FORM 10-Q

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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| ☒ | QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  For the quarterly period ended August 31, 2020 |
| ☐ | TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  For the transition period from \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ to \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_  Commission file number: 0-31555 |
|  |  |

BAB, Inc.

(Name of small business issuer in its charter)

|  |  |
| --- | --- |
| Delaware | 36-4389547 |
| (State or other jurisdiction of incorporation or  organization) | (I.R.S. Employer Identification No.) |

 500 Lake Cook Road, Suite 475, Deerfield, Illinois 60015

(Address of principal executive offices) (Zip Code)

Issuer's telephone number (847) 948-7520

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

|  |  |  |
| --- | --- | --- |
| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
| Common Stock | BABB | OTCQB |

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).   Yes ☒   No ☐

Indicate by checkmark whether the registrant is a large accelerated filer, accelerated filer, a non-accelerated filer, or a smaller reporting company. Large accelerated filer ☐      Accelerated filer ☐     Non-accelerated filer ☐     Smaller reporting company ☒

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

Indicate by check mark whether the registrant is a shell company. Yes ☐         No ☒

As of October 14, 2020 BAB, Inc. had: 7,263,508 shares of Common Stock outstanding.

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**PART I**

|  |  |
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| **ITEM 1.** | **FINANCIAL STATEMENTS** |

**BAB, Inc.**

**Consolidated Balance Sheets**

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SEE ACCOMPANYING NOTES

**BAB, Inc.**

**Consolidated Statements of Income**

**For the Three Months and Nine Months Ended August 31, 2020 and August 31, 2019**

**(Unaudited)**

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SEE ACCOMPANYING NOTES

**BAB, Inc.**

**Consolidated Statements of Cash Flows**

**For the Three Months and Nine Months Ended August 31, 2020 and August 31, 2019**

**(Unaudited)**



 SEE ACCOMPANYING NOTES

**BAB, Inc.**

**Notes to Unaudited Consolidated Financial Statements**

**For the Three Months and Nine Months Ended August 31, 2020 and August 31, 2019**

**(Unaudited)**

**Note 1. Nature of Operations**

BAB, Inc. (“the Company”) has three wholly owned subsidiaries: BAB Systems, Inc. (“Systems”), BAB Operations, Inc. (“Operations”) and BAB Investments, Inc. (“Investments”). Systems was incorporated on December 2, 1992, and was primarily established to franchise Big Apple Bagels® (“BAB”) specialty bagel retail stores. My Favorite Muffin (“MFM”) was acquired in 1997 and is included as a part of Systems. Brewster’s (“Brewster’s”) was established in 1996 and the coffee is sold in BAB and MFM locations. SweetDuet® (“SD”) frozen yogurt can be added as an additional brand in a BAB location. Operations was formed in 1995, primarily to operate Company-owned stores of which there are currently none. The assets of Jacobs Bros. Bagels (“Jacobs Bros.”) were acquired in 1999, and any branded wholesale business uses this trademark. Investments was incorporated in 2009 to be used for the purpose of acquisitions. To date there have been no acquisitions.

The Company was incorporated under the laws of the State of Delaware on July 12, 2000.  The Company currently franchises and licenses bagel and muffin retail units under the BAB, MFM and SD trade names. At August 31, 2020, the Company had 72 franchise units and 7 licensed units in operation in 22 states and the United Arab Emirates. There are 3 units under development. The Company additionally derives income from the sale of its trademark bagels, muffins and coffee through nontraditional channels of distribution including under a licensing agreement with Green Beans Coffee.

The BAB franchised brand consists of units operating as “Big Apple Bagels®,” featuring daily baked bagels, flavored cream cheeses, premium coffees, gourmet bagel sandwiches and other related products. BAB units are primarily concentrated in the Midwest and Western United States.  The MFM brand consists of units operating as “My Favorite Muffin Gourmet Muffin Bakery™” (“MFM Bakery”), featuring a large variety of freshly baked muffins and coffees and units operating as “My Favorite Muffin Your All Day Bakery Café®” (“MFM Cafe”) featuring these products as well as a variety of specialty bagel sandwiches and related products.  The SweetDuet® is a branded self-serve frozen yogurt that can be added as an additional brand in a BAB location.  Although the Company doesn't actively market Brewster's stand-alone franchises, Brewster's coffee products are sold in most franchised units.

The Company is leveraging on the natural synergy of distributing muffin products in existing BAB units and, alternatively, bagel products and Brewster's Coffee in existing MFM units. The Company expects to continue to realize efficiencies in servicing the combined base of BAB and MFM franchisees.

