherwise to enhance materially an existing benefit or right or to add a new material benefit or right); (iv) the Employer's amendment of the Plan to change the application of Earnings to a Participant's Account as permitted under Prop. Treas. Reg. §1.409A-6(a)(4)(iv); (v) the Employer's establishment of a trust or the making of Plan contributions to a trust or other arrangement from which the Plan will pay benefits provided that the contribution to the trust or other arrangement does not cause an amount to be included in the Participant's gross income; (vi) the Participant's exercise of any right existing as of October 3, 2004 (except to enhance an existing benefit or to add a new benefit); (vii) the Employer's amendment of the Plan to cease future Elective Deferrals and Employer Contributions; or (viii) the Employer's termination of the Plan in accordance with Section 6.03. An amendment to the Plan which otherwise would constitute a material modification is not treated as a material modification provided the Employer rescinds the amendment before any Participant exercises any right granted under the amendment and in any event not later than the end of the calendar year in which the Employer made the amendment.

(B) Aggregation. In applying this Section 7.04, "Plan" means under Section 1.37 and the Aggregated Plans provisions under Section 1.04 do not apply.

7.05 2005 and 2006 Operational Rules. The following provisions apply to the Plan during the 2005 and 2006 Taxable Years.

(A) Good Faith. As to 409A Amounts, the Employer will operate the Plan during the 2005 and 2006 Taxable Years in good faith compliance in accordance with: (i) Notice 2005-1; (ii) Code §409A; and (iii) any Applicable Guidance as of the effective date thereof. The Employer also may operate the Plan consistent with the Prop. Treas. Reg. §1.409A before such regulations become effective and may apply such regulations to the extent that they are inconsistent with Notice 2005-1. Although the Employer intends this Plan document to comply with the provisions of Notice 2005-1 and of Prop. Treas. Reg. §1.409A, the Employer will not apply any Plan provision which is inconsistent therewith and, by December 31, 2006, will amend any such provision to comply with Applicable Guidance. The Employer and the Participants may not exercise discretion under the Plan in a manner that would violate Code §409A.

(B) New Payment Elections. A Participant, on or before December 31, 2006, may make a new payment election as to any previously deferred 409A Amount. Any such election must be a permissible election under Section 4.03(A), but an election under this Section 7.05(B) is not treated as a change in the timing or form of distribution and need not comply with Section 4.03(B) as it applies to such changes. In addition, during 2006, a Participant may not make a new payment election under this Section 7.05(B) which: (i) would result in the Participant not receiving any payment which the Plan otherwise would make in 2006; or (ii) would accelerate to 2006 any payment the Plan would otherwise make after 2006.

(C) Payments Linked to Qualified Plans. Notwithstanding Article IV, the Plan will honor any Participant election as to the timing or form of payment of Deferred Compensation that is a 409A Amount provided: (i) such election is controlled by the Participant's distribution election under any Code §401(a) qualified plan; (ii) the election is permitted under the Plan terms as in effect on October 3, 2004; and (iii) the distribution is made or is commenced on or after January 1, 2005, and no later than December 31, 2006.

(D) 2005 Deferral Election by March 15, 2005. Notwithstanding Section 2.03, if the Plan was in existence on or before December 31, 2004 (as described in Notice 2005-1, Q/A 21), a Participant may make an Elective Deferral election as to 409A amounts earned for service to the Employer through December 31, 2005. A Participant must make an election under this Section 7.05(D) no later than March 15, 2005, and in accordance with the Plan terms as in effect on or before December 31, 2005. The election applies only as to amounts not paid or payable to the Participant at the time of the election. Any amounts subject to this election otherwise are 409A Amounts. This Section applies only to the 2005 Taxable Year.

(E) Certain Severance Plans. If the Plan provides severance pay benefits and either: (i) is collectively bargained; or (ii) does not cover any key employees within the meaning of Code §416(i), the Plan provisions governing 409A Amounts are effective as to the severance benefits for Taxable Years commencing in 2006. For 2005, the severance benefit provisions of the Plan remain subject to prior Plan terms. For purposes of this Section 7.05(E), a severance pay benefit means as described in Notice 2005-1, Q/A 19(d).

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(F) Cancellation of Election/Participation. A Participant as to 409A Amounts, on or before December 31, 2005, may elect to terminate participation in the Plan or to cancel (or reduce the amount of) any or all existing Elective Deferral elections and Employer Contributions. The Employer as to 409A Amounts, on or before December 31, 2005, also may terminate any Participant's participation in the Plan or may cancel any Participant's Elective Deferral election or Employer Contribution. The Plan will distribute to an affected Participant all 409A Amounts subject to an election under this Section 7.05(F) and the Participant will include such amounts in income, in the 2005 Taxable Year, or if later, in the Taxable Year in which such amounts are Vested.

