VITAL IMAGES INC
Form 10-Q
November 15, 2002

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2002

OR

o 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 0-22229

VITAL IMAGES, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**42-1321776**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3300 Fernbrook Lane N., Suite 200 **Plymouth, Minnesota**	**55447**
(Address of principal executive offices)	(Zip Code)

(763) 852-4100
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

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On November 8, 2002, there were 8,978,574 shares of the Registrant s common stock, par value $.01 per share, outstanding.

VITAL IMAGES, INC.

Form 10-Q

September 30, 2002

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VITAL IMAGES, INC.
BALANCE SHEETS
AS OF SEPTEMBER 30, 2002 AND DECEMBER 31, 2001
(Unaudited)

	September 30, 2002	December 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,119,780	$ 6,830,906
Marketable securities	3,909,465	
Accounts receivable, net of allowance for doubtful accounts of $218,000 and $185,000 as of September 30, 2002 and December 31, 2001, respectively	5,784,371	3,637,954
Prepaid expenses and other current assets	706,819	557,833
Total current assets	15,520,435	11,026,693
Property and equipment, net	1,943,030	1,552,116
Licensed technology, net	600,000	690,000
TOTAL ASSETS	$ 18,063,465	$ 13,268,809
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 938,156	$ 864,385
Accrued payroll	1,282,680	1,326,214
Deferred revenue	3,736,654	2,199,465
Accrued royalties	461,482	362,637
Other current liabilities	239,898	179,610
Total current liabilities	6,658,870	4,932,311
Deferred revenue	184,156	285,709
Total liabilities	6,843,026	5,218,020
Shareholders equity:		
Preferred stock: $.01 par value; 5,000,000 shares authorized; none issued or outstanding as of September 30, 2002 and December 31, 2001		
Common stock: $.01 par value; 20,000,000 shares authorized; 8,963,459 and 8,186,092 shares issued and outstanding as of September 30, 2002 and December 31, 2001, respectively	89,635	81,861
Additional paid-in capital	31,635,594	28,846,906
Accumulated deficit	(20,504,790)	(20,877,978)
Total shareholders equity	11,220,439	8,050,789

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	18,063,465	$	13,268,809

(The accompanying notes are an integral part of the interim financial statements.)

VITAL IMAGES, INC.
STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001

	For the Three Months Ended September 30, 2002	For the Three Months Ended September 30, 2001	For the Nine Months Ended September 30, 2002	For the Nine Months Ended September 30, 2001
	(Unaudited)		(Unaudited)	
Revenue:				
License fees	$ 4,022,420	$ 2,575,648	$ 10,315,561	$ 7,072,506
Maintenance and services	836,482	547,290	2,678,388	1,525,344
Hardware	733,987	510,458	1,916,664	2,048,176
Total revenue	5,592,889	3,633,396	14,910,613	10,646,026
Cost of revenue:				
License fees	307,388	194,262	791,210	407,746
Maintenance and services	208,379	148,339	900,636	409,163
Hardware	566,091	391,133	1,473,374	1,631,794
Total cost of revenue	1,081,858	733,734	3,165,220	2,448,703
Gross margin	4,511,031	2,899,662	11,745,393	8,197,323
Operating expenses:				
Sales and marketing	2,200,682	1,587,164	5,893,358	4,836,575
Research and development	1,184,030	853,522	3,091,622	2,505,895
General and administrative	736,622	597,354	2,472,216	2,043,498
Total operating expenses	4,121,334	3,038,040	11,457,196	9,385,968
Operating income (loss)	389,697	(138,378)	288,197	(1,188,645)
Interest income, net	32,452	9,786	93,991	41,619
Income (loss) before income taxes	422,149	(128,592)	382,188	(1,147,026)
Income taxes	3,000	3,000	9,000	9,000
Net income (loss)	$ 419,149	$ (131,592)	$ 373,188	$ (1,156,026)
Net income (loss) per share basic	$ 0.05	$ (0.02)	$ 0.04	$ (0.17)
Net income (loss) per share diluted	$ 0.04	$ (0.02)	$ 0.04	$ (0.17)
Shares used in per share calculations:				
Basic	8,956,337	7,119,028	8,822,722	6,933,037
Diluted	9,623,682	7,119,028	9,809,445	6,933,037

(The accompanying notes are an integral part of the interim financial statements.)

VITAL IMAGES, INC.
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001

	For the Nine Months Ended September 30,	
	2002	2001
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 373,188	$ (1,156,026)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	643,871	564,337
Provision for uncollectible accounts receivable	33,000	105,000
Amortization of licensed technology	90,000	30,000
Stock-based compensation	7,300	
Changes in operating assets and liabilities:		
Accounts receivable	(2,179,417)	(406,186)
Prepaid expenses and other current assets	(148,986)	(382,251)
Accounts payable	73,771	(165,686)
Deferred revenue	1,435,636	765,605
Accrued expenses and other liabilities	115,599	417,837
Net cash provided by (used in) operating activities	443,962	(227,370)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(1,034,785)	(367,970)
Additions to licensed technology		(500,000)
Investments in marketable securities	(5,932,219)	
Maturities of marketable securities	2,022,754	
Net cash used in investing activities	(4,944,250)	(867,970)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sales of common stock under warrants	1,719,123	1,231,421
Proceeds from sales of common stock under stock plans	1,070,039	130,571
Net cash provided by financing activities	2,789,162	1,361,992
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,711,126)	266,652
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,830,906	2,291,107
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,119,780	$ 2,557,759

(The accompanying notes are an integral part of the interim financial statements.)

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VITAL IMAGES, INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

(1) BASIS OF PRESENTATION:

The accompanying unaudited financial statements of Vital Images, Inc. (Vital Images or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America. In the opinion of management, these unaudited financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for the periods presented. Operating results for the nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2001.

(2) MAJOR CUSTOMERS AND GEOGRAPHIC DATA:

The following customers accounted for more than 10% of the Company s total revenue for the periods indicated:

	Significant Customer		Revenue	Percentage of Total Revenue
Nine months ended September 30, 2002	Toshiba Corporation, Medical Systems Group	$	5,486,000	37%
Nine months ended September 30, 2001	Toshiba Corporation, Medical Systems Group	$	2,892,000	27%

The Company s accounts receivable are generally concentrated with a small base of customers. As of September 30, 2002, there was one customer accounting for 37% of accounts receivable, while as of December 31, 2001, one customer accounted for 18% of accounts receivable.

Export revenue amounted to 8% and 5% of total revenue for the nine months ended September 30, 2002 and 2001, respectively. Substantially all of the Company s export revenue is negotiated, invoiced and paid in U.S. dollars. Gross export revenue by geographic area is summarized as follows:

	Nine Months Ended September 30,			
		2002		2001
Europe	$	652,000	$	311,000
Asia and Pacific Region		457,000		56,000

Canada, Mexico and other foreign countries		92,000		152,000
Totals	$	1,201,000	$	519,000

(3) NET INCOME (LOSS) PER SHARE:

Basic net income (loss) per share is computed using the weighted average number of common shares outstanding for the period. Diluted net income per share includes the effect of common share equivalents, if any, for each period. For the three and nine months ended September 30, 2002, 667,000 and 987,000 common share equivalents, respectively, were included in the diluted net income per share calculation. For the three and nine months ended September 30, 2001, common share equivalents are not included in the diluted net loss per share calculations, since they are anti-dilutive. Warrants and options to purchase 2,550,000 and 3,797,000 shares of the Company s common stock were outstanding as of September 30, 2002 and 2001, respectively, and could potentially dilute basic earnings per share in future periods if the Company generates net income in future periods.

(4) COMPREHENSIVE INCOME:

There was no accumulated other comprehensive income or loss for the three and nine months ended September 30, 2002 and 2001.

(5) INTANGIBLE ASSETS:

In July 2001, the Company entered into an agreement to license technology from a third party. The Company paid a total of $750,000 to the licensor during 2001. The Company recorded this $750,000 purchase as licensed technology and is amortizing it using the straight-line method over the estimated useful life of the technology of 75 months. The accumulated amortization of the licensed technology was $150,000 and $60,000 at September 30, 2002 and December 31, 2001, respectively. For the three months and nine months ended September 30, 2002, amortization expense for intangible assets was $30,000 and $90,000, respectively. Amortization expense for intangible assets was $30,000 for the three months and nine months ended September 30, 2001. The estimated annual amortization expense for intangible assets is $120,000 for each of the fiscal years ending December 31, 2002, 2003, 2004, 2005 and 2006 and $90,000 for the fiscal year ending December 31, 2007.

(6) RECENT ACCOUNTING PRONOUNCEMENTS:

In June 2001, the Financial Accounting Standards Board approved Statements of Financial Accounting Standards (SFAS) No. 141, Business Combinations and No. 142, Goodwill and Other Intangible Assets. The statements eliminate the pooling-of-interests method of accounting for business combinations and require that goodwill and certain intangible assets not be amortized. Instead, these assets will be reviewed for impairment at least annually with any related losses recognized when incurred. SFAS No. 141 is generally effective for business combinations completed after June 30, 2001. SFAS No. 142 is effective January 1, 2002 for existing goodwill and intangible assets and July 1, 2001 for business combinations completed after June 30, 2001. The adoption of SFAS No. 141 and No. 142 had no impact on the Company s financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of and supersedes SFAS No. 121 and APB Opinion No. 30. SFAS No. 144 is effective for the Company beginning January 1, 2002. The adoption of SFAS No. 144 had no impact on the Company s financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS No. 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers, and amends FASB Statement No. 13, Accounting for Leases. The Company does not expect this statement to materially affect its financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit of Disposal Activities, which replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect this statement to materially affect its financial position or results of operations.

(7) SHAREHOLDERS EQUITY:

In December 2001, the Company announced its decision to redeem its outstanding redeemable, five-year common stock warrants issued in a December 1999 private placement of common stock and warrants. The warrant holders exercised all of the outstanding warrants in December 2001 and January 2002. The net cash proceeds from the January 2002 exercise of 488,000 warrants were approximately $1,719,000.

During the nine months ended September 30, 2002, the Company issued approximately 289,000 shares of common stock upon the exercise of options granted under the Company s stock plans, resulting in proceeds of approximately $1,070,000.

(8) MARKETABLE SECURITIES:

During the nine month period ended September 30, 2002, the Company invested $5,932,219 in marketable securities and had maturities of marketable securities of $2,022,754. The marketable securities consist of U.S. government notes, U.S. government agency notes and commercial paper. As of September 30, 2002, all of the Company s marketable securities were classified as available-for-sale. Available-for-sale securities are stated at fair market value with unrealized holding gains or losses recorded as a separate component of shareholders equity. There were no significant unrealized holding gains or losses during the nine months ended September 30, 2002. All but $500,000 of the marketable securities have contractual maturity dates prior to June 30, 2003. The remaining $500,000 of marketable securities have a contractual maturity date in February 2004.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Vital Images develops, markets and supports 3D medical imaging software for use primarily in disease screening, clinical diagnosis and therapy planning. The Company s software applies proprietary computer graphics and image processing technologies to a wide variety of data supplied by computed tomography (CT) scanners and magnetic resonance (MR) imaging devices. Vital Images products allow clinicians to create both two- and three-dimensional views of human anatomy and to non-invasively navigate within these images to better visualize and understand internal structures and pathologies. The Company believes that its high-speed visualization technology and customized protocols cost-effectively bring 3D visualization and analysis into the routine, day-to-day practice of medicine. The Company, which operates in a single business segment, markets its products to healthcare providers and to manufacturers of diagnostic imaging systems through a direct sales force in the United States and independent distributors in international markets.

Critical Accounting Policies and Estimates

Management s discussion and analysis of its financial position and results of operations are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. The following represents those critical accounting policies and estimates where materially different amounts could be reported under different conditions or using different assumptions.

Allowance for doubtful accounts. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of the Company s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Deferred tax asset. The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. While the Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event the Company were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such a determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such a determination was made.