The accompanying condensed consolidated financial statements are unaudited. These financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted pursuant to such SEC rules and regulations; nevertheless, the Company believes that the disclosures are adequate to make the information presented not misleading.  These financial statements and the notes hereto 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 November 30, 2019 which was filed February 24, 2020.  In the opinion of the Company's management, the condensed consolidated financial statements for the unaudited interim period presented include all adjustments, including normal recurring adjustments, necessary to fairly present the results of such interim period and the financial position as of the end of said period. The results of operations for the interim period are not necessarily indicative of the results for the full year.

**2. Summary of Significant Accounting Policies**

**Unaudited Consolidated Financial Statements**

The accompanying unaudited Condensed Consolidated Financial Statements of BAB, Inc. have been prepared pursuant to generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and the rules and regulations of the United States Securities and Exchange Commission (the “SEC”) for Form 10-Q. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

**Uses of Estimates**

The preparation of the financial statements and accompanying notes are in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. Actual results could differ from those estimates.

**Accounts and Notes Receivable**

Receivables are carried at original invoice amount less estimates for doubtful accounts. Management determines the allowance for doubtful accounts by reviewing and identifying troubled accounts and by using historical collection experience. A receivable is considered to be past due if any portion of the receivable balance is outstanding 90 days past the due date. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded as income when received. Certain receivables have been converted to unsecured interest-bearing notes.

**Property, Plant and Equipment**

Property, equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are 3 to 7 years for property and equipment and 10 years, or term of lease if less, for leasehold improvements. Maintenance and repairs are charged to expense as incurred. Expenditures that materially extend the useful lives of assets are capitalized.

**Advertising and Promotion Costs**

The Company expenses advertising and promotion costs as incurred. All advertising and promotion costs were related to the Company’s franchise operations.

**Leases**

The company accounts for leases under ASC 842. Lease arrangements are determined at the inception of the contract. Operating leases are included in operating lease right-of-use (“ROU”) assets, other current and long-term operating lease liabilities on the consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities on the consolidated balance sheets.

Operating lease ROU assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. As most leases do not provide an implicit rate, we use an incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. The operating lease ROU asset also includes any lease payments made and excludes lease incentives and initial direct costs incurred. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

**2. Summary of Significant Accounting Policies (continued)**

**Recent Accounting Pronouncements**

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The standard’s main goal is to improve financial reporting by requiring earlier recognition of credit losses on financing receivables and other financial assets in scope, including trade receivables. The amendments in this update broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The guidance in ASU 2016-13 is effective for public companies for fiscal years and for interim periods with those fiscal years beginning after December 15, 2019. Early adoption of the guidance is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company will adopt ASU 2019-12 for fiscal year ending November 30, 2021.

In December 2019, the FASB issued ASU 2019-12, *“Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes,”*which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application.

The amendments in ASU 2019-12 are effective for public business entities for fiscal years beginning after December 15, 2020, including interim periods therein. Early adoption of the standard is permitted, including adoption in interim or annual periods for which financial statements have yet been issued.

If an entity early adopts these amendments in an interim period, it should reflect any adjustments as of the beginning of the annual period that includes that interim period. In addition, an entity that elects to early adopt the standard is required to adopt all of the amendments in the same period (i.e., an entity cannot select which amendments to early adopt). The Company is still evaluating the specific effect of this change. The Company will adopt ASU 2019-12 for fiscal year ending November 30, 2021.

Management does not believe that there are any other recently issued and effective or not yet effective pronouncements that would have or are expected to have any significant effect on the Company’s financial position, cash flows or results of operations.

**Statement of Cash Flows**

The chart below shows the cash and restricted cash within the consolidated statements of cash flows as of August 31, 2020 and August 31, 2019 were as follows:

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**3. Revenue Recognition**

**Franchise and related revenue**

The Company sells individual franchises. The franchise agreements typically require the franchisee to pay an initial, non-refundable fee prior to opening the respective location(s), and continuing royalty fees on a weekly basis based upon a percentage of franchisee net sales. The initial term of franchise agreements are typically 10 years.  Subject to the Company’s approval, a franchisee may generally renew the franchise agreement upon its expiration.  If approved, a franchisee may transfer a franchise agreement to a new or existing franchisee, at which point a transfer fee is typically paid by the current owner which then terminates that franchise agreement. A franchise agreement is signed with the new franchisee with no franchise fee required. If a contract is terminated prior to its term, it is a breach of contract and a penalty is assessed based on a formula reviewed and approved by management. Revenue generated from a contract breach is termed settlement income by the Company and included in licensing fees and other income.

