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BAB, INC.  
Form 10KSB  
February 28, 2006

FORM 10-KSB

U.S. SECURITIES AND EXCHANGE COMMISSION Washington, DC 20549

(Mark one)

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

For the year ended: November 30, 2005

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)	(IRS Employer or organization 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  No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for its most recent fiscal year:

\$5,125,000

The aggregate market value of the voting stock held by nonaffiliates computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within the past 60 days: \$3,324,189 based on 3,499,146 shares held by nonaffiliates as of February 16, 2006 and the average of the closing bid (\$0.95) and ask (\$0.95) prices for said shares in the NASDAQ OTC Bulletin Board as of such date.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 7,208,946 shares of Common Stock, as of February 16, 2006.

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Transitional Small Business Disclosure Format (check one):

[ ] Yes [X] No

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

OVERVIEW

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") and Brewster's Coffee trade names. At November 30, 2005, the Company had 150 units in operation in 26 states, and 1 International unit in United Arab Emirates. The Company additionally derives income from the sale of its trademark bagels, muffins and coffee through nontraditional channels of distribution including under licensing agreements with Mrs. Fields Famous Brands (Mrs. Fields), Kohr Bros. Frozen Custard and through direct home delivery of specialty muffin gift baskets and coffee.

The BAB brand franchised and Company-owned stores feature daily baked bagels, flavored cream cheeses, premium coffees, gourmet bagel sandwiches and other related products. Licensed BAB units serve the Company's par-baked frozen bagel products baked daily and 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," featuring a large variety of freshly baked muffins, coffees and related products, and units operating as "My Favorite Muffin and Bagel Cafe," featuring these products as well as a variety of specialty bagel sandwiches and related products. MFM units are primarily in the Middle Atlantic States. The Company has one Brewster's Coffee unit, which is a specialty coffee shop featuring a variety of premium arabica bean coffees, freshly brewed on the premises, sold in bulk and also featuring related products such as bagels, muffins and other beverages. Although the Company doesn't actively market Brewster's stand-alone franchises, Brewster's coffee products are sold in all Company-owned and most franchised units.

The Company has grown significantly since its initial public offering in November 1995 through growth in franchise units and the development of alternative distribution channels for its branded products. 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.

Operating Income

The Company reported net income of \$693,000 for the year ended November 30,

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2005, and net income of \$652,000 for the year ended November 30, 2004. The Company believes that with its continued focus on franchising and licensing operations, it will continue to be profitable. The Company will also continue to review and institute cost controls where deemed necessary.

### Food Service Industry

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Food service businesses are often affected by changes in consumer tastes; national, regional, and local economic conditions; demographic trends; traffic patterns; and the type, number and location of competing restaurants. Multi-unit food service chains, such as the Company's, can also be substantially adversely affected by publicity resulting from problems with food quality, illness, injury or other health concerns or operating issues stemming from one store or a limited number of stores. The food service business is also subject to the risk that shortages or interruptions in supply caused by adverse weather or other conditions could negatively affect the availability, quality and cost of ingredients and other food products. In addition, factors such as inflation, increased food and labor costs, regional weather conditions, availability and cost of suitable sites and the availability of experienced management and hourly employees may also adversely affect the food service industry in general and the Company's results of operations and financial condition in particular.

### CUSTOMERS

The Company-owned stores sell to the general public; therefore the Company is not dependent on a particular customer or small group of customers. Regarding the Company's franchising operation, the franchisees represent a varied geographic and demographic group. Among some of the primary services the Company provides to its franchisees are marketing assistance, training, time-tested, successful recipes, bulk purchasing discounts, food service knowledgeable personnel and brand recognition.

### SUPPLIERS

The Company's major suppliers are Coffee Bean International, Dawn Food Products, Inc., Schreiber Foods and Hawkeye Foodservice. The Company is not dependent on any of these suppliers for future growth and profitability since the products purchased from these suppliers are readily available from other sources.

### LOCATIONS

The Company has 145 franchised locations, 3 licensees and 2 Company-owned stores. Of the 150 locations, 149 are located in 26 states and 1 International unit is located in the United Arab Emirates. Subsequently, one Company-owned location was closed (see Note 11).

### STORE OPERATIONS

BIG APPLE BAGELS--BAB franchised and Company-owned stores daily bake a variety of fresh bagels and offer up to 11 varieties of cream cheese spreads. Stores also offer a variety of breakfast and lunch bagel sandwiches, salads, soups, various dessert items, fruit smoothies, gourmet coffees and other beverages. A typical BAB franchise or Company-owned store is in an area with a mix of both residential and commercial properties and ranges from 1,500 to 2,000 square feet. The Company's current store design is approximately 2,000 square feet, with seating capacity for 30 to 40 persons, and includes 750 square feet devoted to production and baking. A satellite store is typically smaller than a production store, averaging 600 to 1,000 square feet. Although franchise stores may vary in size from Company-owned stores, and from other franchise stores,

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store layout is generally consistent.

MY FAVORITE MUFFIN--MFM franchised stores bake 20 to 25 varieties of muffins daily, from over 250 recipes, plus a variety of bagels. They also serve gourmet coffees, beverages and, at My Favorite Muffin and Bagel Cafe locations, a variety of bagel sandwiches and related products. While some MFM units are located in shopping mall locations with minimal square footage of 400 to 800 square feet, the typical retail center prototype unit is approximately 2,000 square feet with seating for 30 to 40 persons. A typical MFM franchise store is located within a three-mile radius of at least 25,000 residents in an area with a mix of both residential and commercial properties.

BREWSTER'S COFFEE--The Company has one Brewster's Coffee unit, 1,500 square feet, which is a specialty coffee shop featuring a variety of Arabica bean coffees, freshly brewed on the premises and also sold in bulk, and also featuring related products such as bagels, muffins and other beverages. Although the Company doesn't actively market Brewster's stand-alone franchises, Brewster's coffee products are sold in all Company-owned and most of the franchised units.

### FRANCHISING

The Company requires payment of an initial franchise fee per store, plus an ongoing 5% royalty on net sales. Additionally, BAB and MFM franchisees are members of a marketing fund requiring an ongoing 1% contribution based on net sales. The Company currently requires a franchise fee of \$25,000 on a franchisee's first BAB or MFM store. The fee for subsequent production stores is \$20,000 and \$15,000 for a satellite location and \$10,000 for a kiosk.

The Company's current Uniform Franchise Offering Circular provides for, among other things, the opportunity for prospective franchisees to enter into a preliminary agreement for their first production store. This agreement enables a prospective franchisee a period of 60 days in which to locate a site. The fee for this preliminary agreement is \$10,000. If a site is not located and approved by the franchiser within the 60 days, the prospective franchisee will receive a refund of \$7,000. If a site is approved, the entire \$10,000 will be applied toward the initial franchise fee. See also last paragraph under "Government Regulation" section in this 10-KSB.

The Company's franchise agreements provide a franchisee with the right to develop one store at a specific location. Each franchise agreement is for a term of 10 years with the right to renew. Franchisees are expected to be in operation no later than 10 months following the signing of the franchise agreement.

The Company currently advertises its franchising opportunities at franchise trade shows and in directories, newspapers, the internet and business opportunity magazines worldwide. In addition, prospective franchisees contact the Company as a result of patronizing an existing store.

### COMPETITION

The quick service restaurant industry is intensely competitive with respect to product quality, concept, location, service and price. There are a number of national, regional and local chains operating both owned and franchised stores which may compete with the Company on a national level or solely in a specific market or region. The Company believes that because the industry is extremely fragmented, there is a significant opportunity for expansion in the bagel, muffin and coffee concept chains.

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The Company believes the primary direct competitors of its bagel concept units are Bruegger's Bagel Bakery and New World Coffee-Manhattan Bagel Inc. which operates under Einstein Bros. Bagels, Noah's NY Bagel, Manhattan Bagel Bakery and Chesapeake Bagel Bakery brands. There are several other regional bagel chains with fewer than 50 stores, all of which may be expected to compete with the Company. There is not a major national competitor in the muffin business, but there are a number of local and regional operators. Additionally, the Company competes directly with a number of national, regional and local coffee concept stores and brand names.

