Human Resource Management

Vermont Teddy Bear employees were known as the "Bear People," a term that expressed management's appreciation and respect for their dedication. Beth Peters was Vice President of Human Resources. As of June 30, 1998, the company employed 181 individuals, of whom 94 were employed in production-related functions, 67 were employed in sales and marketing positions, and 20 were employed in administrative and management positions.[76] None of the employees belonged to a union. Overall, the company believed that favorable relations existed with all employees.[77]

The company supplemented its regular in-house workforce with homeworkers who performed production functions at their homes. The level of outsourced work fluctuated with company production targets. As of June 30, 1998, there were 21 homeworkers producing product for the company. Homeworkers were treated as independent contractors for all purposes, except for withholding of federal employment taxes. As independent contractors, homeworkers were free to reject or accept any work offered by the company.[78] Independent contractors allowed the company flexibility in meeting heavy demand at holiday periods such as Christmas, Valentine's Day, and Mother's Day. This relationship also allowed the homeworkers flexibility in scheduling their hours of work.

Bear Market

The teddy bear was first created in the United States in 1902. The Steiff Company of Grengen/Brenz, Germany, displayed one at a fair in Leipzig in 1903. Thomas Michton of Brooklyn, New York, was credited with creating the name "Teddy Bear" in honor of President Theodore Roosevelt. At the time of the naming, President Roosevelt had been on a well-publicized hunting trip in Mississippi while negotiating a border dispute with Louisiana. When he came up empty-handed from his hunting, his aides rounded up a bear cub for the President to shoot. His granddaughter, Sarah Alden "Aldie" Gannett, said, "I think he felt he could never face his children again if he shot anything so small. So he let it go."[79]

The incident was popularized in cartoons by Clifford Berryman of the *Washington Post.* Michton and his wife stitched up a couple of honey-colored bears and then displayed them in their novelty store window along with a copy of Berryman's cartoon.

The bears sold in a day. Michton made another stuffed bear and sent it to President Roosevelt requesting his permission to use his name. Roosevelt replied with a handwritten note: "I doubt if my name will mean much in the bear business, but you may use it if you wish." It was simply signed "T. R."[80]

Teddy bears today fall into one of two broad categories: either to a subsegment of the toy industry, plush dolls and animals, or are part of the collectibles industry. Although no one knows exactly how many teddy bears are sold each year, it is known that teddy bears accounted for 70 to 80% of the $1 billion plush toy industry in 1997.[81] "Bears sell across every season, occasion, and holiday," said Del Clark, Director of Merchandising for Fiesta, a Verona, California, maker of stuffed animals.[82] Not only have bears historically been a steady seller, but returns of teddy bears are almost nonexistent.[83]

The U.S. toy industry (including teddy bears, dolls, puzzles, games, action figures and vehicles, and preschool activity toys) was estimated to be worth $25 billion in sales and had been growing at an annual rate of more than 3%.[84] With its combination of a large demographic base of children and a population with a high level of disposable income, the U.S. toy market was larger than those of Japan (the number two market) and Western Europe combined.[85] Most toys that are sold in the United States were made in foreign countries. Chinese-produced toys represented about 30% of all U.S. toy sales due to inexpensive labor and favorable duty rates on imports.[86] The big toy manufacturers were buying each other's operations and those of smaller toy makers. In 1997, the number one toy manufacturer, Mattel (maker of Fisher-Price toys and Barbie dolls), bought Tyco Toys, formerly ranked number three. Hasbro (maker of G.I. Joe, Monopoly, and Milton Bradley toys) was the number two toy maker. Some games and toys maintained popularity over time, others were passing fads. It was difficult to predict which would remain popular over time. In the 1990s, marketing appeared to be the key to success. Toy production and marketing were regularly integrated with movies and television programs. For example, Star Wars action figures and other merchandise accounted for about one third of number 3 toy make Galoob Toys' 1997 sales of $360 million.[87] Small toy makers found it difficult to compete with the multimillion-dollar marketing campaigns and the in-depth market research of companies like Mattel, although there was always an exception such as Beanie Babies.

During 1997, manufacturers' shipments of plush products rose 37.5%, from $984 million to $1.4 billion, largely as a result of the Beanie Baby craze.[88] Designed by Ty Warner, the owner of Ty, Inc., Beanie Babies had been the big sales item since 1996 when they generated sales of $250 million. The $5 toys were produced in limited numbers and sold through specialty toy stores rather than through mass-market retailers. Beanie Baby characters no longer in production fetched up to $3,000 among collectors. Some retailers reported a decline in the sales of other plush toys due to the demand for Beanie Babies.[89]

Competitors of Vermont Teddy Bear were of various types. Major plush doll manufacturers such as Mattel and Hasbro were considered competition in this subsegment of the toy industry. More direct competition for Vermont Teddy came from other bear manufacturers including Steiff of Germany, Dakin, Applause, Fiesta, North American Bear, and Gund, the leading maker of toy bears. Information about some of these direct competitors is presented in **Exhibit 6**.