7.06 Incorporation of Applicable Guidance. In the event of Applicable Guidance that is contrary to any Plan provision, the Employer, as of the effective date of the Applicable Guidance, will operate the Plan in conformance therewith and will disregard any inconsistent Plan provision. Any such Applicable Guidance is deemed to be incorporated by reference into the Plan and to supersede any contrary Plan provision during any period in which the Employer is permitted to comply operationally with the Applicable Guidance and before a formal Plan amendment is required.

* * * * *

Subsidiaries of Build-A-Bear Workshop, Inc.

<u>Subsidiary:</u>	<u>Jurisdiction of Incorporation/Organization:</u>
Build-A-Bear Entertainment, LLC	Missouri
Build-A-Bear Workshop Franchise Holdings, Inc.	Delaware
Build-A-Bear Workshop Canada Ltd.	New Brunswick
Build-A-Bear Retail Management, Inc.	Delaware
Build-A-Bear Workshop UK Holdings Limited	United Kingdom
The Bear Factory Limited	United Kingdom
Amsbra Limited	United Kingdom
Hobbies and Models Limited	United Kingdom
Build-A-Bear Workshop Ireland Limited	Ireland
Build-A-Bear Workshop France, SAS	France

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Build-A-Bear Workshop, Inc.:

We consent to incorporation by reference in the registration statements (No. 333-120012) on Form S-8 of Build-A-Bear Workshop, Inc. our reports dated March 15, 2007, with respect to the consolidated balance sheets of Build-A-Bear Workshop, Inc. and subsidiaries as of December 30, 2006, and December 31, 2005, and the related consolidated statements of operations, stockholders' equity and cash flows, for each of the years in the three-year period ended December 30, 2006, management's assessment of the effectiveness of internal control over financial reporting as of December 30, 2006 and the effectiveness of internal over financial reporting as of December 30, 2006, which reports appear in the December 30, 2006 annual report on Form 10-K of Build-A-Bear Workshop, Inc.

Our report with respect to the consolidated financial statements refers to Build-A-Bear Workshop, Inc's adoption of the provisions of Statement of Financial Accounting Standards No. 123R "Share-Based Payment", effective January 1, 2006.

The Company acquired The Bear Factory Limited and Amsbra Limited, during the fiscal year ended December 30, 2006. Management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, these entities' internal control over financial reporting associated with total revenues of \$32.8 million, included in the consolidated financial statements of the Company for the periods from the respective acquisitions through December 30, 2006. These entities were acquired for total consideration of \$39.4 million, subject to certain contingent purchase price adjustments. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of these entities.

/s/ KPMG LLP

St. Louis, Missouri
March 15, 2007

Exhibit 31.1

Certification of Principal Executive Officer

I, Maxine Clark, certify that:

1. I have reviewed this annual report on Form 10-K of Build-A-Bear Workshop, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 15, 2007 /s/ Maxine Clark

Maxine Clark
Chairman of the Board and Chief Executive Bear
Build-A-Bear Workshop, Inc.
(Principal Executive Officer)

Exhibit 31.2

Certification of Principal Financial Officer

I, Tina Klocke, certify that:

1. I have reviewed this annual report on Form 10-K of Build-A-Bear Workshop, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

March 15, 2007 /s/ Tina Klocke

Tina Klocke
Chief Financial Bear, Treasurer and Secretary
Build-A-Bear Workshop, Inc.
(Principal Financial Officer)

Exhibit 32.1

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Build-A-Bear Workshop, Inc. (the "Company") on Form 10-K for the period ended December 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Maxine Clark, Chairman of the Board and Chief Executive Bear of the Company, certify, to the best of my knowledge, pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 15, 2007

/s/ Maxine Clark

Maxine Clark
Chairman of the Board and
Chief Executive Bear
Build-A-Bear Workshop, Inc.

Exhibit 32.2

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Build-A-Bear Workshop, Inc. (the "Company") on Form 10-K for the period ended December 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Tina Klocke, Chief Financial Bear, Secretary and Treasurer of the Company, certify, to the best of my knowledge, pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 15, 2007

/s/ Tina Klocke

Tina Klocke
Chief Financial Bear, Treasurer and Secretary
Build-A-Bear Workshop, Inc.