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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

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(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 27, 2008

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

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**BUILD-A-BEAR WORKSHOP, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

43-1883836  
(IRS 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)

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 31, 2008, there were 19,354,391 issued and outstanding shares of the registrant's common stock.

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## PART I-FINANCIAL INFORMATION

## Item 1. Financial Statements

**BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

(Dollars in thousands, except share and per share data)

	September 27, 2008	December 29, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 27,323	\$ 66,261
Inventories	47,730	48,638
Receivables	6,685	7,068
Prepaid expenses and other current assets	15,185	14,624
Deferred tax assets	4,185	3,606
Total current assets	101,108	140,197
Property and equipment, net	132,382	139,841
Goodwill	39,496	42,840
Other intangible assets, net	3,880	4,016
Investment in affiliate	7,494	4,307
Other assets, net	8,188	8,330
Total Assets	<u>\$ 292,548</u>	<u>\$ 339,531</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 29,700	\$ 45,044
Accrued expenses	8,584	11,788
Gift cards and customer deposits	21,697	34,567
Deferred revenue	9,665	8,708
Total current liabilities	69,646	100,107
Deferred franchise revenue	2,026	2,511
Deferred rent	43,755	41,697
Other liabilities	1,020	1,608
Stockholders' equity:		
Preferred stock, par value \$0.01, Shares authorized: 15,000,000; No shares issued or outstanding at September 27, 2008 and December 29, 2007	—	—
Common stock, par value \$0.01, Shares authorized: 50,000,000; Issued and outstanding: 19,427,461 and 20,676,357 shares, respectively	194	207
Additional paid-in capital	76,269	88,388
Accumulated other comprehensive income	1,352	6,314
Retained earnings	98,286	98,699
Total stockholders' equity	176,101	193,608
Total Liabilities and Stockholders' Equity	<u>\$ 292,548</u>	<u>\$ 339,531</u>

See accompanying notes to condensed consolidated financial statements.

**BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

(Dollars in thousands, except share and per share data)

	Thirteen weeks ended		Thirty-nine weeks ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
<b>Revenues:</b>				
Net retail sales	\$ 105,786	\$ 108,357	\$ 321,108	\$ 323,342
Franchise fees	982	934	3,055	2,306
Licensing revenue	478	474	1,585	1,314
Total revenues	<u>107,246</u>	<u>109,765</u>	<u>325,748</u>	<u>326,962</u>
<b>Costs and expenses:</b>				
Cost of merchandise sold	63,471	61,387	191,640	181,176
Selling, general and administrative	43,491	42,547	130,492	123,374
Store preopening	871	1,430	2,046	3,487
Store closing	2,916	—	2,916	—
Interest expense (income), net	(135)	(388)	(774)	(1,289)
Total costs and expenses	<u>110,614</u>	<u>104,976</u>	<u>326,320</u>	<u>306,748</u>
Income (loss) before income taxes	(3,368)	4,789	(572)	20,214
Income tax expense (benefit)	(1,353)	1,812	(159)	7,580
Net income (loss)	<u>\$ (2,015)</u>	<u>\$ 2,977</u>	<u>\$ (413)</u>	<u>\$ 12,634</u>
<b>Earnings (loss) per common share:</b>				
Basic	<u>\$ (0.11)</u>	<u>\$ 0.15</u>	<u>\$ (0.02)</u>	<u>\$ 0.62</u>
Diluted	<u>\$ (0.11)</u>	<u>\$ 0.15</u>	<u>\$ (0.02)</u>	<u>\$ 0.62</u>
<b>Shares used in computing common per share amounts:</b>				
Basic	18,815,996	20,242,402	19,299,301	20,248,949
Diluted	18,815,996	20,411,095	19,299,301	20,454,767

See accompanying notes to condensed consolidated financial statements.

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

	Thirty-nine weeks ended	
	September 27, 2008	September 29, 2007
Cash flows from operating activities:		
Net income (loss)	\$ (413)	\$ 12,634
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	21,626	19,207
Impairment of friends 2B made assets	2,867	—
Deferred taxes	(1,056)	(627)
Tax benefit from stock option exercises	—	(225)
Loss on disposal of property and equipment	167	287
Stock-based compensation	2,798	2,213
Change in assets and liabilities:		
Inventories	443	(4,026)
Receivables	305	(1,759)
Prepaid expenses and other assets	(1,017)	(5,057)
Accounts payable	(13,991)	(8,332)
Accrued expenses and other liabilities	(13,504)	(14,041)
Net cash (used in) provided by operating activities	<u>(1,775)</u>	<u>274</u>
Cash flows from investing activities:		
Purchases of property and equipment	(19,249)	(24,812)
Purchases of other assets and other intangible assets	(1,123)	(4,795)
Investment in affiliate	(3,187)	(3,403)
Cash flow used in investing activities	<u>(23,559)</u>	<u>(33,010)</u>
Cash flows from financing activities:		
Exercise of employee stock options and employee stock purchases	185	554
Purchases of Company's common stock	(13,540)	(4,270)
Tax benefit from stock option exercises	—	225
Cash flow used in financing activities	<u>(13,355)</u>	<u>(3,491)</u>
Effect of exchange rates on cash	(249)	108
Net decrease in cash and cash equivalents	(38,938)	(36,119)
Cash and cash equivalents, beginning of period	66,261	53,109
Cash and cash equivalents, end of period	<u>\$ 27,323</u>	<u>\$ 16,990</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	\$ 7,267	\$ 19,763
Noncash Transactions:		
Return of common stock in lieu of tax withholdings and option exercises	\$ 304	\$ 501
Unsettled repurchases of common stock at end of period	\$ 584	\$ —

See accompanying notes to condensed consolidated financial statements.

## Notes to Condensed Consolidated Financial Statements

### 1. Basis of Presentation

The condensed consolidated financial statements included herein are unaudited and have been prepared by Build-A-Bear Workshop, Inc. and its subsidiaries (collectively, the "Company") pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet of the Company as of December 29, 2007 was derived from the Company's audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and reflect all adjustments which are, in the opinion of management, necessary to summarize fairly the financial position of the Company and the results of the Company's operations and cash flows for the periods presented. All of these adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Because of the seasonal nature of the Company's operations, results of operations of any single reporting period should not be considered as indicative of results for a full year. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fiscal year ended December 29, 2007 included in the Company's annual report on Form 10-K filed with the SEC on March 13, 2008.

Certain reclassifications were made to prior years' financial statements to be consistent with the current presentation.

### 2. Stock-based Compensation

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) 123R, *Share-Based Payment*, using the modified prospective method. 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. In addition, the Company uses the straight-line expense attribution method for all stock-based compensation awards with graded vesting. On March 20, 2008, the Company entered into long-term incentive plan agreements with certain key executives that provide restricted shares granted under the agreements will be forfeited if certain financial performance targets for fiscal year 2008 are not met. Upon achievement of the performance goals, restricted shares remain outstanding but are still subject to restriction for the remainder of the vesting period. Compensation expense is recognized over the performance period plus the vesting period. The awards are treated as a liability award during the performance period and as an equity award once the performance objectives have been obtained. As of September 27, 2008, these awards were not expected to vest; accordingly, no compensation expense related to these awards was recognized in the thirty-nine weeks ended September 27, 2008 and no shares related to these awards are included in the dilutive shares as of September 27, 2008.

For the thirteen and thirty-nine weeks ended September 27, 2008, selling, general and administrative expense includes \$0.9 million (\$0.5 million after tax) and \$2.7 million (\$1.9 million after tax), respectively, of stock-based compensation expense. For the thirteen and thirty-nine weeks ended September 29, 2007, selling, general and administrative expenses includes \$0.8 million (\$0.5 million after tax) and \$2.3 million (\$1.4 million after tax), respectively, of stock-based compensation expense.

As of September 27, 2008, there was \$7.6 million of total unrecognized compensation expense related to nonvested restricted stock awards which is expected to be recognized over a weighted-average period of 1.7 years.

### 3. Stock Incentive Plans

In 2000, the Company adopted the Build-A-Bear Workshop, Inc. 2000 Stock Option 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 Plans allow for the grant of incentive stock options, nonqualified stock options and restricted stock. Options granted under the Plans 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 awards is at the discretion of the Committee and generally ranges from one to four years.

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**(a) Stock Options**

The following table is a summary of the balances and activity for the Plans related to stock options for the thirty-nine weeks ended September 27, 2008:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding, December 29, 2007	420,881	\$ 16.25		
Granted	—	—		
Exercised	—	—		
Forfeited	52,204	\$ 15.83		
Outstanding, September 27, 2008	<u>368,677</u>	<u>\$ 16.32</u>	<u>4.4</u>	<u>\$ 334</u>
<b>Options Exercisable As Of:</b>				
September 27, 2008	<u>368,677</u>	<u>\$ 16.32</u>	<u>4.4</u>	<u>\$ 334</u>

No options were exercised in the thirty-nine weeks ended September 27, 2008. The total intrinsic value of options exercised in the thirty-nine weeks ended September 29, 2007 was approximately \$1.4 million. The Company generally issues new shares to satisfy option exercises.

**(b) Restricted Stock**

The following table is a summary of the balances and activity for the Plans related to restricted stock granted as compensation to employees and directors for the thirty-nine weeks ended September 27, 2008:

	Number of Shares	Weighted Average Grant Date Fair Value per Award
Outstanding, December 29, 2007	378,950	\$ 27.77
Granted	443,178	8.85
Vested	101,679	28.74
Canceled or expired	29,346	18.69
Outstanding, September 27, 2008	<u>691,103</u>	<u>\$ 15.87</u>

The total fair value of shares vested during the thirty-nine weeks ended September 27, 2008 and September 29, 2007 was \$1.0 million and \$1.6 million, respectively.

**(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, or calendar quarter. 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 10,892 shares at \$6.34 per share through the ASPP during the 2008 third calendar quarter, which ended September 30, 2008. The purchase occurred in the Company's fiscal 2008 fourth quarter. The expense recorded related to the ASPP during the thirteen weeks ended September 27, 2008 was determined using the Black-Scholes option pricing model and the provisions 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 the thirteen weeks ended September 27, 2008 were: (a) dividend yield of 0%; (b) volatility of 45%; (c) risk-free interest rate of 0.87%; and (d) an expected life of 0.25 years.