In general, these competitors relied on sales though retail outlets and had much greater financial resources to drive sales and marketing efforts than did Vermont Teddy Bear. Unlike Vermont Teddy Bear, these companies depended on foreign manufacturing and sources of raw materials, enabling them to sell comparable products at retail prices below those currently offered by Vermont Teddy. In addition, small craft stores had begun to sell locally produced all-American-made teddy bears, and publications had been developed to teach people to craft their own bears.

The collectible market in bears had recently been booming with people seeking bears as financial investments. Collectible bears are those that are meant to be displayed, not drooled or spit up on by their owners. "In the past 5 to 10 years we've seen a tremendous growth in the

Exhibit 6

Competition: The Vermont Teddy Bear Co., Inc.

Steiff
High-quality bears are manufactured in Germany and the Far East. The bears are not individually customized. The company's trademark is a button sewn into the ear of each bear. Prices of Steiff bears range from $50 for a 6-inch-tall bear to several thousand dollars for a life-size model. The bears are sold in a variety of outlets from discount stores and supermarkets to high-end specialty shops and antique stores.

Gund
This mass producer of a wide range of plush animals established an Internet Web site, allowing users to view and purchase products. Bears are manufactured overseas, primarily in Korea. Appearance of the bears is different from Vermont Teddy Bears', with shorter noses and limbs. They offer a broad range of styles and prices.

Teddy Bear Factory
This is the only other American manufacturer of teddy bears. The company is located in San Francisco and highly regional in its sales and marketing efforts. Vermont Teddy Bear advertises in the San Francisco Bay area but does not consider the Teddy Bear Factory to be strong competition because of the size and because its market is so regional.

North American Bear Company
This middle-sized company manufactures all of its bears in the Orient, primarily in Korea. Appearance of the bears is different from Vermont Teddy Bears, with shorter noses and limbs. The company advertises in trade magazines and has begun to do consumer advertising. It sells to retailers in Europe and Japan and collectors and gift shops in the United States.

Applause Enterprises, Inc.
This company focuses on manufacturing plush toy versions of Sesame Street, Looney Tunes, Star Wars, Muppets and Disney characters as well as nonplush toys. Company was formed by the 1995 merger of plush toy maker Dakin and a company founded by Wallace Berrie.

upscale bear, the limited editions, and the artist-designed bears," said George B. Black, Jr., director of the Teddy Bear Museum in Naples, Florida.[90] The "collectible" segment of the plush market generated $441 million in consumer sales for 1996, up from $354 million in 1995. Collectible plush sales for 1997 were expected to reach nearly $700 million. This would make plush one of the fastest growing categories in the $9.2 billion collectibles industry.[91] Collectible bears started at about $25 but could cost $1,000 or more. This number was somewhat misleading, considering that the value of a collectible bear can be in excess of $50,000. A 1904 Steiff "Teddy Girl" bear sold at a Christie's auction in 1994 for a record $171,380.[92]

Two trade magazines, *Teddy Bear and Friends* and *Teddy Bear Review*, targeted the collectibles market. These magazines tell bear collectors where they can buy and sell old bears. In 1998, major bear shows and jamborees were held in at least 25 states, as well as hundreds of bear-making retreats and workshops.[93]

The concept of Bear-Grams lent itself to two distinct groups of competitors. Vermont Teddy Bear competed not only with soft plush stuffed animals, especially teddy bears, but also with a variety of other special occasion greetings such as flowers, candy, balloons, cakes, and other gift items that could be ordered by phone for special occasions and delivered the next day. Many of these competitors had greater financial, sales, and marketing resources than Vermont Teddy Bear.[94]

Patents, Trademarks, and Licenses

The company's name in combination with its original logo was a registered trademark in the United States. In addition, the company owned the registered trademarks in the United States for "The Vermont Teddy Bear Company," "Bear-Gram," "Teddy Bear-Gram," and "Make A Friend For Life." The company also owned the registered service marks "Bear Counselor," "Vermont Bear-Gram," and "Racer Ted," and had applications pending to register the company's second and third company logos, "Bearanimal," "Coffee Cub," "Vermont Bear-Gram," "Vermont Baby Bear," "The Great American Teddy Bear," "All-American Teddy Bear," "Beau and Beebee," "Teddy-Grams," and "Vermont Teddy Wear."[95]

Vermont Teddy Bear also owned the registered trademark "Vermont Teddy Bear" in Japan and had an application pending to register "The Great American Teddy Bear" in Japan.[96]

Although the company had continuously used the "Bear-Gram" trademark since April 1985, its initial application to register the mark on June 13, 1990, was rejected by the U.S. Patent and Trademark Office due to prior registration of the mark "Bear-A-Grams," by another company on June 7, 1988. The company reapplied to register "Bear-Gram," and its application was approved on November 5, 1996.