Under the terms of our franchise agreements, the Company typically promises to provide franchise rights, pre-opening services such as blueprints, operational materials, planning and functional training courses, and ongoing services, such as management of the marketing fund. Upon adoption of Topic 606, the Company determined that certain pre-opening activities, and the franchise rights and related ongoing services, represented two separate performance obligations. The franchise fee revenue has been allocated to the two separate performance obligations using a residual approach. The Company has estimated the value of performance obligations related to certain pre-opening activities deemed to be distinct based on cost plus an applicable margin, and assigned the remaining amount of the initial franchise fee to the franchise rights and ongoing services. Revenue allocated to preopening activities is recognized when (or as) these services are performed. Revenue allocated to franchise rights and ongoing services is deferred until the store opens, and recognized on a straight line basis over the duration of the agreement, as this ensures that revenue recognition aligns with the customer’s access to the franchise right.

Royalty income is recognized during the respective franchise agreement based on the royalties earned each period as the underlying franchise store sales occur. Adoption of ASC 606 will not change when the royalty revenue is recognized, this new guidance did not impact the recognition of royalty income.

There are two items involving revenue recognition of contracts that require us to make subjective judgments: the determination of which performance obligations are distinct within the context of the overall contract and the estimated stand alone selling price of each obligation. In instances where our contract includes significant customization or modification services, the customization and modification services are generally combined and recorded as one distinct performance obligation.

**Gift Card Breakage Revenue**

The Company sells gift cards to its customers in its retail stores and through its Corporate office. The Company’s gift cards do not have an expiration date and are not redeemable for cash except where required by law. Revenue from gift cards is recognized upon redemption in exchange for product and reported within franchisee store revenue and the royalty and marketing fees are paid and shown in the Condensed Consolidated Statements of Income. Until redemption, outstanding customer balances are recorded as a liability. An obligation is recorded at the time of sale of the gift card and it is included in accrued expenses on the Company’s Condensed Consolidated Balance Sheets.

The Company recognizes gift card breakage proportional to actual gift card redemptions as required under ASC 606 on a quarterly basis and it is included in licensing fees and other revenue. Significant judgments and estimates are required in determining the breakage rate and will be reassessed each quarter.

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**3. Revenue Recognition (continued)**

**Nontraditional and rebate revenue**

As part of the Company’s franchise agreements, the franchisee purchases products and supplies from designated vendors.  The Company may receive various fees and rebates from the vendors and distributors on product purchases by franchisees.  In addition, the Company may collect various initial fees, and those fees are classified as deferred revenue in the balance sheet and straight lined over the life of the contract as deferred revenue in the balance sheet. The Company does not possess control of the products prior to their transfer to the franchisee and products are delivered to franchisees directly from the vendor or their distributors. The Company recognizes the rebates as franchisees purchase products and supplies from vendors or distributors and recognizes the initial fees over the contract life and the fees are reported as licensing fees and other income in the Condensed Consolidated Statements of Income.

**Marketing Fund**

Franchise agreements require the franchisee to pay continuing marketing fees on a weekly basis, based on a percentage of franchisees sales. Marketing fees are not paid on franchise wholesale sales. The balance sheet includes marketing fund cash, which is the restricted cash, accounts receivable and unexpended marketing fund contributions. The Company has determined that although the marketing fees are not separate performance obligations distinct from the underlying franchise right, the Company acts as the principal as it is primarily responsible for the fulfillment and control of the marketing services. As a result, the Company records marketing fees in revenues and related marketing fund expenditures in expenses in the Condensed Consolidated Statement of Income.

**Contract balances**

Information about contract balances is as follows:



**3. Revenue Recognition (continued)**

Accounts receivable represent weekly royalty payments and monthly vendor rebate payments that represent billed and unbilled receivables due as of August 31, 2020 and December 1, 2019. The balance of contract liabilities includes franchise fees, license fees and vendor payments that have ongoing contract rights and the fees are being straight lined over the contract life. Contract liabilities also include marketing fund balances and gift card liability balances.



Transaction price from franchise fees and licensing revenue allocated to remaining performance obligations as of August 31, 2020:



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| --- |
| (a) represents the estimate for the remainder of 2020 |

The Company has elected to apply certain practical expedients as defined in ASC 606-10-50-14 through 606-10-50-14A, including (i) performance obligations that are a part of a contract that has an original expected duration of one year or less; (ii) the right to invoice practical expedient; and (iii) variable consideration related to unsatisfied performance obligations that is allocated entirely to a wholly unsatisfied promise to transfer a distinct service that forms part of a single performance obligation, and the terms of that variable consideration relate specifically to our efforts to transfer the distinct service, or to a specific outcome from transferring the distinct service. As such, sales-based royalty and marketing income, as well as gift card breakage revenue, is not included in the above transaction price chart.