Long-Lived Assets. The Company periodically reviews the carrying amounts of property and equipment and intangible assets purchased in the normal course of business to determine whether current events or circumstances, as defined in Statement of Financial Accounting Standard No 144, Accounting for the Impairment or Disposal of Long-Lived Assets, warrant adjustments to such carrying amounts. In reviewing the carrying values of property and equipment and intangible assets, the Company considers, among other things, the future cash flows expected from the use of the asset.

Revenue Recognition. The Company recognizes revenue in accordance with AICPA Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4 and SOP 98-9. License fees revenue is derived from the licensing of computer software. Hardware revenue is derived from the sale of system hardware, including peripheral equipment. Maintenance and service revenue is derived from hardware and software maintenance and from services consisting of installation, training and engineering services.

In software arrangements that include the rights to multiple software products, system hardware, specified upgrades, maintenance or services, the Company allocates the total arrangement fee among each deliverable based on the relative fair value of each of the deliverables determined based on vendor-specific objective evidence. In software arrangements in which the Company does not have vendor-specific objective evidence, revenue is deferred until the earlier of when vendor-specific objective evidence is determined for the undelivered elements (residual method) or when all elements have been delivered.

Revenue from license fees is recognized when persuasive evidence of an agreement exists, shipment of the product has occurred, no significant Company obligations with regard to implementation remain, the fee is fixed and determinable and collection is probable. Revenue allocable to maintenance is recognized on a straight-line basis over the periods in which it is provided. The Company evaluates arrangements that include services to determine whether those services are essential to the functionality of other elements of the arrangement. Generally, the Company s services are not considered essential to the functionality of other elements, and accordingly, revenue allocable to services is recognized as the services are performed. In arrangements where the Company is performing significant customization or modification of software, revenue from the arrangements is recognized using contract accounting, generally on a percentage-of-completion basis. Hardware revenue is recognized upon shipment when all other revenue recognition criteria in the arrangement have been met.

Revenue

Revenue was $5,593,000 for the three months ended September 30, 2002, compared with $3,633,000 for the three months ended September 30, 2001, a 54% increase. For the nine months ended September 30, 2002, revenue was $14,910,000 compared with $10,646,000 in the comparable nine-month period of the prior year, a 40% increase. The revenue growth was driven by the increase in the Company s core revenue components of software license fees and maintenance and services revenue. Core revenue increased 56% to $4,859,000 for the third quarter of 2002 from $3,123,000 for the same period of 2001. For the nine months ended September 30, 2002, core revenue increased 51% to $12,994,000 from $8,598,000 for the nine months ended September 30, 2001. The increase in software license fee revenue for the quarter and year to date resulted from increased sales to Toshiba Corporation, Medical Systems Group (Toshiba) and to end users through our direct sales channel.

For the nine months ended September 30, 2002, revenue from Toshiba totaled $5,486,000, or 37% of 2002 total revenue, compared with $2,892,000, or 27% of 2001 total revenue for the nine months ended September 30, 2001. In addition, the Company continued to generate strong revenue growth from the sale of *Vitrea® 2* options, including *VScore* , CT Colonography, Automated Vessel Measurements and CT Brain Perfusion.

Maintenance and services revenue increased 53% to $836,000 for the three months ended September 30, 2002 compared to $547,000 for the three months ended September 30, 2001. Maintenance and services revenue increased 76% to $2,678,000 for the nine months ended September 30, 2002 compared to $1,525,000 for the nine months ended September 30, 2001. The increase in maintenance and services revenue for the nine months ended September 30, 2002 was partially due to revenue from engineering services rendered under product development agreements with Medtronic Surgical Navigation Technologies (SNT) and Toshiba.

The Company recorded $320,000 of such services revenue for the nine months ended September 30, 2002 for engineering services rendered to others. Maintenance revenue for the three and nine months ended September 30, 2002 increased as the Company added new customers to the installed base, and training revenue increased due to an increase in the number of training sessions sold with customer purchases of software.

Hardware revenue increased 44% to $734,000 for the third quarter of 2002 from $510,000 in the third quarter of 2001. For the nine months ended September 30, 2002, hardware revenue decreased 6% to $1,917,000 from $2,048,000 for the nine months ended September 30, 2001. This decrease was primarily the result of a change to the sales model with Toshiba made during the third quarter of 2001. Previously, all of the Company s sales to Toshiba were complete systems sales, including hardware. Sales to Toshiba are now software-only sales, which generate higher margins, but lower revenue, than complete system sales.

Gross Margin

The gross margin percentage increased to 81% and 79% for the three and nine months ended September 30, 2002, respectively, from 80% and 77% for the three and nine months ended September 30, 2001, respectively. The increase in gross margin is primarily attributable to the change in the sales model with Toshiba to software-only sales. The Company anticipates that as software-only sales continue to account for a more significant proportion of the Company s total revenue, the overall gross margin percentage in future periods will approximate the results of this quarter.

Sales and Marketing

Sales and marketing expenses increased to $2,201,000, or 39% of total revenue, for the three months ended September 30, 2002 from $1,587,000, or 44% of total revenue, for the three months ended September 30, 2001, a 39% increase. For the nine months ended September 30, 2002, sales and marketing expenses increased 22% to $5,893,000, or 40% of total revenue, from $4,837,000, or 46% of total revenue, for the nine months ended September 30, 2001. The increases were primarily due to increased compensation costs as a result of additional personnel required to support recent growth and increased sales commissions as a result of increased revenue. There was also an increase in expenses related to selling and promoting *Vitrea 2* and *Vitrea 2* options. The Company expects sales and marketing costs to increase in future periods as a result of the cost of additional sales and customer support personnel but to continue to decline as a percentage of total revenue.

Research and Development

Research and development expenses increased 39% to $1,184,000, or 21% of total revenue, for the three months ended September 30, 2002, compared with $854,000, or 24% of total revenue, for the same period last year. For the nine month period ended September 30, 2002, research and development expenses increased 23% to $3,092,000, or 21% of total revenue, from $2,506,000, or 24% of total revenue, for the comparable period in the prior year. In addition, $205,000 of expenses was classified in cost of revenue for the first nine months of 2002 in connection with engineering services provided to others under various product development agreements. The expense increase was primarily due to increased compensation costs resulting from additional personnel supporting the development of *Vitrea 2,* the amortization of licensed technology and an increase in depreciation expense for computer equipment for new personnel as well as upgrades for older computer equipment for the three and nine months ended September 30, 2002 compared with the three and nine months ended September 30, 2001. The Company anticipates that research and development costs will increase in future periods as the Company develops software tools for applications with large potential markets, such as cardiovascular disease, disease screening applications such as colon cancer, and surgical and therapy planning,

but that they will continue to decline as a percentage of total revenue.

General and Administrative

General and administrative expenses increased to $737,000, or 13% of total revenue, for the three months ended September 30, 2002, from $597,000, or 16% of total revenue, for the three months ended September 30, 2001, a 23% increase. The increase for the three months ended September 30, 2002 compared to September 30, 2001 was primarily due an increase in investor relations and shareholder communication expenses, higher insurance costs due to the growth of the Company as well as premium rate increases and an increase in consulting fees. For the nine months ended September 30, 2002, general and administrative expenses increased 21% to $2,472,000, or 17% of total revenue, from $2,043,000, or 19% of total revenue, for the nine months ended September 30, 2001. General and administrative expenses for the nine months ended September 30, 2002 include $230,000 related to severance for the Company s former chief executive officer, which was incurred in the first quarter. For the nine months ended September 30, 2002, general and administrative expenses increased primarily due to the severance costs, higher insurance costs due to the growth of the Company as well as premium rate increases and an increase in consulting fees. Excluding the comparative impact of the severance costs incurred in the first quarter of 2002, the Company believes that general and administrative expenses will increase in future periods due to increased infrastructure costs as the business grows, but that they will decrease as a percentage of total revenue.

Results of Operations

The increasing revenue from *Vitrea 2* and add-on software options shipments, net of the increased expenses attributable to the development of the Company s infrastructure and the development and promotion of the *Vitrea 2* product, resulted in operating income of $390,000 and $288,000 for the three and nine months ended September 30, 2002, respectively, compared with operating losses of $138,000 and $1,189,000 for the three and nine months ended September 30, 2001, respectively.

Interest Income

The increase in interest income was due to a higher average balance of cash, cash equivalents and marketable securities during the three and nine months ended September 30, 2002 compared to the three and nine months ended September 30, 2001.

Income Taxes

The income tax provisions for the three and nine months ended September 30, 2002 and 2001 consist solely of certain state minimum fees. A valuation allowance has been established to completely reserve for the deferred tax assets of the Company due to the Company s history of generating net operating losses.

Liquidity and Capital Resources

As of September 30, 2002, the Company had $5,120,000 in cash and cash equivalents, working capital of $8,862,000, and no material borrowings.

In the first nine months of 2002, net cash provided by operations was $444,000 compared to cash used in operations of $227,000 in the nine months ended September 30, 2001. In the nine-month period ended September 30, 2002, the generation of cash was primarily from operating income, an increase in deferred

revenue and non-cash expenses related to depreciation and amortization partially offset by an increase in accounts receivable. For the nine-month period ended September 30, 2001, cash flows were used primarily to fund operating losses and an increase in accounts receivable, which were partially offset by an increase in deferred revenue and non-cash expenses related to depreciation and amortization. An increase in accrued expenses and other liabilities increased operating cash flows for the nine months ended September 30, 2002 and 2001, while an increase in prepaid expenses and other current assets decreased operating cash flows for the nine months ended September 30, 2002 and 2001.

The increase in accounts receivable for the nine months ended September 30, 2002 and 2001 was primarily due to volume increases in *Vitrea 2* sales and a longer average collection period. The increases in deferred revenue for the nine months ended September 30, 2002 and 2001 were primarily due to volume increases in *Vitrea 2* sales and renewals of annual maintenance. The decrease in accounts payable for the nine months ended September 30, 2001 was due to the timing of purchases of hardware sold with the *Vitrea 2* system. The increase in accounts payable for the nine months ended September 30, 2002 was due to the timing of payments.

The Company used $4,944,000 and $868,000 of cash for net investing activities in the nine months ended September 30, 2002 and 2001, respectively. Additions to property plant and equipment were $1,035,000 and $368,000 for the nine months ended September 30, 2002 and 2001, respectively. The purchases for both periods were primarily to upgrade computer equipment and to purchase computer equipment for new personnel. Capital expenditures included leasehold improvements during the second quarter of 2002 for a new training facility. For the nine months ended September 30, 2001, the company entered into an agreement to license technology from a third party for $500,000 and was obligated to pay an additional $250,000 plus interest. The additional $250,000 plus interest was paid in full in December 2001. There were $5,932,000 in investments of marketable securities and $2,023,000 in maturities of marketable securities during the period ended September 30, 2002. The marketable securities are invested in U.S. government obligations, U.S. government agency obligations, corporate commercial obligations and certificates of deposits.

Cash provided by financing activities totaled $2,789,000 and $1,362,000 for the nine months ended September 30, 2002 and 2001, respectively, resulting from the sale of common stock upon the exercise of options granted under stock option plans and the exercise of warrants. In December 2001, the Company announced its decision to exercise its right to redeem its outstanding redeemable, five-year common stock warrants issued in a December 1999 private placement. The warrant holders exercised all of the outstanding warrants in December 2001 and January 2002. The net cash proceeds from the January 2002 exercises were approximately $1,719,000.

The Company has never paid or declared any cash dividends and does not intend to pay dividends in the near future.

