BAB, INC.
Form 10QSB
October 11, 2007

FORM 10-QSB

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended: **August 31, 2007**
¨ 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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x No ¨

As of October 11, 2007, BAB, Inc. had : 7,263,508 shares of Common Stock outstanding.

TABLE OF CONTENTS

*Table of Contents*

## PART I

## ITEM 1. FINANCIAL INFORMATION

**BAB, Inc.**
**Condensed Consolidated Balance Sheet (Unaudited)**
**As of August 31, 2007**

| | | |
|---|---|---|
| **ASSETS** | | |
| Current Assets | | |
| Cash | $ | 1,479,713 |
| Restricted cash | | 272,529 |
| Receivables | | |
| Trade accounts receivable (net of allowance for doubtful accounts of $4,650) | | 98,933 |
| Marketing fund contributions receivable from franchisees and stores | | 14,841 |
| Notes receivable | | 5,672 |
| Inventories | | 53,664 |
| Prepaid expenses and other current assets | | 117,452 |
| Total Current Assets | | 2,042,804 |
| | | |
| Noncurrent Assets | | |
| Property, plant and equipment (net of accumulated depreciation of $518,982) | | 72,064 |
| Notes receivable (net of allowance for doubtful accounts of $4,931) | | 1,711 |
| Trademarks | | 763,667 |
| Goodwill | | 3,542,772 |
| Total Noncurrent Assets | | 4,380,214 |
| | | |
| Total Assets | $ | 6,423,018 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current Liabilities | | |
| Current portion of long-term debt | $ | 22,005 |
| Accounts payable | | 37,412 |
| Accrued expenses and other current liabilities | | 354,204 |
| Unexpended marketing fund contributions | | 207,283 |
| Deferred franchise fee revenue | | 170,000 |
| Deferred revenue | | 50,885 |
| Total Current Liabilities | | 841,789 |
| | | |
| Noncurrent Liabilities | | |
| Long-term debt (net of current portion) | | 251,567 |
| Deferred revenue (net of current portion) | | 12,510 |
| Total Noncurrent Liabilities | | 264,077 |
| Total Liabilities | | 1,105,866 |
| | | |
| Stockholders' Equity (Deficit) | | |
| Common stock | | 13,508,256 |
| Additional paid-in capital | | 923,255 |
| Treasury stock | | (222,781) |

| | | |
|---|---|---|
| Accumulated deficit | | (8,891,578) |
| Total Stockholders' Equity | | 5,317,152 |
| Total Liabilities and Stockholders' Equity | $ | 6,423,018 |

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*Table of Contents*

**BAB, Inc.**
**Condensed Consolidated Statements of Operations**
**For the Quarter and Year to Date Periods Ended August 31, 2007 and August 31, 2006**
**(Unaudited)**