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### 4. Earnings per Share

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

	Thirteen weeks ended		Thirty-nine weeks ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net income (loss)	\$ (2,015)	\$ 2,977	\$ (413)	\$ 12,634
Weighted average number of common shares outstanding	18,815,996	20,242,402	19,299,301	20,248,949
Effect of dilutive securities:				
Stock options	—	133,036	—	158,018
Restricted stock	—	35,657	—	47,800
Weighted average number of common shares—dilutive	18,815,996	20,411,095	19,299,301	20,454,767
Earnings (loss) per share:				
Basic	\$ (0.11)	\$ 0.15	\$ (0.02)	\$ 0.62
Diluted	\$ (0.11)	\$ 0.15	\$ (0.02)	\$ 0.62

In calculating diluted loss per share for the thirteen and thirty-nine weeks ended September 27, 2008, options to purchase 368,677 shares of common stock were outstanding as of the end of the period, but were not included in the computation of diluted loss per share due to their anti-dilutive effect. An additional 691,103 shares of restricted common stock were outstanding at the end of the period, but excluded from the calculation of diluted loss per share for the thirteen and thirty-nine weeks ended September 27, 2008 due to their anti-dilutive effect under the provisions of SFAS No. 128, *Earnings per Share* (SFAS No. 128).

In calculating diluted earnings per share for the thirteen and thirty-nine weeks ended September 29, 2007, options to purchase 141,096 shares of common stock were outstanding as of 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 333,068 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 the provisions of SFAS No. 128.

### 5. Income Taxes

The Company accounts for uncertainty in income taxes in accordance with Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes—An interpretation of FASB Statement No. 109* (FIN 48). As of September 27, 2008 and December 29, 2007, the Company had approximately \$1.0 million and \$1.2 million, respectively, of unrecognized tax benefits. In the next twelve months, Company management does not expect any significant changes.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 27, 2008 and December 29, 2007, there was approximately \$0.2 million of accrued interest related to uncertain tax positions.

The Internal Revenue Service's audit of the Company's fiscal 2005 federal tax return has been completed. No adjustments to taxable income were required.

### 6. Comprehensive Income (Loss)

Comprehensive income (loss) for the thirteen weeks ended September 27, 2008 and September 29, 2007 was \$(7.7) million and \$4.1 million, respectively, and for the thirty-nine week period ended September 27, 2008 and September 29, 2007 was \$(5.4) million and \$15.3 million, respectively. The difference between comprehensive income (loss) and net income (loss) resulted from foreign currency translation adjustments.

### 7. 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, Puerto Rico, the United Kingdom, Ireland, France, and other retail delivery operations, including the Company's webstores 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 (outside of France), Asia, Africa, and Australia. The licensing and entertainment segment has been established to market the naming and branding rights of the Company's intellectual properties for



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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 financial statements.

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

	<u>Retail</u>	<u>International Franchising</u>	<u>Licensing &amp; Entertainment</u>	<u>Total</u>
<b>Thirteen weeks ended September 27, 2008</b>				
Net sales to external customers	\$105,786	\$ 982	\$ 478	\$107,246
Income (loss) before income taxes	(4,234)	526	340	(3,368)
Capital expenditures, net	5,513	143	—	5,656
Depreciation and amortization	7,197	184	2	7,383
<b>Thirteen weeks ended September 29, 2007</b>				
Net sales to external customers	\$108,357	\$ 934	\$ 474	\$109,765
Income before income taxes	3,993	470	326	4,789
Capital expenditures, net	12,341	123	—	12,464
Depreciation and amortization	6,458	127	3	6,588
<b>Thirty-nine weeks ended September 27, 2008</b>				
Net sales to external customers	\$321,108	\$ 3,055	\$ 1,585	\$325,748
Income (loss) before income taxes	(3,430)	1,733	1,125	(572)
Capital expenditures, net	19,679	693	—	20,372
Depreciation and amortization	21,053	566	7	21,626
<b>Thirty-nine weeks ended September 29, 2007</b>				
Net sales to external customers	\$323,342	\$ 2,306	\$ 1,314	\$326,962
Income before income taxes	18,382	854	978	20,214
Capital expenditures, net	29,367	240	—	29,607
Depreciation and amortization	18,828	371	8	19,207
<b>Total Assets as of:</b>				
September 27, 2008	\$281,600	\$ 8,447	\$ 2,501	\$292,548
December 29, 2007	\$334,040	\$ 3,671	\$ 1,820	\$339,531

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

	North America (1)	Europe (2)	Other (3)	Total
Thirteen weeks ended September 27, 2008				
Net sales to external customers	\$ 87,310	\$ 18,955	\$ 981	\$ 107,246
Property and equipment, net	113,582	18,798	2	132,382
Thirteen weeks ended September 29, 2007				
Net sales to external customers	\$ 95,131	\$ 13,700	\$ 934	\$ 109,765
Property and equipment, net	118,328	19,075	11	137,414
Thirty-nine weeks ended September 27, 2008				
Net sales to external customers	\$ 272,098	\$ 50,595	\$ 3,055	\$ 325,748
Property and equipment, net	113,582	18,798	2	132,382
Thirty-nine weeks ended September 29, 2007				
Net sales to external customers	\$ 289,183	\$ 35,473	\$ 2,306	\$ 326,962
Property and equipment, net	118,328	19,075	11	137,414

- (1) North America includes the United States, Canada and Puerto Rico
- (2) Europe includes company-owned stores in the United Kingdom, Ireland and France
- (3) Other includes franchise businesses outside of the United States, Canada, Puerto Rico, the United Kingdom, Ireland and France

## 8. Investment in Affiliate

The Company holds a minority interest in Ridemakerz, LLC, which is accounted for under the equity method. Ridemakerz is an early-stage company that has developed an interactive retail concept that allows children and families to build and customize their own personalized cars. In 2006, the Company invested \$0.6 million, which represented an ownership interest of approximately 10%. The Company invested an additional \$2.4 million in fiscal 2007 and \$2.5 million in the first nine months of fiscal 2008. The Company has also entered into a series of agreements whereby the Company has agreed to perform advisory and operational support services for Ridemakerz in exchange for additional equity. For the thirteen and thirty-nine weeks ended September 27, 2008, the Company received \$0.2 million and \$0.7 million, respectively, in equity in exchange for support services provided. For the thirteen and thirty-nine weeks ended September 29, 2007, the Company received \$0.3 million and \$0.9 million, respectively, in equity in exchange for support services provided. In 2007, the Company also purchased a call option from a group of other Ridemakerz investors for \$150,000 for 1.25 million Ridemakerz common units at an exercise price of \$1.25 per unit. The call option was immediately exercisable and expires April 30, 2012. Simultaneously, the Company granted a put option to the same group of investors for 1.25 million common units at an exercise price of \$0.50 per unit. The put option became exercisable on April 30, 2008 and expires on April 30, 2012. As of September 27, 2008, the investment in Ridemakerz was approximately \$7.5 million, which represented an ownership interest of approximately 21%. Due to the structure of the Company's investment in Ridemakerz, no income or loss allocations were recorded in the thirteen or thirty-nine weeks ended September 27, 2008 or September 29, 2007. Under the current agreements, Build-A-Bear Workshop, Inc. could own up to approximately 34% of fully diluted equity in Ridemakerz.

As of September 27, 2008 and December 29, 2007, outstanding receivables from Ridemakerz were \$1.0 million and \$0.8 million, respectively.

## 9. Closure of friends 2B made Concept

On September 16, 2008, the Company announced plans to close its friends 2B made concept, a line of make-your-own dolls and related products. The closure plan affects the Company's nine friends 2B made locations, all but one of which is inside or adjacent to a Build-A-Bear Workshop store, separate friends 2B made fixtures in approximately 50 Build-A-Bear Workshop stores, and the concept's website, [www.friends2bmade.com](http://www.friends2bmade.com). While the Company expects to complete the closures by the end of the third quarter of fiscal 2009, the specific timing of the closures is dependent on finalizing third-party agreements and is therefore subject to change. During the third quarter of fiscal 2008, the Company recorded a pre-tax charge of \$2.9 million, or \$0.09 per diluted share, related to the closures, which consisted primarily of asset impairment charges and is included in "Store closing" expenses in the Condensed Consolidated Statements of Operations. This charge is a component of net income (loss) in the retail segment. In addition, the Company expects to incur pre-tax charges of approximately \$1.9 to \$2.3 million during the fourth quarter of fiscal 2008 and through the third quarter of fiscal 2009. The majority of these charges are attributable to potential lease termination costs and other potential costs associated with the closure plan.

## Item 2. 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. These risks and uncertainties include, without limitation, those detailed under the caption "Risk Factors" in our annual report on Form 10-K for the year ended December 29, 2007, as filed with the SEC, and the following: general economic conditions may continue to deteriorate, which could lead to disproportionately reduced consumer demand for our products, which represent relatively discretionary spending; customer traffic may continue to decrease in the shopping malls where we are located, on which we depend to attract guests to our stores; we may be unable to generate interest in and demand for our interactive retail experience, or to identify and respond to consumer preferences in a timely fashion; our marketing and online initiatives may not be effective in generating sufficient levels of brand awareness and guest traffic; we may be unable to generate sufficient comparable store sales; we may be unable to open new stores or may be unable to effectively manage our growth; we may be unable to effectively manage our international franchises or laws relating to those franchises may change; high petroleum product prices could adversely affect our inventory transportation costs and our profitability; we may be unable to repurchase shares at all or at the times or in the amounts we currently anticipate or the results of the share repurchase program may not be as beneficial as we currently anticipate; we may be unable to realize some of the expected benefits of the acquisition of Amsbra and Bear Factory, and the inclusion of France as a Company-owned country; we may lose key personnel, be unable to hire qualified additional personnel, or experience turnover of our management team; the ability of our principal vendors to deliver merchandise may be disrupted; the availability and costs of our products could be adversely affected by risks associated with international manufacturing and trade; we may be unable to realize the anticipated benefits from our company-owned distribution center or our third-party distribution center providers may perform poorly; fluctuations in our quarterly results of operations could cause the price of our common stock to substantially decline; we may be unable to renew or replace our store leases, or enter into leases for new stores on favorable terms or in favorable locations, or may violate the terms of our current leases; our market share could be adversely affected by a significant, or increased, number of competitors; we may suffer negative publicity or be sued due to violations of labor laws or unethical practices by manufacturers of our merchandise; our products could become subject to recalls or product liability claims that could adversely impact our financial performance and harm our reputation among consumers; we may improperly obtain or be unable to protect information from our guests in violation of privacy or security laws or expectations; we may fail to renew, register or otherwise protect our trademarks or other intellectual property; and we may have disputes with, or be sued by, third parties for infringement or misappropriation of their proprietary rights. These risks, uncertainties and other factors may adversely affect our business, growth, financial condition or profitability, or subject us to potential liability, and cause our actual results, performance or achievements to be materially different from those expressed or implied by our forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### 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 primarily 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 September 27, 2008, we operated 288 stores in the United States, Canada, and Puerto Rico, 53 stores in the United Kingdom, Ireland and France, and had 60 franchised stores operating internationally under the Build-A-Bear Workshop brand. In addition to our stores, we market our products and build our brand through our multiple websites, which simulates our interactive shopping experience, as well as non-traditional store locations in five Major League Baseball® ballparks, one location in a zoo and one location in a science center. Seasonal locations, such as ballparks and zoos, are excluded from our store count.