The Company competes against numerous small, independently owned bagel bakeries, and national fast food restaurants, such as Dunkin' Donuts, McDonald's, Panera, and Starbucks, that offer bagels, muffins, coffee and related products as part of their product offerings. In the supermarket bakery sections, the Company's bagels compete against Thomas' Bagels and other brands of fresh and frozen bagels. Certain of these competitors may have greater product and name recognition and larger financial, marketing and distribution capabilities than the Company. In addition, the Company believes the startup costs associated with opening a retail food establishment offering similar products on a stand-alone basis are competitive with the startup costs associated with opening its concept stores and, accordingly, such startup costs are not an impediment to entry into the retail bagel, muffin or coffee businesses.

The Company believes that its stores compete favorably in terms of food quality and taste, convenience, customer service and value, which the Company believes are important factors to its targeted customers. Competition in the food service industry is often affected by changes in consumer taste, national, regional and local economic and real estate conditions, demographic trends, traffic patterns, the cost and availability of labor, consumer purchasing power, availability of product and local competitive factors. The Company attempts to manage or adapt to these factors, but not all such factors are within the Company's control and such factors could cause the Company and some, or all, of its franchisees to be adversely affected.

The Company competes for qualified franchisees with a wide variety of investment opportunities in the restaurant business, as well as other industries. Investment opportunities in the bagel bakery cafe business include franchises offered by New World Coffee-Manhattan Bagel Inc. The Company's continued success is dependent to a substantial extent on its reputation for providing high quality and value with respect to its service, products and franchises. This reputation may be affected not only by the performance of Company-owned stores but also by the performance of its franchise stores, over which the Company has limited control.

### TRADEMARKS AND SERVICE MARKS

The trademarks, tradenames and service marks used by the Company contain common descriptive English words and thus may be subject to challenge by users of these words, alone or in combination with other words, to describe other services or products. Some persons or entities may have prior rights to these names or marks in their respective localities. Accordingly, there is no assurance that such marks are available in all locations. Any challenge, if successful, in whole or in part, could restrict the Company's use of the marks in areas in which the challenger is found to have used the name prior to the Company's use. Any such restriction could limit the expansion of the Company's use of the marks into that region, and the Company and its franchisees may be materially and adversely affected.

The trademarks and service marks "Big Apple Bagels," "Brewster's Coffee" and "My Favorite Muffin" are registered under applicable federal trademark law. These marks are licensed by the Company to its franchisees pursuant to franchise

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agreements. In February 1999 the Company acquired the trademark of "Jacobs Bros. Bagels" upon purchasing certain assets of Jacobs Bros. The "Jacobs Bros. Bagels" mark is also registered under applicable federal trademark law.

The Company is aware of the use by other persons and entities in certain geographic areas of names and marks which are the same as or similar to the Company's marks. Some of these persons or entities may have prior rights to those names or marks in their respective localities. Therefore, there is no assurance that the marks are available in all locations. It is the Company's policy to pursue registration of its marks whenever possible and to vigorously oppose any infringement of its marks.

### GOVERNMENT REGULATION

The Company is subject to the Trade Regulation Rule of the Federal Trade Commission (the "FTC") entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (the "FTC Franchise Rule") and state and local laws and regulations that govern the offer, sale and termination of franchises and the refusal to renew franchises. Continued compliance with this broad federal, state and local regulatory network is essential and costly, the failure to comply with such regulations may have a material adverse effect on the Company and its franchisees. Violations of franchising laws and/or state laws and regulations regulating substantive aspects of doing business in a particular state could limit the Company's ability to sell franchises or subject the Company and its affiliates to rescission offers, monetary damages, penalties, imprisonment and/or injunctive proceedings. In addition, under court decisions in certain states, absolute vicarious liability may be imposed upon franchisers based upon claims made against franchisees. Even if the Company is able to obtain insurance coverage for such claims, there can be no assurance that such insurance will be sufficient to cover potential claims against the Company.

The Company and its franchisees are required to comply with federal, state and local government regulations applicable to consumer food service businesses, including those relating to the preparation and sale of food, minimum wage requirements, overtime, working and safety conditions, citizenship requirements, as well as regulations relating to zoning, construction, health and business licensing. Each store is subject to regulation by federal agencies and to licensing and regulation by state and local health, sanitation, safety, fire and other departments. Difficulties or failures in obtaining the required licenses or approvals could delay or prevent the opening of a new Company-owned or franchise store, and failure to remain in compliance with applicable regulations could cause the temporary or permanent closing of an existing store. The Company believes that it is in material compliance with these provisions. Continued compliance with these federal, state and local laws and regulations is costly but essential, and failure to comply may have an adverse effect on the Company and its franchisees.

The Company's franchising operations are subject to regulation by the FTC under the Uniform Franchise Act which requires, among other things, that the Company prepare and periodically update a comprehensive disclosure document known as a Uniform Franchise Offering Circular ("UFOC") in connection with the sale and operation of its franchises. In addition, some states require a franchiser to register its franchise with the state before it may offer a franchise to a prospective franchisee. The Company believes its UFOC, together with any applicable state versions or supplements, comply with both the FTC guidelines and all applicable state laws regulating franchising in those states in which it has offered franchises.

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The Company is also subject to a number of state laws, as well as foreign laws (to the extent it offers franchises outside of the United States), that regulate substantive aspects of the franchiser-franchisee relationship, including, but not limited to, those concerning termination and non-renewal of a franchise.

### EMPLOYEES

As of November 30, 2005, the Company employed 44 persons, consisting of 25 working in the Company-owned stores, of which 12 are part-time employees. The remaining employees are responsible for management, 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. The subsequent closure of one Company-owned store reduced the total employees by 9 full time and 3 part-time (see Note 11).

### ITEM 2. DESCRIPTION OF PROPERTY

The Company's principal executive office, consisting of approximately 7,150 square feet, is located in Deerfield, Illinois and is leased pursuant to a lease expiring March 1, 2011. Additionally, the Company leases space for each of its Company-owned stores. Lease terms for these stores are generally for initial terms of five years and contain options for renewal for one or more five-year terms. (See Note 7 in the audited consolidated financial statements included herein.)

### ITEM 3. LEGAL PROCEEDINGS

None

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

None

## PART II

### ITEM 5. MARKET FOR THE COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The following table sets forth the quarterly high and low sale prices for the Company's Common Stock, as reported in the Nasdaq Small Cap Market for the two years ended November 30, 2005. The Company's Common Stock is traded on the NASDAQ OTC-Bulletin Board under the symbol "BABB." The following numbers have been adjusted for a 4:1 stock split, which was effective January 20, 2003.

#### BAB, Inc.

YEAR ENDED NOVEMBER 30, 2004	LOW	HIGH
First quarter	.44	.82
Second quarter	.55	1.15
Third quarter	.55	.80
Fourth quarter	.57	1.10
YEAR ENDED NOVEMBER 30, 2005		
First quarter	.75	1.00

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Second quarter	.78	.97
Third quarter	.85	1.30
Fourth quarter	.90	1.45

As of February 16, 2006, the Company's Common Stock was held by 196 holders of record. Registered ownership includes nominees who may hold securities on behalf of multiple beneficial owners. The Company estimates that the number of beneficial owners of its common stock at February 16, 2006, is approximately 1,500 based upon information provided by a proxy services firm.

### STOCK OPTIONS

In May 2001, the Company's Board of Directors approved a Long-Term Incentive and Stock Option Plan ( Plan), with an amendment in May 2003 to increase the Plan from the reserve of 1,100,000 shares to 1,400,000 shares of common stock for grant. A total of 1,185,000 stock options have been granted since plan inception. In 2005, 2004, 2003 and 2002, 95,000, 115,000, 300,000 and 600,000 stock options, respectively, were granted to directors, officers and employees. On December 7, 2005, 75,000 options were granted, leaving 215,000 options available for grant. As of February 16, 2006, there were 960,285 stock options exercised or forfeited under the stock option plan. (See Note 6 of the audited consolidated financial statements included herein.)