| | 3 months ended | | 9 months ended | |
|---|---|---|---|---|
| | August 31, 2007 | Restated August 31, 2006 | August 31, 2007 | Restated August 31, 2006 |
| **REVENUES** | | | | |
| Royalty fees from franchised stores | $ 557,467 | $ 591,519 | $ 1,656,363 | $ 1,715,490 |
| Net sales by Company-owned stores | 124,408 | 116,282 | 357,770 | 384,523 |
| Franchise fees | 70,000 | 20,000 | 195,000 | 225,500 |
| Licensing fees and other income | 230,147 | 217,158 | 761,365 | 644,153 |
| Total Revenues | 982,022 | 944,959 | 2,970,498 | 2,969,666 |
| **OPERATING EXPENSES** | | | | |
| Food, beverage and paper costs | 41,120 | 35,893 | 113,069 | 123,779 |
| Store payroll and other operating expenses | 111,481 | 108,822 | 335,525 | 369,815 |
| Selling, general and administrative expenses: | | | | |
| Payroll-related expenses | 338,338 | 314,869 | 1,079,812 | 1,030,477 |
| Occupancy | 35,552 | 34,903 | 108,781 | 106,564 |
| Advertising and promotion | 30,949 | 18,857 | 85,752 | 78,482 |
| Professional service fees | 40,986 | 44,554 | 153,109 | 166,173 |
| Travel expenses | 24,574 | 27,209 | 67,889 | 73,373 |
| Depreciation and amortization | 8,432 | 17,229 | 35,227 | 51,797 |
| Other | 126,942 | 114,306 | 432,348 | 356,565 |
| Total Operating Expenses | 758,374 | 716,642 | 2,411,512 | 2,357,025 |
| **Income from operations** | 223,648 | 228,317 | 558,986 | 612,641 |
| Interest income | 16,618 | 20,421 | 51,337 | 33,129 |
| Interest expense | (3,357) | (7,067) | (12,531) | (23,687) |
| Other income | - | - | - | 1,585 |
| | | | | |
| Income before provision for income taxes | 236,909 | 241,671 | 597,792 | 623,668 |
| Provision for income taxes | | | | |
| Current | - | - | - | - |
| Deferred | - | - | - | - |
| | - | - | - | - |
| **Net Income** | $ 236,909 | $ 241,671 | $ 597,792 | $ 623,668 |
| Net Income per share - Basic | $ 0.03 | $ 0.03 | $ 0.08 | $ 0.09 |
| Net Income per share - Diluted | $ 0.03 | $ 0.03 | $ 0.08 | $ 0.09 |
| | | | | |
| Weighted average shares outstanding - Basic | 7,263,099 | 7,222,932 | 7,261,048 | 7,222,436 |
| Weighted average shares outstanding - Diluted | 7,282,574 | 7,255,733 | 7,278,535 | 7,258,862 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cash dividends per share | $ | 0.02 | $ | 0.02 | $ | 0.08 | $ | 0.12 |

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*Table of Contents*

**BAB, Inc.**
**Condensed Consolidated Statements of Cash Flows**
**For the Year to Date Periods Ended August 31, 2007 and August 31, 2006**
**(Unaudited)**

| | 9 Months Ended | |
|---|---|---|
| | | Restated |
| | August 31, 2007 | August 31, 2006 |
| **Operating activities** | | |
| Net income | $ 597,792 | $ 623,668 |
| Depreciation and amortization | 35,227 | 51,797 |
| Loss on sale of equipment | | 17,151 |
| Provision for uncollectible accounts, net of recoveries | (6,076) | (7,951) |
| Share-based compensation | 25,820 | |
| Changes in: | | |
| Trade accounts receivable | (3,511) | 31,291 |
| Restricted cash | (38,415) | (37,455) |
| Marketing fund contributions receivable | 14,637 | 8,120 |
| Notes receivable | 9,191 | 48,635 |
| Inventories | (7,616) | 20,627 |
| Prepaid expenses and other | (17,013) | 14,893 |
| Accounts payable | (18,549) | (54,333) |
| Accrued liabilities | (91,300) | (19,835) |
| Unexpended marketing fund contributions | 20,804 | 30,247 |
| Deferred revenue | (99,002) | (66,498) |
| Net Cash Provided by Operating Activities | 421,989 | 660,357 |
| | | |
| **Investing activities** | | |
| Purchase of equipment | (3,636) | (6,940) |
| Sale of equipment | - | 5,000 |
| Net Cash Used In Investing Activities | (3,636) | (1,940) |
| | | |
| **Financing activities** | | |
| Repayment of borrowings | (170,735) | (183,104) |
| Proceeds from exercise of stock options | 20,477 | 6,077 |
| Payment of dividend | (581,048) | (866,685) |
| Net Cash Used In Financing Activities | (731,306) | (1,043,712) |
| | | |
| Net Decrease in Cash | (312,953) | (385,295) |
| | | |
| Cash, Beginning of Period | 1,792,666 | 2,206,524 |
| Cash, End of Period | $ 1,479,713 | $ 1,821,229 |
| | | |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | $ 3,460 | $ 13,996 |
| | | |
| Income taxes paid | $ - | $ - |

SEE ACCOMPANYING NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

*Table of Contents*

**BAB, Inc.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**Quarter and Year to Date Periods Ended August 31, 2007 and August 31, 2006**

**(Unaudited)**

## Note 1 - Nature of Operations

BAB, Inc. (the "Company") was incorporated under the laws of the State of Delaware on July 12, 2000. The Company currently operates, franchises and licenses bagel, muffin and coffee retail units under the Big Apple Bagels ("BAB"), My Favorite Muffin ("MFM"), Jacobs Bros. Bagels, and Brewster's Coffee trade names. The Company additionally derives income from the sale of its trademark bagels, muffins and coffee through nontraditional channels of distribution, including license agreements and direct home delivery of specialty muffin gift baskets and coffee.