**4. Units Open and Under Development**

Units which are open or under development at August 31, 2020 are as follows:



**5. Earnings per Share**

The following table sets forth the computation of basic and diluted earnings per share: 

**6. Goodwill and Other Intangible Assets**

Accounting Standard Codification (“ASC”) 350 “Goodwill and Other Intangible Assets” requires that assets with indefinite lives no longer be amortized, but instead be subject to annual impairment tests.

Following the guidelines contained in ASC 350, the Company tests goodwill and intangible assets that are not subject to amortization for impairment annually or more frequently if events or circumstances indicate that impairment is possible. The Company has elected to conduct its annual test during the first quarter. During the quarter ended February 28, 2020, management qualitatively assessed goodwill to determine whether testing was necessary. Factors that management considers in this assessment include macroeconomic conditions, industry and market considerations, overall financial performance (both current and projected), changes in management and strategy, and changes in the composition and carrying amounts of net assets. If this qualitative assessment indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying value, a quantitative assessment is then performed. After reviewing the changes to the Company’s operations and overall business environment since the first quarter 2020, management believes that the decrease in sales is temporary and has determined that the carrying value of goodwill was not impaired at August 31, 2020, and was not considered necessary. In addition, the overall fair market value of the Company exceeds the book value of intangibles and goodwill as of August 31, 2020.

###### Due to the impact of the COVID-19 pandemic sales were affected from April and May of 2020. The pandemic affected sales for the third quarter and continues to affect sales in the fourth quarter, but we have seen sales recovery at store locations and it continues to move towards pre-COVID sales levels. With some degree of sales recovery occurring beginning in June and the Payroll Protection Program Loan received in May 2020, which will more than likely be forgiven, we believe that there will be no material effect on the intangible and goodwill values. Management has reviewed goodwill and intangibles for the third quarter 2020 and will continue to review goodwill and intangible assets for impairment in the future in combination with the results of the third quarter as more information and results are seen for the economic recovery of the franchise systems related to the Coronavirus pandemic.

###### **7. Lease Commitments**

The Company rents its office under an operating lease which requires it to pay base rent, real estate taxes, insurance and general repairs and maintenance. A lease was signed in June of 2018, effective October 1, 2018, expiring on March 31, 2024 with an option to renew for a 5 year period. A six month rent abatement and tenant allowance was provided in the lease, with any unused portion to be applied to base rent. The unused portion was determined to be $21,300. The renewal option has not been included in the measurement of the lease liability.

Monthly rent expense is recognized on a straight-line basis over the term of the lease. At August 31, 2020 the remaining lease term was 43 months. The operating lease is included in the balance sheet at the present value of the lease payments at a 5.25% discount rate. The discount rate was considered to be an estimate of the Company’s incremental borrowing rate.

###### **7. Lease Commitments (continued)**

Gross future minimum annual rental commitments as of August 31, 2020 are as follows:



**8. Payroll Protection Program Loan**

On May 1, 2020, BAB Systems, Inc. received loan proceeds of $228,155 from Lake Forest Bank and Trust Company, N.A., pursuant to the Paycheck Protection Program (the “PPP”) under Division A, Title 1 of the CARES Act, which was enacted March 27, 2020.

The PPP Loan, which was in the form of a Note dated April 30, 2020 was issued to BAB Systems, Inc. The BAB PPP Loan has a two-year term and bears interest at a rate of 1% per annum. Monthly principal and interest payments are deferred for nine months after the date of disbursement. The BAB PPP Loan may be prepaid at any time prior to maturity with no prepayment penalties. The Note contains events of default and other provisions customary for a loan of this type.

Under the terms of the CARES Act, PPP Loan participants can apply for and be granted forgiveness for all or a portion of loans granted under the PPP. Under the terms of the PPP, PPP loans and accrued interest are forgivable between eight weeks and twenty-four weeks, as long as the borrower uses the loan proceeds for eligible purposes, including payroll, benefits, rent and utilities, and maintains its payroll levels. The amount of loan forgiveness will be reduced if the borrower terminates employees or reduces salaries during the eight week period. BAB has used the loan proceeds for purposes consistent with the PPP, and anticipates that all or a majority of the loan amount will be forgiven, but there is no assurance provided that the Company will obtain forgiveness of the PPP Loan in whole or part.

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**9. Stockholder’s Equity**

On December 5, 2019, a $.01 quarterly and a $0.02 special cash distribution/dividend per share was declared and paid on January 8, 2020. On March 4, 2020, a $0.01 quarterly cash distribution/dividend per share was declared to shareholders of record as of March 23, 2020 and paid April 08, 2020.

On March 13, 2019 and June 5, 2019 the Board of Directors declared a $0.01 per share quarterly cash distribution/dividend to shareholders of record as of March 29, 2019 and June 21, 2019 and paid April 18, 2019 and July 10, 2019, respectively.