The following summarizes our contractual obligations, including purchase commitments, as of September 30, 2002, and the effect such obligations are expected to have on our liquidity and cash flow for each of the next five the years ended December 31:

	2002	2003	2004	2005	2006
Operating leases	$ 353,000	$ 383,000	$ 385,000	$ 225,000	$

If the Company s operations progress as anticipated, of which there can be no assurance, management believes that its cash and cash equivalents on hand and generated from operations should be sufficient to satisfy its cash

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requirements for at least the next twelve months. The timing of the Company s future capital requirements, however, will depend on a number of factors, including the ability and willingness of physicians to use three-dimensional visualization and analysis software in clinical diagnosis, surgical planning, patient screening and other diagnosis and treatment protocols; the ability of the Company to successfully market its products; the ability of the Company to differentiate its volume rendering software from competing products employing surface rendering or other technologies; the ability of the Company to build and maintain an effective sales and distribution channel; the impact of competition in the medical visualization business; the ability of the Company to obtain any necessary regulatory approvals; and the ability of the Company to enhance existing products and develop new products on a timely basis. To the extent that the Company s operations do not progress as anticipated, additional capital may be required. There can be no assurance that any required additional capital will be available on acceptable terms or at all, and the failure to obtain any such capital would have a material adverse effect on the Company s business.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board approved Statements of Financial Accounting Standards (SFAS) No. 141, Business Combinations , and No. 142, Goodwill and Other Intangible Assets. The statements eliminate the pooling-of-interests method of accounting for business combinations and require that goodwill and certain intangible assets not be amortized. Instead, these assets will be reviewed for impairment at least annually with any related losses recognized when incurred. SFAS No. 141 is generally effective for business combinations completed after September 30, 2001. SFAS No. 142 is effective January 1, 2002 for existing goodwill and intangible assets and July 1, 2001 for business combinations completed after September 30, 2001. The adoption of SFAS No. 141 and No. 142 had no impact on the Company s financial position or results of operations.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of and supersedes SFAS No. 121 and APB Opinion No. 30. SFAS No. 144 is effective for the Company beginning January 1, 2002. The adoption of SFAS No. 144 had no impact on the Company s financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS No. 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers, and amends FASB Statement No. 13, Accounting for Leases. The Company does not expect this statement to materially affect its financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit of Disposal Activities, which replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect this statement to materially affect its financial position or results of operations.

Foreign Currency Transactions

Substantially all of the Company s foreign transactions are negotiated, invoiced and paid in U.S. dollars.

Certain Important Factors

This Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and information that are based on management s beliefs, as well as on assumptions made by, and upon information currently available to, management. When used in this Form 10-Q, the words expect, anticipate, intend, plan, believe, seek, and estimate or similar expressio intended to identify such forward-looking statements. However, this Form 10-Q also contains other forward-looking statements. Forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions, including, but not limited to, the following factors, which could cause the Company s future results and shareholder values to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company: the dependence on growth of the industry in which the Company operates, the extent to which the Company s products gain market acceptance, the need for and availability of additional capital, regulatory approvals, the potential for litigation regarding patent and other intellectual property rights, the introduction of competitive products by others, dependence on major customers, fluctuations in quarterly results, the progress of product development, the availability of third-party reimbursement, and the receipt and timing of regulatory approvals and other factors detailed from time to time in the Company s filings with the Securities and Exchange Commission, including those set forth under the heading Important Factors in the Company s Annual Report on Form 10- K for the year ended December 31, 2001.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

It is the Company s practice not to enter into derivative financial instruments. The Company s exposure to market risk is limited to interest income sensitivity, which is affected by changes in the general level of United States interest rates, particularly because the Company s marketable securities are generally in debt securities issued by corporations and the United States government. The Company s investments are with high-quality issuers and the amount of credit exposure to any one issuer is limited. Accordingly, the Company believes that it does not have significant overall market risk exposure as of September 30, 2002.

Foreign Currency Rate Risk

As described above, substantially all of the Company s foreign transactions are negotiated, invoiced and paid in U.S. dollars. Therefore, the Company does not currently have any significant foreign currency exposure, and it does not expect to incur any significant currency-related gains or losses in 2002. The Company did not engage in foreign currency hedging activities during the nine months ended September 30, 2002 or during fiscal 2001.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Based on their evaluation as of a date within 90 days of the filing date of this report, the Company s principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the Exchange Act) are effective

to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) Changes in internal controls. There were no significant changes in the Company s internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. There were no significant deficiencies or material weaknesses, and therefore there were no corrective actions taken.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Form 8-K. The Company filed no reports on Form 8-K during the three months ended September 30, 2002 or during the period from September 30, 2002 to the date of filing of this Quarterly Report on Form 10-Q.

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.

VITAL IMAGES, INC.

November 14, 2002

/s/ Gregory S. Furness
Gregory S. Furness
Chief Financial Officer and
Senior Vice President-Finance
(Chief Accounting Officer)

CERTIFICATIONS

I, Jay D. Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vital Images, Inc.;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Jay D. Miller
Jay D. Miller
President and Chief Executive Officer

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I, Gregory S. Furness, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vital Images, Inc.;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

d) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

e) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Gregory S. Furness
Gregory S. Furness
Chief Financial Officer and
Senior Vice President-Finance

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210,788

146

%

2015

11,178

—

6,930

—

62

%

2016[3]

—

—

—

—

—

2017[4]

50,000[5]

—

—

—

0

%

(1) Ms. Clark in 2011 and 2012; Ms. John in 2013 through 2017.

(2) Amounts prorated for the number of weeks Ms. John was employed by the Company in fiscal 2013. Includes $365,586 earned under the 2013 long-term performance-based cash incentive program plus a $32,809 discretionary bonus awarded by the Committee to offset the impact of unbudgeted management transition costs.

(3) The performance-based restricted stock granted to Ms. John in 2016 has a three-year performance period that runs through fiscal 2018. As a result, none of the shares can be earned until completion of performance period.

(4) The performance-based restricted stock granted to Ms. John in 2017 has a three-year performance period runs through fiscal 2019. As a result, none of the shares can be earned until completion of performance period.

(5) Represents performance-based restricted stock granted in 2015 with a three-year performance period. Because the Company did not achieve the threshold cumulative consolidated pre-tax income target for fiscal years 2015, 2016 and 2017, the entire award was forfeited.

Compensation Philosophy

The fundamental objectives of our executive compensation program are to attract and retain highly qualified executive officers, to motivate these executive officers to materially contribute to our long-term business success, and to align the interests of our executive officers and stockholders by rewarding our executives for individual and corporate performance based on targets established by the Committee.

We believe that achievement of these compensation program objectives enhances long-term stockholder value. When designing compensation packages to reflect these objectives, the Committee is guided by the following four principles:

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- ***Alignment with stockholder interests:*** Compensation should be tied, in part, to our stock performance through the granting of equity awards to align the interests of executive officers with those of our stockholders.
- ***Recognition for business performance:*** Compensation should correlate in large part with our overall financial performance.
- ***Accountability for individual performance:*** Compensation should partially depend on the individual executive's performance, in order to motivate and acknowledge the key contributors to our success.
- ***Competition:*** Compensation should generally reflect the competitive marketplace and be consistent with that of other well-managed companies in our peer group and the broader retail industry sector.

In implementing this compensation philosophy, the Committee takes into account the compensation amounts from the previous years for each of the NEOs, and internal compensation equity among the NEOs. Historically, the Committee has strived to structure compensation packages so that total payout, taking into consideration performance-based compensation, will be near the median of the Company's peer group if the Company meets its financial targets and above the median if the Company exceeds its financial targets and the individual NEOs perform well in their roles throughout the fiscal year. Over the past several years, however, our NEOs' compensation packages have generally fallen below the median.

2017 Compensation Determination Process

Each year the Committee engages in a review of our executive compensation with the goal of ensuring the appropriate combination of fixed and variable compensation linked to individual and corporate performance.

Role of the Committee and Board of Directors

The Committee charter provides the Committee with the option of either determining the Chief Executive Officer's compensation, or recommending such compensation to the Board for determination. The Committee has historically chosen to consult with the full Board of Directors, other than the Chief Executive Officer, on the Chief Executive Officer's compensation, because the Committee believes that the Chief Executive's performance and compensation are so critical to the success of the Company that Board involvement in such matters is appropriate. The Committee also determines the compensation and review process for all executive officers other than the Chief Executive. Because the Committee charter specifically delegates this responsibility to the Committee, it only involves the full Board in an advisory capacity with respect to the compensation decision-making process for the other NEOs.

Role of Management

Also in the course of its review, the Committee considered the advice and input of the Company's management. Specifically, the Committee leverages the Company's management, human resources department and legal department to assist the Committee in the timely and cost-effective fulfillment of its duties. The Committee solicits input from the Chief Executive and human resources department regarding compensation policies and levels. The legal department assists the Committee in the documentation of compensation decisions. In addition, the Build-A-Bear Workshop, Inc. 2017 Omnibus Incentive Plan (the "2017 Incentive Plan") provides that the Chief Executive Officer and Chief Human Resources Officer have the limited authority to grant equity awards to Company employees other than executive officers. The Build-A-Bear Workshop, Inc. Third Amended and Restated 2004 Stock Incentive Plan (the "2004 Inventive Plan"), under which fiscal 2017 annual bonuses and long-term incentive compensation awards were made, includes the same limited authority provision. The Committee does not permit members of the Company's management to materially participate in the determination of their particular compensation; nor does the Committee permit members of management, including the Chief Executive, to be physically present for those portions of Committee meetings during which the particular member of the management team's performance and compensation are reviewed and determined.

Role of Committee Consultants

For 2017, the Committee retained Meridian Compensation Partners, LLC ("Meridian") as its independent consultant on executive and Director compensation. Meridian's engagement is to act as the Committee's independent advisor on executive and Director compensation and in this role, Meridian assisted the Committee in the determination of the peer group, the compensation benchmarking process, and the review and establishment of compensation policies and programs for NEOs.

The Committee did not direct Meridian to perform its services in any particular manner or under any particular method, and all decisions with respect to the NEOs' compensation are made by the Committee. The Committee has the final authority to retain and terminate the compensation consultant and evaluates the consultant annually. The Company has no relationship with Meridian (other than the relationship undertaken by the Committee) and, after consideration of NYSE listing standards pertaining to the independence of compensation consultants, the Committee determined that Meridian is independent. Meridian does not provide any additional services to the Company.

Compensation Market Data and Benchmarking

The Committee believes that external market data is an important tool by which to measure the fairness and competitiveness of the Company's executive compensation. In September 2016, Meridian reviewed the Company's compensation peer group and developed recommendations for changes for the January 2017 market study. The peer group review considered the following characteristics:

- industry;
- revenues;
- net income;
- market value;
- number of employees; and
- number of stores.

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As a result of the review, the Committee approved the use of the following 17 peer companies for the January 2017 market study:

bebe stores, inc.	Duluth Holdings Inc.	Trans World Entertainment Corporation
Christopher & Banks Corporation	Five Below, Inc.	Vera Bradley Inc.
Citi Trends Inc.	Francesca's Holdings Corp.	Vince Holding Corp.
Dave & Buster's Entertainment, Inc.	Kirkland's, Inc.	Weyco Group, Inc.
Destination Maternity Corporation	Shoe Carnival Inc.	Zumiez Inc.
Destination XL Group, Inc.	Tilly's, Inc.	

Leapfrog Enterprises Inc. and Pacific Sunwear California, Inc. were eliminated from the Company's peer group for the 2017 analysis. Leapfrog was acquired in 2016, and Pacific Sunwear filed for bankruptcy in 2016. Duluth Holdings Inc. and Weyco Group, Inc. were added to the 2017 peer group because they met the Committee's selection criteria described above. The Company still competes with much larger companies for executive talent, but the Committee believes that the 2017 peer group is more appropriate in most instances for compensation benchmarking purposes. In addition to the peer group information, Meridian also provided size-adjusted, retail industry survey market data provided by Equilar, Inc.

In January 2017, the Committee reviewed a report from Meridian comparing each element of total direct compensation for the Company's NEOs against market data. The Committee observed that total target direct compensation levels for 2016 were within a reasonable range of the market 50th percentile for our executive team.

While market data is an important measuring tool, it is only one of four principal considerations under the Company's compensation philosophy.

2017 Base Salary

Base salary provides fixed compensation to an individual that reflects his or her job responsibilities, experience, value to the Company, and demonstrated performance.