The Company has four wholly owned subsidiaries: BAB Systems, Inc. (Systems); BAB Operations, Inc. (Operations); Brewster's Franchise Corporation (BFC); and My Favorite Muffin Too, Inc. (MFM). Systems was incorporated on December 2, 1992, and was primarily established to franchise BAB specialty bagel retail stores. Operations was formed on August 30, 1995, primarily to operate Company-owned stores. There is currently one Company-owned store which serves as the franchise training facility. BFC was established on February 15, 1996 to franchise "Brewster's Coffee" concept coffee stores. MFM, a New Jersey corporation, was acquired on May 13, 1997. MFM franchises "MFM" concept muffin stores.

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-KSB for the year ended November 30, 2006 which was filed February 28, 2007. In the opinion of the Company's management, the condensed consolidated financial statements for the unaudited interim periods presented include all adjustments, including normal recurring adjustments, necessary to fairly present the results of such interim periods 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. Stores Open and Under Development

Stores which are open or under development at August 31, 2007 are as follows:

| | |
|---|---|
| Stores open: | |
| Company-owned | 1 |
| Franchisees | 128 |
| Licensed | 2 |
| Under development | 6 |
| | |
| Total | 137 |

*Table of Contents*

### 3. Earnings per Share

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

| | 3 months ended | | 9 months ended | |
|---|---|---|---|---|
| | August 31, 2007 | Restated August 31, 2006 | August 31, 2007 | Restated August 31, 2006 |
| **Numerator:** | | | | |
| Net income available to common shareholders | $ 236,909 | $ 241,671 | 597,792 | 623,668 |
| **Denominator:** | | | | |
| Weighted average outstanding shares | | | | |
| Basic | 7,263,099 | 7,222,932 | 7,261,048 | 7,222,436 |
| Earnings per Share - Basic | $ 0.03 | $ 0.03 | $ 0.08 | $ 0.09 |
| Effect of dilutive common stock | 19,475 | 32,801 | 17,487 | 36,426 |
| Weighted average outstanding shares | | | | |
| Diluted | 7,282,574 | 7,255,733 | 7,278,535 | 7,258,862 |
| Earnings per share - Diluted | $ 0.03 | $ 0.03 | $ 0.08 | $ 0.09 |

The following shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

| | 3 months ended | | 9 months ended | |
|---|---|---|---|---|
| | August 31, 2007 | August 31, 2006 | August 31, 2007 | August 31, 2006 |
| Shares excluded from calculation of diluted EPS | 267,500 | 72,500 | 267,500 | 72,500 |

### 4. Long-Term Debt

On June 25, 2004, the Company entered into a Business Loan and Security Agreement ("Bank Agreement") with Associated Bank which provided for a term loan in the original amount of $723,700. The term loan under the Bank Agreement was secured by substantially all of the assets of the Company and was being repaid in monthly installments of $21,900, including interest at a rate of 5.5 percent per annum, with final payment due July 1, 2007. Final payment was made in July, 2007.

The current total debt balance of $273,572 represents a note payable to a former shareholder that requires an annual payment of $35,000, including interest at 4.75%, due October 1 and running through 2016.

**5. Stock Options**

In May 2001, the Company approved a Long-Term Incentive and Stock Option Plan (Plan). The Plan reserves 1,400,000 shares of common stock for grant. As of August 31, 2007, 1,400,000 stock options were granted to directors, officers and employees. As of August 31, 2007, there were 956,036 stock options exercised and 51,182 stock options forfeited or expired under the Plan.