### DIVIDEND POLICY

The Board of Directors of the Company declared semi-annual cash dividends of \$0.02 per share on May 12, 2005, payable June 21, 2005 to common stockholders of record as of May 31, 2005. On October 7, 2005, the Board of directors of the Company declared a \$0.02 semi-annual dividend and a special dividend of \$0.06 per share, payable January 3, 2006 to common stockholders of record as of December 7, 2005. This transaction was recorded as a dividend payable of \$577,781 as of November 30, 2005. (See Note 5 of the audited consolidated financial statements included herein.)

In 2004, cash dividend of \$0.02 were declared January 1, 2004 and June 17, 2004 and paid February 2, 2004 and July 23, 2004, respectively. On November 2, 2004 a \$0.02 semi-annual and \$0.06 per share special dividend was declared and paid January 7, 2005. This transaction was recorded as a dividend payable at November 30, 2004 of \$572,982.

There can be no assurance that the Company will be able to pay dividends, either regular or special, in the future.

### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The selected financial data contained herein has been derived from the consolidated financial statements of the Company included elsewhere in this Report on Form 10-KSB. The data should be read in conjunction with the consolidated financial statements and notes thereto. Certain statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations, including statements regarding the development of the

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Company's business, the markets for the Company's products, anticipated capital expenditures, and the effects of completed and proposed acquisitions, and other statements and disclosures contained herein and throughout this Annual Report regarding matters that are not historical facts, are forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995). In such cases, we may use words such as "believe," "intend," "expect," "anticipate" and the like. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. 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 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.

### GENERAL

The Company has 148 franchised and licensed units and 2 Company-owned stores as of the end of 2005. Units in operation at the end of 2004 included 167 franchised and licensed units and 3 Company-owned stores. System-wide revenues in 2005 were \$48 million compared to \$50 million in 2004.

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

During 2005, even though revenue declined due to fewer Company-owned stores and lower franchising revenues, the Company continued to control costs. Total operating expenses decreased to \$4,398,000, or 85.8% of total revenue in 2005 compared to \$4,999,000, or 87.6% in 2004.

### YEAR 2005 COMPARED TO YEAR 2004

Total revenues from all sources decreased \$583,000, or 10.2%, to \$5,125,000 in 2005 from \$5,708,000 in the prior year primarily due to fewer Company-owned store locations and fewer franchise locations in 2005 versus 2004. Net sales at Company-owned stores decreased \$353,000, or 19.7% to \$1,440,000 in 2005, versus \$1,793,000 in 2004. Of this decrease in revenue for Company-owned locations in 2005 compared to 2004, \$297,000 was because of locations closed in 2005 and 2004. There was also a \$21,000 decrease in wholesale revenue from operating locations and a \$103,000 decrease in store revenues from operating locations, offset by a \$69,000 increase in sales from a franchise location temporarily managed by the Company-owned store division in 2005.

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Royalty revenue from franchise stores was down \$74,000, or 3.1%, to \$2,277,000 in 2005 as compared \$2,351,000 in 2004, primarily due to less franchise locations open during 2005. Franchise fee revenue decreased \$213,000, or 49.5%, to \$218,000, in 2005 versus \$431,000 in 2004. The Company opened less units, 5, in 2005 versus 12 in 2004, primarily due to the fact more new franchises are opening stores in developing centers which leads to longer timeframes between execution of franchise agreements to occupancy. At November 30, 2005, the Company had 8 units under development versus only 4 at November 30, 2004. Licensing fees and other income increased \$56,000, or 4.9%, to \$1,190,000 in 2005 as compared to \$1,134,000 in 2004. A Trademark infringement lawsuit against a former franchisee resulted in \$90,000 of income in 2005, Sign Shop revenue increased \$29,000 in 2005 as compared to 2004 and a fee of \$34,000 was received for the sale of assets from a franchise location temporarily managed by the Company-owned store division in 2005. These increases were offset by a \$41,000 decrease in subleased property rent, a \$51,000 decrease in licensing fees and a \$5,000 decrease in revenue for Company-owned assets sold.

Food, beverage and paper costs incurred at Company-owned stores decreased \$96,000, or 16.1% in 2005 to \$500,000, or 34.7% of Company-owned store revenue, compared to \$596,000 in 2004, or 33.3% of Company-owned store revenue. In 2005 store payrolls decreased \$151,000 to \$531,000, or 36.9% of Company-owned store revenue, as compared to \$682,000, or 38.1% in 2004. Company-owned locations' rent, taxes and utilities and other operating expenses decreased \$329,000, or 34.7% to \$618,000, or 42.9% of Company-owned store revenue in 2005, compared to \$947,000, or 52.8% of Company-owned store revenue in 2004.

Corporate office payroll and payroll related expenses increased \$6,000, or less than 1%, to \$1,432,000, or 27.9% of revenue in 2005 from \$1,426,000, or 25.0% in 2004, occupancy expense decreased \$22,000, or 15.1% in 2005, to \$125,000, from \$147,000 in 2004. Professional fees decreased to \$208,000 in 2005, from \$214,000 in 2004, and SG&A decreased to \$571,000 in 2005 from \$598,000 in 2004. There was a reduction in depreciation and amortization expense of \$69,000, or 44.9% in 2005, to \$85,000, or 1.7% of revenues as compared to \$154,000, or 2.7% in 2004, primarily because of a reduction in depreciable assets in 2005 for Company-owned store locations. Provision for uncollectible accounts increased \$73,000, to \$36,000, or 0.7% in 2005 compared to (\$37,000), or (0.7%) in 2004. In 2004, management collected more than expected on accounts that were previously considered uncollectible.

Management continues to control costs wherever possible as evidenced by the fact total operating expense declined \$601,000, or 12% from \$4,999,000, or 87.6% of revenue in 2004, to \$4,398,000 or 85.8% in 2005.

Income from operations for the period ended November 30, 2005 was \$727,000 as compared to \$709,000 in 2004. Interest expense decreased \$38,000 to \$44,000 during 2005, compared to \$82,000 in 2004, primarily due to a decrease in outstanding debt and a lower effective interest rate during 2005 compared to 2004.

Net income totaled \$693,000, or 13.5% of revenue in 2005 as compared to \$652,000, or 11.4% of revenue in the prior year.

### LIQUIDITY AND CAPITAL RESOURCES

The net cash provided from operating activities totaled \$943,000 during 2005. Cash provided from operating activities principally represents net income of \$693,000, plus depreciation and amortization of \$85,000 and provision for doubtful accounts of \$36,000, a reduction in trade accounts receivable of \$94,000, a reduction in restricted cash of \$118,000 and an increase in deferred

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revenue of \$191,000, offset by a decrease in accrued liabilities of (\$93,000), a decrease in Marketing Fund obligations of (\$117,000), an increase in prepaid and other assets of (\$22,000), an increase in inventories of (\$1,000), and a decrease in accounts payable of (\$39,000) in 2005. In 2004 the net cash provided from operating activities totaled \$845,000. Cash provided from operating activities principally represented net income of \$652,000, plus depreciation and amortization of \$154,000, the benefit for uncollectible accounts of (\$37,000), a gain on disposal of property of \$3,000, a reduction in trade accounts receivable of \$58,000, a decrease in restricted cash of \$43,000, an increase in accrued liabilities of \$51,000, a reduction in inventories of \$13,000, an increase in accounts payable of \$22,000 and a decrease in prepaid expenses of \$43,000, offset by a decrease in Marketing Fund obligations of (\$43,000) and a decrease in deferred revenue of (\$115,000) in 2004.