On September 5, 2019, a $0.01 quarterly cash distribution/dividend per share was declared to shareholders of record as of September 20, 2019 paid on October 08, 2019.

On May 6, 2013, the Board of Directors (“Board”) of BAB, Inc. authorized and declared a dividend distribution of one right for each outstanding share of the common stock of BAB, Inc. to stockholders of record at the close of business on May 13, 2013. Each right entitles the registered holder to purchase from the Company one one-thousandth of a share of the Series A Participating Preferred Stock of the Company at an exercise price of $0.90 per one-thousandth of a Preferred Share, subject to adjustment. The complete terms of the Rights are set forth in a Preferred Shares Rights Agreement, dated May 6, 2013, between the Company and IST Shareholder Services, as rights agent.

The Board adopted the Rights Agreement to protect stockholders from coercive or otherwise unfair takeover tactics. In general terms, it works by imposing a significant penalty upon any person or group that acquires 15% (or 20% in the case of certain institutional investors who report their holdings on Schedule 13G) or more of the Common Shares without the approval of the Board. As a result, the overall effect of the Rights Agreement and the issuance of the Rights may be to render more difficult a merger, tender or exchange offer or other business combination involving the Company that is not approved by the Board. However, neither the Rights Agreement nor the Rights should interfere with any merger, tender or exchange offer or other business combination approved by the Board.

Full details about the Rights Plan are contained in a Form 8-K filed by the Company with the U.S. Securities and Exchange Commission on May 7, 2013.

On June 18, 2014 an amendment to the Preferred Shares Rights Agreement was filed appointing American Stock Transfer & Trust Company, LLC as successor to Illinois Stock Transfer Company. All original rights and provisions remain unchanged. On August 18, 2015 an amendment was filed to the Preferred Shares Rights Agreement changing the final expiration date to mean the fifth anniversary of the date of the original agreement. All other original rights and provisions remain the same. On May 22, 2017 an amendment was filed extending the final expiration date to mean the seventh anniversary date of the original agreement. All other original rights and provisions remain the same. On February 22, 2019 an amendment was filed extending the final expiration date to mean the ninth anniversary date of the original agreement. All other original rights and provisions remain the same.

**10. Uncertainties and COVID-19**

The COVID-19 outbreak in the United States has resulted in reduced customer traffic for our franchisees, resulting in reduced royalty revenue and ultimately reduced nontraditional revenues with a significant impact in April and May. Management believes that the disruption in customer traffic is temporary and as of the end of August 2020, most states have opened up or are opening up for limited indoor and outdoor dining.

In order to support our franchisees during this difficult time, the Company waived the 3% marketing fees from March 16, 2020 through May 31, 2020, with graduated amounts of marketing fees reinstated beginning in June and July 2020. We provided our franchisees information on the CARES stimulus package and several franchises received Payroll Protection Program (PPP) loans. We applied and received PPP loan funds. For information, see the 8-K filed on May 5, 2020 with the Security and Exchange Commission.

While the Coronavirus pandemic has created challenges for restaurants around the country, we are proud of the work our franchisees have put in to adapt to changing regulations and government mandates. As states begin to open up and ease restrictions we have seen franchise locations total system-wide sales rebound from down approximately 66.8% in week 20 of our fiscal year to down approximately 9.5% in week 45. We are continuing to evaluate the effects of the Coronavirus pandemic outbreak on our operations.

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

Certain statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations, including statements regarding the development of the Company's business, the markets for the Company's products, anticipated capital expenditures, and the effects of completed and proposed acquisitions, and other statements contained herein regarding matters that are not historical facts, are forward-looking statements as is within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Because such statements include risks and uncertainties, actual results could differ materially from those expressed or implied by such forward-looking statements as set forth in this report, the Company's Annual Report on Form 10-K and other reports that the Company files with the Securities and Exchange Commission. Certain risks and uncertainties are wholly or partially outside the control of the Company and its management, including its ability to attract new franchisees; the continued success of current franchisees; the effects of competition on franchisee**s** and consumer acceptance of the Company's products in new and existing markets; fluctuation in development and operating costs; brand awareness; availability and terms of capital; adverse publicity; acceptance of new product offerings; availability of locations and terms of sites for store development; food, labor and employee benefit costs; changes in government regulation (including increases in the minimum wag**e);** regional economic and weather conditions; the hiring, training, and retention of skilled corporate and restaurant management; and the integration and assimilation of acquired concepts. Accordingly, readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. The Company undertakes no obligation to publicly release the results of any revision to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

**General**

There are 72 franchised and 7 licensed units at August 31, 2020 compared to 73 franchised and 6 licensed units at August 31, 2019.  System-wide revenues for the nine months ended August 31, 2020 were $20.2 million and August 31, 2019 was $24.9 million.