Salaries or minimum salaries for the NEO's are established in their employment agreements. These salaries or minimum salaries and the amount of any increase over minimums are determined by the Committee based on its subjective evaluation of a variety of factors, including:

- the nature and responsibility of the position;
- the impact, contribution, expertise and experience of the individual executive;
- competitive market information regarding salaries to the extent available and relevant;
- the importance of retaining the individual along with the competitiveness of the market for the individual executive's talent and services; and
- the recommendations of the Chief Executive Officer (except in the case of her own compensation).

Typically, the Committee considers these factors during an annual review in March. In March 2017, the Committee considered base salary increases for the NEOs. The Committee undertook an annual performance review of each of the NEOs. Those NEOs each prepared a self-evaluation. The Chief Executive Officer completed evaluations of the NEOs other than herself and discussed those evaluations with, and received input from, the Committee. The Chief Executive Officer was primarily responsible for providing feedback to the other NEOs regarding their performance. In the case of the Chief Executive Officer, the Non-Executive Chairman presented the Committee's and the Board's feedback to the Chief Executive Officer on her self-evaluation.

Following completion of these reviews of each individual's 2016 performance, and with particular weighting on the Company's 2016 financial results that reflected a late year decline in retail traffic, the Committee approved no base salary increases for the NEOs from 2016 to 2017.

2017 Bonus Plan

The Committee continued the use of a cash bonus plan in 2017 for the NEOs, granting potential cash bonuses pursuant to the Build-A-Bear Workshop, Inc. 2017 Bonus Plan (the "2017 Bonus Plan") for the NEOs only if the Company achieved certain financial performance levels. Thus, consistent with all four elements of its compensation philosophy, the Committee aligned the NEOs' 2017 cash bonuses completely with the interests of our stockholders. The 2017 Bonus Plan was developed in accordance with the terms of the 2004 Incentive Plan.

On March 14, 2017, the Committee established the 2017 performance objectives for the range of bonuses to be paid to the Company's NEOs and the target bonus awards expressed as a percentage of eligible base salary ("Base Bonus Payout"). The 2017 base bonus calculation for each NEO was determined by multiplying the Base Bonus Payout by the officer's eligible base salary according to the following schedule ("Base Bonus Calculation"), which was unchanged from 2016:

Name	**Base Bonus Payout**	
Sharon John	100	%
Voin Todorovic	50	%
Jennifer Kretchmar	50	%
J. Christopher Hurt	50	%
Eric Fencl	50	%

For the 2017 Bonus Plan, the Committee focused the performance goals on a single performance metric—pre-tax income. The cash bonus, if any, to be paid to each respective NEO was to be calculated based on the pre-tax income goals described in the table below.

Achievement Level	**Consolidated Pre-Tax Income**	**Percentage of Base Bonus Calculation**	
Threshold	$ 13,000,000	25	%
Target	16,000,000	100	%
Maximum	20,000,000	200	%

The 2017 Bonus Plan provided for bonus payouts only if the Company's 2017 consolidated pre-tax income (after providing for any bonus expense) exceeded the threshold amount. Under the 2017 Bonus Plan, consolidated pre-tax income results that fell between any of the achievement levels set forth in the table above would be interpolated in accordance with the methodology set forth in the 2017 Bonus Plan, in the sole discretion of the Committee. This discretion included the ability to reduce the otherwise applicable percentage of Base Bonus Calculation for each achievement level, but the Committee did not have the discretion to increase the amount of compensation payable above the maximum percentage of Base Bonus Calculation for each achievement level.

In March 2018, the Committee determined that the Company met the threshold 2017 consolidated pre-tax income level for a bonus payout under the 2017 Bonus Plan but did not attain the target level. In accordance with the 2017 Bonus Plan, the Committee interpolated between the two payout amounts and approved bonus payouts of 45% of target for 2017 performance. Please refer to the Summary Compensation Table for bonuses earned by the NEOs under the 2017 Bonus Plan.

2017 Long-Term Incentive Program

The objective of the Company's long-term incentive program is to provide a long-term retention incentive for the NEOs and to align their interests directly with those of our stockholders by way of stock ownership.

Long-term incentive compensation awards made in fiscal 2017 were made under the terms of the 2004 Incentive Plan. Under the 2004 Incentive Plan, the Committee has the discretion to determine whether equity awards will be granted to NEOs and if so, the number of shares subject to each award. The 2004 Incentive Plan allows the Committee to grant the following types of awards, in its discretion: options, stock appreciation rights, cash-based awards or other stock-based awards, such as common stock, restricted stock and other awards valued in whole or in part by reference to the fair market value of the Company's common stock. In most instances, these long-term grants vest over a multi-year basis.

The Committee meets in March of every year to determine the recipients of annual long-term incentive awards and to grant such awards by formal action. The practice of granting long-term incentive awards in March by Committee action applies uniformly to the NEOs and other employees of the Company and, with rare exceptions, is the only practice employed by the Company in connection with the granting of equity awards. The Committee does, however, have the discretion to make grants whenever it deems it appropriate in the best interests of the Company. Additionally, employees other than executive officers who are hired or promoted by the Company after the March Committee meeting may receive grants from the Chief Executive Officer or Chief Human Resources Officer at the levels previously approved by the Committee, at the date of such hire or promotion.

The Company does not have any program, plan or practice in place to time option or other award grants with the release of material, non-public information and does not release such information for the purpose of affecting the value of executive compensation. The exercise price of stock subject to options awarded under the 2004 Incentive Plan is the fair market value of the Company's common stock on the date of grant. Under the terms of the 2004 Incentive Plan, the fair market value of the stock is the closing sale price of the Company's common stock on the date of grant as reported by the NYSE.

Historically, the Company has granted stock-based compensation in the form of either (1) time-based restricted stock; (2) stock options; (3) performance-based restricted stock; or (4) a combination of these vehicles.

In January, February and March 2017, the Committee reviewed a report of updated market data and industry compensation trends developed by Meridian. The Committee also reviewed the Company's recent financial and share price performance and the availability of shares to grant under our 2004 Incentive Plan. In March 2017, the Committee allocated the annual long-term incentive compensation to the NEOs as follows: time-based restricted stock (60% of grant value), non-qualified stock options (10% of grant value), and three-year performance-based restricted stock (30% of grant value). The performance-based restricted stock awards will be earned if pre-established three-year pre-tax income growth goals are attained. The design and mix were structured to maintain a strong emphasis on performance and to align with peer practices.

The Committee determined the amount of long-term incentive awards granted to each executive using three key considerations: (1) market data for grant levels provided in the Meridian study; (2) grant levels required to bring the NEOs' total target direct compensation at or near the median of total compensation of similarly situated executives within our peer group; and (3) grant levels required to retain key individual employee contributors. In establishing the size of the 2017 award pool, the Committee considered the amount of stock and options outstanding, the expense associated with the grants and the potentially dilutive effect on stockholders, in addition to the overall compensation policy of the Company to place emphasis on incentive compensation over base salaries. After reviewing these considerations, the Committee determined to increase the target annual grant levels over 2016 levels for certain NEOs. The target grant levels for Messrs. Hurt and Fencl were increased from 2016 levels to better align their compensation with peer market levels. The target grant levels for other NEOs remained unchanged from 2016 to 2017.

On March 14, 2017, the Committee approved the following 2017 long-term incentive awards to the NEOs under the 2004 Incentive Plan:

Name	**Number of Shares of Time-Based Restricted Stock**	**Number of Time-Based Non-Qualified Stock Options**	**Target Number of Shares of Performance-Based Restricted Stock**
Sharon John	84,747	29,673	42,373
Voin Todorovic	20,340	7,122	10,169
Jennifer Kretchmar	20,340	7,122	10,169
J. Christopher Hurt	20,340	7,122	10,169
Eric Fencl	13,560	4,749	6,780

The stock options and time-based restricted stock vest at the rate of one-third per year over three years from the date of grant, beginning on March 31, 2018.

The number of 2017 three-year performance-based restricted stock shares that will be earned by each NEO, if any, will be calculated by multiplying the target shares awarded to such executive officer set forth above by the average of

the applicable Percentage of Target Number of Three-Year Performance-Based Restricted Stock Earned Calculation based on the Company's achievement of consolidated pre-tax income goals for fiscal 2017, fiscal 2018 and fiscal 2019. The pre-tax income achievement level amounts were set for fiscal 2017. For fiscal 2018 and fiscal 2019, the pre-tax income achievement level amounts will be based upon a pre-established percentage of growth over actual pre-tax income results for the prior fiscal year. Any shares that are earned will vest on April 30, 2020.

Fiscal 2017-2019 Performance-Based Restricted Stock Payout

Consolidated Pre-Tax Income Achievement Level	**Percentage of Target Number of Three-Year Performance-Based Restricted Stock Earned Calculation**	
Below Threshold	0	%
Threshold	25	%
Target	100	%
Maximum	200	%

Pursuant to the terms of the 2004 Incentive Plan, the Committee may, in its sole discretion, provide for the following upon a change in control: (1) accelerated vesting of any outstanding award; (2) termination of an award in exchange for the payment of cash; and/or (3) issuance of substitute awards. The 2017 equity award agreements for the NEOs and other participants each contain a clause subjecting the grants to accelerated vesting upon a change in control. The Committee believes that this change in control protection is prevalent among other companies in the peer group, and the value of the stock grants as a retention tool would be diminished if this protection were not included in the grant terms.

Further information regarding the 2017 grants of long-term incentive awards made to NEOs can be found in the 2017 Grants of Plan-Based Awards Table.

2018 Long-Term Incentive Program

At our 2017 Annual Meeting of Stockholders, our stockholders approved the 2017 Incentive Plan to replace the 2004 Incentive Plan. Incentive compensation awards made by the Company in fiscal 2018, including long-term incentive compensation awards, were granted under the 2017 Incentive Plan.

As noted above, the objectives of the Company's long-term incentive program are to provide a long-term retention incentive for the NEOs and to align their interests directly with those of our stockholders. The Committee continued to apply these objectives in making its annual long-term incentive program grants to the NEOs in March 2018 in the form of both time- and performance-based compensation. In addition to these annual grants, on March 15, 2018, the Committee granted the NEOs an additional business transformation incentive grant under the Plan to further align the Company's compensation program with its initiatives to return to long-term profitable growth. This additional long-term incentive award was designed to increase management focus on total revenue growth in the face of continuing traditional mall traffic challenges and encourage share price appreciation, profit growth, and retention. The Committee allocated the total 2018 long-term incentive compensation to the Chief Executive Officer in the form of performance-based equity (50% of total grant value) and time-based equity (50% of total grant value). The details of our 2018 long-term incentive program for NEOs will be disclosed fully in our 2019 proxy statement.

Insider Trading Policy

The Build-A-Bear Workshop, Inc. Insider Trading Policy prohibits the Directors, NEOs and other employees from selling the Company's securities "short"— that is, selling securities that are borrowed (and not owned) so as to be able to profit from a decrease in the Company's share price. The Company's insider trading policy also prohibits Directors, NEOs and other employees from pledging Company securities or buying or selling puts (i.e., options to sell), calls (i.e., options to purchase), future contracts, or other forms of derivative securities relating to the Company's securities.

Policy for Adjustment or Recovery of Awards in the Event of Accounting Restatement

The 2017 Bonus Plan provides that in the event of a restatement impacting consolidated pre-tax income, the Company would recover from the NEO the applicable amount which should not have been paid based on the restatement, plus interest. In addition, the 2017 award agreements for performance-based restricted stock also provide that in the event of a restatement impacting pre-tax income, the NEO would reimburse the Company or forfeit any shares that should not have been earned or vested based on the restatement.

Executive Stock Ownership Guidelines

The Committee maintains stock ownership guidelines for NEOs. The guidelines require executives to acquire and maintain a minimum level of stock ownership in Company stock.

The current ownership guidelines for our NEOs are set forth in the table below.