On September 16, 2008, we announced plans to close the friends 2B made concept, a line of make-your-own dolls and related products. We expect to complete the nine location closures by the end of the third quarter of fiscal 2009, however the specific timing of the closures is dependent on finalizing third-party agreements, and is therefore subject to change. In addition to closing the nine friends 2B made doll locations, we will remove friends 2B made products from separate display fixtures in approximately 50 Build-A-Bear Workshop stores and discontinue product sales at [www.friends2bmade.com](http://www.friends2bmade.com).

On August 11, 2008, we renewed our line of credit agreement with U.S. Bank, National Association. The amended agreement increases the seasonal overline on the line of credit to be in effect from July 1 to December 31 of each year from \$30 million to \$50 million and increases the available line of credit for the first half of each calendar year from \$15 million to \$40 million. In addition, the fixed charge coverage ratio covenant was reduced from 1.5:1 to 1.3:1 and the interest rate was reduced from, at our option, prime minus 1.0% or LIBOR plus 1.5% to prime minus 1.0% or LIBOR plus 1.3%. The amended agreement is now secured by our assets and a pledge of 65% of our ownership interest in certain of our foreign subsidiaries.

On April 2, 2006, we 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).

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The results of the U.K. Acquisition operations have been included in the Company's consolidated financial statements since that date. In conjunction with those transactions, we obtained 40 retail locations in the United Kingdom and Ireland. In 2007, the Company expanded its Company-owned store base to France, which was previously under a franchise agreement and had one store within a department store in operation that was subsequently closed. The Company currently operates three Company-owned stores in France.

We operate in three reportable segments (retail, international franchising, and licensing and entertainment) 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, Puerto Rico, the United Kingdom, Ireland, France, all non-traditional store locations and multiple e-commerce websites or "webstores";
- 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 the thirteen and thirty-nine weeks ended September 27, 2008 and September 29, 2007 are set forth in the notes to our condensed consolidated financial statements included elsewhere in this quarterly report on Form 10-Q.

Store contribution, for our consolidated operations, was 15.8% for the thirty-nine weeks ended September 27, 2008 and 20.9% for the thirty-nine weeks ended September 29, 2007 and consolidated net income as a percentage of total revenues was -0.1% for the thirty-nine weeks ended September 27, 2008 and 3.9% for the thirty-nine weeks ended September 29, 2007. See "— Non-GAAP Financial Measures" for a definition of store contribution and a reconciliation of store contribution to net income. The decrease in our store contribution over the prior year was primarily due to the decline in gross margin resulting primarily from a lack of sales leverage on store occupancy costs, and higher costs associated with maintaining multiple websites, including Build-A-Bearville, our new online virtual world site. We have historically maintained what we believe to be a high store contribution level through the creation of economies of scale which allow us to decrease the cost of our product on a per unit basis and through continued expense management focused on labor planning, monitoring of warehousing and distribution costs, store supplies, travel and other expenses.

We use comparable store sales as one of the performance measures for our business. Comparable store sales percentage changes are based on net retail sales, excluding our webstore and seasonal and event-based locations. Stores are considered comparable beginning in their thirteenth full month of operation. In the fiscal 2008 first quarter our European operations met the criteria for inclusion in the comparable store sales calculation for the first time. As such, there is no historic comparable store sales data for the European operations. The percentage change in comparable store sales for the periods presented below is as follows:

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
North America	(14.4)%	(10.1)%	(15.8)%	(8.7)%
Europe	8.2%	—	8.3%	—
Consolidated	(11.6)%	(10.1)%	(13.1)%	(8.7)%

We believe the decline in comparable store sales was attributed primarily to the following factors:

- We believe that a combination of falling housing prices, rising unemployment and a growing concern about the future of the U.S. economy has resulted in a significant decline in consumer sentiment resulting in a pullback in consumer spending and has impacted our comparable store sales.
- We believe the decline in shopping mall customer traffic during the fiscal 2008 third quarter compared to the same period in fiscal 2007 has impacted the number of new and returning Guests visiting our stores and therefore our comparable store sales.
- Changes in media, online entertainment, children's media consumption, and play patterns, particularly for girls, have increased the interactive play alternatives available to children and have, we believe, impacted our comparable store sales.

The Company is addressing the decline in comparable store sales with the following key initiatives:

- Understanding that today our customers are more value oriented in their purchase decisions, we have expanded our assortment of products priced at \$10 and \$12. Today these products make up about 30% of our total assortment as

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compared to less than 10% of our assortment last year. Furthermore, we have priced our holiday collectible product at \$18, a price point below the holiday product offering last year. The holiday product is also enhanced with the added value of our first proprietary book, “Holly and Hal Moose: Our Uplifting Christmas Adventure”, that tells a story and builds character profiles for these animals.

- We have developed new marketing programs and enhanced existing programs to communicate the value of our products as well as our unique position of having both a real world and virtual world experience. Accordingly, we have refined our communication strategies and reallocated our marketing spending to more effectively deliver the news of our added product value, shared interactive store experience and new virtual platform to our Guests.
- We believe that our investment in buildabearville.com offers us unique opportunities to expand the entertainment platform of our brand. For example, in the holiday season, buildabearville.com will have unique offerings tied into our holiday products including the launch of animated “webisodes”, brief two minute vignettes that tell the story of the characters from their accompanying book. We believe that the integration of storytelling, animated episodes and character building across real stores and online will increase the awareness and engagement of our Guests with our overall brand. In addition, we will initiate the sale of product for use in the virtual world starting with our Bear Bills (virtual world currency) game cards. We also recently launched our Jr. Cybearguide program to increase brand connectiveness with, and to get feedback on future virtual world developments from, our online citizens.
- Managing expenses with an emphasis on store payroll costs as a percentage of sales, warehousing and distribution costs, travel expenses and elimination of non-essential activities and expenses.
- Reducing the number of new store openings, from 50 in 2007 to 25 in 2008 and to six new stores planned in 2009 which we believe will allow the Company to take a highly selective approach to new store openings and to focus on existing markets and stores.

## **Expansion and Growth Potential**

### **Retail Stores:**

The table below sets forth the number of Build-A-Bear Workshop Company-owned stores in the United States, Canada, Puerto Rico (collectively, “North America”), the United Kingdom, Ireland, and France (collectively, “Europe”) for the periods presented:

	<b>Thirty-nine weeks ended</b>	
	<b>September 27, 2008</b>	<b>September 29, 2007</b>
Beginning of period	321	271
Opened	20	38
End of period	341	309

During fiscal 2008, we anticipate opening 20 Build-A-Bear Workshop stores in North America and five new stores in Europe. We believe there is a market potential for at least 350 Build-A-Bear Workshop stores in North America and approximately 70 to 75 stores in the United Kingdom and Ireland.

We also have store locations for our proprietary friends 2B made line of make-your-own dolls and related products. As of September 27, 2008, we operated one stand-alone friends 2B made store and eight friends 2B made stores adjacent to Build-A-Bear Workshop stores in the United States. Other than the one stand-alone store, these friends 2B made stores are not included in our store count, but rather are considered expansions of existing Build-A-Bear Workshop stores. On September 16, 2008, we announced plans to close the friends 2B made concept. For additional information on the closure plan, refer to Note 9 – Closure of friends 2B made Concept to the Condensed Consolidated Financial Statements.

### **Non-Traditional Store Locations:**

In fiscal 2004, we began offering merchandise in seasonal, event-based locations such as Major League Baseball® ballparks. We expect to expand our future presence at select seasonal, event-based locations contingent on their availability. As of September 27, 2008, we had a total of five ballpark locations, one store within a zoo and one store within a science center. Seasonal locations, such as ballparks and zoos, are excluded from our store count.

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### **International Franchise Revenue:**

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

	Thirty-nine weeks ended	
	September 27, 2008	September 29, 2007
Beginning of period	53	34
Opened	12	15
Closed	(5)	(3)
End of period	<u>60</u>	<u>46</u>

As of September 27, 2008, we had master franchise agreements, which typically grant franchise rights for a particular country or countries, covering 20 countries. We anticipate signing additional master franchise agreements in the future. We expect our franchisees to open approximately 10 stores in fiscal 2008, net of closures. We believe there is a market potential for approximately 300 franchised stores outside of the United States, Canada, Puerto Rico, the United Kingdom, Ireland and France.

### **Results of Operations**

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

#### **BUILD-A-BEAR WORKSHOP, INC. AND SUBSIDIARIES** **CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS** **(Unaudited)**

	Thirteen weeks ended		Thirty-nine weeks ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
<b>Revenues:</b>				
Net retail sales	98.6	98.7	98.6	98.9
Franchise fees	0.9	0.9	0.9	0.7
Licensing revenue	0.5	0.4	0.5	0.4
Total revenues	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<b>Costs and expenses:</b>				
Cost of merchandise sold (1)	60.0	56.7	59.7	56.0
Selling, general and administrative	40.6	38.8	40.1	37.7
Store preopening	0.8	1.3	0.6	1.1
Store closing (2)	2.7	0.0	0.9	0.0
Interest expense (income), net	(0.1)	(0.4)	(0.2)	(0.4)
Total costs and expenses	<u>103.1</u>	<u>95.6</u>	<u>100.2</u>	<u>93.8</u>
Income (loss) before income taxes	(3.1)	4.4	(0.2)	6.2
Income tax (benefit) expense	(1.3)	1.7	(0.1)	2.3
Net income (loss)	<u>(1.9)</u>	<u>2.7</u>	<u>(0.1)</u>	<u>3.9</u>

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

(2) Store closing costs for the thirteen and thirty-nine weeks ended September 27, 2008 represent asset impairment and other charges related to the closure of the friends 2B made concept.

