WINMARK CORP
Form 10-Q
April 26, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 30, 2019

or

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

For the transition period from to

Commission File Number: 000-22012

WINMARK CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota	41-1622691
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(Address of principal executive offices) (Zip Code)

(763) 520-8500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

Common stock, no par value, 3,761,686 shares outstanding as of April 19, 2019.

Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1: Financial Statements

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

	March 30, 2019	December 29, 2018
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 1,066,800	$ 2,496,000
Restricted cash	65,000	80,000
Receivables, less allowance for doubtful accounts of $1,700 and $400	1,455,500	1,553,100
Net investment in leases - current	17,321,500	18,547,500
Income tax receivable	—	565,500
Inventories	113,800	107,600
Prepaid expenses	954,100	901,600
Total current assets	20,976,700	24,251,300
Net investment in leases - long-term	17,786,000	20,455,500
Property and equipment, net	908,800	866,200
Operating lease right of use assets	6,056,100	—
Goodwill	607,500	607,500
Other assets	496,700	482,600
	$ 46,831,800	$ 46,663,100
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current Liabilities:		
Notes payable, net of unamortized debt issuance costs of $13,900 and $13,900	$ 3,236,100	$ 3,236,100
Accounts payable	1,717,800	1,351,800
Income tax payable	1,664,700	—
Accrued liabilities	2,669,100	3,128,600
Discounted lease rentals	3,070,700	3,021,900
Deferred revenue	1,750,700	1,744,900
Total current liabilities	14,109,100	12,483,300
Long-Term Liabilities:		
Line of credit	11,500,000	—
Notes payable, net of unamortized debt issuance costs of $79,100 and $82,600	24,795,900	25,604,900
Discounted lease rentals	1,937,300	2,723,500
Deferred revenue	8,247,900	8,432,400

Operating lease liabilities	5,823,000	—
Other liabilities	764,800	1,079,200
Deferred income taxes	1,148,900	1,148,300
Total long-term liabilities	54,217,800	38,988,300
Shareholders' Equity (Deficit):		
Common stock, no par value, 10,000,000 shares authorized, 3,759,186 and 3,907,686 shares issued and outstanding	—	4,425,600
Retained earnings (accumulated deficit)	(21,495,100)	(9,234,100)
Total shareholders' equity (deficit)	(21,495,100)	(4,808,500)
	$ 46,831,800	$ 46,663,100

The accompanying notes are an integral part of these financial statements

3

Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended	
	March 30, 2019	March 31, 2018
Revenue:		
Royalties	$ 11,761,400	$ 11,049,000
Leasing income	5,155,300	5,528,800
Merchandise sales	611,000	776,900
Franchise fees	391,800	400,900
Other	411,700	405,400
Total revenue	18,331,200	18,161,000
Cost of merchandise sold	571,500	742,500
Leasing expense	698,700	554,900
Provision for credit losses	10,100	95,000
Selling, general and administrative expenses	6,984,400	6,694,400
Income from operations	10,066,500	10,074,200
Interest expense	(442,200)	(743,800)
Interest and other income (expense)	(300)	(1,000)
Income before income taxes	9,624,000	9,329,400
Provision for income taxes	(2,351,800)	(2,369,000)
Net income	$ 7,272,200	$ 6,960,400
Earnings per share - basic	$ 1.86	$ 1.81
Earnings per share - diluted	$ 1.73	$ 1.69
Weighted average shares outstanding - basic	3,906,895	3,847,312
Weighted average shares outstanding - diluted	4,198,454	4,124,573

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

Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

	Common Stock Shares	Amount	Retained Earnings (Accumulated Deficit)	Total
BALANCE, December 29, 2018	3,907,686	$ 4,425,600	$ (9,234,100)	$ (4,808,500)
Repurchase of common stock	(150,000)	(5,081,000)	(18,947,100)	(24,028,100)
Stock options exercised	1,500	156,600	—	156,600
Compensation expense relating to stock options	—	498,800	—	498,800
Cash dividends ($0.11 per share)	—	—	(586,100)	(586,100)
Comprehensive income (Net income)	—	—	7,272,200	7,272,200
BALANCE, March 30, 2019	3,759,186	$ —	$ (21,495,100)	$ (21,495,100)

	Common Stock Shares	Amount	Retained Earnings (Accumulated Deficit)	Total
BALANCE, December 31, 2017	3,843,078	$ 1,476,200	$ (37,189,700)	$ (35,713,500)
Stock options exercised	6,428	48,400	—	48,400
Compensation expense relating to stock options	—	490,800	—	490,800
Cash dividends ($0.15 per share)	—	—	(423,200)	(423,200)
Comprehensive income (Net income)	—	—	6,960,400	6,960,400
BALANCE, March 31, 2018	3,849,506	$ 2,015,400	$ (30,652,500)	$ (28,637,100)

Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended	
	March 30, 2019	March 31, 2018
OPERATING ACTIVITIES:		
Net income	$ 7,272,200	$ 6,960,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	80,100	75,800
Provision for credit losses	10,100	95,000
Compensation expense related to stock options	498,800	490,800
Deferred income taxes	600	—
Deferred initial direct costs	(14,200)	(979,800)
Amortization of deferred initial direct costs	209,500	299,700
Operating lease right of use asset amortization	102,300	—
Tax benefits on exercised stock options	12,100	—
Change in operating assets and liabilities:		
Receivables	97,600	203,200
Principal collections on lease receivables	4,662,800	—
Income tax receivable/payable	2,218,100	2,192,900
Inventories	(6,200)	17,400
Prepaid expenses	(52,500)	248,300
Other assets	(14,100)	(47,800)
Accounts payable	366,000	(5,400)
Accrued and other liabilities	(1,105,000)	774,400
Rents received in advance and security deposits	6,500	(38,700)
Deferred revenue	(178,700)	12,700
Net cash provided by operating activities	14,166,000	10,298,900
INVESTING ACTIVITIES:		
Purchase of property and equipment	(122,700)	(170,200)
Purchase of equipment for lease contracts	(1,717,400)	(6,196,800)
Principal collections on lease receivables	—	5,881,000
Net cash used for investing activities	(1,840,100)	(486,000)
FINANCING ACTIVITIES:		
Proceeds from borrowings on line of credit	14,000,000	—
Payments on line of credit	(2,500,000)	(10,800,000)
Payments on notes payable	(812,500)	(812,500)
Repurchases of common stock	(24,028,100)	—
Proceeds from exercises of stock options	156,600	48,400
Dividends paid	(586,100)	(423,200)
Proceeds from discounted lease rentals	—	2,916,800
Net cash used for financing activities	(13,770,100)	(9,070,500)
NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH	(1,444,200)	742,400

Cash, cash equivalents and restricted cash, beginning of period	2,576,000	1,163,200
Cash, cash equivalents and restricted cash, end of period	$ 1,131,800	$ 1,905,600
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	$ 417,000	$ 758,100
Cash paid for income taxes	$ 121,100	$ 176,000

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the Consolidated Condensed Balance Sheets to the total of the same amounts shown above:

	Three Months Ended	
	March 30, 2019	March 31, 2018
Cash and cash equivalents	$ 1,066,800	$ 1,800,600
Restricted cash	65,000	105,000
Total cash, cash equivalents and restricted cash	$ 1,131,800	$ 1,905,600

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

Table of Contents

WINMARK CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

1. Management's Interim Financial Statement Representation:

The accompanying consolidated condensed financial statements have been prepared by Winmark Corporation and subsidiaries (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The Company has a 52/53 week year which ends on the last Saturday in December. The information in the consolidated condensed financial statements includes normal recurring adjustments and reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of such financial statements. The consolidated condensed financial statements and notes are presented in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions for Form 10-Q, and therefore do not contain certain information included in the Company's annual consolidated financial statements and notes. This report should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's latest Annual Report on Form 10-K.

Revenues and operating results for the three months ended March 30, 2019 are not necessarily indicative of the results to be expected for the full year.

Reclassifications

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

2. Organization and Business:

The Company offers licenses to operate franchises using the service marks Plato's Closet®, Once Upon A Child®, Play It Again Sports®, Style Encore® and Music Go Round®. The Company uses its Winmark Franchise Partners® mark in connection with its strategic consulting and corporate development activities. The Company also operates both middle market and small-ticket equipment leasing businesses under the Winmark Capital® and Wirth Business Credit® marks.

3. Recent Accounting Pronouncements:

Recently Issued Accounting Pronouncements

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

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which provides guidance on accounting for leases that supersedes existing lease accounting guidance. The ASU's core principle is that a lessee should recognize lease assets and lease liabilities for those leases classified as operating leases under existing lease accounting guidance. The new standard also makes targeted changes to lessor accounting, as well as adding new disclosures for leasing activities. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842 (Leases), which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. In July 2018, the FASB also issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which provides an optional transition method that allows entities to elect to apply the standard prospectively at its effective date, versus recasting the prior periods presented. The Company used the prospective approach of adoption when the new guidance was adopted on December 30, 2018, the first day of fiscal 2019. In addition, the Company elected the package of practical expedients permitted under the transition guidance within the new standard which allowed it to carry forward historical lease classification. Upon adoption, as a lessee, the Company recognized operating lease right-of-use assets of $6.0 million and operating lease liabilities of $6.3 million on its Consolidated Condensed Balance Sheets. The adoption of the standard did not have

Table of Contents

a material impact on its Consolidated Condensed Statements of Operations or Shareholders' Equity (Deficit). As a lessor, the adoption of the new standard required the Company to present cash receipts from leases within operating activities in the Consolidated Condensed Statements of Cash Flows, where in prior periods such cash receipts are presented within investing activities. For the three months ended March 30, 2019, principal collections on lease receivables were $4.7 million.