***Table of Contents***

| | 9 months ended | |
|---|---|---|
| | August 31, 2007 | August 31, 2006 |
| | Options | Options |
| Options Outstanding at beginning of period | 432,949 | 163,034 |
| Granted | 0 | 75,000 |
| Forfeited | 0 | (5,499) |
| Exercised | (40,167) | (13,986) |
| Options Outstanding at end of period | 392,782 | 218,549 |

Effective December 1, 2006, the Company adopted the provisions of FASB Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") using the modified prospective transition method. Under this method, prior periods are not revised for comparative purposes and the Company recognizes compensation cost using a fair-value based method for all share-based payments granted after November 30, 2006, plus any awards granted to employees up through November 30, 2006 that remain unvested at that time. Prior to December 1, 2006, the Company accounted for its share-based compensation plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." The Company recorded compensation cost arising from share-based payment arrangements in payroll-related expenses on the Condensed Consolidated Statement of Operations for the Company's stock option plan of approximately $26,000 for the nine months ended August 31, 2007.

The following table illustrates the pro forma effect on the Company's net income and net income per share as if the Company had adopted the fair value based method of accounting for stock-based compensation under FASB No. 123, "Accounting for Stock-Based Compensation," for the three months and nine months ended August 31, 2006 and the assumptions used to estimate the fair value of options granted under the stock option plan for the three and nine months then ended.

| | **3 months ended Restated August 31, 2006** | **9 months ended Restated August 31, 2006** |
|---|---|---|
| **Pro forma impact of fair value method** | | |
| Reported net income | $ 241,671 | $ 623,668 |
| Less: Fair value impact of employee stock compensation | (8,403) | (30,594) |
| Pro forma net income | $ 233,268 | $ 593,074 |
| | | |
| **Earnings per common share** | | |
| Basic - as reported | $ 0.03 | $ 0.09 |
| Diluted - as reported | $ 0.03 | $ 0.09 |
| Basic - pro forma | $ 0.03 | $ 0.08 |
| Diluted - pro forma | $ 0.03 | $ 0.08 |
| | | |
| **Weighted average Black Scholes fair value assumptions** | | |
| Risk free interest rate | 4.39% | 4.39% |
| Expected life | 10.0 yrs | 10.0 yrs |
| Expected volatility | 1.228 | 1.228 |
| Expected dividend yield | 7.00% | 7.00% |

***Table of Contents***

As of August 31, 2007, there was approximately $74,000 of total unrecognized compensation cost related to non-vested stock option compensation arrangements granted under the incentive plan. That cost is to be recognized over a weighted average period of approximately 4.25 years.

The Company uses historical volatility of common stock over a period equal to the expected life of the options to estimate their fair value. The dividend yield assumption is based on the Company's history and expectation of future dividend payouts on the common stock. The risk-free interest rate is based on the implied yield available on U.S. treasury zero-coupon issues with an equivalent remaining term. The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. To value option grants and other awards for actual and pro forma stock-based compensation, the Company uses the Black-Scholes option valuation model. When the measurement date is certain, the fair value of each option grant is estimated on the date of grant and is based on the assumptions used for the expected stock price volatility, expected term, risk-free interest rates and future dividend payments.

The Company's stock options expire in 10 years and vary in vesting from immediate to a vesting period over five years.

The following table summarizes the stock options outstanding and exercisable at August 31, 2007:

| Options Outstanding | | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| Outstanding at 8/31/07 | Wghtd. Avg.Remaining Life | Wghtd. Avg.Exercise Price | Aggregate Intrinsic Value | Exercisable at 8/31/07 | Wghtd. Avg.Exercise Price | Aggregate Intrinsic Value |
| 392,782 | 8.53 | $ 1.12 | $ - | 127,649 | $ 0.92 | $ 7,659 |

The aggregate intrinsic value in the table above is before income taxes, based on the Company's closing stock price of $.98 as of the last business day of the period ended August 31, 2007. Total intrinsic value of those options exercised during the quarter and nine months ended August 31, 2007 is $0 and $19,000, respectively.