The Company's revenues are derived primarily from the ongoing royalties paid to the Company by its franchisees and receipt of initial franchise fees.  Additionally, the Company derives revenue from the sale of licensed products (My Favorite Muffin mix, Big Apple Bagels cream cheese and Brewster's coffee), and through nontraditional channels of distribution through a licensing agreement with Green Beans Coffee.

Royalty fees represent a 5% fee on net retail and wholesale sales of franchised units. Royalty revenues are recognized on an accrual basis using actual franchise receipts. Generally, franchisees report and remit royalties on a weekly basis. The majority of month-end receipts are recorded on an accrual basis based on actual numbers from reports received from franchisees shortly after the month-end. Estimates are utilized in certain instances where actual numbers have not been received and such estimates are based on the average of the last 10 weeks’ actual reported sales.

There are two items involving revenue recognition of contracts that require us to make subjective judgments: the determination of which performance obligations are distinct within the context of the overall contract and the estimated stand alone selling price of each obligation. In instances where our contract includes significant customization or modification services, the customization and modification services are generally combined and recorded as one distinct performance obligation.

The Company earns licensing fees from the sale of BAB branded products, which includes coffee, cream cheese, muffin mix and frozen bagels from a third-party commercial bakery, to the franchised and licensed units.

As of August 31, 2020, the Company employed 12 full-time employees at the Corporate office. The employees are responsible for corporate management and oversight, accounting, advertising and franchising.  None of the Company's employees are subject to any collective bargaining agreements and management considers its relations with its employees to be good.

**Results of Operations**

**Three Months Ended August 31, 2020 versus Three Months Ended August 31, 2019**

For the three months ended August 31, 2020 and August 31, 2019, the Company reported net income of $104,000 and net income of $149,000, respectively. Total revenue of $624,000 decreased $169,000, or 21.3%, for the three months ended August 31, 2020, as compared to total revenue of $793,000 for the three months ended August 31, 2019. Marketing fee revenues of $173,000, decreased $80,000, or 31.6% for the three months in 2020, compared to $253,000 in 2019. The 3% marketing fee was waived from March 16, 2020 to May 31, 2020 with graduated amounts of marketing fees reinstated beginning in June and July 2020 with the fee returning to 3% in August.

Royalty fee revenue of $375,000, for the quarter ended August 31, 2020, decreased $61,000, or 14.0%, from the $436,000 for quarter ended August 31, 2019. The royalty revenue reduction was due to states limiting or eliminating in store dining and operating restrictions in states due to the Coronavirus pandemic.

Franchise fee revenues of $5,000, for the quarter ended August 31, 2020, increased $2,000, or 66.7%, from the $3,000 for the quarter ended August 31, 2019. There was one transfer for $1,000 in 2020 with none in 2019 and no new store openings in either year.

Licensing fee and other income of $72,000, for the quarter ended August 31, 2020, decreased $29,000 or 28.7% from $101,000 for same quarter 2019. There was a $33,000 decrease in nontraditional revenues, offset by a $4,000 increase in other revenue in 2020 compared to same period 2019.

Total operating expenses of $521,000, for the quarter ended August 31, 2020, decreased $118,000, or 18.5% from $639,000 for the quarter ended August 31, 2019. The decrease was primarily a reduction in Marketing Fund expenses of $80,000 because expenses were reduced to offset the reduction in funds collected. BAB Systems waived marketing fees for March 16, 2020 through May 31, 2020 to help franchisees during the sales reduction because of COVID19. For third quarter 2020 employee salaries decreased $11,000 because of an employee retiring and a salary reduction, there was a reduction in franchise advertising of $17,000, a $7,000 reduction in professional fees and a $10,000 reduction in travel related to the pandemic, offset by an increase in employee benefit expense of $3,000 and a $4,000 timing difference increased annual meeting and Directors fees compared to 2019.

There was no income tax expense for the three months ending August 31, 2020 and $5,000 for the same period in 2019.

**Earnings per share, as reported for basic and diluted outstanding shares for the quarters ended August 31, 2020 and August 31, 2019 was $.01and $0.02 respectively.**

**Nine Months Ended August 31, 2020 versus Nine Months Ended August 31, 2019**

For the nine months ended August 31, 2020 the Company reported net income of $75,000 compared to net income of $374,000 in 2019. Total revenue of $1,671,000 decreased $609,000, or 26.7%, for the nine months ended August 31, 2020, as compared to total revenue of $2,280,000 for the nine months ended August 31, 2019. Marketing fee revenues of $447,000 decreased $291,000, or 39.4% for the nine months in 2020, as compared to $738,000 for the same period 2019. The 3% marketing fee was waived from March 16, 2020 to May 31, 2020 with a reduction in fees collected in June and July of 2020 in order to assist franchisees in cost reduction during the Coronavirus pandemic.