#### **Thirteen weeks ended September 27, 2008 compared to thirteen weeks ended September 29, 2007**

*Total revenues.* Net retail sales decreased to \$105.8 million for the thirteen weeks ended September 27, 2008 from \$108.4 million for the thirteen weeks ended September 29, 2007, a decrease of \$2.6 million, or 2.4%. Net retail sales for new stores contributed a \$5.5 million increase in net retail sales in North America and a \$4.6 million increase in Europe. For the thirteen weeks ended September 27, 2008, consolidated comparable store sales (North America and Europe) declined 11.6%. Comparable store sales

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in North America declined \$13.0 million or 14.4%, while comparable store sales in Europe increased by \$1.0 million or 8.2%. A decrease of \$0.7 million of other items, including, but not limited to, the impact of foreign currency translation, a decrease in non-store location sales, an increase in webstore sales and a decrease in deferred revenue also contributed to the change in net retail sales.

We believe the decline in comparable store sales was attributed primarily to the following factors:

- We believe that a combination of falling housing prices, rising unemployment and a growing concern about the future of the U.S. economy has resulted in a significant decline in consumer sentiment resulting in a pullback in consumer spending and has impacted our comparable store sales.
- We believe the decline in shopping mall customer traffic during the fiscal 2008 third quarter compared to the same period in fiscal 2007 has impacted the number of new and returning Guests visiting our stores and therefore our comparable store sales.
- Changes in media, online entertainment, children's media consumption, and play patterns, particularly for girls, have increased the interactive play alternatives available to children and have, we believe, impacted our comparable store sales.

Revenue from franchise fees increased to \$1.0 million for the thirteen weeks ended September 27, 2008 from \$0.9 million for the thirteen weeks ended September 29, 2007, an increase of \$0.1 million. This increase was primarily due to the addition of new franchise agreements and new franchised stores opened in the past year. Revenue from licensing totaled \$0.5 million for the thirteen weeks ended September 27, 2008 and for the thirteen weeks ended September 29, 2007.

*Gross margin.* Gross margin decreased to \$42.3 million for the thirteen weeks ended September 27, 2008 from \$47.0 million for the thirteen weeks ended September 29, 2007, a decrease of \$4.7 million, or 11.0%. As a percentage of net retail sales, gross margin decreased to 40.0% for the thirteen weeks ended September 27, 2008 from 43.3% for the thirteen weeks ended September 29, 2007, a decrease of 330 basis points as a percentage of net retail sales ("bps"). This decrease resulted primarily from reduced sales leverage on store occupancy costs in North America partially offset by improved sales leverage on store occupancy costs in Europe and a slight improvement in consolidated merchandise margin. Consolidated distribution and warehousing costs as a percent of net retail sales increased as an increase in North America, driven by higher diesel fuel surcharges, was partially offset by improved cost trends in Europe.

*Selling, general and administrative.* Selling, general and administrative expenses were \$43.5 million for the thirteen weeks ended September 27, 2008 as compared to \$42.5 million for the thirteen weeks ended September 29, 2007, an increase of \$1.0 million, or 2.2%. As a percentage of total revenues, selling, general and administrative expenses increased to 40.6% for the thirteen weeks ended September 27, 2008 as compared to 38.8% for the thirteen weeks ended September 29, 2007, an increase of 180 bps. The dollar increase was primarily due to having 32 more stores in operation at September 27, 2008 as compared to September 29, 2007 as well as expenses associated with maintaining multiple websites, including the new social networking site, buildabearville.com<sup>TM</sup>, launched in December 2007. The increase in selling, general and administrative expenses as a percent of revenues was primarily due to decreased sales leverage on store payroll as well as costs associated with buildabearville.com. Partially offsetting these increases were improved sales leverage on expenses in European operations as well as lower advertising expense.

*Store preopening.* Store preopening expense was \$0.9 million for the thirteen weeks ended September 27, 2008 as compared to \$1.4 million for the thirteen weeks ended September 29, 2007. The decrease in store preopening for the period was the result of timing of store preopening activities. We expect to open 5 stores during the fiscal 2008 fourth quarter as compared to 11 stores opened during the same period in fiscal 2007. Preopening expenses include expenses for stores that opened in the current period as well as expenses incurred for stores that will open in future periods.

*Store closing.* Store closing expense was \$2.9 million for the thirteen weeks ended September 27, 2008 and consisted primarily of asset impairment charges related to the closure of the friends 2B made concept.

*Interest expense (income), net.* Interest income, net of interest expense, was \$0.1 million for the thirteen weeks ended September 27, 2008 as compared to \$0.4 million for the thirteen weeks ended September 29, 2007. This decrease was primarily due to lower interest rates in the fiscal 2008 third quarter as compared to the fiscal 2007 third quarter.

*Provision for income taxes.* The income tax benefit was \$1.4 million for the thirteen weeks ended September 27, 2008 as compared to income tax expense of \$1.8 million for the thirteen weeks ended September 29, 2007. The effective tax rate was 40.2% for the thirteen weeks ended September 27, 2008 compared to 37.8% for the thirteen weeks ended September 29, 2007. We expect the effective tax rate for full year 2008 to be approximately 35% to 36% compared to 35.7% in fiscal year 2007.

### **Thirty-nine weeks ended September 27, 2008 compared to thirty-nine weeks ended September 29, 2007**

*Total revenues.* Net retail sales decreased to \$321.1 million for the thirty-nine weeks ended September 27, 2008 from \$323.3 million for the thirty-nine weeks ended September 29, 2007, a decrease of \$2.2 million, or 0.7%. Net retail sales for new stores



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contributed a \$26.3 million increase in net retail sales in North America and a \$12.2 million increase in Europe. For the thirty-nine weeks ended September 27, 2008, consolidated comparable store sales (North America and Europe) declined 13.1%. Comparable store sales in North America declined \$43.5 million or 15.8%, while comparable store sales in Europe increased by \$2.8 million or 8.3%. Other items, including, but not limited to, the impact of foreign currency translation, a decrease in non-store location sales, a decrease in webstore sales and an increase in deferred revenue had a minimal net impact on net retail sales.

We believe the decline in comparable store sales was attributed primarily to the following factors:

- We believe that the more difficult macroeconomic conditions including higher fuel costs, falling housing prices, rising unemployment and the more recent growing concern about the future of the U.S. economy has resulted in a significant decline in consumer sentiment resulting in a pullback in consumer spending and has impacted our comparable store sales.
- We believe that the decline in shopping mall customer traffic during fiscal 2008 compared to fiscal 2007 has impacted the number of new and returning Guests visiting our stores and therefore our comparable store sales.
- Changes in media, online entertainment, children's media consumption, and play patterns, particularly for girls, have increased the interactive play alternatives available to children and have, we believe, impacted our comparable store sales.

Revenue from franchise fees increased to \$3.0 million for the thirty-nine weeks ended September 27, 2008 from \$2.3 million for the thirty-nine weeks ended September 29, 2007, an increase of \$0.7 million. This increase was primarily due to the addition of new franchisee agreements and new franchised stores opened in the past year. Revenue from licensing increased to \$1.6 million for the thirty-nine weeks ended September 27, 2008 from \$1.3 million for the thirty-nine weeks ended September 29, 2007, an increase of \$0.3 million. This increase was primarily related to increased licensing activities.

*Gross margin.* Gross margin decreased to \$129.5 million for the thirty-nine weeks ended September 27, 2008 from \$142.2 million for the thirty-nine weeks ended September 29, 2007, a decrease of \$12.7 million, or 8.9%. As a percentage of net retail sales, gross margin decreased to 40.3% for the thirty-nine weeks ended September 27, 2008 from 44.0% for the thirty-nine weeks ended September 29, 2007, a decrease of 370 bps. This decrease resulted primarily from a lack of sales leverage on store occupancy costs in North America partially offset by improved sales leverage on store occupancy costs in Europe.

*Selling, general and administrative.* Selling, general and administrative expenses were \$130.5 million for the thirty-nine weeks ended September 27, 2008 as compared to \$123.4 million for the thirty-nine weeks ended September 29, 2007, an increase of \$7.1 million, or 5.8%. As a percentage of total revenues, selling, general and administrative expenses increased to 40.1% for the thirty-nine weeks ended September 27, 2008 as compared to 37.7% for the thirty-nine weeks ended September 29, 2007, an increase of 240 bps. The dollar increase was primarily due to having 32 more stores in operation at September 27, 2008 as compared to September 29, 2007 and the costs associated with maintaining multiple websites, including the new social networking site, *buildabearville.com*<sup>TM</sup>, launched in December 2007. The increase in selling, general and administrative expenses as a percent of revenues was primarily due to a decrease in sales leverage on store payroll costs and costs associated with *buildabearville.com*. Partially offsetting this increase was improved sales leverage on expenses in European operations.

*Store preopening.* Store preopening expense was \$2.0 million for the thirty-nine weeks ended September 27, 2008 as compared to \$3.5 million for the thirty-nine weeks ended September 29, 2007. We expect to open 25 stores during fiscal 2008 as compared to 50 stores opened in fiscal 2007. Preopening expenses include expenses for stores that opened in the current period as well as expenses incurred for stores that will open in future periods.

*Store closing.* Store closing expense was \$2.9 million for the thirty-nine weeks ended September 27, 2008 and consisted primarily of asset impairment charges related to the closure of the friends 2B made concept.

*Interest expense (income), net.* Interest income, net of interest expense, was \$0.8 million for the thirty-nine weeks ended September 27, 2008 as compared to \$1.3 million for the thirty-nine weeks ended September 29, 2007. This decrease was primarily due to lower interest rates in fiscal 2008 period as compared to fiscal 2007 period.

*Provision for income taxes.* The income tax benefit was \$0.2 million for the thirty-nine weeks ended September 27, 2008 as compared to income tax expense of \$7.6 million for the thirty-nine weeks ended September 29, 2007. The effective tax rate was 27.8% for the thirty-nine weeks ended September 27, 2008 and 37.5% for the thirty-nine weeks ended September 29, 2007. We expect the effective tax rate for full year 2008 to be approximately 35% to 36% compared to 35.7% in fiscal year 2007.

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### Non-GAAP Financial Measures

We use the term “store contribution” in this quarterly report on Form 10-Q. Store contribution consists of income (loss) before income tax expense (benefit), interest, store depreciation and amortization, store preopening expense, store closing 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.