**6. Goodwill and Other Intangible Assets**

In accordance with SFAS No. 142, goodwill and indefinite-lived intangible assets are tested for impairment upon adoption of the standard and annually thereafter. SFAS No. 142 requires that goodwill be tested for impairment using a two-step process. The first step is to identify a potential impairment and the second step measures the amount of the impairment loss, if any. Goodwill is deemed to be impaired if the carrying amount of a reporting unit's net assets exceeds its estimated fair value. SFAS No. 142 requires that indefinite-lived intangible assets be tested for impairment using a one-step process, which consists of a comparison of the fair value to the carrying value of the intangible asset. Intangible assets are deemed to be impaired if the net book value exceeds the estimated fair value. The Company completed its annual goodwill impairment assessment during the first quarter ended February 28, 2007, and it indicated no impairment of goodwill.

**7. Commitments and Contingencies**

None

*Table of Contents*

**8. Restatement**

During the last quarter of the year ended November 30, 2006, the Company adopted SEC Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which addresses how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. As a result, an adjustment was made to the November 30, 2005 Stockholders' Equity, in the amount of $74,000, relating to the accrual for accounting fees and the period in which services for the respective fiscal period were to be performed. The effect of the adoption of SAB No. 108 on the statement of operations for the three and nine months ended August 31, 2006 was to decrease and increase professional service fees by $5,000 and $12,000, respectively, and, therefore, increase and decrease the previously reported net income.

The impact to the specific balances in the Consolidated Statement of Income as of and for the three and nine months ended August 31, 2006, as a result of the above adjustments, is as follows. The amounts previously reported are derived from the original Form 10-QSB for the quarter ended August 31, 2006 filed on October 13, 2006.

| | **3 Months Ended 8/31/06** | | **9 Months Ended 8/31/06** | |
|---|---|---|---|---|
| | **As Previously Reported** | **As Restated** | **As Previously Reported** | **As Restated** |
| **Statement of Operations Captions:** | | | | |
| **Total Revenues** | $ 944,959 | $ 944,959 | $ 2,969,666 | $ 2,969,666 |
| Food, beverage and paper costs | 35,893 | 35,893 | 123,779 | 123,779 |
| Store payroll and other operating expenses | 108,822 | 108,822 | 369,815 | 369,815 |
| Selling, general and administrative expenses: | | | | |
| Payroll-related expenses | 314,869 | 314,869 | 1,030,477 | 1,030,477 |
| Occupancy | 34,903 | 34,903 | 106,564 | 106,564 |
| Advertising and promotion | 18,857 | 18,857 | 78,482 | 78,482 |
| Professional service fees | 52,999 | 44,554 | 157,728 | 166,173 |
| Travel expenses | 27,209 | 27,209 | 73,373 | 73,373 |
| Depreciation and amortization | 17,229 | 17,229 | 51,797 | 51,797 |
| Other | 111,056 | 114,306 | 353,315 | 356,565 |
| **Total Operating Expenses** | 721,837 | 716,642 | 2,345,330 | 2,357,025 |
| **Income from operations** | 223,122 | 228,317 | 624,336 | 612,641 |
| Interest income | 20,421 | 20,421 | 33,129 | 33,129 |
| Interest expense | (7,067) | (7,067) | (23,687) | (23,687) |
| Other income | - | - | 1,585 | 1,585 |
| | | | | |
| **Income before provision for income taxes** | $ 236,476 | $ 241,671 | $ 635,363 | $ 623,668 |
| Provision for income taxes | | | | |
| Current | - | - | - | - |
| Deferred | - | - | - | - |
| | - | - | - | - |
| **Net Income** | $ 236,476 | $ 241,671 | $ 635,363 | $ 623,668 |
| Net Income per share - Basic | $ 0.03 | $ 0.03 | $ 0.09 | $ 0.09 |
| Net Income per share - Diluted | $ 0.03 | $ 0.03 | $ 0.09 | $ 0.09 |