Position	**Multiple of Base Salary**
Chief Executive Officer	Five times (5X)
All Other NEOs	One time (1X)

The executives have three years to reach the applicable minimum holding requirement and, thereafter, may not sell shares if such sale would cause the executive's holdings to fall below the minimum holding requirement. The withholding of shares to satisfy income tax withholding associated with a stock option exercise or restricted stock vesting or to pay the exercise price in connection with a stock option exercise is not considered a sale of Company stock for the purposes of these guidelines. Each of the NEOs complied with these guidelines in 2017. The Committee will continue to monitor stock ownership guidelines and levels for the NEOs on an annual basis.

Retirement and Other Post-Termination Benefits

We have entered into Employment Agreements with our NEOs that provide for a continuation of certain post-employment benefits, to the extent permitted under the applicable employment benefit plan(s). Such benefits plans are the same for all employees (except for the long-term disability insurance for which the Company pays 100% of the premiums for senior level employees, including the NEOs, as discussed below). The Employment Agreements for the NEOs also provide for certain payments to be made to the NEOs if their employment is terminated under certain circumstances, including a change in control of the Company. See "Executive Employment and Severance Agreements" for a discussion of such terms of our NEOs' employment agreements.

Other Benefits

The Company seeks to maintain an open and inclusive culture in its facilities and operations among executives and other Company employees. Thus, the Company does not provide executives with reserved parking spaces or separate dining or other facilities, nor does the Company have programs for providing personal-benefit perquisites to executives, such as permanent lodging or defraying the cost of personal entertainment or family travel. With the exception of disability insurance (as noted below), the Company's health care and other insurance programs are the same for all eligible employees, including the NEOs.

Insurance

All full-time Company employees, including the NEOs, are eligible to participate in medical, dental, vision, long- and short-term disability and life insurance plans and flexible spending accounts. The terms of such benefits for the Company's NEOs are the same as those for all Company employees, except that with respect to long-term disability insurance, the Company pays 100% of the premium for senior level employees, including the NEOs.

401(k)

The Company sponsors the Build-A-Bear Workshop, Inc. Employee Savings Trust, which is a qualified retirement plan with a 401(k) feature. Participants are provided the opportunity to make salary reduction contributions to the plan on a pre-tax basis. The Company has the ability to make discretionary matching contributions and discretionary profit sharing contributions to such plan. In 2017, the Company matched 50% of the participants' 2016 contributions of up to 6% of the participant's salary. The Company matching contribution is not fully vested until the participant has been employed by the Company for five years.

401(k) Mirror Plan

The Company sponsors the Build-A-Bear Workshop, Inc. Non-Qualified Deferred Compensation Plan, a non-qualified plan which mirrors the substantive terms of the Build-A-Bear Workshop, Inc. Employee Savings Trust. The non-qualified plan permits certain highly compensated employees, including the NEOs, whose deferrals are otherwise limited to the qualified plan, to make additional pre-tax deferrals of compensation. The Company may make matching contributions to this non-qualified plan to replicate Company matching contributions that would have been made to the qualified plan, but for limitations in the Code. In 2017, the Company matched 50% of the participants' 2016 contributions of up to 6% of the participant's salary, divided between the 401(k) plan and the 401(k) mirror plan. The Company matching contribution is not fully vested until the participant has been employed by the Company for five years. Of the NEOs, only Mr. Hurt participated in this plan during 2017. Because Mr. Hurt did not make contributions in 2016, however, he did not receive a Company matching contribution in 2017.

Federal Income Tax and Accounting Considerations

Code Section 162(m)

Code Section 162(m) limits deductions for certain executive compensation in excess of $1 million in any fiscal year. Under Code Section 162(m) as in effect prior to and during 2017, certain performance-based compensation is not subject to this deductibility limit. Historically, the Company has attempted to structure its compensation arrangements to permit deductibility under Code Section 162(m), unless the benefit of such deductibility was outweighed by the need for flexibility or the attainment of other corporate objectives. Since corporate objectives may not always be consistent with the requirements for full deductibility, the Committee, if it deemed appropriate, entered into compensation arrangements under which payments may not be deductible under Code Section 162(m).

The applicable performance-based deductibility exception to Code Section 162(m) has been repealed for tax years beginning in 2018 under the Tax Cuts and Jobs Act. As a result, compensation paid to our NEOs in excess of $1 million will not be deductible unless it qualifies for transition relief applicable to performance-based compensation paid pursuant to a written binding contract that was in effect as of November 2, 2017. Despite the Committee originally structuring certain performance-based compensation in a manner that would have made it exempt from the Code Section 162(m) deduction limit, no assurance can be given that such compensation will, in fact, be fully deductible because of the ambiguities and uncertainties as to the interpretation and scope of the tax reform transition rules. Furthermore, the Committee expects in the future to approve additional compensation that will not be deductible for income tax purposes.

Accounting Considerations

The Committee has taken certain accounting rules and consequences into consideration when determining the type of equity awards that executive officers should receive as part of the Company's long-term incentive plan component of compensation packages. The vesting of time-based restricted stock and stock option grants made to the Company's executive officers and employees and the associated Financial Accounting Standards Board's Accounting Standards Codification Topic 718 ("FASB ASC Topic 718") expense recognition is tied to the passage of time rather than conditioned upon fulfillment of certain performance targets. Performance-based restricted stock is earned and FASB ASC Topic 718 expense recognition is based on the fulfillment of specified performance targets and upon the passage of time.

COMPENSATION AND DEVELOPMENT COMMITTEE REPORT

The Company's Compensation and Development Committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on such review and discussions, the Committee recommended to the Company's Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Submitted by the Compensation and Development Committee of the Board of Directors:

Coleman Peterson, Chairman
Craig Leavitt
Anne Parducci
Sarah Personette
Michael Shaffer

The Compensation and Development Committee Report and the Report of the Audit Committee below will not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement or portions thereof into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates this information by reference, and will not otherwise be deemed filed under such Acts.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During all of fiscal 2017, the Compensation and Development Committee was comprised of Coleman Peterson (Chair), Timothy Kilpin and Sarah Personette. Mary Lou Fiala also served on the Committee until her resignation

from the Board in May 2017, and Anne Parducci joined the Committee in September 2017 when she was appointed to the Board. None of the members of the Compensation and Development Committee during fiscal 2017 were employees or current or former officers of the Company, nor had any relationship with the Company required to be disclosed as transactions with related persons pursuant to Item 404(a) of Regulation S-K. No executive of the Company served on the compensation committee or board of any company that employed any member of the Company’s Compensation and Development Committee or Board of Directors.

2017 SUMMARY COMPENSATION TABLE

The following table sets forth information concerning the annual and long-term compensation for all services rendered in all capacities to the Company for the fiscal years ended December 30, 2017, December 31, 2016, and January 2, 2016. The Company cautions that the amounts reported in the Stock Awards and Option Awards columns may not represent the amounts that the Named Executive Officers will actually realize from the awards. Whether, and to what extent, a Named Executive Officer realizes value will depend on the Company's stock price when restricted stock vests or the stock option is exercised and on continued employment.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(2)	Non-Equity Incentive Plan Compensation ($)(3)	All Other Compensation ($)(4)	Total ($)
Sharon John	2017	700,000	-	750,011	124,057	315,000	5,367	1,894,435
President and	2016	694,231	-	625,003	663,492	-	5,362	1,988,088
Chief Executive Officer	2015	665,625	53,250	454,154	250,846	412,688	3,443	1,840,006
Voin Todorovic	2017	350,000	-	180,009	29,776	78,750	4,953	643,488
Chief Financial Officer	2016	343,308	-	149,988	159,226	-	4,926	657,448
	2015	316,154	12,646	120,140	66,341	98,008	105,384	718,673
Jennifer Kretchmar	2017	409,500	-	180,009	29,776	92,138	5,003	716,426
Chief Merchandising Officer	2016	404,146	-	149,988	159,226	-	1,003	714,363
	2015	383,692	15,348	120,140	66,341	118,945	817	705,283
J. Christopher Hurt (5)	2017	400,000	-	180,009	29,776	90,000	4,995	704,780
Chief Operations Officer	2016	395,385	-	102,511	108,812	-	995	607,703
	2015	267,461	50,200	120,709	64,002	117,800	110,720	730,892
Eric Fencl	2017	327,800	-	120,006	19,855	73,755	4,911	546,326
Chief Administrative Officer,	2016	324,892	-	87,520	92,885	-	4,894	510,191
General Counsel and Secretary	2015	313,077	12,523	102,550	56,639	97,054	3,510	585,353

(1) The amounts appearing in the Stock Awards column represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 for restricted stock awards granted in fiscal 2017, fiscal 2016, and fiscal 2015. In fiscal 2017, fiscal 2016 and fiscal 2015, the grants consisted of both time-based restricted stock and performance-based restricted stock. Recipients of time-based restricted stock have the right to vote and receive dividends as to all unvested shares. All time-based restricted stock reported vests at the rate of one-third per year over three years, beginning on March 31 of the year following the year of grant. Recipients of performance-based restricted stock do not have dividend and voting rights unless and until applicable performance criteria is satisfied and the awards vest. Performance-based restricted stock awarded in fiscal 2017 will be earned based on pre-established pre-tax income growth objectives for fiscal 2017, 2018 and 2019 and if earned, will vest on April 30, 2020. The reported grant date fair value of all performance-based awards is based on assumed results at the target achievement level per the instructions to Item 402(c) of Regulation S-K. See the 2017 Grants of Plan-Based

Awards Table. See also Note 11 to the Company's Consolidated Financial Statements filed as part of our Annual Report on Form 10-K for the year ended December 30, 2017 for a discussion of the assumptions used in the valuation of awards. The grant date fair value of the performance-based restricted stock awards granted in 2017 for each Named Executive Officer assuming that the maximum level of performance conditions is achieved is as follows: Ms. John—$750,002; Mr. Todorovic—$179,991; Ms. Kretchmar—$179,991; Mr. Hurt—$179,991; and Mr. Fencl—$120,006.

(2) The amounts appearing in the Option Awards column represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 for options granted in fiscal 2017, 2016 and 2015. See Note 11 to the Company's Consolidated Financial Statements filed as part of our Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of the assumptions used in the valuation of the awards. The exercise price of the options granted in fiscal 2017 is equal to the closing price of the Company's common stock on March 14, 2017, the date of grant, and the options vest at the rate of one-third per year over three years from the grant date beginning on March 31, 2018.

(3) The amounts appearing in the Non-Equity Incentive Plan Compensation column for 2017 represent the 2017 Bonus Plan payout for each of the NEOs.

(4) "All Other Compensation" includes relocation reimbursement, the Company's contribution to the 401(k) plan, and payment by the Company of long-term disability and life insurance premiums for the benefit of the Named Executive Officers. For fiscal 2017, Company contributions to our 401(k) plan were as follows: Ms. John—$3,975; Mr. Todorovic—$3,975; Ms. Kretchmar—$3,975; Mr. Hurt—$3,975; and Mr. Fencl—$3,975. For fiscal 2017, Company-paid premiums for long-term disability insurance were as follows: Ms. John—$804; Mr. Todorovic—$684; Ms. Kretchmar—$684; Mr. Hurt—$684; and Mr. Fencl—$660. For fiscal 2017, Company-paid premiums for life insurance were as follows: Ms. John—$588; Mr. Todorovic—$294; Ms. Kretchmar—$344; Mr. Hurt—$336; and Mr. Fencl—$276.

(5) Mr. Hurt's employment with the Company commenced April 15, 2015.

2017 GRANTS OF PLAN-BASED AWARDS

The following table sets forth certain information with respect to plan-based awards granted to each of our Named Executive Officers during the fiscal year ended December 30, 2017. All awards were granted pursuant to the Company's 2004 Incentive Plan.