The company also claimed copyright, service mark, or trademark protection for its teddy bear designs, its marketing slogans, and its advertising copy and promotional literature.

On May 16, 1997, Vermont Teddy Bear sued Disney Enterprises, Inc., for injunctive relief and unspecified damages claiming that Disney copied its bear-by-mail concept with Pooh-Grams based on Disney's Winnie the Pooh character. The complaint accused Disney of unfair competition and trademark infringement saying the Pooh-Gram is "confusingly similar" to Bear-Grams in name, logo, how it is personalized, how it is delivered, and even how it is marketed.[97] Disney introduced Pooh-Grams in its fall 1996 catalog and escalated its promotion of the product using the Internet, print, and radio advertising. Disney disagreed saying that the Vermont Teddy lawsuit was without merit because Winnie the Pooh has been a well-known Disney character for 25 years and there are all kinds of grams—mail-grams, candy-grams, money-grams, telegrams, flower-grams—not just Bear-Grams.

On September 9, 1997, Vermont Teddy announced that it had entered into an agreement to resolve its dispute with Walt Disney Co. Under the agreement, Disney will continue to offer its Pooh-Gram products and services but will voluntarily limit its use of the Pooh-Gram mark in certain advertising and will adequately distinguish its trademarks and service marks from those of Vermont Teddy Bear. Vermont Teddy in turn will be allowed to offer certain Winnie-the-Pooh merchandise for sale in its mail order catalogs but cannot offer the merchandise with its Bear-Gram program.[98]

Finance

On November 23, 1993, Vermont Teddy Bear Co., Inc., sold 1.15 million shares of stock at $10 a share through an underwriting group led by Barrington Capital Group L.P. The stock rose as high as $19 before closing the day at $16.75, an increase of 67.5% in its first day of trading. The market's reaction to the IPO signaled that investors thought the stock was undervalued at $10 and that the company had a great deal of growth potential. During fiscal 1998, the company's stock price fluctuated between $2.56 and $0.75 a share. This was an indication that investors reconsidered the growth potential of Vermont Teddy Bear.

Vice President of Finance was Mark Sleeper. **Exhibits** 7 and 8 detail Vermont Teddy Bear's financial situation. Prior to 1994, Vermont Teddy Bear had experienced a great deal of success and profitability. The company's net sales increased 61% from $10,569,017 in 1992 to $17,025,856 in 1993, while the cost of goods sold decreased from 43.1% of sales to 41.8% during the same time period. Net income increased 314% from $202,601 in 1992 to $838,955 in 1993.

Sales reached a peak in 1994 at $20,560,566. This represented a 21% growth over 1993. Unfortunately profits did not experience similar growth. Had it not been for an almost $70,000 tax refund, the company would have experienced a net loss in 1994. The company's net profit fell to $17,523 after taxes in 1994 due to a substantial increase in both selling expense and general and administrative expenses. These two items combined for an increase of 35% over comparable figures for 1993.

In 1995, sales fell to $20,044,796. Although this represented only a 2.5% decline, this decline in sales painted a picture for the next two years. While sales were decreasing, selling and general and administrative expenses continued to climb. These expenses grew by 10% to $13,463,631 in 1995. These two items represented 67% of sales in 1996, whereas they were 53% of sales in 1993.

After three years of declining sales, Vermont Teddy Bear's sales grew by 4.4% in 1998 to $17,207,543. Vermont Teddy Bear experienced a loss of $2,422,477 in 1995. It returned to profitability in 1996, earning $151,953. Unfortunately that was the last profitable year for the company. Losses were $1,901,745 in 1997 and $1,683,669 in 1998. Interest expense had risen dramatically for the company from $35,002 in 1995 to $608,844 in 1998.