***Table of Contents***

**9. Segment Information**

The following table presents segment information for the nine months ended August 31, 2007 and 2006:

| | Net Revenues 9 months ended | | Operating Income (Loss) 9 months ended | |
|---|---|---|---|---|
| | 8/31/2007 | Restated 8/31/2006 | 8/31/2007 | Restated 8/31/2006 |
| Company Store Operations | $ 663,944 | $ 574,625 | $ (112,254) | $ (192,176) |
| Franchise Operations and Licensing Fees | 2,306,554 | 2,395,041 | 1,335,141 | 1,446,735 |
| | $ 2,970,498 | $ 2,969,666 | $ 1,222,887 | $ 1,254,559 |
| Corporate Expenses | | | (663,901) | (641,918) |
| Interest Income, Net of Interest Expense | | | 38,806 | 11,027 |
| Net Income | | | $ 597,792 | $ 623,668 |

There has not been a substantial change in total assets of either segment since November 30, 2006.

**10. Subsequent Event**

On October 2, 2007, the Company paid out a $0.02 per share quarterly cash dividend to shareholders of record at the close of business on September 20, 2007. Total dividend payment equaled $145,270.

**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-KSB 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 franchisees and Company-owned store results; 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 wage); 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.

*Table of Contents*

**General**

The Company has one Company-owned store, 128 franchised and 2 licensed units at August 31, 2007. Units in operation at August 31, 2006 included one Company-owned store, 140 franchised and 4 licensed units. System-wide revenues for the nine months ended August 31, 2007 were $34.4 million as compared to August 31, 2006 which were $35.3 million.

The Company's revenues are derived primarily from ongoing royalties paid to the Company by its franchisees, from the operation of Company-owned stores and receipt of 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 licensing agreements (Kohr Bros. and Mrs. Fields Famous Brands).

At August 31, 2007, the Company had 17 employees at the Corporate level to oversee operations of the franchise, licensed and Company-owned store operations, as compared to 18 employees at August 31, 2006.

**Results of Operations**

**Three Months Ended August 31, 2007 versus Three Months Ended August 31, 2006 (Restated)**

For the three months ended August 31, 2007, the Company reported net income of $237,000 versus net income of $242,000 for the same period in 2006. Total revenue of $982,000 increased $37,000, for the three months ended August 31, 2007, as compared to total revenue of $945,000 for the three months ended August 31, 2006.

Royalty fee revenue of $557,000, for the quarter ended August 31, 2007, decreased $34,000 from the quarter ended August 31, 2006. The Company had 128 franchise locations at August 31, 2007 as compared to 140 locations at August 31, 2006.

Franchise fee revenue of $70,000, for the quarter ended August 31, 2007, increased $50,000 from the quarter ended August 31, 2006. Two stores opened during the quarter ended August 31, 2007, versus none in the same quarter of 2006.

Licensing fee and other income of $230,000, for the quarter ended August 31, 2007, increased $13,000 from the quarter ended August 31, 2006. In 2007, Sign Shop revenue increased $23,000 due to work associated with marketing promotions kicked off at the November 2006 Franchise Convention, offset by a decrease in non-traditional income of $8,000.

Company-owned store sales of $124,000, for the quarter ended August 31, 2007, increased $8,000 from the quarter ended August 31, 2006.

Total operating expenses of $758,000 were up $41,000, for the quarter ended August 31, 2007, versus $717,000 in 2006. Sign Shop expenses increased $14,000 due to work associated with the November 2006 Franchise Convention. Compensation expense increased $23,000 in the current quarter, with $9,000 of the increase a result of adopting FASB 123(R) (See Note 5).

Interest income of $17,000 decreased $4,000, for the quarter ended August 31, 2007, over the same period in 2006, as the average cash balance was lower in 2007.

Interest expense of $3,000 decreased $4,000 due to lower outstanding debt.

Net Income per share, as reported for basic and diluted outstanding shares, was $0.03 for the three months ended August 31, 2007 and August 31, 2006.

*Table of Contents*

**Nine Months Ended August 31, 2007 versus Nine Months Ended August 31, 2006 (Restated)**

For the nine months ended August 31, 2007, the Company reported net income of $598,000 versus net income of $624,000 for the same period in 2006. Total revenue of $2,970,000 increased $1,000, for the nine months ended August 31, 2007, as compared to the nine months ended August 31, 2006.