Royalty fee revenue of $1,001,000, for the nine months ended August 31, 2020, decreased $227,000, or 18.5%, from the $1,228,000 for the nine months ended August 31, 2019. The royalty revenue decreased was due to dining closures and operating restrictions in states due to the Coronavirus pandemic in 2020.

Franchise fee revenues of $12,000, for the nine months ended August 31, 2020, decreased $8,000, or 40.0% from $20,000 for the period ended August 31, 2019. There was one transfer in 2020 and two transfers in 2019. In addition, franchise fees include $11,000 for 2020 and $10,000 for 2019 from the adoption of ASC606 franchise fees revenue recognition standard.

Licensing fee and other income of $211,000 for the nine months ended August 31, 2020 decreased $83,000, or 28.2%, from $293,000 for the nine months ended August 31, 2019. The decrease was primarily due to a decrease in settlement and other income of $28,000and a decrease of $55,000 for nontraditional revenue related to decreased sales as a result of the Coronavirus pandemic.

Total operating expenses of $1,581,000 decreased $310,000, or 16.4%, for the nine months ended August 31, 2020, from $1,891,000 for the same period 2019. The decrease was primarily due to reducing expenses for the Marketing Fund because the 3% fees were not collected from March 16, 2020 through May 31, 2020, this was a $291,000 expense reduction for the nine months ended August 31, 2020. There was a $12,000 decrease in payroll and payroll related expenses, a $19,000 decrease in advertising, an $18,000 decrease in travel and a $10,000 decrease in professional services. The expense reduction was instituted as a result of reduced revenue due to restaurant restrictions from the Coronavirus Pandemic. The reduced expenses were offset by an increase in occupancy expense of $18,000 due to full rent paid in 2020 versus reduced rent negotiated with the new lease in 2019, employee benefits of $3,000, a $10,000 increase in provision for bad debt, a $3,000 increase in repair and maintenance, a $2,000 increase in insurance and a $4,000 increase in general services for 2020 compared to 2019.

There was an income tax expense of $15,000 for 2020 and 2019.

Earnings per share, as reported for basic and diluted outstanding shares for the nine months ended August 31, 2020 were $0.01and 2019 was $0.05 per share.

**Liquidity and Capital Resources**

At August 31, 2020, the Company had working capital of $735,000 and unrestricted cash of $1,077,000. At November 30, 2019 the Company had working capital of $813,000 and unrestricted cash of $1,095,000.

During the nine months ended August 31, 2020, the Company had net income of $75,000 and operating activities used cash of $49,000. The principal adjustments to reconcile the net loss to cash used in operating activities for the nine months ending August 31, 2020 was depreciation and amortization of $2,000 and noncash lease expense of $74,000, less the provision for uncollectible accounts of $8,000. In addition, changes in operating assets and liabilities decreased cash by $196,000. During the nine months ended August 31, 2019, the Company had net income of $374,000 and operating activities provided cash of $277,000. The principal adjustments to reconcile net income to cash provided in operating activities for the nine months ending August 31, 2019 was noncash lease expense of $52,000, depreciation and amortization of $1,000 and a decrease in the provision for uncollectible accounts of $15,000. In addition, changes in operating assets and liabilities decreased cash by $184,000.

The Company’s investing activities were $10,000 and $6,000, respectively for the nine months ended August 31, 2020 and 2019.

On May 1, 2020 the Company received loan proceeds of $228,000 through the CARES act offered by the Treasury Department and Small Business Administration. The loan can be forgiven based on a formula if the company maintains employee retention and payroll expenses for an eight or 24 week period, in additions to certain other expenses (rent and utilities). See Note 8 for additional information.

During January and April 2020 the Company used $291,000 for cash distribution/dividend payments for the nine month period ended August 31, 2020 and used $363,000 for cash distribution/dividend payments during the same period in 2019.

**Cash Distribution and Dividend Policy**

Due to the impact of the Coronavirus Pandemic, the Company’s intent is to suspend future dividends. Future cash distributions/dividends will be considered after reviewing profitability expectations and financing needs and will be declared at the discretion of the Board of Directors. The Company will continue to analyze its ability to pay cash distributions/dividends on a quarterly basis.

Determination of whether distributions are considered a cash distribution, cash dividend or combination of the two will not be made until after December 31, 2020, as the classification or combination is dependent upon the Company’s earnings and profits for tax purposes for its fiscal year ending November 30, 2020.