The company included in its quarterly report to the SEC (Filing Date: 5/14/98) that it had been operating without a working capital line of credit since July 18, 1997. On that date, the company completed a sale-leaseback transaction involving its factory headquarters and a portion of its property located in Shelburne, Vermont. This financing replaced the company's mortgage and line of credit. The company received $5.9 million from this transaction. Of this amount, $3.3 million was used to pay off the mortgage and $600,000 was used to pay off the line of credit. A $591,000 transactions cost was associated with the sale-leaseback. The lease obligation was repayable on a 20-year amortization schedule through July 2017.

On October 10, 1997, Vermont Teddy received a commitment from Green Mountain Capital L.P. whereby it agreed to lend the company up to $200,000 for up to five years at 12% interest. The loan was secured by security interest in the company's real and personal property. Green Mountain Capital also received warrants to purchase 100,000 shares of common stock at an exercise price of $1.00. The warrants could be exercised any time from two years from the date of the loan to seven years from the date of the loan.

To reduce costs, the company closed its retail store in New York City and planned to close the Freeport, Maine, and North Conway, New Hampshire, stores before the end of 1998 because the revenue increases necessary to support the annual lease obligations would not be achievable in the short run. The company's lease obligation of $300,000 per year on the New York City store would continue until a replacement tenant was found.

On May 22, 1998, it was announced that The Vermont Teddy Bear Co., Inc., had signed a letter of intent with the Shepherd Group, a Boston-based private equity investment firm, for a proposed $600,000 equity investment with the company. The Shepherd Group invested in venture and existing small- to middle-market companies focusing on companies with high-growth potential and unique market-ready quality products and services. In return for the $600,000 investment, the Shepherd Group received 60 shares of Series C Preferred Stock as well as warrants to purchase 495,868 shares of Common Stock at $1.21 per share. The transaction was subject to final agreements and various approvals and conditions.

The Series C Convertible Redeemable Stock carried a 6% coupon, and each share was convertible into 8,264,467 shares of the company's Common Stock. The Preferred had voting rights, and the Shepherd Group was entitled to two seats on the company's Board of Directors.

Elisabeth Robert noted, "The additional funds will provide working capital for the company to pursue growth in the Bear-Gram channel and to maximize the benefits of importing raw materials. Additionally Tom Shepherd has strong financial and operations experience and will bring a valuable perspective to the Board of Directors. Tom's strong suit has been working with companies that have not yet realized the full potential of their brand."[99]

According to some analysts, the survival of this company was going to depend on maintaining a source of working capital, cost containment, and a rebound in sales back to their 1995 level. The company had taken an aggressive approach to ensuring survival, but this was not done cheaply. High interest rates were paid and warrants to purchase stock, at what might turn out to be a bargain price, had been issued.

Exhibit 7

Consolidated Balance Sheets: The Vermont Teddy Bear Co., Inc.

Year Ending June 30	1998	1997	1996	1995	1994[1]	1993[1]	1992[1]
Assets							
Current assets							
Cash and marketable securities	$ 1,527,052	$ 441,573	$ 1,121,500	$ 1,070,862	$ 2,379,760	$ 8,561,525	$ —
Accounts receivable, trade	51,538	46,304	131,550	122,679	142,029	103,762	77,815
Inventories	2,396,245	3,302,313	1,974,731	3,042,484	4,024,247	2,425,233	1,135,940
Prepaid expenses	444,229	386,947	277,502	213,236	568,680	123,886	10,681
Due from officer	—	—	—	—	565,714	—	—
Deferred income taxes	233,203	259,016	240,585	126,393	322,106	194,082	—
Total current assets	4,652,267	4,436,153	3,745,868	4,575,654	8,002,536	11,408,488	1,224,436
Property and equipment	8,844,475	9,845,935	10,300,318	10,493,214	3,052,002	861,419	589,196
Construction in progress	—	—	—	—	3,275,527	—	—
Due from officer	—	—	—	—	128,008	128,008	102,480
Deposits and other assets	903,110	272,348	98,086	102,676	121,640	97,400	14,356
Notes receivable	87,500	95,000	95,000	190,000	190,000	—	—
Total assets	$14,487,352	$14,649,436	$14,239,272	$15,361,544	$14,769,713	$12,495,315	$1,930,468
Liabilities and shareholders' equity							
Current liabilities							
Cash overdraft	$ —	$ —	$ —	$ —	$ —	$ —	$148,048
Line of credit	—	550,000	—	—	—	—	—
Notes payable, bank	45,603	—	—	—	36,748	108,748	180,748
Current installments of							
Long-term debt	231,133	3,443,096	187,095	27,805	21,981	22,793	19,075
Capital lease obligations	225,738	103,759	104,146	126,306	99,901	45,604	41,795
Accounts payable	1,846,042	2,562,536	1,353,698	2,513,468	3,336,558	1,319,499	1,604,066
Accrued expenses	916,191	657,347	449,048	860,440	442,467	381,146	[illegible]