Royalty fee revenue of $1,656,000, for the nine months ended August 31, 2007, decreased $59,000 from the nine months ended August 31, 2006. The Company had 128 franchise locations at August 31, 2007 as compared to 140 locations at August 31, 2006.

Franchise fee revenue of $195,000, for the nine months ended August 31, 2007, decreased $31,000 from the nine months ended August 31, 2006. There were 5 new store openings during the nine months ended August 31, 2007, versus 7 in the same period of 2006.

Licensing fee and other income of $761,000, for the nine months ended August 31, 2007, increased $117,000 from the nine months ended August 31, 2006. In 2007, Sign Shop revenue increased $97,000 due to work associated with marketing promotions kicked off at the November 2006 Franchise Convention.

Company-owned store sales of $358,000, for the nine months ended August 31, 2007, decreased $27,000 from the nine months ended August 31, 2006. This decrease is due to the fact the Company had one Company-owned store for the entire period in 2007, versus two Company-owned stores for a portion of the same period in 2006.

Total operating expenses of $2,412,000 increased $55,000 for the nine months ended August 31, 2007, versus $2,357,000 in 2006. Sign Shop expenses increased $62,000 in 2007, as a result of the higher revenues for the work associated with the November 2006 Franchise Convention. Compensation expense increased $49,000, with $26,000 of the increase a result of adopting FASB 123(R) (See Note 5).

Interest income of $51,000 increased $18,000, for the nine months ended August 31, 2007, over the same period in 2006, as a result of investing excess cash in higher yield investments for the full nine months in 2007 versus only part of 2006.

Interest expense of $13,000 decreased $11,000 due to lower outstanding debt.

Net Income per share, for the nine months ended August 31, 2007, was $0.08 on a basic and fully diluted basis versus $0.09 on a basic and fully diluted basis for the nine months ended August 31, 2006.

**Liquidity and Capital Resources**

The net cash provided by operating activities totaled $422,000 for the nine months ended August 31, 2007, versus cash provided by operating activities of $660,000 for the same period in 2006. Cash provided by operating activities principally represents net income of $598,000, plus depreciation and amortization of $35,000, less a decrease in the provision for uncollectible accounts of $6,000, plus an increase in share-based compensation expense of $26,000, less increases to trade accounts receivable of $4,000, restricted cash of $38,000, inventories of $8,000, prepaid expenses and other assets of $17,000, less decreases to accounts payable of $19,000, accrued liabilities of $91,000 and deferred revenue of $99,000, plus decreases to Marketing Fund contributions receivable of $15,000 and notes receivable of $9,000, plus an increase to unexpended Marketing Fund contributions of $21,000. Operating activities in 2006 provided $660,000, represented by net income of $624,000, plus depreciation and amortization of $52,000, less a decrease in the provision for uncollectible accounts of $8,000, plus a loss on sale of equipment of $17,000, less increases to restricted cash of $37,000 and decreases to accounts payable of $54,000, accrued liabilities of $20,000, and deferred revenue of $66,000, plus decreases to accounts receivable of $31,000, Marketing Fund contributions receivable of $8,000, notes receivable of $49,000, inventories of $21,000, prepaid expenses and other of $15,000, plus an increase to unexpended Marketing Fund contributions of $30,000.

*Table of Contents*

Cash used in investing activities during the nine months ended August 31, 2007 totaled $4,000, for the purchase of equipment. Cash used during 2006 totaled $2,000, representing equipment purchases of $7,000, offset by proceeds from equipment sales of $5,000.

Financing activities used $731,000 during the nine months ended August 31, 2007, due to the repayment of notes payable of $171,000 and the payment of cash dividends of $581,000, offset by proceeds from the exercise of stock options in the amount of $20,000. In fiscal 2006 for this same period, financing activities used $1,044,000 due to repayment of notes payable of $183,000 and payment of cash dividends of $867,000, offset by proceeds from the exercise of stock options in the amount of $6,000.