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

	Thirty-nine weeks ended September 27, 2008			Thirty-nine weeks ended September 29, 2007		
	North America	Europe	Total	North America	Europe	Total
Net income (loss)	\$ 231	\$ (644)	\$ (413)	\$ 17,071	\$ (4,437)	\$ 12,634
Income tax expense (benefit)	(279)	120	(159)	7,580	—	7,580
Interest expense (income)	(506)	(268)	(774)	(1,121)	(168)	(1,289)
Store depreciation and amortization (1)	13,541	2,524	16,065	12,779	1,858	14,637
Store preopening expense	1,593	453	2,046	2,910	577	3,487
Store closing expense (2)	2,916	—	2,916	—	—	—
General and administrative expense (3)	31,690	2,750	34,440	30,374	2,550	32,924
Franchising and licensing contribution (4)	(3,431)	—	(3,431)	(2,210)	—	(2,210)
Non-store activity contribution (5)	(1,601)	(269)	(1,870)	(2,554)	(204)	(2,758)
Store contribution	\$ 44,154	\$ 4,666	\$ 48,820	\$ 64,829	\$ 176	\$ 65,005
Total revenues	\$275,152	\$50,596	\$325,748	\$291,489	\$35,473	\$326,962
Franchising and licensing revenues	(4,640)	—	(4,640)	(3,620)	—	(3,620)
Revenues from non-store activities (5)	(10,414)	(857)	(11,271)	(11,112)	(587)	(11,699)
Store location net retail sales	\$260,098	\$49,739	\$309,837	\$276,757	\$34,886	\$311,643
Store contribution as a percentage of store location net retail sales	17.0%	9.4%	15.8%	23.4%	0.5%	20.9%
Total net income as a percentage of total revenues	0.1%	-1.3%	-0.1%	5.9%	-12.5%	3.9%

- (1) 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.
- (2) Store closing expense for the thirty-nine weeks ended September 27, 2008 represents asset impairment and other charges related to the closure of the friends 2B made concept.
- (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 costs 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 international franchising and licensing and entertainment 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 webstores and seasonal and event-based locations.

## Seasonality and Quarterly Results

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: (1) the timing of our new store openings and related expenses; (2) the profitability of our stores; (3) increases or decreases in our comparable store sales; (4) the timing and frequency of our marketing initiatives; (5) changes in general economic conditions and consumer spending patterns; (6) changes in consumer preferences; (7) the effectiveness of our inventory management; (8) the actions of our competitors or mall anchors and co-tenants; (9) seasonal shopping patterns and holiday and vacation schedules; (10) the timing and frequency of national media appearances and other public relations events; and (11) weather conditions.

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.

Historically, for North American stores open more than twelve months, seasonality has not been a significant factor in our results of operations, although we cannot assure you that this will continue to be the case. European-based store sales have historically been weighted more heavily in the fourth quarter as compared to North American stores. In addition, 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. The 2008 fiscal fourth quarter will have 14 weeks.

## Liquidity and Capital Resources

Our cash requirements are primarily for the opening of new stores, information systems, including website enhancements and maintenance and working capital. Historically, we have met these requirements through cash flow provided by operations, capital generated from the sale and issuance of our securities to private investors and through our initial public offering, and our revolving line of credit.

*Operating Activities.* Cash used in operating activities was \$1.8 million for the thirty-nine weeks ended September 27, 2008 as compared to cash provided by operating activities of \$0.3 million for the thirty-nine weeks ended September 29, 2007, or a decrease of \$2.1 million. Generally, changes in cash from operating activities are driven by changes in net income or loss and changes in operating assets and liabilities. In 2008, the increase in cash used in operating activities, as compared to 2007, was primarily due to a decline in net income driven by lower third quarter sales. In the 2008 period, the change in operating assets and liabilities was driven by decreases in accounts payable and accrued expenses, primarily attributable to the timing of cash payments and reduced taxes payable. In the 2007 period, the change in operating assets and liabilities was driven by the decrease in gift cards and customer deposit liability and an increase in prepaid rent due to new stores in the United Kingdom.

*Investing Activities.* Cash used in investing activities was \$23.6 million for the thirty-nine weeks ended September 27, 2008 as compared to \$33.0 million for the thirty-nine weeks ended September 29, 2007. Cash used in investing activities during the thirty-nine weeks ended September 27, 2008 and September 29, 2007 primarily relates to new store construction costs and additional investment in Ridemakerz.

*Financing Activities.* Cash used in financing activities was \$13.4 million in the thirty-nine weeks ended September 27, 2008 which consisted primarily of cash spent for repurchases of the Company's common stock. Cash flows used in financing activities of \$3.5 million for the thirty-nine weeks ended September 29, 2007 consisted primarily of cash spent for the repurchase of the Company's common stock, partially offset by proceeds from the exercise of stock options and employee stock purchases and the tax benefit from the exercise of stock options. No borrowings were made under our line of credit in either the thirty-nine weeks ended September 27, 2008 or the thirty-nine weeks ended September 29, 2007.

*Capital Resources.* As of September 27, 2008, we had a cash balance of \$27.3 million held in both domestic and foreign financial institutions. 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 on August 11, 2008 to increase the availability for the first half of each calendar year from \$15 million to \$40 million and the availability for the seasonal overline from \$30 million to \$50 million. The seasonal overline is in effect from July 1 to December 31 each year. Borrowings under the credit agreement are secured by our assets and a pledge of 65% of our ownership interest in our foreign subsidiaries. The credit agreement expires on December 31, 2009 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 credit agreement. Borrowings bear interest at our option of prime minus 1.0% or LIBOR plus 1.3%. Financial covenants include 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. As of September 27, 2008, we were in compliance with these covenants. There were no borrowings under our line of credit as of September 27, 2008. There was a standby letter of credit of approximately \$1.1 million outstanding under the credit agreement as of September 27, 2008. Accordingly, there was approximately \$48.9 million available for borrowing under the line of credit as of September 27, 2008.

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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 United Kingdom and Ireland 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. Rents are charged quarterly and paid in advance.

Our French leases each have terms of 10 years. French leases for premier retail properties frequently have entry fees and/or key money payments required to be made in conjunction with signature of the leases. Such entry fees or key money payments may be recovered, in whole or in part, upon disposal of the leases. The leases typically provide the lessee with the first right for renewal at the end of the lease. Rent deposits consisting of three months rent are also required to be paid on execution of the leases. Rents are negotiated on a fixed basis, but are reviewed annually in relation to an inflation index and therefore also have a variable rent component. Rents are charged quarterly and paid in advance.

In fiscal 2008, we expect to spend \$25 to \$30 million on capital expenditures. Capital spending through the thirty-nine weeks ended September 27, 2008 totaled \$20.4 million, on track with our full year plans. Capital spending in fiscal 2008 is primarily for the opening of 25 new stores (20 in North America and 5 in Europe), and the continued installation and upgrades of central office information technology systems. In fiscal 2007, the average investment per new store in North America, which includes leasehold improvements, fixtures, equipment and inventory, was approximately \$0.6 million.

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 December 31, 2009.

On March 10, 2008, we announced an expanded share repurchase program. Under this expanded share repurchase program, we currently intend to purchase up to \$50 million of our common stock in the open market (including through 10b5-1 trading plans), through privately negotiated transactions, or through an accelerated repurchase transaction. The primary source of funding for the program is expected to be cash on hand. The timing and amount of share repurchases, if any, will depend on price, market conditions, applicable regulatory requirements, and other factors. The program authorizes the Company to repurchase shares over the next 12 months, does not require us to repurchase any specific number of shares, and may be modified, suspended or terminated at any time without prior notice. Shares repurchased under the program will be subsequently retired. As of September 27, 2008, approximately 1.7 million shares at an average price of \$8.52 per share have been repurchased under this expanded program for an aggregate amount of \$14.1 million.

### ***Off-Balance Sheet Arrangements***

The Company holds a minority interest in Ridemakerz, LLC, which is accounted for under the equity method. The Company purchased a call option from a group of other Ridemakerz investors for \$150,000 for 1.25 million Ridemakerz common units at an exercise price of \$1.25 per unit. The call option was immediately exercisable and expires April 30, 2012. Simultaneously, the Company granted a put option to the same group of investors for 1.25 million common units at an exercise price of \$0.50 per unit. The put option became exercisable on April 30, 2008 and expires on April 30, 2012. As of September 27, 2008, the investment in Ridemakerz was approximately \$7.5 million, which represented an ownership interest of approximately 21%. Under the current agreements, Build-A-Bear Workshop, Inc. could own up to approximately 34% of fully diluted equity in Ridemakerz. See Note 8 – Investment in Affiliate to the Condensed Consolidated Financial Statements for additional information.

### **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 provide assurance, however, that our business will not be affected by inflation in the future.

### **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.

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We believe our selection and application of accounting policies, and the estimates inherently required therein, is 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 and use of estimates are discussed in and should be read in conjunction with the annual consolidated financial statements and notes included in our annual report on Form 10-K, as filed with the Securities and Exchange Commission on March 13, 2008, which includes audited consolidated financial statements for our 2007, 2006 and 2005 fiscal years. 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.

### ***Goodwill and Other Intangible Assets***

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 values of impaired assets is reduced to fair value. We reviewed our goodwill and other intangible assets as of December 29, 2007 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.

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 replaced the former Buy Stuff® Club. 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 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 semi-annually in order to allow time for more definite trends to emerge.

In 2007, we reduced the estimated liability associated with the former Buy Stuff cards by \$0.4 million. Redemptions of Buy Stuff cards were no longer allowed after August 31, 2007. Existing points earned on Buy Stuff cards can be transferred to the new Stuff Fur Stuff club program. Based on the most recent assessment at the end of fiscal 2008 third quarter, no adjustment was made to the deferral rate.

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### **Leases**

We lease all of our store locations and our corporate headquarters. We account for our leases under the provisions of FASB Statement No. 13, *Accounting for Leases* (SFAS 13) and subsequent amendments, which require that our leases be evaluated and classified as operating or capital leases for financial reporting purposes. All of our store leases are classified as operating leases pursuant to the requirements of SFAS 13. We disburse cash for leasehold improvements and furniture, fixtures and equipment to build out and equip our leased premises. We may also expend cash for permanent improvements that we make to leased premises that generally are reimbursed to us by our landlords as construction allowances (also known as tenant improvement allowances) pursuant to agreed-upon terms in our leases. Landlord allowances can take the form of up-front cash, full or partial credits against minimum or percentage rents otherwise payable by us, or a combination thereof. Under the provisions of FASB Technical Bulletin No. 88-1, "Issues Relating to Accounting for Leases," we account for these landlord allowances as lease incentives resulting in a deferred credit to be recognized over the term of the lease as a reduction of rent expense.