Cash provided from investing activities during 2005 totaled \$15,000, and was provided from the collection of notes receivable in the amount of \$58,000, offset by purchases of property and equipment of (\$16,000) and issuance of notes receivable of (\$27,000). Cash provided from investing activities during 2004 totaled \$27,000, and was provided from the sale of property and equipment of \$50,000 and collection of notes receivable in the amount of \$120,000, offset by the issuance of new notes receivable of (\$26,000) and purchases of property and equipment of (\$117,000).

Financing activities used \$946,000 during 2005, due to the repayment of notes payable of (\$253,000) and the payment of dividends (\$717,000), offset by proceeds of \$24,000 from the exercise of stock options. Financing activities used \$549,000 during 2004, due to the repayment of notes payable of (\$1,005,000), the purchase of Treasury Stock in the amount of (\$11,000) and the payment of dividends (\$278,000), offset by proceeds of \$724,000 received on a term loan from Associated Bank and the exercise of stock options in the amount of \$20,000.

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

### OFF BALANCE SHEET ARRANGEMENTS

The Company has no off balance sheet arrangements, other than the lease commitments disclosed in Note 7 of the audited consolidated financial statements included herein.

### CRITICAL ACCOUNTING POLICIES

The Company's significant accounting policies are presented in the Notes to the Consolidated Financial Statements (see Note 2 of the audited consolidated financial statements included herein). While all of the significant accounting policies impact the Company's Consolidated Financial Statements, some of the policies may be viewed to be more critical. The more critical policies are those that are most important to the portrayal of the Company's financial condition and results of operation, and that require management's most difficult, subjective and/or complex judgments and estimates. Management bases its judgments and estimates on historical experience and various other factors that are believed to be reasonable under the circumstances. The results of judgments and estimates form the basis for making judgments about the Company's value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions. Management believes the following are its' most critical accounting policies because they require more significant judgments and estimates in preparation of its' consolidated financial statements.

Revenue Recognition

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Systems royalty fees from franchised stores represent a fee of 5% of net retail sales of franchised units. Royalty revenues are recognized on the accrual basis using estimates based on past history and seasonality.

The Company recognizes franchise fee revenue upon the opening of a franchise store. Direct costs associated with the franchise sales are deferred until the franchise fee revenue is recognized. These costs include site approval, construction approval, commissions, blueprints and training costs.

The Company's revenue recognition policies comply with the criteria set forth in Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements."

### Long-Lived Assets

-----

Property and equipment are recorded at cost. Improvements and replacements are capitalized, while expenditures for maintenance and routine repairs that don't extend the life of the asset are charged to expense as incurred. Depreciation is calculated on the straight-line basis over the estimated useful lives of the assets. Property, equipment and leasehold improvements are stated at cost, less accumulated depreciation. Estimated useful lives for the purpose of depreciation and amortization are 3 to 7 years for property and equipment and 10 years, or the term of the lease if less, for leasehold improvements.

The Company's intangible assets consist primarily of trademarks and goodwill. Beginning in 2003, SFAS 142, "Goodwill and Other Intangible Assets" was adopted by the Company. This requires that assets with indefinite lives no longer be amortized, but instead be subject to annual impairment tests. The Company no longer amortizes goodwill or trademarks. (See Note 2 of the audited consolidated financial statements included herein.)

### Concentrations of Credit Risk

-----

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of royalty and wholesale accounts receivables. Amounts due from franchisees represented approximately 55% and 56% of the receivable balance at November 30, 2005 and 2004, respectively. The Company believes it has maintained adequate reserves for doubtful accounts. The Company reviews the collectibility of receivables periodically, taking into account payment history and industry conditions.

### Valuation Allowance and Deferred Taxes

-----

A valuation allowance is the portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized.

As of November 30, 2005, the Company has cumulative net operating loss carryforwards expiring between 2017 and 2021 for U.S. federal income tax purposes of approximately \$6,921,000. The net operating loss carryforwards are subject to limitation in any given year as a result of the Company's initial public offering and may be further limited if certain other events occur. A valuation allowance has been established for \$2,317,000 at November 30, 2005 for the deferred tax benefit related to those loss carryforwards and other deferred tax assets for which it is considered more likely than not that the benefit will not be realized. (See Note 3 of the audited consolidated financial statements

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included herein.)

In prior years, the Company established a full valuation allowance because it believed there was uncertainty as to realization of the net operating loss carryforward deferred tax asset based on historical operating results. The full valuation allowance still exists at the end of 2005 because the Company believes it is appropriate.

### Recent Accounting Pronouncements

-----

In December 2003, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." This Statement, which is effective for years ending after December 15, 2003 amends SFAS No. 123, "Accounting for Stock-Based Compensation," and provides alternative methods of transition for a voluntary change to the fair value-based methods of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 regardless of the accounting method used to account for stock-based compensation. The Company has chosen to continue to account for stock-based compensation of employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The effects of the enhanced disclosure provisions as defined by SFAS 148 are included in Note 6 of this report.

In December 2004, FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets—an amendment to APB Opinion No. 29." This Statement amends APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Provisions of this Statement are effective for fiscal periods beginning after June 15, 2005. Adoption of SFAS No. 153 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

### Recent Accounting Pronouncements (Continued)

-----

In December 2004, the FASB issues SFAS No. 123(R), "Share-Based Payment." SFAS No. 123(R) establishes accounting standards for transactions in which a company exchanges its equity instruments for goods or services. In particular, this Statement will require companies to record compensation expense for all share-based payments, such as employee stock options, at fair market value. This Statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 (the Company's period beginning December 1, 2006). Adoption of SFAS No. 123(R) is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, - a replacement of APB Opinion No. 20 and FASB Statement No. 3." This Statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include

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specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and correction of errors made in fiscal years beginning after the date this Statement is issued. Adoption of SFAS No. 154 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Management has considered all other recently issued accounting pronouncements and does not believe that the adoption of such pronouncements will have a material impact on the Company's financial statements.

ITEM 7. FINANCIAL STATEMENTS

The Consolidated Financial Statements and Report of Independent Auditors' is included immediately following.

BAB, Inc.  
Years Ended November 30, 2005 and November 30, 2004

C o n t e n t s  
-----

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Income  
Consolidated Statements of Stockholders' Equity  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

Exhibit A  
-----

BAB, Inc.  
Consolidated Balance Sheets  
November 30, 2005 and 2004

=====  
Report of Independent Registered Public Accounting Firm

Stockholders and Board of Directors of

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BAB, Inc.

We have audited the accompanying consolidated balance sheets of BAB, Inc. as of November 30, 2005 and 2004 and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BAB, Inc. as of November 30, 2005 and 2004, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Altschuler, Melvoin and Glasser LLP  
Chicago, Illinois  
January 20, 2006

Exhibit A  
-----

BAB, Inc.  
Consolidated Balance Sheets  
November 30, 2005 and 2004  
=====

	2005
Assets	
Current Assets	
Cash	\$ 2,206,524
Restricted Cash	204,055
Receivables	
Trade accounts receivable (net of allowance for doubtful accounts of \$83,220 in 2005 and \$83,914 in 2004)	104,110
Marketing fund contributions receivable from franchisees and stores	30,389
Notes receivable (net of allowance for doubtful accounts of \$7,769 in 2005 and \$17,293 in 2004)	33,700
Inventories	65,255
Prepaid expenses and other current assets	135,488
Total Current Assets	2,779,521