As a lessor, leasing income for direct financing leases is recognized under the effective interest method. The effective interest method of income recognition applies a constant rate of interest equal to the internal rate of return on the lease. For sales-type leases in which the equipment has a fair value greater or less than its carrying amount, selling profit/loss is recognized at commencement. For subsequent periods or for leases in which the equipment's fair value is equal to its carrying amount, the recording of income is consistent with the accounting for a direct financing lease. For leases that are accounted for as operating leases, income is recognized on a straight-line basis when payments under the lease contract are due.

Additional information and disclosures required by this new standard for the Company as a lessee are contained in Note 11 – "Operating Leases", and as a lessor in Note 6 – "Investment in Leasing Operations".

4. Contract Liabilities:

The Company's contract liabilities for its franchise revenues consist of deferred revenue associated with franchise fees and software license fees. The table below presents the activity of the current and noncurrent deferred franchise revenue during the first three months of 2019 and 2018, respectively:

	March 30, 2019	March 31, 2018
Balance at beginning of period	$ 10,177,300	$ 10,310,200
Franchise and software license fees collected from franchisees, excluding amount earned as revenue during the period	292,000	486,000
Fees earned that were included in the balance at the beginning of the period	(470,700)	(473,300)
Balance at end of period	$ 9,998,600	$ 10,322,900

The following table illustrates future estimated revenue to be recognized for the remainder of 2019 and full fiscal years thereafter related to performance obligations that are unsatisfied (or partially unsatisfied) as of March 30, 2019.

Contract Liabilities expected to be recognized in	Amount
2019	$ 1,268,900
2020	1,630,600
2021	1,491,700
2022	1,346,800
2023	1,175,600
Thereafter	3,085,000
	$ 9,998,600

5. Fair Value Measurements:

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

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

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

8

Table of Contents

6. Investment in Leasing Operations:

Investment in leasing operations consists of the following:

	March 30, 2019	December 29, 2018
Direct financing and sales-type leases:		
Minimum lease payments receivable	$ 35,791,700	$ 40,822,400
Estimated unguaranteed residual value of equipment	4,431,300	4,741,200
Unearned lease income, net of initial direct costs deferred	(5,658,100)	(6,739,900)
Security deposits	(4,125,600)	(4,118,300)
Equipment installed on leases not yet commenced	5,283,100	5,094,800
Total investment in direct financing and sales-type leases	35,722,400	39,800,200
Allowance for credit losses	(651,400)	(861,200)
Net investment in direct financing and sales-type leases	35,071,000	38,939,000
Operating leases:		
Operating lease assets	567,300	777,000
Less accumulated depreciation and amortization	(530,800)	(713,000)
Net investment in operating leases	36,500	64,000
Total net investment in leasing operations	$ 35,107,500	$ 39,003,000

As of March 30, 2019, the $35.1 million total net investment in leases consists of $17.3 million classified as current and $17.8 million classified as long-term. As of December 29, 2018, the $39.0 million total net investment in leases consists of $18.5 million classified as current and $20.5 million classified as long-term.

As of March 30, 2019, leased assets with two customers approximated 19% and 10%, respectively, of the Company's total assets. A portion of the lease payments receivable from these customers are assigned as collateral in non-recourse financing with financial institutions. See Note 10 – "Discounted Lease Rentals".