		Estimated Possible Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards	Grant Date Fair Value of Stock and Option Awards
Name	**Grant Date**	**Threshold ($)**	**Target ($)**	**Maximum ($)**	**Threshold (#)**	**Target (#)**	**Maximum (#)**	**(#)**	**(#)**	**($/Sh)**	**Awards**
Sharon John	03/14/17 [1]	$175,000	700,000	1,400,000							
	03/14/17 [2]				10,593	42,373	84,746				375,001
	03/14/17 [3]							84,747			750,011
	03/14/17 [4]								29,673	$8.85	124,057
Voin Todorovic	03/14/17 [1]	87,500	350,000	700,000							
	03/14/17 [2]				2,542	10,169	20,338				89,996
	03/14/17 [3]							20,340			180,009
	03/14/17 [4]								7,122	8.85	29,776
Jennifer Kretchmar	03/14/17 [1]	102,375	409,500	819,000							
	03/14/17 [2]				2,542	10,169	20,338				89,996
	03/14/17 [3]							20,340			180,009
	03/14/17 [4]								7,122	8.85	29,776
J. Christopher Hurt	03/14/17 [1]	100,000	400,000	800,000							
	03/14/17 [2]				2,542	10,169	20,338				89,996
	03/14/17 [3]							20,340			180,009
	03/14/17 [4]								7,122	8.85	29,776

Eric Fencl	03/14/17 [(1)]	81,950	327,800	655,600							
	03/14/17 [(2)]				1,695	6,780	13,560				60,003
	03/14/17 [(3)]							13,560			120,006
	03/14/17 [(4)]								4,749	8.85	19,855

(1) The amounts disclosed represent the range of possible cash payouts for fiscal 2017 awards under the 2017 Bonus Plan. This chart reflects the threshold, target and maximum bonus amounts payable under the 2017 Bonus Plan performance year if pre-established financial targets would have been met. The amounts listed above were calculated based on the threshold, target, and maximum percentages as a percentage of the executive's 2017 base salary. As noted in the section entitled "Compensation Discussion and Analysis", the Company's pre-tax income for fiscal 2017 was above the threshold level and below the target level and, therefore, the payout was interpolated between the two payout amounts.

(2) These restricted stock awards are performance-based, and shares earned will vest on April 30, 2020 to the extent the Company achieves pre-established pre-tax income growth objectives for 2017, 2018 and 2019, as discussed in the "Compensation Discussion and Analysis" section. The NEOs do not have the right to vote or receive dividends with respect to any of shares of performance-based restricted stock unless and until the shares are earned and vest. The fair market value of the restricted stock on the date of grant was $8.85 per share. The grant date fair value is computed in accordance with FASB ASC Topic 718 and is based on the target number of shares of performance-based restricted stock.

(3) These restricted stock awards are subject to time-based vesting only and will vest in equal installments over three years beginning on March 31, 2018. The NEOs have the right to vote and receive dividends as to all unvested shares of time-based restricted stock. The fair market value of the restricted stock on the date of grant was $8.85 per share. The grant date fair value is computed in accordance with FASB ASC Topic 718.

(4) These non-qualified stock options are subject to time-based vesting only and will vest in equal annual installments over three years beginning on March 31, 2018. The stock option exercise price is the closing price of the Company's stock on the date of grant. The grant date fair value is computed in accordance with FASB ASC Topic 718.

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OUTSTANDING EQUITY AWARDS AT 2017 FISCAL YEAR-END

The following table discloses information regarding outstanding awards issued under the Company’s 2004 Incentive Plan, as of the fiscal year end of December 30, 2017.

	Option Awards					Stock Awards					
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Number of Securities Underlying Unexercised Options (#) Unexercisable** [1]		**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares of Stock That Have Not Vested (#)** [2]	**Market Value of Shares of Stock That Have Not Vested ($)** [3]	**Equity Incentive Plan Awards: Number of Unearned Shares That Have Not Vested (#)**		**Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares of Stock That Have Not Vested ($)**	
Sharon John	195,512	-	(4)	$ 6.56	6/3/2023						
	27,225	-	(5)	9.43	3/18/2024						
	14,686	7,343	(5)	20.80	3/17/2025						
	30,994	61,988	(5)	13.69	3/7/2026						
	-	29,673	(6)	8.85	3/14/2027						
								85,000	(7)	782,000	(7)
						122,461	$ 1,147,893	42,373	(8)	389,832	(8)
Voin Todorovic	2,640	-	(5)	12.64	9/15/2024						
	3,884	1,942	(5)	20.80	3/17/2025						
	7,438	14,876	(5)	13.69	3/7/2026						
	-	7,122	(6)	8.85	3/14/2027						
								12,783	(7)	117,604	(7)
						29,569	277,656	10,169	(8)	93,555	(8)
Jennifer Kretchmar	3,972	-	(5)	11.43	8/12/2024						
	3,884	1,942	(5)	20.80	3/17/2025						
	7,438	14,876	(5)	13.69	3/7/2026						
		7,122	(6)	8.85	3/14/2027						

							14,956 [7]	137,595 [7]
					29,569	277,656	10,169 [8]	93,555 [8]
J. Christopher Hurt	3,948	1,974 [5]	20.47	3/15/2025				
	5,083	10,166 [5]	13.69	3/7/2026				
	-	7,122 [6]	8.85	3/14/2027				
							14,609 [7]	134,403 [7]
					27,288	256,579	10,169 [8]	93,555 [8]
Eric Fencl	19,596	- [4]	5.11	3/17/2019				
	17,176	- [4]	6.59	3/23/2020				
	10,568	- [4]	6.21	3/22/2021				
	6,477	- [5]	9.43	3/18/2024				
	3,316	1,658 [5]	20.80	3/17/2025				
	4,339	8,678 [5]	13.69	3/7/2026				
	-	4,749 [6]	8.85	3/14/2027				
							11,972	110,142
					19,465	183,871	6,780	62,376

(1) The amounts appearing in this column represent the total number of time-based non-qualified stock options that have not vested as of December 30, 2017.

(2) The amounts appearing in this column represent the total number of time-based restricted shares that have not vested as of December 30, 2017 and performance-based restricted stock that has been earned but has not vested as of December 30, 2017. Time-based restricted stock granted on March 17, 2015 vests at the rate of one-third per year over three years from the date of grant beginning on March 15, 2016. The amounts of unvested restricted stock held under the March 2015 time-based restricted stock award by our Named Executive Officers at December 30, 2017 are as follows: Ms. John—4,968; Mr. Todorovic—1,314; Ms. Kretchmar—1,314; and Mr. Fencl—1,122. Performance-based restricted stock granted on March 17, 2015 that was earned vests at the rate of one-third per year over three years from March 15, 2016. The amounts of unvested restricted stock held under the portion of the March 2015 performance-based restricted stock award that was earned by our Named Executive Officers at December 30, 2017 are as follows: Ms. John—2,310; Mr. Todorovic—611; Ms. Kretchmar—611; and Mr. Fencl—521. Time-based restricted stock granted to Mr. Hurt on April 15, 2015 vests at the rate of one-third per year over three years beginning on March 15, 2016, and the amount of unvested restricted stock under this grant at December 30, 2017 was 1,335 shares. Performance-based restricted stock granted to Mr. Hurt on April 15, 2015 that was earned vests at the rate of one-third per year over three years beginning on March 15, 2016, and the amount of unvested restricted stock under this grant at December 30, 2017 was 621 shares. Time-based restricted stock granted on March 7, 2016 vests at the rate of one-third per year over three years from the date of grant beginning on March 15, 2017. The amounts of unvested time-based restricted stock held under the March 2016 award by our Named Executive Officers at December 30, 2017 are as follows: Ms. John—30,436; Mr. Todorovic—7,304; Ms. Kretchmar—7,304; Mr. Hurt—4,992; and Mr. Fencl—4,262. Time-based restricted stock granted on March 14, 2017 vests at the rate of one-third per year over three years from the date of grant beginning on March 31, 2018. The amounts of unvested time-based restricted stock held under the March 2017 award by our Named Executive Officers at December 30, 2017 are as follows: Ms. John—84,747; Mr. Todorovic—20,340; Ms. Kretchmar—20,340; Mr. Hurt—20,340; and Mr. Fencl—13,560.

(3) The amounts appearing in this column represent the aggregate market value of time-based restricted shares that have not vested and performance-based restricted shares that have been earned but have not vested as of December 30, 2017. The amounts reported are based on the closing price of $9.20 for the shares of common stock on December 29, 2017.

(4) These stock options vest at the rate of 25% per year over four years from the date of grant beginning on the first anniversary of the grant date.

(5) These stock options vest at the rate of one-third per year over three years from March 15 of the year following the grant year.

(6) These stock options vest at the rate of one-third per year over three years from March 31 of the year following the grant year.

(7) The amounts reflect the number and payout value of unearned performance-based restricted shares based on the assumed achievement of target consolidated total revenue performance goals for 2016, 2017 and 2018. The payout value is based on the closing price of $9.20 for the shares of common stock on December 29, 2017. If earned, the performance-based shares will vest on April 30, 2019.

(8) The amounts reflect the number and payout value of unearned performance-based restricted shares based on the assumed achievement of target pre-tax income growth objectives for 2017, 2018 and 2019 as discussed in the "Compensation Discussion and Analysis" section. The payout value is based on the closing price of $9.20 for the shares of common stock on December 29, 2017. If earned, the performance-based shares will vest on April 30, 2020.

2017 OPTION EXERCISES AND STOCK VESTED

The following table provides information regarding stock options that were exercised by our Named Executive Officers and restricted stock that vested during the fiscal year ended December 30, 2017.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)(1)
Sharon John	—	$ —	57,714	$561,635
Voin Todorovic	—	—	6,566	58,487
Jennifer Kretchmar	—	—	7,066	63,185
J. Christopher Hurt	—	—	4,452	39,623
Eric Fencl	—	—	7,869	69,215

(1) Amounts reported were determined by multiplying the number of shares that vested by the per share closing price of the Company's common stock on the vesting date.

2017 NON-QUALIFIED DEFERRED COMPENSATION

The following table provides information regarding our Named Executive Officers' non-qualified deferred compensation during the fiscal year ended December 30, 2017.

Name	Executive Contributions in Last FY($)	Registrant Contributions in Last FY($)[1]	Aggregate Earnings in Last FY($)	Aggregate Balance at Last FYE($)[2]
Sharon John	$ -	$ -	$ -	$ -
Voin Todorovic	-	-	-	-
Jennifer Kretchmar	-	-	-	-
J. Christopher Hurt[3]	20,615	3,975	7,031	53,323
Eric Fencl	-	-	-	-

(1) The amounts included in these columns are reported as compensation in the Summary Compensation Table included in this proxy statement.

(2) For prior years, all amounts contributed by a Named Executive Officer and by the Company in such years have been reported in the Summary Compensation Table in our previously filed proxy statements in the year earned to the extent the executive was named in such proxy statements and the amounts were so required to be reported in such tables.

(3) Mr. Hurt was the only Named Executive Officer who contributed to the Non-Qualified Deferred Compensation Plan during 2017. In March of each year, contributions to the plan during the preceding fiscal year are matched by the Company. Amounts shown for Registrant Contributions were made in March 2017 as the Company's matching contribution for the 2016 contributions, which was 50% of Mr. Hurt's contributions up to 6% of his salary, divided between the Company's qualified 401(k) plan and its Non-Qualified and Deferred Compensation Plan. The Company's matching contribution does not fully vest until the participant has been employed by the Company for five years.

A description of the Company's Non-Qualified Deferred Compensation Plan is included in the "Compensation Discussion and Analysis" Section.

EXECUTIVE EMPLOYMENT AND SEVERANCE AGREEMENTS

The Company currently has employment agreements with each of our Named Executive Officers and certain other executives. The material terms of the agreements are described below.