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Property, plant and equipment, net	169,081
Notes Receivable	40,849
Trademarks	763,666
Goodwill	3,542,772
Other (net of accumulated amortization of \$293,329 in 2005 and \$284,173 in 2004)	12,053
<hr/>	
Total Noncurrent Assets	4,528,421
<hr/>	
Total Assets	\$ 7,307,942
<hr/>	
Liabilities and Stockholders' Equity	
Current liabilities	
Current portion of long-term debt	\$ 266,824
Accounts payable	93,428
Accrued expenses and other current liabilities	507,279
Dividends payable	577,781
Unexpended marketing fund contributions	158,913
Deferred revenue	71,579
Deferred franchise fee revenue	210,000
<hr/>	
Total Current liabilities	1,885,804
<hr/>	
Long-term debt net of current portion	444,307
Deferred revenue	86,980
<hr/>	
NonCurrent Liabilities	531,287
<hr/>	
Total Liabilities	2,417,091
<hr/>	
Stockholders' equity (deficit)	
Common stock (\$.001 par value; 15,000,000 shares authorized; 8,412,391 and 8,232,939 shares issued, and 7,208,946 and 7,029,494 shares outstanding as of November 30, 2005 and November 30, 2004, respectively)	13,508,202
Additional paid-in capital	870,935
Treasury stock	(222,781)
Accumulated deficit	(9,265,505)
<hr/>	
Total Stockholders' equity	4,890,851
<hr/>	
Total Liabilities and Stockholders' Equity	\$ 7,307,942
<hr/>	

See accompanying notes

BAB, Inc.  
Consolidated Statements of Income  
Years Ended November 30, 2005 and 2004

2005

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Revenues

Net sales by Company-owned stores	\$	1,440,
Royalty fees from franchised stores		2,277,
Franchise fees		217,
Licensing fees and other income		1,190,
		-----
		5,125,
		-----

Operating expenses

Food, beverage and paper costs		500,
Store payroll and other operating expenses		1,148,
Selling, general and administrative expenses		
Payroll related expenses		1,431,
Occupancy		125,
Advertising and promotion		149,
Professional service fees		207,
Travel expenses		142,
Depreciation and amortization		84,
Other		607,
		-----
		4,398,
		-----

Income from operations \$ 726,

Interest income		9,
Interest expense		(44,
		-----
		(34,
		-----

Net income \$ 692,

Net income per common share

Basic		\$0
Diluted		\$0

Shares used in computing per share amounts

Basic		7,183,
Diluted		7,240,

See accompanying notes

BAB, Inc.  
 Consolidated Statements of Stockholders' Equity  
 Years Ended November 30, 2005 and 2004

Additional

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	Common Stock		Paid-in	Treasury Stock	Accumulated	
	Shares	Amount	Capital	Shares	Deficit	
	-----	-----	-----	-----	-----	
Balance, November 30, 2003 (Restated)	7,969,403	\$13,507,759	\$827,451	(1,177,777)	(\$212,000)	(\$9,000)
Stock options exercised	263,536	264	20,111			
Purchase of treasury stock				(25,668)	(10,781)	
Dividends paid and accrued						
Net income						
Balance, November 30, 2004	8,232,939	13,508,023	847,562	(1,203,445)	(222,781)	(9,200)
Stock options exercised	179,452	179	23,373			
Dividends paid and accrued						
Net income						
Balance, November 30, 2005	8,412,391	\$13,508,202	\$870,935	(1,203,445)	(\$222,781)	(\$9,200)

See accompanying notes

BAB, Inc.  
Consolidated Statements of Cash Flows  
Years Ended November 30, 2005 and 2004

Cash flows from operating activities

	2005
	-----
Net income	\$ 69
Depreciation and amortization	8
Provision for doubtful accounts (net of recoveries)	3
Loss (gain) on sale or disposal of property and equipment	
Changes in	
Trade accounts receivable	9
Restricted cash	11
Marketing Fund contributions receivable from franchisees and stores	3
Inventories	(

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Prepaid expenses and other assets	(2)
Accounts payable	(3)
Accrued expenses and other current liabilities	(9)
Deferred revenue	19
Unexpended Marketing Fund	(15)
	-----
Net cash provided by operating activities	94
	-----
Investing activities	
Purchases of property and equipment	(1)
Proceeds from sale of property and equipment	
Issuance of notes receivable	(2)
Proceeds from notes receivable	5
	-----
Net cash provided by investing activities	1
	-----
Financing activities	
Proceeds from long term debt	
Repayment of long-term debt	(25)
Purchase of treasury stock	
Proceeds from exercise of stock options	2
Dividends paid	(71)
	-----
Net cash used in financing activities	(94)
	-----
Net increase in cash	1
Cash, beginning of year	2,19
	-----
Cash, end of year	\$ 2,20
	-----
Supplemental disclosure of cash flow information	
Interest paid	\$ 4
Income taxes paid	
	-----

### Supplemental disclosure of noncash investing and financing activities:

On October 7, 2005 a semi-annual \$0.02 per share cash dividend and a special dividend of \$0.06 per share was declared, payable January 3, 2006, and was recorded as a dividend payable in the amount of \$577,781 at November 30, 2005. On November 2, 2004 a semi annual \$.02 per share cash dividend and a special dividend of \$0.06 per share was declared, payable January 7, 2005, and recorded as a dividend payable in the amount of \$572,982 at November 30, 2004. See accompanying notes.

See accompanying notes

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### 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") 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 under license agreements and through direct home delivery of specialty muffin 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. 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, including one which currently serves as the franchise training facility. BFC was established on February 15, 1996 to franchise "Brewster's Coffee" concept coffee stores. My Favorite Muffin Too, Inc., a New Jersey corporation, was acquired on May 13, 1997. My Favorite Muffin Too, Inc. franchises "MFM" concept muffin stores. The assets of Jacobs Bros. Bagels (Jacobs Bros.) were acquired on February 1, 1999. (See Note 6.) The company continues to operate one store with the Jacobs Bros. name.

### Note 2 - Summary of Significant Accounting Policies

#### Principles of Consolidation

-----

The consolidated financial statements include the accounts of the Company and its direct and indirect wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

#### Use of Estimates

-----

The preparation of financial statements 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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Revenue Recognition

-----

Systems royalty fees from franchised stores represent a fee of 5% of net sales of franchised units. Royalty revenues are recognized on the accrual basis.

The Company recognizes franchise fee revenue upon the opening of a franchise store. Direct costs associated with franchise sales are deferred until the franchise fee revenue is recognized. These costs include site approval, construction approval, commissions, blueprints and training costs.

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November 30, 2005 and 2004

## Note 2 - Summary of Significant Accounting Policies (Continued)

The Company earns a licensing fee from the sale of par-baked bagels from a third-party commercial bakery and from the sale of coffee from a coffee bean roaster for the sale of BAB branded product to the franchised and licensed units noted in the table below. Stores which have been opened, and unopened stores for which a Franchise Agreement has been executed at November 30, 2005 and 2004 are as follows:

	2005	2004
	----	----
Stores opened		
Company-owned	2	3
Franchisee-owned	145	162
Licensed	3	5
	-----	-----
	150	170
Unopened stores		
Franchise Agreement	8	4
	-----	-----
	158	174

### Segments

-----

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information," which established annual reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. The Company's operations are within two reportable segments operating in the United States: Company Store Operations and Franchise Operations.

### Marketing Fund

-----

Systems established a Marketing Fund (Fund) during 1994. Franchisees and Company-owned stores are required to contribute to the Fund based on their retail sales. The Fund also earns revenues from commissions paid by certain vendors on the sale of BAB licensed products to franchisees.

### Cash

----

Bank deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. Deposits may from time to time exceed federally insured limits. As of November 30, 2005 and 2004, the Fund cash balances, which are restricted, were \$128,129 and \$245,679 respectively. Also included in restricted cash at both November 30, 2005 and 2004 is a \$75,926 certificate of deposit that serves as collateral for a Letter of Credit for the Corporate Office facility lease entered with IL-Corporate 500 Centre, L.L.C., as required by the lease.

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### Accounts Receivable

-----

Receivables are carried at original invoice amount less estimates made for doubtful accounts. Management determines the allowances for doubtful accounts by reviewing and identifying troubled accounts on a periodic basis and by using historical experience applied to an aging of accounts. 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.

### Note 2 - Summary of Significant Accounting Policies (Continued)

#### Inventories

-----

Inventories are valued at the lower of cost or market under the first-in, first-out (FIFO) method.