### **New Accounting Pronouncements**

There are no new accounting pronouncements for which adoption is expected to have a material effect on the Company's financial statements in future accounting periods.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Our market risks relate primarily to changes in interest rates. 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 could have been impacted by changes in interest rates. We had no borrowings outstanding under our revolving credit facility during the thirty-nine weeks ended September 27, 2008. 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 4. Controls and Procedures.**

*Disclosure Controls and Procedures:* The Company's management, with the participation of the Company's Chief Executive Bear and Chief Financial Bear, have evaluated the effectiveness of the Company's 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. Based on such evaluation, the Company's management, including the Chief Executive Bear and Chief Financial Bear, have concluded that the Company's disclosure controls and procedures were effective as of September 27, 2008, the end of the period covered by this quarterly report.

It should be noted that our management, including the Chief Executive Bear and the Chief Financial Bear, does not expect that the Company's 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.

*Changes in Internal Control Over Financial Reporting:* The Company's management, with the participation of the Company's Chief Executive Bear and Chief Financial Bear, also conducted an evaluation of the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the period covered by this report.

**PART II – OTHER INFORMATION**

**Item 1A. Risk Factors**

There have been no changes to our Risk Factors as disclosed in our Annual Report on Form 10-K for the year ended December 29, 2007 as filed with the Securities and Exchange Commission on March 13, 2008. Furthermore, our current risk factors include potential product recalls or product liability claims that could adversely impact our financial performance and harm our reputation among consumers.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**ISSUER PURCHASES OF EQUITY SECURITIES**

<u>Period</u>	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plan or Program
Jun. 29, 2008 – Jul. 26, 2008 (2)	—	\$ —	—	\$ 31,916,003
Jul. 27, 2008 – Aug. 23, 2008 (2)	—	\$ —	—	\$ 31,916,003
Aug. 24, 2008 – Sep. 27, 2008 (1) (2)	89,572	\$ 7.90	89,456	\$ 31,209,013
<b>Total</b>	<u>89,572</u>	<u>\$ 7.90</u>	<u>89,456</u>	<u>\$ 31,209,013</u>

- (1) Includes 116 shares of our common stock delivered to us in fiscal September in satisfaction of the tax withholding obligation of holders of restricted shares which vested during the quarter. Our equity incentive plans provide that the value of shares delivered to us to pay the withheld to cover tax obligations is calculated as the average of the high and low trading price of our common stock on the date the relevant transaction occurs.
- (2) On March 10, 2008, we announced an expanded \$50 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, applicable regulatory requirements, and other factors. Purchases may be increased, decreased or discontinued at any time without notice. Shares purchased under the program were subsequently retired.

**Item 6. Exhibits**

The following is a list of exhibits filed as a part of the quarterly report on Form 10-Q:

<u>Exhibit No.</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)

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<u>Exhibit No.</u>	<u>Description</u>
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*	Employment, Confidentiality and Noncompete Agreement dated as of July 1, 2008 between Eric Fencel and the Registrant
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.



**BUILD-A-BEAR WORKSHOP, INC.  
SIGNATURES**

Pursuant to the requirements 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.

Date: November 6, 2008

BUILD-A-BEAR WORKSHOP, INC.  
(Registrant)

By: /s/ Maxine Clark  
Maxine Clark  
Chairman of the Board and Chief Executive Bear

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

**EMPLOYMENT, CONFIDENTIALITY AND NONCOMPETE AGREEMENT**

This Employment, Confidentiality and Noncompete Agreement (“Agreement”) is made and entered into effective as of the 1<sup>st</sup> day of July 2008, by and between Build-A-Bear Workshop, Inc., a Delaware corporation (“Company”), and Eric Fencl (“Employee”).

WHEREAS, Company desires to employ and Employee desires to be employed as the Chief Bearrister – General Counsel of Company.

WHEREAS, Company has pioneered the retail concept of “make your own” stuff plush toys, including animals and dolls, and is engaged in, among other things, the business of production, marketing, promotion and distribution of plush stuff toys, clothing, accessories and similar items, including without limitation, the ownership, management, franchising, leasing and development of retail stores in which the basic operation is the selling of such items, and the promotion of the related concepts and characters through merchandising and mass media. The Company is headquartered and its principal place of business are located in, and this Agreement is being signed in, St. Louis, Missouri.

WHEREAS, Company conducts business in selected locations throughout the United States and internationally through franchise arrangements.

WHEREAS, Company has expended a great deal of time, money and effort to develop and maintain its proprietary Confidential Information (as defined herein) which is material to Company and which, if misused or disclosed, could be very harmful to Company’s business.

WHEREAS, the success of Company depends to a substantial extent upon the protection of its Confidential Information and goodwill by all of its employees.

WHEREAS, Company compensates its employees to, among other things, develop and preserve goodwill with its customers, landlords, suppliers and partners on Company’s behalf and business information for Company’s ownership and use.

WHEREAS, if Employee were to leave Company, Company, in all fairness, would need certain protections in order to prevent competitors of Company from gaining an unfair competitive advantage over Company or diverting goodwill from Company, or to prevent Employee from misusing or misappropriating the Confidential Information.

NOW, THEREFORE, in consideration of the compensation and other benefits of Employee’s employment by Company and the recitals, mutual covenants and agreements hereinafter set forth, Employee and Company agree as follows:

1. Employment Services.

(a) Employee is hereby employed by Company, and Employee hereby accepts such employment, upon the terms and conditions hereinafter set forth. Employee shall serve as Chief Bearrister – General Counsel during the Employment Period, on a full-time basis. Employee shall carry out such duties as are assigned to him by Company’s Chief Executive Bear.

(b) Employee agrees that throughout Employee's employment with Company, Employee will (i) faithfully render such services as may be delegated to Employee by Company, (ii) devote substantially all of Employee's entire business time, good faith, best efforts, ability, skill and attention to Company's business, and (iii) follow and act in accordance with all of the rules, policies and procedures of Company, including but not limited to working hours, sales and promotion policies, and specific Company rules. Company further agrees that it shall not during the Initial Term of this Agreement require Employee to relocate his residence outside of the St. Louis metropolitan area.

(c) "Company" means Build-A-Bear Workshop, Inc. or one of its Subsidiaries, whichever is Employee's employer. The term "Subsidiary" means any corporation, joint venture or other business organization in which Build-A-Bear Workshop, Inc. now or hereafter, directly or indirectly, owns or controls more than fifty percent (50%) interest.

2. Term of Employment. The term of this Agreement shall commence on the date first set forth above, and shall end on the third anniversary hereof, unless sooner terminated as provided in Section 4 hereof (the "Initial Term"). Following the Initial Term, this Agreement shall renew for successive one-year periods (each a "Renewal Period"; collectively, the Initial Term and each Renewal Period, the "Employment Period"), unless either party notifies the other party of its decision not to renew the Agreement at least 30 days prior to the third anniversary date or the expiration of any Renewal Period, or unless the Agreement is sooner terminated as provided in Section 4 hereof. For the avoidance of doubt, if either party provides notice of non-renewal of the Agreement at least 30 days prior to the end of the Initial Term or the end of any Renewal Period, then the Agreement shall expire.

### 3. Compensation.

(a) Base Salary. During the Employment Period, Company shall pay Employee as compensation for his services an annual base salary of not less than Two Hundred Sixty Four Thousand Dollars (\$264,000), payable in accordance with Company's usual practices. Employee's annual base salary rate shall be reviewed by the Compensation Committee of the Board of Directors (the "Compensation Committee") at least annually for increase following each fiscal year so that Employee's salary will be commensurate for similarly situated executives with firms similarly situated to Company; *provided, however*, that if Employee's individualized performance targets (set for each fiscal year by Employee and Employee's team leader) are achieved, Employee's annual base salary rate shall not be subject to decrease at any time during the Employment Period and shall be subject to annual increase by no less than the average percentage increase given to all other Company executive employees for such fiscal year (the "Average Increase").

(b) Bonus. Should Company exceed the sales, profits and other objectives established by Compensation Committee for any fiscal year, Employee shall be eligible to receive a bonus for such fiscal year in the amount as determined by the Compensation Committee; provided however the potential bonus opportunity for Employee in any given fiscal year will be set by the Compensation Committee such that, if the Company exceeds its objectives, the Company will pay Employee not less than thirty five percent (35%) of Employee's annual base pay for such fiscal year. Any bonus payable to Employee will be payable in cash, stock or stock options, or combination thereof, all as determined by the Board of Directors or any duly authorized committee thereof, and unless a different payout schedule is

applicable for all executive employees of the Company, any such bonus payment will be payable in a single, lump sum payment. In the event of termination of this Agreement because of Employee's death or disability (as defined by Section 4.1(b)), termination by the Company without Cause pursuant to Section 4.1(c), or pursuant to Employee's right to terminate this Agreement for Good Reason under Section 4.1(d), the bonus criteria shall not change and any bonus shall be pro-rated based on the number of full calendar weeks during the applicable fiscal year during which Employee was employed hereunder and shall be paid at the time and in the form such bonus would have been paid had Employee's employment continued. No bonus shall be payable hereunder for any other termination of employment by Executive prior to the last day of a fiscal year.

Such bonus, if any, shall be payable after Company's accountants have determined the sales and profits and have issued their audit report with respect thereto for the applicable fiscal year, which determination shall be binding on the parties. Any such bonus shall be paid within seventy-five (75) days after the end of each calendar year, regardless of Employee's employment status at the time payment is due. If timely payment is not made, the Company shall indemnify the Employee against any additional tax liability that the Employee may incur proximately as a result of the payment being made after the seventy-five day period.

(c) Stock Options. Employee may have been granted in the past, and/or may in the future be granted, a certain number of restricted shares and/or stock options to purchase shares of Company's common stock (the "Common Stock"), pursuant to the terms set forth more particularly in the stock option and/or restricted stock agreements ("Stock Agreement") used in connection with the Build-A-Bear Workshop, Inc. 2004 Stock Incentive Plan (or any successor plan) (the "Plan"). The Plan and applicable Stock Agreement(s) shall govern any grants of restricted shares and/or stock options to purchase shares of Company's Common Stock.

(d) Discounts. Employee and his immediate family will be entitled to a 20% discount for all merchandise purchased at Company's stores.