Ms. John's agreement has an initial term of three years from March 7, 2016 and renews from year-to-year thereafter. The agreement may be terminated by the Company prior to the end of the term upon death, disability, for cause (as defined in the agreement) or without cause. Ms. John may terminate the agreement with or without good reason (as defined in the agreement). If we terminate Ms. John's employment without cause or if Ms. John terminates her employment for good reason, we are obligated to (i) in the case of termination prior to a change in control or following a date which is 24 months after a change in control, continue her base salary for a period of 12 months after her termination; or (ii) in the case of termination during the 24-month period following a change in control, continue her base salary for a period of 24 months and pay her target bonus amount for the fiscal year in which the termination occurs. In any case, we are obligated to pay a lump sum equivalent to 18 months of the Company-paid portion of health, dental and vision coverage. As compensation for her services, Ms. John will receive an annual base salary at a rate not less than $700,000 which rate will be reviewed annually and be commensurate with similarly situated executives in similarly situated firms. If the Company meets or exceeds certain performance objectives determined annually by the Compensation and Development Committee, Ms. John will receive an annual bonus of not less than 100% of her annual base salary, payable in either cash, stock, stock options or a combination thereof. The employment agreement also provides that for the term of the employment agreement and for one year thereafter, subject to specified limited exceptions, Ms. John may not become employed by or interested directly or indirectly in or associated with the Company's competitors who are located within the United States or within any country where the Company has established a retail presence. In the event of her termination due to death, disability, or by the Company without cause, or if Ms. John terminates her employment for good reason, Ms. John or her beneficiaries or estate, will still be entitled to a bonus for such year prorated based on the number of full weeks she was employed during the year, subject to achievement of the bonus criteria (if such termination occurs within 24 months after a change of control, Ms. John will be entitled to receive her target bonus for the fiscal year in which the termination occurs prorated based on the number of full weeks she was employed during the year and paid within 30 days of such termination). If any payments under the employment agreement or another arrangement would become subject to the excise tax imposed by Section 4999 of the Code, the payments will be (i) paid in full, or (ii) paid to a lesser extent such that the excise tax would no longer be applicable, whichever amount would result in the greatest amount of payments to Ms. John on an after-tax basis.

The employment agreements with Ms. Kretchmar and Messrs. Fencl, Hurt and Todorovic (the "non-CEO NEOs") have an initial term of three years from March 7, 2016 and renew from year-to-year thereafter. The agreements may be terminated by the Company prior to the end of the term upon death, disability, for cause (as defined in the agreements) or without cause. Each of the non-CEO NEOs may terminate his or her agreement with or without good reason (as defined in the agreements). If we terminate a non-CEO NEO's employment without cause, or if the non-CEO NEO terminates his or her employment for good reason, we are obligated to (i) in the case of termination prior to a change in control or following a date which is 24 months after a change in control, continue his or her base salary for a period of 12 months after his or her termination, or (ii) in the case of termination during the 24-month period following a change in control, continue his or her base salary for a period of 18 months and pay such NEO an amount equal to the NEO's target bonus prorated for the year of termination. In any case, we are obligated to pay a lump sum equivalent to

18 months of the Company-paid portion of health, dental and vision coverage. As compensation for their services, the non-CEO NEOs will receive an annual base salary at a rate not less than $350,000 in the case of Mr. Todorovic, $409,500 in the case of Ms. Kretchmar, $400,000 in the case of Mr. Hurt, and $327,800 in the case of Mr. Fencl, in each case which rate will be reviewed annually and be commensurate with similarly situated executives in similarly situated firms. If the Company meets or exceeds certain performance objectives determined annually by the Compensation and Development Committee, each of the non-CEO NEOs will receive an annual bonus of not less than 50% of his or her annual base salary, payable in either cash, stock, stock options or a combination thereof. The employment agreements also provide that for the terms of the employment agreements and for one year thereafter, subject to specified limited exceptions, the non-CEO NEOs may not become employed by or interested directly or indirectly in or associated with the Company’s competitors who are located within the United States or within any country where the Company has established a retail presence. In the event of his or her termination due to death, disability, or by the Company without cause, or if a non-CEO NEO terminates his or her employment for good reason, the non-CEO NEO or his or her beneficiaries or estate, will still be entitled to a bonus for such year prorated based on the number of full weeks he or she was employed during the year, subject to achievement of the bonus criteria (if such termination occurs within 24 months after a change of control, the non-CEO NEO will be entitled to receive his or her target bonus for the fiscal year in which the termination occurs prorated based on the number of full weeks he or she was employed during the year and paid within 30 days of such termination). If any payments under the employment agreement or another arrangement would become subject to the excise tax imposed by Section 4999 of the Code, the payments will be (i) paid in full, or (ii) paid to a lesser extent such that the excise tax would no longer be applicable, whichever amount would result in the greatest amount of payments to the non-CEO NEO on an after-tax basis.

Potential Payments Upon Termination or Change-In-Control

Our Named Executive Officers are eligible to receive certain benefits in the event of termination of such officer's employment, including following a change-in-control. The following table presents potential payments to Mses. John and Kretchmar and Messrs. Todorovic, Hurt and Fencl as if his or her employment had been terminated as of December 30, 2017, the last day of fiscal 2017.

The termination benefits provided to our Named Executive Officers upon their voluntary termination of employment or retirement do not discriminate in scope, terms or operation in favor of our executive officers compared to the benefits offered to all salaried employees, so those benefits are not included in the table below. The amounts presented in the table are in addition to amounts each Named Executive Officer earned or accrued prior to termination, such as the officer's balances, if any, in our Non-Qualified Deferred Compensation Plan, previously vested options and restricted stock, and accrued vacation. For information about these previously earned and accrued amounts, see the "Outstanding Equity Awards at 2017 Fiscal Year-End", "2017 Option Exercises and Stock Vested" and "2017 Non-Qualified Deferred Compensation" tables located elsewhere in this proxy statement.

Name/Circumstance	Salary Continuation	Bonus[1]	Equity With Accelerated Vesting[2]	Continued Perquisites and Benefits[3]	Total
Sharon John					
Death	$ -	$315,000	$ 2,308,858	$ -	$2,623,858
Disability	-	315,000	2,308,858	-	2,623,858
Severance Termination[4]	700,000	315,000	-	15,784	1,030,784
Termination for Cause	-	-	-	-	-
Involuntary Termination if Change-in Control [5]	1,400,000	700,000	2,308,858	15,784	4,424,642
Change-in-Control (no termination)	-	-	2,308,858	-	2,308,858
Voin Todorovic					
Death	-	78,750	485,686	-	564,436
Disability	-	78,750	485,686	-	564,436
Severance Termination[4]	350,000	78,750	-	15,784	444,534
Termination for Cause	-	-	-	-	-
Involuntary Termination if Change-in Control [5]	525,000	175,000	485,686	15,784	1,201,470
Change-in-Control (no termination)	-	-	485,686	-	485,686
Jennifer Kretchmar					
Death	-	92,138	505,678	-	597,816
Disability	-	92,138	505,678	-	597,816
Severance Termination[4]	409,500	92,138	-	15,784	517,422
Termination for Cause	-	-	-	-	-
Involuntary Termination if Change-in Control [5]	614,250	204,750	505,678	15,784	1,340,462
Change-in-Control (no termination)	-	-	505,678	-	505,678
J. Christopher Hurt					
Death	-	90,000	481,500	-	571,500
Disability	-	90,000	481,500	-	571,500
Severance Termination[4]	400,000	90,000	-	14,392	504,392
Termination for Cause	-	-	-	-	-
Involuntary Termination if Change-in Control [5]	600,000	200,000	481,500	14,392	1,295,892
Change-in-Control (no termination)	-	-	481,500	-	481,500
Eric Fencl					
Death	-	73,755	353,259	-	427,014
Disability	-	73,755	353,259	-	427,014
Severance Termination[4]	327,800	73,755	-	10,891	412,446
Termination for Cause	-	-	-	-	-
Involuntary Termination if Change-in Control [5]	491,700	163,900	353,259	10,891	1,019,750
Change-in-Control (no termination)	-	-	353,259	-	353,259

(1) Where indicated, the Named Executive Officer is entitled to a prorated bonus based on the number of full calendar weeks during the applicable fiscal year during which the executive was employed. Amount shown is the actual bonus approved in March 2018 based on the Company's 2017 performance. See footnote 5 for an explanation of

the bonus amount reported for Involuntary Termination if Change-in-Control.

(2) The amounts appearing in this column represent the aggregate market value of time-based restricted shares and performance-based restricted shares and the value of stock options, the vesting of which would have been accelerated, each based on the closing price of $9.20 for the shares of common stock on December 29, 2017.

(3) The Company will pay each Named Executive Officer a lump sum payment equivalent to 18 months of the Company-paid portion of health, dental and vision coverage.

(4) Severance Termination would occur if the Company terminated the executive without cause or if the executive terminated his or her employment for good reason prior to a change in control or following a date which is 24 months after a change in control, as each term is defined in the applicable employment agreement. Upon a termination in this case, each Named Executive Officer is entitled to salary continuation for 12 months.

(5) If a Named Executive Officer's employment is terminated during the 24-month period following a change in control, we are obligated to (i) in the case of Ms. John, continue her base salary for 24 months and pay her target bonus amount for the fiscal year in which the termination occurs, and (ii) in the case of the non-CEO Named Executive Officers, continue his or her base salary for 18 months and pay an amount equal to the Named Executive Officer's target bonus prorated for the year of termination.

CEO PAY RATIO

The Dodd–Frank Wall Street Reform and Consumer Protection Act requires companies to disclose the pay ratio of our Chief Executive Officer to our median employee. We identified our median employee taking into account all full-time, part-time, seasonal and temporary employees. As permitted by Item 402(u) of Regulation S-K, we excluded individuals employed in certain countries, as the total number of these excluded employees is less than 5% of our total worldwide workforce. We included employees in the United States (3,514) and the United Kingdom (941) and excluded employees in Canada (160), Ireland (35), Denmark (25) and China (11).

To identify the median of annual total compensation of all included employees, we examined the total compensation, our consistently applied compensation measure, for all full pay periods from the beginning of fiscal 2017 through October 1, 2017 (the "Testing Date") for all included individuals, excluding our Chief Executive Officer, who were employed by us on the Testing Date. We calculated annual total compensation using the same methodology we use for calculating the total compensation of our Named Executive Officers as disclosed in the Summary Compensation Table in this proxy statement. We applied a British pound to U.S. dollar exchange rate to the compensation elements paid in British currency, utilizing the exchange rate as of September 29, 2017, the last business date prior to the Testing Date. We did not make any assumptions, adjustments, or estimates with respect to total compensation, and we did not annualize the compensation for any employees.

The 2017 annual total compensation of our Chief Executive Officer was $1,894,435, and the 2017 annual total compensation for the median employee was $6,198. The resulting ratio of our Chief Executive Officer's pay to the pay of our median employee for fiscal year 2017 is 305.7 to 1. We believe it is noteworthy that given the nature of our business, a significant number of our employees are part-time, seasonal or temporary employees. Furthermore, the ratio of our Chief Executive Officer annual total compensation to that of the median employee was impacted by the fact that approximately 20% of our employees are located in the United Kingdom where applicable wage regulations for younger workers resulted in a higher pay ratio.

PROPOSAL NO. 2. RATIFICATION OF APPOINTMENT OF INDEPENDENT ACCOUNTANTS

Ernst & Young LLP served as the Company's independent registered public accounting firm for the year ended December 30, 2017. The Audit Committee of the Board of Directors has appointed Ernst & Young LLP to act in that capacity for fiscal 2018, which ends on February 2, 2019. A representative of Ernst & Young LLP is expected to be present at the annual meeting with the opportunity to make a statement if he or she desires to do so and to be available to respond to appropriate questions from stockholders.

Although the Company is not required to submit this appointment to a vote of the stockholders, the Audit Committee of the Board of Directors continues to believe it appropriate as a matter of policy to request that the stockholders ratify the appointment of Ernst & Young LLP as principal independent registered public accounting firm. If the stockholders do not ratify the appointment, the Audit Committee will investigate the reasons for stockholder rejection and consider whether to retain Ernst & Young LLP or appoint another independent registered public accounting firm. Even if the appointment is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and its stockholders.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE RATIFICATION OF ERNST & YOUNG LLP AS THE COMPANY’S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING FEBRUARY 2, 2019.