#### Property, Plant and Equipment

-----

Property and equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on 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.

#### Goodwill and Other Intangible Assets

-----

The Company's intangible assets consist primarily of trademarks and goodwill. SFAS No. 142, "Goodwill and Other Intangible Assets" was adopted beginning with the quarter ended February 29, 2003. This requires that assets with indefinite lives no longer be amortized but instead be subject to annual impairment tests using a discounted cash flow model to determine the assets fair value. The Company no longer amortizes goodwill or trademarks, but instead, the Company's intangible assets are tested annually for impairment. No impairment has been recorded for the years ended November 30, 2005 or 2004.

The net book value of intangible assets with definite lives totaled \$12,053 and \$21,209 at November 30, 2005 and 2004, respectively. The gross value of definite lived intangible assets and their respective accumulated amortization are as follows:

Definite Lived Intangible Assets	Original Cost	Accumulated Amortization as of November 30, 2005
-----	-----	-----
Noncompete Agreement	\$ 210,000	\$ 210,000
Master Lease Origination Fees	95,382	83,329
	-----	-----
Total	\$ 305,382	\$ 293,329

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Definitive lived intangible assets are being amortized over their useful lives. The Company recorded amortization expense for definitive lived intangible assets of \$9,157 and \$20,965 for years ended November 30, 2005 and 2004, respectively. The amortization expense on these intangible assets is as follows for November 30:

2006	9,200
2007	2,853
	-----
Total	\$ 12,053

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

### Advertising and Promotion Costs

-----

The Company expenses advertising and promotion costs as incurred. Advertising and promotion expense was \$149,648 and \$149,033 in 2005 and 2004, respectively. Included in advertising expense was \$66,331 and \$66,384 in 2005 and 2004, respectively, related to the Company's franchise operations.

### Note 2 - Summary of Significant Accounting Policies (Continued)

#### Income Taxes

-----

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The benefits from net operating losses carried forward may be impaired or limited in certain circumstances. In addition, a valuation allowance can be provided for deferred tax assets when it is more likely than not that all or some portion of the deferred tax asset will not be realized. The Company has established a full valuation allowance on the net deferred tax assets due to the uncertainty of realization. (See Note 3.)

#### Earnings Per Share

-----

The Company computes earnings per share ("EPS") under SFAS No. 128, "Earnings per Share." Basic net earnings are divided by the weighted average number of common shares outstanding during the year to calculate basic net earnings per common share. Diluted net earnings per common share are calculated to give effect to the potential dilution that could occur if warrants, options or other contracts to issue common stock were exercised and resulted in the issuance of additional common shares.

The computation of basic and diluted EPS is as follows:

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Numerator:

Net income attributable to common stockholders \$ 692,85

Denominator:

Denominator for basic earnings per share -  
Weighted average shares 7,183,78

Common stock equivalents 56,93

Denominator for dilutive earnings per share -  
Weighted average shares 7,240,72

Basic and diluted income per share \$ 0.1

Stock Options

The Company uses the intrinsic method, as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation," to account for stock options granted to employees and directors. No compensation expense is recognized for stock options because the exercise price of the options is at least equal to the market price of the underlying stock on the grant date.

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

Stock Warrants

Stock warrants granted as consideration in purchase acquisitions have been recorded as an addition to additional paid-in capital in the accompanying balance sheet based on the fair value of such stock warrants on the date of the acquisition.

Fair Value of Financial Instruments

The carrying amounts of financial instruments including cash, accounts receivable, notes receivable, accounts payable and short-term debt approximate their fair values because of the relatively short maturity of these instruments. The carrying value of long-term debt, including the current portion, approximate fair value based upon market prices for the same or similar instruments.

Note 2 - Summary of Significant Accounting Policies (Continued)

Reclassification

Certain items in prior year financial statements have been reclassified to conform to the presentation used in 2005.

Recent Accounting Pronouncements

## Edgar Filing: BAB, INC. - Form 10KSB

In December 2003, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." This Statement, which is effective for years ending after December 15, 2003 amends SFAS No. 123, "Accounting for Stock-Based Compensation," and provides alternative methods of transition for a voluntary change to the fair value-based methods of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 regardless of the accounting method used to account for stock-based compensation. The Company has chosen to continue to account for stock-based compensation of employees using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The effects of the enhanced disclosure provisions as defined by SFAS 148 are included in Note 6 of this report.

In December 2004, FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets—an amendment to APB Opinion No. 29." This Statement amends APB 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Provisions of this Statement are effective for fiscal periods beginning after June 15, 2005. Adoption of SFAS No. 153 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issues SFAS No. 123(R), "Share-Based Payment." SFAS No. 123(R) establishes accounting standards for transactions in which a company exchanges its equity instruments for goods or services. In particular, this Statement will require companies to record compensation expense for all share-based payments, such as employee stock options, at fair market value. This Statement is effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 (the Company's period beginning December 1, 2006). Adoption of SFAS No. 123(R) is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, - a replacement of APB Opinion No. 20 and FASB Statement No. 3." This Statement replaces APB Opinion No. 20, "Accounting Changes," and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and correction of errors made in fiscal years beginning after the date this Statement is issued. Adoption of SFAS No. 154 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Management has considered all other recently issued accounting pronouncements and does not believe that the adoption of such pronouncements will have a

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material impact on the Company's financial statements.

### Note 3 - Income Taxes

The components of the income tax (benefit) provision are as follows:

	2005
Federal income tax provision computed at federal statutory rate	\$ 235,57
State income taxes net of federal tax provision	33,38
Other adjustments	98,46
Change in valuation allowance	(230,56)
Utilization of net operating losses	(136,85)
	\$
Provision for Deferred Income Taxes	\$

Deferred income tax assets (liabilities) are as follows:

	2005
Deferred revenue	\$ 143,068
Deferred rent revenue	15,318
Marketing Fund net contributions	49,737
Allowance for doubtful accounts	32,304
Allowance for doubtful accounts-notes receivable	3,016
Accrued expenses	3,882
Net operating loss carryforwards	2,686,525
Other	-
Valuation allowance	(2,316,591)
	\$
Total Deferred Income Tax Assets	617,259
	\$
Depreciation and amortization	(611,126)
Franchise Costs	(6,133)
	\$
Total Deferred Income Tax Liabilities	(617,259)
	\$
Total Net Deferred Tax Assets/Liabilities	-
	\$

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

As of November 30, 2005, the Company has net operating loss carryforwards

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expiring between 2017 and 2021 for U.S. federal income tax purposes of approximately \$6,921,000. The net operating loss carryforwards are subject to limitation in any given year as a result of the Company's initial public offering and may be further limited if certain other events occur. A valuation allowance has been established for \$2,316,591 and \$2,684,013 as of November 30, 2005 and 2004, respectively, for the deferred tax benefit related to those loss carryforwards and other deferred tax assets.

### Note 4 - Long-Term Obligations

Long-term debt consisted of the following:

	2005	2004
	-----	-----
Bank note payable	\$ 416,552	\$ 649,065
Note payable to former stockholder	294,579	314,635
	-----	-----
	711,131	963,700
Less current portion	(266,824)	(252,569)
	-----	-----
Long-Term Debt, Net of Current Portion	\$ 444,307	\$ 711,131

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 is secured by substantially all of the assets of the Company and is to be repaid in monthly installments of \$21,900, including interest at a rate of 5.5 % per annum, with a final payment due July 1, 2007. The balance of this note payable was \$416,552 and \$649,065 as of November 30, 2005 and 2004, respectively.

On September 6, 2002, the Company signed a note payable requiring annual installments of \$35,000, including interest at a rate of 4.75% per annum, for a term of 15 years, in the original amount of \$385,531. The Company purchased and retired 1,380,040 shares of BAB common stock from a former stockholder. The balance of this note payable was \$294,579 and \$314,635 as of November 30, 2005 and 2004, respectively.