**Dividend Policy**

It is the Company's intent that future dividends will be considered after reviewing returns to shareholders, profitability expectations and financing needs and will be declared at the discretion of the Board of Directors. Although there can be no assurances the Company will be able to pay future dividends, it is the Company's intent going forward to continue to declare and pay cash dividends on a quarterly basis.

The Company believes execution of this policy will not have any material adverse effects on its ability to fund current operations or future capital investments.

The Company has no financial covenants on any of its outstanding debt.

**Adoption of SEC Staff Bulletin No. 108**

During the year ended November 30, 2006, the Company adopted the SEC Staff issued Staff Accounting Bulletin (SAB) No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which addresses how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. For the year ended November 30, 2006, there was an adjustment to Stockholders' Equity, in the amount of $74,000, related to the accrual for accounting fees and the period in which services for the respective fiscal period were performed, and there was no income statement effect because the related accrual was overstated by the same amount at the beginning and end of the year. (See Note 8 Restatement)

**Recent Accounting Pronouncements**

Effective December 1, 2006, the Company adopted the provisions of FASB Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") using the modified prospective transition method. Under this method, prior periods are not revised for comparative purposes and the Company recognizes compensation cost using a fair-value based method for all share-based payments granted after November 30, 2006, plus any awards granted to employees up through November 30, 2006 that remain unvested at that time. Prior to December 1, 2006, the Company accounted for its share-based compensation plans in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees". The Company recorded compensation cost arising from share-based payment arrangements in payroll-related expenses on the Condensed Consolidated Statement of Operations for the Company's stock option plan of approximately $26,000 for the nine months ended August 31, 2007.

In July 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting and reporting for uncertainties in income tax law. FIN No. 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 (the Company’s fiscal year beginning December 1, 2007). The Company has not yet determined the impact, if any, that may result from the adoption of FIN No. 48.

***Table of Contents***

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. Where applicable, SFAS No. 157 simplifies and codifies related guidance within GAAP and does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (the Company's fiscal year beginning December 1, 2007), and interim periods within those fiscal years. Earlier adoption is encouraged. The adoption of SFAS No. 157 is not expected to have a material impact on the Company's financial position, or results of operations or cash flows.

**Critical Accounting Policies**

The Company has identified 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 the following areas: revenue recognition, long-lived assets, concentrations of credit risks, valuation allowance and deferred taxes. Details regarding the Company's use of these policies and the related estimates are described in the Company's Annual Report on Form 10-KSB for the fiscal year ended November 30, 2006, filed with the Securities and Exchange Commission on February 28, 2007. There have been no material changes to the Company's critical accounting policies that impact the Company's financial condition, results of operations or cash flows for the nine months ended August 31, 2007.

**ITEM 3. CONTROLS AND PROCEDURES**

**Disclosure controls**

The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as amended) as of August 31, 2007. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation, Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

**Internal control over financial reporting**

The Chief Executive Officer and the Chief Financial Officer confirm that there was no change in the Company's internal control over financial reporting during the quarter ended August 31, 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

*Table of Contents*

## PART II

**ITEM 1. LEGAL PROCEEDINGS**

None

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

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**

See index to exhibits

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 11, 2007

/s/ Jeffrey M. Gorden
Jeffrey M. Gorden
Chief Financial Officer

---

*Table of Contents*

**INDEX TO EXHIBITS**

(a) EXHIBITS

The following exhibits are filed herewith.

| INDEX NUMBER | DESCRIPTION | |
|---|---|---|
| 21.1 | List of Subsidiaries of the Company | |
| 31.1 | Section 302 of the Sarbanes-Oxley Act of 2002 | Certification of Chief Executive Officer |
| 31.2 | Section 302 of the Sarbanes-Oxley Act of 2002 | Certification of Chief Financial Officer |
| 32.1 | Section 906 of the Sarbanes-Oxley Act of 2002 | Certification of Chief Executive Officer |
| 32.2 | Section 906 of the Sarbanes-Oxley Act of 2002 | Certification of Chief Financial Officer |