(e) Vacation. Employee shall be entitled to paid vacation and paid sick leave on the same basis as may from time to time apply to other Company executive employees generally. Vacations will be scheduled with the approval of Company's Chief Executive Bear, who may block out certain periods of time during which vacations may not be taken, including preceding Valentine's Day, preceding Easter, from November 1 through December 31, during Company inventory, and just prior to store openings. One-third of one year's vacation (or any part of it) may be carried over to the next year; provided that such carry over is used in the first calendar quarter of the next year. Unless approved by the Chief Executive Bear, all unused vacation shall be forfeited. No more than two weeks of vacation can be taken at one time. Employee shall also be entitled to one (1) additional day per calendar year of paid vacation to be taken in the month of his birthday.

(f) Other. Employee shall be eligible for such other perquisites as may from time to time be awarded to Employee by Company payable at such times and in such amounts as Company, in its sole discretion, may determine. All such compensation shall be subject to customary withholding taxes and other employment taxes as required with respect thereto. During the Employment Period, Employee shall also qualify for all rights and benefits for which Employee may be eligible under any benefit plans including group life, medical, health, dental and/or disability insurance or other benefits

("Welfare Benefits") which are provided for employees generally at his then current location of employment. Employee may, in his sole discretion, decline any perquisite, Welfare Benefit, proposed annual salary increase, or bonus payment.

#### 4. Termination Provisions.

4.1 Termination of Employment. Prior to the expiration of the Employment Period, this Agreement and Employee's employment may be terminated as follows:

(a) Upon Employee's death;

(b) By the Company upon thirty (30) day's prior written notice to Employee in the event Employee, by reason of permanent physical or mental disability (which shall be determined by a physician selected by Company or its insurers and acceptable to Employee or Employee's legal representative (such agreement as to acceptability not to be withheld unreasonably), shall be unable to perform the essential functions of his position, with or without reasonable accommodation, for six (6) consecutive months; provided, however, Employee shall not be terminated due to permanent physical or mental disability unless or until said disability also entitles Employee to benefits under such disability insurance policy as is provided to Employee by Company, provided however that continued entitlement to disability benefits coverage shall be not required where Employee fails to qualify for benefits coverage continuation due to an act or omission by Employee.

(c) By the Company with or without Cause. For the purposes of this Agreement, "Cause" shall mean: (i) Employee's engagement in any conduct which, in Company's reasonable determination, constitutes gross misconduct, or is illegal, unethical or improper provided such conduct brings detrimental notoriety or material harm to Company; (ii) gross negligence or willful misconduct; (iii) any act which results in a conviction for a felony involving moral turpitude, fraud or misrepresentation; (v) a material breach of a material provision of this Agreement by Employee, or (v) failure of Employee to follow a written directive of the Chief Executive Bear or the Board of Directors within thirty (30) days after receiving such notice, provided that such directive is reasonable in scope or is otherwise within the Chief Executive Bear's or the Board's reasonable business judgment, and is reasonably within Employee's control; provided Employee does not cure said conduct or breach (to the extent curable) within thirty (30) days after the Chief Executive Bear or the Board of Directors provides Employee with written notice of said conduct or breach. In the event of termination for Cause, the Employee will be afforded an opportunity prior to the actual date of termination to discuss the matter with the Company.

(d) By the Employee with or without Good Reason. For purposes of this Agreement, "Good Reason" shall mean (i) a material breach of a material provision of this Agreement by Company, provided Company does not cure said breach within thirty (30) days after Employee provides the Board of Directors with written notice of the breach or (ii) Company's issuance of a notice of non-renewal of this Agreement under Section 2, which results in expiration of this Agreement and a failure of Company and Employee to enter into a new written employment agreement.

#### 4.2 Impact of Termination.

(a) Survival of Covenants. Upon termination of this Agreement, all rights and obligations of the parties hereunder shall cease, except termination of employment pursuant to Section 4 or otherwise shall not terminate or otherwise affect the rights and obligations of the parties pursuant to Sections 5 through 13 hereof.

(b) Severance. In the event during the Employment Period (i) the Company terminates Employee's employment other than for Cause pursuant to Section 4.1(c) or (ii) the Employee terminates his employment for Good Reason pursuant to Section 4.1(d), the Company shall continue his base salary for a period of twelve (12) months from termination, such payments to be reduced by the amount of any compensation from a subsequent employer during such period. Employee shall accept these payments in full discharge of all obligations of any kind which Company has to him except obligations, if any (i) for post-employment benefits expressly provided under this Agreement and/or at law, (ii) to repurchase any capital stock of Company owned by Employee (as may or may not be set forth in the applicable stock agreement); or (iii) for indemnification under separate agreement by virtue of Employee's status as a director/officer of the Company. Employee shall also be eligible to receive a bonus with respect to the year of termination as provided in Section 3(b).

Notwithstanding anything herein to the contrary, in the event that Employee is determined to be a specified employee within the meaning of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), for purposes of any payment on termination of employment hereunder, payment(s) shall be made or begin, as applicable, on the first payroll date which is more than six months following the date of separation from service, to the extent required to avoid any adverse tax consequences under Section 409A of the Code. Any payments that would have been made during such 6-month period shall be made in a lump sum on the first payroll date which is more than six months following the date Employee separates from service with Company.

(c) Termination due to Employee Non-Renewal of Term or Termination by Employee without Good Reason. If the Agreement expires either at the end of the Initial Term or at the end of any Renewal Period, due to the issuance of notice of non-renewal by Employee under Section 2, then no severance under Section 4(b) shall be paid to the Employee and his employment shall terminate upon the anniversary date. If Employee terminates his employment without Good Reason, then no severance under 4.2(b) shall be paid to Employee and his employment shall terminate on the effective date of such termination.

(d) Welfare Benefits. Upon termination or expiration of this Agreement for any reason, Employee shall be provided with such Welfare Benefits continuation notices, rights and obligations as may be required under federal or state law (including COBRA). During the period that Welfare Benefits are continued under COBRA, the Company shall continue to pay the Company's portion of the medical plan premium for the benefit of Employee.

## 5. Confidential Information.

(a) Employee agrees to keep secret and confidential, and not to use or disclose to any third parties, except as directly required for Employee to perform Employee's employment responsibilities for Company, any of Company's proprietary Confidential Information.

(b) Employee acknowledges and confirms that certain data and other information (whether in human or machine readable form) that comes into his possession or knowledge (whether before or after the date of this Agreement) and which was obtained from Company, or obtained by Employee for or on behalf of Company, and which is identified herein (the "Confidential Information") is the secret, confidential property of Company. This Confidential Information includes, but is not limited to:

(1) lists or other identification of customers or prospective customers of Company;

(2) lists or other identification of sources or prospective sources of Company's products or components thereof, its landlords and prospective landlords and its current and prospective alliance, marketing and media partners (and key individuals employed or engaged by such parties);

(3) all compilations of information, correspondence, designs, drawings, files, formulae, lists, machines, maps, methods, models, studies, surveys, scripts, screenplays, artwork, sketches, notes or other writings, plans, leases, records and reports;

(4) financial, sales and marketing data relating to Company or to the industry or other areas pertaining to Company's activities and contemplated activities (including, without limitation, leasing, manufacturing, transportation, distribution and sales costs and non-public pricing information);

(5) equipment, materials, designs, procedures, processes, and techniques used in, or related to, the development, manufacture, assembly, fabrication or other production and quality control of Company's products, stores and services;

(6) Company's relations with its past, current and prospective customers, suppliers, landlords, alliance, marketing and media partners and the nature and type of products or services rendered to, received from or developed with such parties or prospective parties;

(7) Company's relations with its employees (including, without limitation, salaries, job classifications and skill levels); and

(8) any other information designated by Company to be confidential, secret and/or proprietary (including without limitation, information provided by customers, suppliers and alliance partners of Company).

Notwithstanding the foregoing, the term Confidential Information shall not consist of any data or other information which has been made publicly available or otherwise placed in the public domain other than by Employee in violation of this Agreement.

(c) During the Employment Period, Employee will not copy, reproduce or otherwise duplicate, record, abstract, summarize or otherwise use, any papers, records, reports, studies, computer printouts, equipment, tools or other property owned by Company except as expressly permitted by Company in writing or required for the proper performance of his duties on behalf of Company.

6. **Post-Termination Restrictions.** Employee recognizes that (i) Company has spent substantial money, time and effort over the years in developing and solidifying its relationships with its customers, suppliers, landlords and alliance, marketing and media partners and in developing its Confidential Information; (ii) long-term customer, landlord, supplier and partner relationships often can be difficult to develop and require a significant investment of time, effort and expense; (iii) Company has paid its employees to, among other things, develop and preserve business information, customer, landlord, vendor and partner goodwill, customer, landlord, vendor and partner loyalty and customer, landlord, vendor and partner contacts for and on behalf of Company; and (iv) Company is hereby agreeing to employ and pay Employee based upon Employee's assurances and promises not to divert goodwill of customers, landlords, suppliers or partners of Company, either individually or on a combined basis, or to put himself in a position following Employee's employment with Company in which the confidentiality of Company's Confidential Information might somehow be compromised. Accordingly, Employee agrees that during the Employment Period and for the period of time set forth below following termination of employment, provided termination is in accordance with the terms of paragraph 4.1(b), (c), or (d), or due to expiration of the Agreement due to non-renewal by either party, Employee will not, directly or indirectly (whether as owner, partner, consultant, employee or otherwise):

(a) for one (1) year, engage in, assist or have an interest in, or enter the employment of or act as an agent, advisor or consultant for, any person or entity which is engaged in, or will be engaged in, the development, manufacture, supplying or sale of a product, process, service or development which is competitive with a product, process, service or development on which Employee worked or with respect to which Employee has or had access to Confidential Information while at Company ("Restricted Activity"), and which is located within the United States or within any country where the Company has established a retail presence either directly or through a franchise arrangement; or

(b) for one (1) year, induce or attempt to induce any employee, consultant, partner or advisor of Company to accept employment or an affiliation with any entity engaged in a Restricted Activity;

*provided, however,* that following termination of his employment, Employee shall be entitled to be an employee of an entity that engages in Restricted Activity so long as: (i) the sale of stuffed plush toys is not a material business of the entity; (ii) Employee has no direct or personal involvement in the sale of stuffed plush toys ; and (iii) neither Employee, his relatives, nor any other entities with which he is affiliated own more than 1% of the entity. As used in this paragraph 6, "material business" shall mean that either (A) greater than 10% of annual revenues received by such entity were derived from the sale of stuffed plush toys and related products, or (B) the annual revenues received or projected to be received by such entity from the sale of stuffed plush toys and related products exceeded \$10 million, or (C) or the entity otherwise annually derives or is projected to derive annual revenues in excess of \$5 million from a retail concept that is similar in any material regard to Company.