As of November 30, 2005, annual maturities on long-term obligations due are as follows:

Year Ending November 30:	
2006	266,824
2007	192,740
2008	23,051

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2009	24,146
2010	25,292
Thereafter	179,078
	-----
Total	\$ 711,131

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

### Note 5 - Stockholders' Equity

In 2004, the Company purchased 25,668 shares of common stock from a previous member of the Board of Directors and in 2003 the Company purchased 1,177,777 shares of common stock from three stockholders. The Company is holding these shares as treasury stock.

On May 12, 2005, a \$0.02 per share dividend was declared and was paid on June 21, 2005. On October 7, 2005, an \$0.08 cash dividend was declared consisting of a \$0.02 semi-annual and a \$0.06 special dividend payable January 3, 2006. This transaction was recorded as a dividend payable in the amount of \$577,781 at November 30, 2005. In 2004, cash dividends of \$0.02 were declared on January 1, 2004, payable February 2, 2004 and June 17, 2004 payable July 23, 2004. On November 2, 2004 a \$0.02 semi-annual and \$0.06 per share special dividend was declared and paid January 7, 2005. The transaction was recorded as a dividend payable of \$572,982 at November 30, 2004.

### Note 6 - Stock Options and Warrants

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. The Plan will terminate on May 25, 2011. The Plan permits granting of awards to employees and non-employee directors and agents of the Company in the form of stock appreciation rights, stock awards and stock options. The Plan is currently administered by a Committee of the Board of Directors appointed by the Board. The Plan gives broad powers to the Board or Committee to administer and interpret the Plan, including the authority to select the individuals to be granted options and rights, and to prescribe the particular form and conditions of each option or right granted.

Under the stock option plans, the exercise price of each option equals the market price of the Company's stock on the date of grant. The options granted vary in vesting from immediate to a vesting period over three years. The options granted are exercisable within a 10 year period from the date of grant. All stock issued from the granted options must be held for one year from date of exercise. Options issued and outstanding expire on various dates through June 1, 2015. Range of exercise prices of options granted as of November 30, 2005 are \$0.065 to \$0.97.

Activity under the Plan during the two years ended November 30, is as follows:

2005		
Options	Weighted Average	Options

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		exercise price		
Options outstanding at beginning of year	258,486	\$	0.246	413,772
Granted	95,000		0.914	115,000
Forfeited	(11,000)		0.727	(6,750)
Exercised	(179,452)		0.132	(263,536)
	-----		-----	-----
Outstanding at end of year	163,034	\$	0.722	258,486

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

Range of exercise price	Options Outstanding			Options exercisable
	Options outstanding	Weighted average remaining contractual life	Weighted average exercise price	
\$0.065	2,284	6.5	\$0.065	
\$0.46 - \$0.51	62,750	8.0	\$0.492	
\$0.60	10,000	8.6	\$ 0.60	
\$0.88 - \$0.97	68,000	9.0	\$0.933	
\$0.86	20,000	9.6	\$0.86	
	-----		-----	
	163,034		\$0.722	

Note 6 - Stock Options and Warrants (Continued)

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting and Disclosure of Stock-Based Compensation." Accordingly, no employee compensation expense has been recognized for the Plan in the financial statements. Had employee compensation expense for the Company's Plan been recorded in the financial statements, consistent with provisions of SFAS No. 123, net earnings would have been reduced by \$31,710 in fiscal 2005 and \$25,987 in fiscal 2004 based on the Black-Scholes option-pricing model. The Company's net income and net income per share for 2005 and 2004 would have been as follows:

	2005	2004
Pro forma impact of fair value method		
Reported net income	\$ 692,857	\$ 652,27
Less: fair value impact of employee stock compensation	(31,710)	(25,98
	-----	-----
Pro forma net income	\$ 661,147	\$ 626,28

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Earnings per common share		
Basic and diluted - as reported	\$ 0.10	\$0.0
Basic and diluted - pro forma	\$ 0.09	\$0.0
Weighted average Black-Scholes fair value assumptions		
Risk free interest rate	4.0%	3.0
Expected life	5.3 yrs	3.0
Expected volatility	2.548%	1.64
Expected dividend yield	5.5%	7.

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

On February 1, 1999, the Company purchased certain assets of a related group of entities doing business as Jacobs Bros. Bagels (Jacobs Bros.), a chain operating retail bagel stores in the Chicago, Illinois area. The assets acquired included 8 retail locations and a central commissary facility in exchange for \$950,000 in cash and warrants to acquire 333,332 shares of the Company's common stock. The warrants provide for the purchase of 183,332 and 150,000 shares of common stock at an exercise price of \$1.88 and \$2.25 per share, respectively. The warrants were first exercisable on February 1, 2000 and expire on January 31, 2006. None of the warrants have yet been exercised.

#### Note 7 - Commitments

The Company rents its Corporate Office and Company-owned store facilities under leases which require it to pay real estate taxes, insurance and general repairs and maintenance. Rent expense for the years ended November 30, 2005 and November 30, 2004 was \$212,739 and \$272,893, net of sublease income of \$140,108 and \$163,938, respectively. Monthly rent is recorded on a straight-line basis over the term of the lease with a deferred rent liability being recognized. As of November 30, 2005, future minimum annual rental commitments under leases, net of sublease income of \$123,730 in 2006, \$127,432 in 2007, \$130,252 in 2008, \$132,952 in 2009 and \$11,117 in 2010 are as follows:

Year Ending November30:		
2006	\$	122,585
2007		120,812
2008		126,643
2009		139,250
2010		151,367
Thereafter		81,108
		-----
Total	\$	741,765

#### Note 8 - Related Party Transactions

Michael K. Murtaugh, the Company's Vice President and General Counsel, was the sole stockholder of Bagel One, Inc., which owned and operated a Big Apple Bagels franchise store in Illinois. A note receivable owed by Bagel One, Inc. to Systems, guaranteed by Mr. Murtaugh, effective March 2000 in the amount of \$30,025 for a term of six years bearing 9% interest, had an outstanding balance of \$2,244, and \$6,244 as of November 30, 2005 and 2004, respectively. There are no payments in arrears. Interest income recognized and received by Systems amounted to \$300 and \$907 in 2005 and 2004, respectively.

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### Note 9 - Employee Benefit Plan

The Company maintains a qualified 401(k) plan which allows eligible participants to make pretax contributions. Company contributions are discretionary. The Company contributed \$15,000 and \$20,000 in 2005 and 2004, respectively.

### Note 10 - Segment Information

Segment information has been reclassified to reflect licensing fees revenue, goodwill and certain definite lived assets and the amortization expense related to these intangibles in Systems so as to reflect a truer segment income stream and asset relationship as the business has changed focus to the franchise division.

The following tables present segment information for the years ended November 30, 2005 and 2004:

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

	Net Revenues		Operatin
	2005	2004	2005
Company Store Operations	\$ 1,906,953	\$ 2,241,699	\$ (364,6
Franchise Operations and Licensing Fees	3,218,142	3,466,347	1,805,0
	\$ 5,125,095	\$ 5,708,046	\$ 1,440,4
Corporate Expenses			(713,4
Interest Expense, Net of Interest Income			(34,1
Net Income			\$ 692,8

### Operating Segment Data

	Identifiable Assets	Capital Expenditures
Year ended November 30, 2005		
Company Store Operations	\$ 187,467	\$ 14,422
Franchise Operations (other than goodwill)	267,969	1,537
Goodwill and Other Indefinite Lived Intangible Assets	4,306,439	-
	\$ 4,761,875	\$ 15,959
Year ended November 30, 2004		
Company Store Operations	\$ 286,292	\$ 7,739

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Franchise Operations (other than goodwill)	430,955	109,401
Goodwill and Other Indefinite Lived Intangible Assets	4,306,439	-
	-----	-----
	\$ 5,023,686	\$ 117,140

Note 10 - Segment Information (continued)

### Reconciliation to Total Assets as Reported

-----

		2005
		----
Assets-Total reportable segments- Identifiable assets	\$	4,761,875
Unallocated amounts		
Cash		2,410,579
Prepaid expenses and other current assets		135,488
		-----
Total Consolidated Assets	\$	7,307,942
		=====

There were no sales to any individual customer during either year in the two-year period ended November 30, 2005 that represented 10% or more of net sales.