Future minimum lease payments receivable under lease contracts and the amortization of unearned lease income, net of initial direct costs deferred, is as follows for the remainder of fiscal 2019 and the full fiscal years thereafter as of March 30, 2019:

	Direct Financing and Sales-Type Leases		Operating Leases
	Minimum Lease	Income	Minimum Lease
Fiscal Year	Payments Receivable	Amortization	Payments Receivable

2019	$ 18,871,400	$ 3,994,900	$ 44,000
2020	12,861,900	1,475,300	—
2021	4,006,000	185,900	—
2022	40,000	1,400	—
2023	8,000	500	—
Thereafter	4,400	100	—
	$ 35,791,700	$ 5,658,100	$ 44,000

The activity in the allowance for credit losses for leasing operations during the first three months of 2019 and 2018, respectively, is as follows:

	March 30, 2019	March 31, 2018
Balance at beginning of period	$ 861,200	$ 711,200
Provisions charged to expense	10,100	95,000
Recoveries	4,200	(25,600)
Deductions for amounts written-off	(224,100)	—
Balance at end of period	$ 651,400	$ 780,600

Table of Contents

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

	March 30, 2019		December 29, 2018	
	Investment In Leases	Allowance for Credit Losses	Investment In Leases	Allowance for Credit Losses
Collectively evaluated for loss potential	$ 35,722,400	651,400	$ 39,800,200	$ 861,200
Individually evaluated for loss potential	—	—	—	—
Total	$ 35,722,400	$ 651,400	$ 39,800,200	$ 861,200

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

	March 30, 2019				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 34,506,800	$ —	$ —	$ —	$ 34,506,800
Small-Ticket	1,215,600	—	—	—	1,215,600
Total Investment in Leases	$ 35,722,400	$ —	$ —	$ —	$ 35,722,400

	December 29, 2018				
	0-60 Days Delinquent and Accruing	61-90 Days Delinquent and Accruing	Over 90 Days Delinquent and Accruing	Non-Accrual	Total
Middle-Market	$ 38,395,000	$ —	$ —	$ 70,000	$ 38,465,000
Small-Ticket	1,335,200	—	—	—	1,335,200
Total Investment in Leases	$ 39,730,200	$ —	$ —	$ 70,000	$ 39,800,200

The Company leases high-technology and other business-essential equipment to its leasing customers. Upon expiration of the initial term or extended lease term, depending on the structure of the lease, the customer may return the equipment, renew the lease for an additional term, or purchase the equipment. Due to the uncertainty of such outcome at the end of the lease term, the lease as recorded at commencement represents only the current terms of the agreement. As a lessor, the Company’s leases do not contain non-lease components. The residual values reflect the estimated amounts to be received at lease termination from sales or other dispositions of leased equipment to unrelated parties. The leased equipment residual values are based on the Company’s best estimate. The Company’s risk management strategy for its residual value includes the contractual obligations of customer to maintain, service, and insure the leased equipment, the use of third party remarketers as well as the analytical review of historical asset dispositions.

Leasing income as presented on the Consolidated Condensed Statements of Operations consists of the following:

	Three Months Ended March 30, 2019
Interest income on direct financing and sales-type leases	$ 2,182,500
Selling profit (loss) at commencement of sales-type leases	873,500
Operating lease income	638,300
Income on sales of equipment under lease	1,225,600
Other	235,400
Leasing income	$ 5,155,300

Table of Contents

7. Earnings Per Share:

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

	Three Months Ended	
	March 30, 2019	March 31, 2018
Denominator for basic EPS — weighted average common shares	3,906,895	3,847,312
Dilutive shares associated with option plans	291,559	277,261
Denominator for diluted EPS — weighted average common shares and dilutive potential common shares	4,198,454	4,124,573
Options excluded from EPS calculation — anti-dilutive	5,280	15,929

8. Shareholders' Equity (Deficit):

Dividends

On January 23, 2019, the Company's Board of Directors approved the payment of a $0.15 per share quarterly cash dividend to shareholders of record at the close of business on February 6, 2019, which was paid on March 1, 2019.

Repurchase of Common Stock

In February 2019, the Company's Board of Directors authorized the repurchase of up to 150,000 shares of our common stock for a price of $159.63 per share through a tender offer (the "Tender Offer"). The Tender Offer began on the date of the announcement, February 28, 2019 and expired on March 28, 2019. Upon expiration, the Company accepted for payment 150,000 shares for a total purchase price of approximately $24.0 million, including fees and expenses related to the Tender Offer. The Tender Offer was financed in part by net borrowings under the Line of Credit. (See Note 9 – "Debt").

Under a previous Board of Directors' authorization, as of March 30, 2019, the Company has the ability to repurchase an additional 130,604 shares of its common stock. Repurchases may be made from time to time at prevailing prices, subject to certain restrictions on volume, pricing and timing.

Stock Option Plans and Stock-Based Compensation

The Company had authorized up to 750,000 shares of common stock be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2001 Stock Option Plan (the "2001 Plan"). The 2001 Plan expired on February 20, 2011. As of March 30, 2019, the Company has authorized up to 700,000 shares of common stock to be reserved for granting either nonqualified or incentive stock options to officers and key employees under the Company's 2010 Stock Option Plan (the "2010 Plan").