**Recent Accounting Pronouncements**

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The standard’s main goal is to improve financial reporting by requiring earlier recognition of credit losses on financing receivables and other financial assets in scope, including trade receivables. The amendments in this update broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The guidance in ASU 2016-13 is effective for public companies for fiscal years and for interim periods with those fiscal years beginning after December 15, 2019. Early adoption of the guidance is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company will adopt ASU 2019-12 for fiscal year ending November 30, 2021.

In December 2019, the FASB issued ASU 2019-12, *“Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes,”*which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application.

The amendments in ASU 2019-12 are effective for public business entities for fiscal years beginning after December 15, 2020, including interim periods therein. Early adoption of the standard is permitted, including adoption in interim or annual periods for which financial statements have yet been issued.

If an entity early adopts these amendments in an interim period, it should reflect any adjustments as of the beginning of the annual period that includes that interim period. In addition, an entity that elects to early adopt the standard is required to adopt all of the amendments in the same period (i.e., an entity cannot select which amendments to early adopt). The Company is still evaluating the specific effect of this change. The Company will adopt ASU 2019-12 for fiscal year ending November 30, 2021.

Management does not believe that there are any other recently issued and effective or not yet effective pronouncements that would have or are expected to have any significant effect on the Company’s financial position, cash flows or results of operations.

**Critical Accounting Policies**

The Company has identified other significant accounting policies that, as a result of the judgments, uncertainties, uniqueness and complexities of the underlying accounting standards and operations involved could result in material changes to its financial condition or results of operations under different conditions or using different assumptions.  The Company's most critical accounting policies are related to revenue recognition, valuation of long-lived and intangible assets, deferred tax assets and the related valuation allowance.  Details regarding the Company's use of these policies and the related estimates are described in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2019, filed with the Securities and Exchange Commission on February 24, 2020.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

BAB, Inc. has no interest, currency or derivative market risk.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of both our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this report. Based on such evaluation, both our Chief Executive Officer and Chief Financial Officer have concluded that, as of August 31, 2020 our disclosure controls and procedures are effective (i) to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and (ii) to ensure that information required to be disclosed by us in the reports that we submit under the Exchange Act is accumulated and communicated to our management, including our executive and financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act) during the nine months of fiscal year 2020 to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Compliance with Section 404 of Sarbanes-Oxley Act**

The Company is in compliance with Section 404 of the Sarbanes-Oxley Act of 2002 (the “Act”).

**PART II**

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| **ITEM 1.** | **LEGAL PROCEEDINGS** |

We may be subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of such proceedings or claims cannot be predicted with certainty, management does not believe that the outcome of any of such proceedings or claims will have a material effect on our financial position. We know of no pending or threatened proceeding or claim to which we are or will be a party.

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| **ITEM 2.** | **UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS** |

None.

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| **ITEM 3.** | **DEFAULTS UPON SENIOR SECURITIES** |

None.

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| **ITEM 4.** | **MINE SAFETY DISCLOSURES** |

Not applicable

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| **ITEM 5.** | **OTHER INFORMATION** |

None.

(a)  EXHIBITS

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| --- | --- |
| The following exhibits are filed herewith. |  |

Exhibit 21.1

BAB Systems, Inc., an Illinois corporation

BAB Operations, Inc., an Illinois corporation

BAB Investments, Inc., an Illinois corporation

SIGNATURE

In accordance with the requirements of the Exchange Act, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BAB, Inc.

|  |  |
| --- | --- |
| Dated: October 14, 2020 | /s/ Geraldine Conn |
|  | Geraldine Conn |
|  | Chief Financial Officer |

Exhibit 31.1

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13A-14 (a) OR RULE 15d-14 (a) OF THE SECURITIES EXCHANGE ACT OF 1934.**

I, Michael W. Evans, certify that:

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

Date: October 14, 2020 by / s/ Michael W. Evans

Michael W. Evans, Chief Executive Officer

Exhibit 31.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13A-14 (a) OR RULE 15d-14 (a) OF THE SECURITIES EXCHANGE ACT OF 1934.**

I, Geraldine Conn, certify that:

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

Date: October 14, 2020 By: /s/ Geraldine Conn

Geraldine Conn, Chief Financial Officer

Exhibit 32.1

BAB, Inc.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the BAB, Inc. (the "Company") Quarterly Report on Form 10-Q for the period ended August 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael W. Evans, Chief Executive Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

Date:  October 14, 2020                                                         By:  /s/ Michael W. Evans

  Michael W. Evans, Chief Executive Officer

Exhibit 32.2

BAB, Inc.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350

AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the BAB, Inc. (the "Company") Quarterly Report on Form 10-Q for the period ended August 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Geraldine Conn, Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

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

Date:  October 14, 2020 By:   /s/ Geraldine Conn

Geraldine Conn, Chief Financial Officer