7. Acknowledgment Regarding Restrictions. Employee recognizes and agrees that the restraints contained in Section 6 (both separately and in total), including the geographic scope thereof in light of the Company's marketing efforts, are reasonable and enforceable in view of Company's legitimate interests in protecting its Confidential Information and customer goodwill and the limited scope of the restrictions in Section 6.

8. Inventions.

Any and all ideas, inventions, discoveries, patents, patent applications, continuation-in-part patent applications, divisional patent applications, technology, copyrights, derivative works, trademarks, service marks, improvements, trade secrets and the like (collectively, "Inventions"), which are developed, conceived, created, discovered, learned, produced and/or otherwise generated by Employee, whether individually or otherwise, during the time that Employee is employed by Company, whether or not during working hours, that relate to (i) current and anticipated businesses and/or activities of Company, (ii) the current and anticipated research or development of Company, or (iii) any work performed by Employee for Company, shall be the sole and exclusive property of Company, and Company shall own any and all right, title and interest to such Inventions. Employee assigns, and agrees to assign to Company whenever so requested by Company, any and all right, title and interest in and to any such Invention, at Company's expense, and Employee agrees to execute any and all applications, assignments or other instruments which Company deems desirable or necessary to protect such interests, at Company's expense.

(b) Employee acknowledges that as part of his work for the Company he may be asked to create, or contribute to the creation of, computer programs, documentation and other copyrightable works. Employee hereby agrees that any and all computer programs, documentation and other copyrightable materials that he has prepared or worked on for the Company, or is asked to prepare or work on by the Company, shall be treated as and shall be a "work made for hire," for the exclusive ownership and benefit of Company according to the copyright laws of the United States, including, but not limited to, Sections 101 and 201 of Title 17 of the U.S. Code ("U.S.C.") as well as according to similar foreign laws. Company shall have the exclusive right to register the copyrights in all such works in its name as the owner and author of such works and shall have the exclusive rights conveyed under 17 U.S.C. §§ 106 and 106A including, but not limited to, the right to make all uses of the works in which attribution or integrity rights may be implicated. Without in any way limiting the foregoing, to the extent the works are not treated as works made for hire under any applicable law, Employee hereby irrevocably assigns, transfers, and conveys to Company and its successors and assigns any and all worldwide right, title, and interest that Employee may now or in the future have in or to the works, including, but not limited to, all ownership, U.S. and foreign copyrights, all treaty, convention, statutory, and common law rights under the law of any U.S. or foreign jurisdiction, the right to sue for past, present, and future infringement, and moral, attribution, and integrity rights. Employee hereby expressly and forever irrevocably waives any and all rights that he may have arising under 17 U.S.C. §§ 106A, rights that may arise under any federal, state, or foreign law that conveys rights that are similar in nature to those conveyed under 17 U.S.C. §§ 106A, and any other type of moral right or droit moral.

9. **Company Property.** Employee acknowledges that any and all notes, records, sketches, computer diskettes, training materials and other documents relating to Company obtained by or provided to Employee, or otherwise made, produced or compiled during the Employment Period, regardless of the type of medium in which they are preserved, are the sole and exclusive property of Company and shall be surrendered to Company upon Employee's termination of employment and on demand at any time by Company.

10. **Nondisparagement.** **Employee agrees that he will not in any way disparage Company or its affiliated entities, officers, or directors. Further, Employee agrees that he will neither make nor solicit any comments, statements, or the like to the media or to third parties that may be considered to be derogatory or detrimental to the good name or business reputation of Company or any of its affiliated entities, officers or directors.**

11. **Non-Waiver of Rights.** Either party's failure to enforce at any time any of the provisions of this Agreement or to require at any time performance by the other party of any of the provisions hereof shall in no way be construed to be a waiver of such provisions or to affect either the validity of this Agreement, or any part hereof, or the right of the non-breaching party thereafter to enforce each and every provision in accordance with the terms of this Agreement.

12. **Company's Right to Injunctive Relief.** In the event of a breach or threatened breach of any of Employee's duties and obligations under the terms and provisions of Sections 5, 6, or 8 hereof, Company shall be entitled, in addition to any other legal or equitable remedies it may have in connection therewith (including any right to damages that it may suffer), to temporary, preliminary and permanent injunctive relief restraining such breach or threatened breach. Employee hereby expressly acknowledges that the harm which might result to Company's business as a result of any noncompliance by Employee with any of the provisions of Sections 5, 6 or 8 would be largely irreparable. Employee specifically agrees that if there is a question as to the enforceability of any of the provisions of Sections 5, 6 or 8 hereof, Employee will not engage in any conduct inconsistent with or contrary to such Sections until after the question has been resolved by a final judgment of a court of competent jurisdiction.

13. **Judicial Enforcement.** If any provision of this Agreement is adjudicated to be invalid or unenforceable under applicable law in any jurisdiction, the validity or enforceability of the remaining provisions thereof shall be unaffected as to such jurisdiction and such adjudication shall not affect the validity or enforceability of such provisions in any other jurisdiction. To the extent that any provision of this Agreement is adjudicated to be invalid or unenforceable because it is overbroad, that provision shall not be void but rather shall be limited only to the extent required by applicable law and enforced as so limited. The parties expressly acknowledge and agree that this Section is reasonable in view of the parties' respective interests.

14. **Employee Representations.** Employee represents that the execution and delivery of the Agreement and Employee's employment with Company do not violate any previous employment agreement or other contractual obligation of Employee. Employee further represents and agrees that he will not, during his employment with Company, improperly use or disclose any proprietary information or trade secrets of former employers and will not bring on to the premises of the Company any unpublished documents or any property belonging to his former employers unless consented to in writing by such employers.

15. Amendments. No modification, amendment or waiver of any of the provisions of this Agreement shall be effective unless in writing specifically referring hereto, and signed by the parties hereto. This Agreement supersedes all prior agreements and understandings between Employee and Company to the extent that any such agreements or understandings conflict with the terms of this Agreement.

16. Assignments. This Agreement shall be freely assignable by Company to and shall inure to the benefit of, and be binding upon, Company, its affiliates, successors and assigns and/or any other entity which shall succeed to the business presently being conducted by Company. Being a contract for personal services, neither this Agreement nor any rights hereunder shall be assigned by Employee.

17. Choice of Forum and Governing Law. In light of Company's substantial contacts with the State of Missouri, the parties' interests in ensuring that disputes regarding the interpretation, validity and enforceability of this Agreement are resolved on a uniform basis, and Company's execution of, and the making of, this Agreement in Missouri, the parties agree that: (i) any litigation involving any noncompliance with or breach of the Agreement, or regarding the interpretation, validity and/or enforceability of the Agreement, shall be filed and conducted in the state or federal courts in St. Louis City or County, Missouri; and (ii) the Agreement shall be interpreted in accordance with and governed by the laws of the State of Missouri, without regard for any conflict of law principles.

18. Notices. Except as otherwise provided for herein, any notices to be given by either party to the other shall be affected by personal delivery in writing or by mail, registered or certified, postage prepaid, with return receipt requested. Mailed notices shall be addressed as follows:

a. If to Company:

Maxine Clark  
Chief Executive Bear  
1954 Innerbelt Business Center  
St. Louis, MO 63114

b. If to Employee:

Eric Fencl

**19. Arbitration. Any controversy or claim arising out of, or relating to this Agreement, the breach thereof, or Employee's employment by Company, shall, at Company's sole option, be settled by binding arbitration in the County of St. Louis in accordance with the rules then in force of the American Arbitration Association, and judgment upon the award rendered may be entered and enforced in any court having jurisdiction thereof. The controversies or claims subject to arbitration at Company's option under this Agreement include, without limitation, those arising under Title VII of the Civil Rights Act of 1964, 42 U.S.C. Section 1981, the Age Discrimination in Employment Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the**

Worker Adjustment and Retraining Notification Act, the Missouri Human Rights Act, local laws governing employment, and the statutory and/or common law of contract and tort. In the event Employee commences any action in court which Company has the right to submit to binding arbitration, Company shall have sixty (60) days from the date of service of a summons and complaint upon Company to direct in writing that all or any part of the dispute be arbitrated. Any remedy available in any court action shall also be available in arbitration.

20. Headings. Section headings are provided in this Agreement for convenience only and shall not be deemed to substantively alter the content of such sections.

**PLEASE NOTE: BY SIGNING THIS AGREEMENT, EMPLOYEE IS HEREBY CERTIFYING THAT EMPLOYEE (A) HAS RECEIVED A COPY OF THIS AGREEMENT FOR REVIEW AND STUDY BEFORE EXECUTING IT; (B) HAS READ THIS AGREEMENT CAREFULLY BEFORE SIGNING IT; (C) HAS HAD SUFFICIENT OPPORTUNITY BEFORE SIGNING THE AGREEMENT TO ASK ANY QUESTIONS EMPLOYEE HAS ABOUT THE AGREEMENT AND HAS RECEIVED SATISFACTORY ANSWERS TO ALL SUCH QUESTIONS; AND (D) UNDERSTANDS EMPLOYEE'S RIGHTS AND OBLIGATIONS UNDER THE AGREEMENT.**

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the day and year first above written.

**THIS AGREEMENT CONTAINS A BINDING ARBIRTARTION PROVISION WHICH MAY BE ENFORCED BY COMPANY.**

/s/ Eric R. Fencil

Eric Fencil

Address:

**BUILD-A-BEAR WORKSHOP, INC.**

By: /s/ Maxine Clark

Name: Maxine Clark

Title: Chief Executive Bear

## Certification of Principal Executive Officer

I, Maxine Clark, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 officer(s) 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 officer(s) 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.

/s/ Maxine Clark

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

Date: November 6, 2008

## Certification of Principal Financial Officer

I, Tina Klocke, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 officer(s) 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 officer(s) 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.

/s/ Tina Klocke

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Tina Klocke

Chief Financial Bear, Treasurer and Secretary

Build-A-Bear Workshop, Inc.

(Principal Financial Officer)

Date: November 6, 2008

**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 quarterly report of Build-A-Bear Workshop, Inc. (the "Company") on Form 10-Q for the period ended September 27, 2008 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.

/s/ Maxine Clark

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Maxine Clark

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

Date: November 6, 2008

**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 quarterly report of Build-A-Bear Workshop, Inc. (the "Company") on Form 10-Q for the period ended September 27, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Tina Klocke, Chief Financial Bear, Treasurer and Secretary 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.

/s/ Tina Klocke

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Tina Klocke

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

Date: November 6, 2008