Income taxes payable	—	—	37,365	90,889	117,810	117,810	—
Total current liabilities	3,264,707	7,316,738	2,131,352	3,618,908	4,055,465	1,995,600	2,150,509
Construction loan payable							
Long-term debt	338,317	372,999	3,505,812	3,252,379	60,408	82,411	81,401
Capital lease obligations	5,748,182	209,054	312,814	347,874	398,220	58,883	61,350
Other liabilities	—	—	84,430	204,430	—	—	—
Accrued interest payable, debentures	—	—	—	—	—	—	958,219
Deferred income taxes	233,203	259,016	240,585	126,393	105,992	47,492	—
Total liabilities	9,584,409	8,157,807	6,274,993	7,549,984	4,620,085	2,184,386	3,251,479
Shareholders' equity							
Preferred stock $.05 par value:							
Authorized 1,000,000 shares							
Series A	1,044,000	900,000	900,000	900,000	900,000	900,000	—
Cumulative dividends at 8%							
Preferred stock $.05 par value:							
Authorized 375,000 shares							
Series B	10,245	10,245	—	—	—	—	—
Common stock, $.05 par value:							
Authorized 20,000,000 shares	259,787	258,638	258,638	258,625	258,625	258,625	200,000
Additional paid-in capital	10,587,316	10,565,482	10,074,595	10,073,842	10,073,842	10,073,842	185,868
Treasury stock at cost							
(12,000 shares)	(106,824)	(106,824)	(106,824)	(106,824)	(106,824)	—	—
Accumulated deficit	(6,891,581)	(5,135,912)	(3,162,130)	(3,314,083)	(976,015)	(921,538)	(1,706,879)
Total shareholders' equity	4,902,943	6,491,629	7,964,279	7,811,560	10,149,628	10,310,929	(1,321,011)
Total liabilities and shareholders' equity	$14,487,352	$14,649,436	$14,239,272	$15,361,544	$14,769,713	$12,495,315	$1,930,468

Note:
1. Fiscal year ending December 31.

Source: The Vermont Teddy Bear Company, Inc., *1998 Annual Report.*

Exhibit 8

Statement of Operations: The Vermont Teddy Bear Co., Inc.

Year Ending June 30	1998	1997	1996	1995	1994[1]	1993[1]	1992[1]
Net sales	$17,207,543	$16,489,482	$17,039,618	$20,044,796	$20,560,566	$17,025,856	$10,569,017
Cost of goods sold	7,397,450	7,068,549	7,309,038	9,101,028	8,619,580	7,123,930	4,555,424
Gross margin	9,810,093	9,420,935	9,730,580	10,943,768	11,940,986	9,901,926	6,013,593
Selling expenses	7,866,843	7,961,003	6,287,208	9,121,023	8,907,440	6,862,328	4,454,891
General and administrative expenses	3,031,716	2,938,251	2,954,601	4,342,608	3,311,306	2,184,500	1,266,770
Total expenses	10,898,559	10,899,254	9,241,809	13,463,631	12,218,746	9,046,828	5,721,661
Operating income (loss)	(1,088,466)	(1,478,321)	488,771	(2,519,863)	(277,760)	855,098	291,932
Interest income	26,126	53,267	41,092	192,156	248,987	27,887	2,152
Miscellaneous income	29,243	(11,973)	63,236	1,620	1,620	25,000	—
Interest expense	(650,572)	(464,768)	(441,146)	(35,002)	(24,848)	(97,810)	(91,483)
Income (loss) before taxes	(1,683,669)	(1,901,795)	151,953	(2,361,089)	(52,001)	810,175	202,601
Income tax provision (benefit)				61,388	(69,524)	(28,780)	—
Net income (loss)	$(1,683,669)	$(1,901,795)	$ 151,953	$(2,422,477)	$ 17,523	$ 838,955	$ 202,601
Preferred stock dividends	(72,000)	(72,000)	—	(72,000)	(72,000)	(53,614)	—
Net earnings (loss) common shareholders	(1,611,669)	(1,829,795)	151,953	(2,350,477)	89,523	892,569	202,601
Net earnings (loss) per common share	(0.34)	(0.38)	0.03	(0.48)	(0.10)	0.19	0.05
Weighted average number of shares outstanding	5,172,475	5,160,750	5,160,583	5,160,500	5,164,057	4,210,070	4,024,140

Note:
1. Fiscal year ending December 31.

Source: The Vermont Teddy Bear Company, Inc., *1998 Annual Report.*