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

Stock option activity under the 2001 Plan, 2010 Plan and Nonemployee Directors Plan (collectively, the "Option Plans") as of March 30, 2019 was as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Intrinsic Value
Outstanding, December 29, 2018	639,380	$ 84.12	5.61	$ 47,808,100
Exercised	(1,500)	104.41		
Outstanding, March 30, 2019	637,880	$ 84.07	5.36	$ 66,671,400
Exercisable, March 30, 2019	471,230	$ 67.90	4.29	$ 56,871,600

Table of Contents

No options were granted during the three months ended March 30, 2019 or the three months ended March 31, 2018. All unexercised options at March 30, 2019 have an exercise price equal to the fair market value on the date of the grant.

Compensation expense of $498,800 and $490,800 relating to the vested portion of the fair value of stock options granted was expensed to “Selling, General and Administrative Expenses” in the first three months of 2019 and 2018, respectively. As of March 30, 2019, the Company had $3.9 million of total unrecognized compensation expense related to stock options that is expected to be recognized over the remaining weighted average vesting period of approximately 2.4 years.

9. Debt:

Line of Credit

As of March 30, 2019, there was $11.5 million in borrowings outstanding under the Company’s revolving credit facility with CIBC Bank USA and BMO Harris Bank N.A. (the “Line of Credit”) bearing interest at 5.50% leaving $38.5 million available for additional borrowings.

The Line of Credit has been and will continue to be used for general corporate purposes. During the first quarter of 2019, the Line of Credit was used to finance in part the Tender Offer (as indicated above). The Line of Credit, which terminates in July 2021, is secured by a lien against substantially all of the Company’s assets, contains customary financial conditions and covenants, and requires maintenance of minimum levels of debt service coverage and tangible net worth and maximum levels of leverage (all as defined within the Line of Credit). As of March 30, 2019, the Company was in compliance with all of its financial covenants.

Notes Payable

As of March 30, 2019, the Company had $17.5 million in principal outstanding from the $25.0 million Series A notes issued in May 2015 and $10.6 million in principal outstanding from the $12.5 million Series B notes issued in August 2017 under its Note Agreement with Prudential Investment Management, Inc., its affiliates and managed accounts (“Prudential”).

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

The Company's obligations under the Note Agreement are secured by a lien against substantially all of the Company's assets (as the notes rank pari passu with the Line of Credit), and the Note Agreement contains customary financial conditions and covenants, and requires maintenance of minimum levels of fixed charge coverage and tangible net worth and maximum levels of leverage (all as defined within the Note Agreement). As of March 30, 2019, the Company was in compliance with all of its financial covenants.

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

10. Discounted Lease Rentals:

The Company utilized certain lease receivables and underlying equipment as collateral to borrow from financial institutions at a weighted average rate of 6.43% at March 30, 2019 on a non-recourse basis. As of March 30, 2019, $3.1 million of the $5.0 million liability balance is current.

Table of Contents

11. Operating Leases:

As of March 30, 2019, the Company leases its Minnesota corporate headquarters in a facility with an operating lease that expires in December 2029 as well as satellite office space in California with an operating lease that expires in August 2022. Our leases include both lease (fixed payments including rent) and non-lease components (common area or other maintenance costs and taxes) which are accounted for as a single lease component as we have elected the practical expedient to group lease and non-lease components for all leases. The corporate headquarters lease provides us the option to extend the lease for two additional five year periods. The California lease provides us an option to extend the lease for an additional three year period. The lease renewal options are at our sole discretion; therefore, the renewals to extend the lease term are not included in our right of use assets and lease liabilities as they are not reasonably certain of exercise. The weighted average remaining lease term for these leases is 10.5 years and the weighted average discount rate is 5.5%. As our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments. The Company recognized $365,600 and $286,200 of rent expense for the periods ended March 30, 2019 and March 31, 2018, respectively.

Maturities of operating lease liabilities is as follows for the remainder of fiscal 2019 and full fiscal years thereafter as of March 30, 2019:

Operating Lease Liabilities expected to be recognized in	Amount
2019	$ 321,800
2020	762,500
2021	783,600
2022	784,400
2023	763,300
Thereafter	5,042,900
Total lease payments	8,458,500
Less imputed interest	(2,045,100)
Present value of lease liabilities	$ 6,413,400

Of the $6.4 million operating lease liability outstanding at March 30, 2019, $0.6 million is included in Accrued liabilities in the Current liabilities section of the Consolidated Condensed Balance Sheets.

Supplemental cash flow information related to our operating leases is as follows for the period ended March 30, 2019:

Three
Months
Ended