Principal Accountant Fees

The following table presents fees for professional services rendered by Ernst & Young LLP for the audit of the Company's annual financial statements for the fiscal years ended December 30, 2017 and December 31, 2016, as well as fees billed for other services rendered by Ernst & Young LLP during those periods:

	Fiscal 2017	**Fiscal 2016**
Audit Fees[(1)]	**$828,031**	$786,400
Audit-Related Fees	**7,000**	2,000
Tax Fees[(2)]	**218,548**	394,600
All Other Fees	**—**	—
Total Fees	**$1,053,579**	$1,183,000

(1) Audit Fees are fees paid for professional services rendered for the audit of the Company's annual consolidated financial statements, reviews of the Company's interim consolidated financial statements and statutory audit requirements at certain non-U.S. locations.

(2) Tax Fees are fees paid for an international expansion review, transfer pricing studies, compliance services and tax consultation.

Policy Regarding Pre-Approval of Services Provided by the Independent Registered Public Accounting Firm

The Audit Committee Charter requires the Audit Committee's pre-approval of all audit and permitted non-audit services to be performed for the Company by the independent registered public accounting firm. In determining whether proposed services are permissible, the Audit Committee considers whether the provision of such services is compatible with maintaining auditor independence. As part of its consideration of proposed services, the Audit Committee may consult with management, but may not delegate this authority to management. Pursuant to a delegation of authority from the Audit Committee, the Chair of the Audit Committee may pre-approve such audit or permitted non-audit services. If the Chair approves any such services, any such approvals are presented to the full Audit Committee at the next scheduled Audit Committee meeting. All of the services performed by Ernst & Young LLP during the 2017 and 2016 fiscal years were pre-approved by the Audit Committee.

PROPOSAL NO. 3. ADVISORY (NON-BINDING) VOTE APPROVING EXECUTIVE COMPENSATION

We are asking our stockholders to provide advisory approval of the compensation of our Named Executive Officers. As described in the "Compensation Discussion and Analysis" section of this proxy statement, the Compensation and Development Committee has designed and implemented executive compensation programs that are intended to align with our stockholders' interests. The fundamental objectives of our executive compensation program are to attract and retain highly qualified executive officers, to motivate these executive officers to materially contribute to our long-term business success, and to align the interests of our executive officers and stockholders by rewarding our executives for individual and corporate performance based on targets established by the Compensation and Development Committee. We believe that the information provided in the "Executive Compensation" section of this proxy statement, and in

particular the information discussed in the “Compensation Discussion and Analysis” portion, demonstrates that our executive compensation program was designed appropriately to meet these objectives. Accordingly, we ask our stockholders to vote “FOR” the following resolution at the annual meeting:

“RESOLVED, that the stockholders approve, on an advisory basis, the compensation paid to the Named Executive Officers, as disclosed in the proxy statement for the 2018 Annual Meeting of Stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, and other related disclosure.”

While this vote is advisory, and not binding on our Company, it will provide information to our Compensation and Development Committee regarding investor sentiment about our executive compensation philosophy, policies and practices, which the Committee will be able to consider when determining executive compensation for the remainder of fiscal 2018 and beyond.

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE APPROVAL, ON A NON-BINDING BASIS, OF OUR NAMED EXECUTIVE OFFICER COMPENSATION.

REPORT OF THE AUDIT COMMITTEE

The primary function of the Audit Committee is to assist the Board of Directors in its oversight of the Company's financial reporting processes. Management is responsible for the Company's financial statements and overall reporting process, including the system of internal controls. The independent auditors are responsible for conducting annual audits and quarterly reviews of the Company's financial statements and expressing an opinion as to the conformity of the annual financial statements with generally accepted accounting principles.

The Audit Committee submits the following report pursuant to the SEC rules:

- The Audit Committee has reviewed and discussed with management and with Ernst & Young LLP, the Company's independent registered public accounting firm, the audited consolidated financial statements of the Company for the year ended December 30, 2017 (the "2017 Financial Statements").
- Ernst & Young LLP has advised the management of the Company and the Audit Committee that it has discussed with them all the matters required to be discussed by Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 1301, "Communications with Audit Committees."
- The Audit Committee has received from Ernst & Young LLP the written disclosures and the letter required by applicable requirements of the PCAOB regarding Ernst & Young LLP's communications with the Audit Committee concerning independence and has discussed Ernst & Young LLP's independence with them.
- Based upon the aforementioned review, discussions and representations of Ernst & Young LLP, and the unqualified audit opinion presented by Ernst & Young LLP on the 2017 Financial Statements, the Audit Committee recommended to the Board of Directors that the 2017 Financial Statements be included in the Company's Annual Report on Form 10-K for the 2017 fiscal year and that Ernst & Young LLP be selected as the independent registered public accounting firm for the Company for fiscal 2018.

Submitted by the Audit Committee of the Board of Directors:

Michael Shaffer, Chairman
Maxine Clark
Robert L. Dixon, Jr.
Craig Leavitt

STOCKHOLDER COMMUNICATIONS WITH THE BOARD

Our Board of Directors has adopted a policy to provide a process for holders of our securities to send written

communications to our Board. Any stockholder wishing to send communications to our Board should send the written communication and the following information to our Corporate Secretary, Build-A-Bear Workshop, Inc., 1954 Innerbelt Business Center Drive, St. Louis, Missouri 63114:

- stockholder's name, number and type of securities owned, length of period held, and proof of ownership;
- name, age, business and residential address of stockholder; and
- any individual Director or committee to which the stockholder would like to have the written statement and other information sent.

The Corporate Secretary, or his or her designee, will collect and organize all of such stockholder communications as he or she deems appropriate and, at least once each fiscal quarter, forward these materials to the Non-Executive Chairman, any committee Chair or individual Director. The Corporate Secretary may refuse to forward material which he or she determines in good faith to be scandalous, threatening or otherwise inappropriate for delivery. The Corporate Secretary will also maintain copies of such materials.

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SELECTION OF NOMINEES FOR THE BOARD OF DIRECTORS

The Nominating and Corporate Governance Committee is responsible for identifying and recommending to the Board candidates to serve as members of the Board. The Nominating and Corporate Governance Committee has not adopted specific, minimum qualifications that nominees must meet in order for the Nominating and Corporate Governance Committee to recommend them to the Board, but rather, each nominee is individually evaluated based on his or her individual merits, taking into account our needs and the composition of the Board. The Nominating and Corporate Governance Committee seeks independent Directors who represent a mix of backgrounds and experiences that will enhance the quality of the Board's deliberations and decisions. Candidates should have substantial experience with one or more publicly traded national or multinational companies or shall have achieved a high level of distinction in their chosen fields. The Nominating and Corporate Governance Committee has not adopted a formal policy with respect to diversity; however, the Board and the Nominating and Corporate Governance Committee believe that Board membership should reflect diversity in its broadest sense, including persons diverse in geography, gender, and ethnicity. The Nominating and Corporate Governance Committee will consider candidates submitted by a variety of sources including, without limitation, incumbent Directors, stockholders and our management. Periodically, the Company has engaged independent third party search firms to assist the Company in identifying and evaluating qualified Board candidates.

In all cases, members of the Nominating and Corporate Governance Committee discuss and evaluate each potential candidate's educational background, employment history, outside commitments and other relevant factors in detail, and suggest individuals qualified to serve on the Board to explore in more depth. Once a candidate is identified whom the Nominating and Corporate Governance Committee wants to seriously consider and move toward nomination, the Chairman of the Nominating and Corporate Governance Committee, or his or her designee, meets with that nominee to evaluate his or her potential interest in serving on the Board and sets up interviews with the full Nominating and Corporate Governance Committee.

Any stockholder or interested party wishing to submit a candidate for consideration should send the following information to the Corporate Secretary, Build-A-Bear Workshop, Inc., 1954 Innerbelt Business Center Drive, St. Louis, Missouri 63114:

- stockholder's name, number of shares owned, length of period held, and proof of ownership;
- name, age and address of candidate;
- a detailed resume describing, among other things, the candidate's educational background, occupation, employment history, and material outside commitments (for example, memberships on other boards and committees, charitable foundations and the like);
- a supporting statement which describes the candidate's reasons for seeking election to the Board and documents his or her ability to serve on the Board;
- any information relating to the candidate that is required to be disclosed in the solicitation of proxies for election of Directors;
- a description of any arrangements or understandings between the stockholder and the candidate;
- any other information that would be useful to the Committee in considering the candidate; and
- a signed statement from the candidate, confirming his or her willingness to serve on the Board.

The Corporate Secretary will promptly forward such materials to the Nominating and Corporate Governance Committee Chair and the Non-Executive Chairman. The Corporate Secretary will also maintain copies of such

materials for future reference by the Nominating and Corporate Governance Committee when filling Board positions. The same criteria apply with respect to the Nominating and Corporate Governance Committee's evaluation of all candidates for membership to the Board. However, separate procedures will apply, as provided in the bylaws, if a stockholder wishes to submit at an annual meeting a Director candidate who is not approved by the Nominating and Corporate Governance Committee or the full Board.

STOCKHOLDER PROPOSALS

Our amended and restated bylaws provide that stockholders seeking to bring business before an annual meeting of stockholders, or to nominate candidates for election as Directors at an annual meeting of stockholders, must provide timely notice in writing. To be timely, a stockholder's notice must be delivered to or mailed and received at our principal executive offices not more than 120 days or less than 90 days prior to the anniversary date of the immediately preceding annual meeting of stockholders, or between January 10, 2019 and February 9, 2019, in the case of the 2019 annual meeting. However, in the event that no annual meeting was held in the previous year or the annual meeting is called for a date that is not within 30 days before or after such anniversary date, notice by the stockholder, in order to be timely, must be received no later than the close of business on the 10th day following the date on which notice of the date of the annual meeting was mailed to stockholders or made public, whichever first occurs. Our amended and restated bylaws also specify requirements as to the form and content of a stockholder's notice. These provisions may preclude stockholders from bringing matters before an annual meeting of stockholders or from making nominations for Directors at an annual meeting of stockholders.

Stockholder proposals intended to be presented at the 2019 annual meeting must be received by the Company at its principal executive office no later than November 29, 2018 in order to be eligible for inclusion in the Company's proxy statement and proxy relating to that meeting. Upon receipt of any proposal, the Company will determine whether to include such proposal in accordance with regulations governing the solicitation of proxies.

OTHER MATTERS

Management does not intend to bring before the meeting any matters other than those specifically described above and knows of no matters other than the foregoing to come before the meeting. If any other matters or motions properly come before the meeting, it is the intention of the persons named in the accompanying proxy to vote such proxy in accordance with the recommendation of management on such matters or motions, including any matters dealing with the conduct of the meeting.

By Order of the Board of Directors

Eric Fencl
Chief Administrative Officer,

General Counsel and Secretary

MARCH 29, 2018

APPENDIX A

DIRECTIONS TO THE COMPANY'S WORLD BEARQUARTERS

1954 INNERBELT BUSINESS CENTER DRIVE

ST. LOUIS, MISSOURI 63114

Build-A-Bear Workshop's World Bearquarters is located at 1954 Innerbelt Business Center Drive. Signs will be posted in the parking lot to direct you to the appropriate entrance.

FROM LAMBERT INTERNATIONAL AIRPORT

Take I-70 east and merge onto I-170 south via Exit 238B. Take the Page Avenue exit, Exit 4. Turn right onto Page Avenue and right onto Innerbelt Business Center Drive.

FROM DOWNTOWN ST. LOUIS OR ILLINOIS

Take I-70 west and merge onto I-170 south via Exit 238B. Take the Page Avenue exit, Exit 4. Turn right onto Page Avenue and right onto Innerbelt Business Center Drive.

FROM NORTH COUNTY LOCATIONS

Take I-170 south to the Page Avenue exit, Exit 4. Turn right onto Page Avenue and right onto Innerbelt Business Center Drive.

FROM SOUTH COUNTY LOCATIONS

Take I-270 north to I-64/US-40 east via Exit 12. Merge onto I-170 north. Take the Page Avenue exit, Exit 4. Turn left onto Page Avenue and turn right onto Innerbelt Business Center Drive.

FROM WEST COUNTY LOCATIONS

Take I-64/US-40 east and merge onto I-170 north. Take the Page Avenue exit, Exit 4. Turn left onto Page Avenue and turn right onto Innerbelt Business Center Drive.

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