BAB, Inc  
Notes to the Consolidated Financial Statements  
November 30, 2005 and 2004

Note 11 - Subsequent event

During December 2005, management was negotiating the possible renewal of the Company's lease, which was scheduled to expire on December 31, 2005, on one of the two remaining Company-owned stores. Management was not able to negotiate terms that were deemed to be acceptable and decided to close the store effective December 31, 2005. Net sales for this store amounted to approximately \$632,000 and \$747,000 for the years ended November 30, 2005 and 2004, respectively. Food, beverage and paper costs, store payroll and other operating expenses for this store amounted to approximately \$691,000 and \$814,000 for the years ended November 30, 2005 and 2004, respectively.

ITEM 8. CHANGES IN AND DISAGREEMENT WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

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None

### ITEM 8A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14(c) of the Securities Exchange Act of 1934 within 90 days of the filing date of the annual report. Based upon their evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the 90 day evaluation period. As a result, no corrective actions were required or undertaken.

### PART III

### ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's executive officers and directors, and persons who beneficially own more than ten percent of the Company's Common Stock, to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission (the "SEC"). Executive officers, directors and greater than ten percent beneficial owners are required by the SEC to furnish the Company with copies of all Section 16(a) forms they file.

Based upon a review of the copies of such forms furnished to the Company, the Company believes that all Section 16(a) filing requirements applicable to its executive officers and directors were met during the year ended November 30, 2005.

### CODE OF ETHICS

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BAB, Inc.  
Code of Ethics  
November 30, 2005

BAB, Inc. (the Company) is formally establishing, although it believes it has complied with the tenants of such a document during its existence, a Code of Ethics, pursuant to Section 406 of the Sarbanes-Oxley Act, which is designed to deter wrongdoing and to promote:

- o Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

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- o Full, fair, accurate, timely and understandable disclosure in reports and documents that the Company files with, or submits to, the Securities and Exchange Commission, and in other public communications made by the Company;
- o Compliance with applicable government laws, rules and regulations;
- o The prompt internal reporting of violations of the Code to the appropriate person or persons identified in the Code; and
- o Accountability for adherence to the Code.

The Code of Ethics promulgated by Sarbanes-Oxley, expects the highest standard of ethical conduct and fair dealing of its Senior Financial Officers (SFO), defined as the Chief Executive Officer and Chief Financial Officer. While, per Sarbanes-Oxley, this policy is intended to only cover the actions of the SFO, the Company expects it's Controller, other officers, directors and employees will also review this Code and abide by its provisions. The Company's reputation is a valuable asset and as such must continually be guarded by all associated with the Company so as to earn the trust, confidence and respect of our suppliers, customers and shareholders.

The Company's SFO are committed to conducting business in accordance with the highest ethical standards. The SFO must comply with all applicable laws, rules and regulations. Furthermore, SFO must not commit an illegal or unethical act, or instruct or authorize others to do so.

### CONFLICTS OF INTEREST

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The SFO must act in the best interests of the Company, and should avoid any situation that presents an actual, potential or apparent conflict between their personal interests and the interests of the Company.

The SFO have a conflict when their personal interests, relationships or activities, or those of a member of their immediate family, interfere or conflict, or even appear to interfere or conflict, with the Company's interests. A conflict of interest prevents one from acting objectively with the Company's best interests in mind, or prevents one from exercising sound, ethical business judgment.

### PUBLIC COMMUNICATIONS

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The Company is committed to providing Company information to the public in a manner that complies with all applicable legal and regulatory requirements and that promotes investor confidence by facilitating fair, orderly and efficient behavior. The Company's reports and documents filed with the Securities and Exchange Commission, as well as any other public communications, must be complete, fair, accurate and timely. The SFO must do everything in their power to comply with these standards.

### CODE OF ETHICS (Continued)

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### GIFTS

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The SFO may not give or receive kickbacks, rebates, gifts, services or any other benefits, other than gifts of nominal value (amounts would be considered in excess of nominal value if they create the appearance of impropriety, or actually influence the Company to give preferential, versus arms-length, treatment to the provider) from a supplier, competitor, government official, customer or any other person the Company does, or expects to do business with.

### LOANS

-----

SFO may not accept loans, or loan guarantees, from the Company, or from any persons or entities, either doing business with, or seeking business with the Company. The Company will not make any loans to SFO, officers, directors, employees or any outside parties doing business with, or seeking business with the Company.

### CONFIDENTIAL INFORMATION

-----

SFO, officers, directors and employees are to respect the confidentiality of Company, employee, supplier, customer, competitor and any other persons or entities' information that is not a matter of public record. Confidential information must not be used for personal gain.

### COMPLIANCE WITH THIS CODE

-----

SFO are expected to fully comply with this Code. This Code will be strictly enforced and any violations will be dealt with immediately, and depending on the severity of noncompliance, could lead to disciplinary action including termination. Furthermore, violations involving unlawful behavior will be reported to appropriate outside authorities. If anyone is unclear as to the possibility of a violation of this Code, he should seek the opinion of the Company's Vice President and General Counsel, the Audit Committee and/or outside legal counsel.

If SFO, officers, directors and employees have knowledge, or are suspicious of any non-compliance with this Code, or are concerned that circumstances could lead to a violation of this Code, they should discuss this with their immediate supervisor, the Company's Vice President and General Counsel, the Audit Committee and/or outside legal counsel.

The Company will not allow any retaliation against an employee, officer, or director who acts in good faith in reporting any actual or suspected violation. Open communication of issues and concerns without fear of retribution or retaliation is vital to the success of this Code.

### ADHERENCE TO THE CODE

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The Vice President and General Counsel will have primary authority and responsibility for the enforcement of this Code, subject to the supervision of the Audit Committee of the Board of Directors, and shall promptly notify the Audit Committee of any violation of this Code.

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### ITEM 10. EXECUTIVE COMPENSATION.

The following table sets forth the cash compensation earned by executive officers that received annual salary and bonus compensation of more than \$100,000 during years 2005, 2004 and 2003 (the "Named Executive Officers"). The Company has no employment agreements with any of its executive officers.

#### Summary Compensation Table

Name and Principal Position	Year End	Annual Compensation			Long Term Compensation	
		Salary	Bonus	Other	Awards	Securities
		(\$)	(\$)	(\$)	Restricted Stock Awards (\$)	Underlying Options/SARS (#)
Michael W. Evans, President and CEO	2005	233,492	35,851	--	--	20,000
	2004	221,209	39,600	--	--	20,000
	2003	211,750	20,000	--	--	80,000
Michael K. Murtaugh, Vice President and General Counsel	2005	175,902	26,888	--	--	20,000
	2004	165,906	29,700	--	--	20,000
	2003	157,300	20,000	--	--	80,000
Jeffrey M. Gorden, Chief Financial Officer	2005	126,430	--	--	--	6,000
	2004	121,919	5,000	--	--	5,500
	2003	116,443	6,000	--	--	20,668
John J. Bracken,* Vice President Operations	2005	99,053	--	--	--	6,000
	2004	106,694	3,500	--	--	3,000
	2003	103,058	1,000	--	--	20,668

Stock options were issued at fair market value on the issue date to officers owning less than 10% of the Company stock and 110% of fair market value at issue date to those officers having a 10% or greater ownership of Company stock and all options expire 10 years after date of grant. Options issued during 2005 were issued on January 25, 2005 with a fair market issue price of \$0.88 and vests as follows: 1/3 in 12 months, 1/3 in 24 months and 1/3 in 36 months from issue date and 20,000 options issued June 1, 2005 with a fair market issue price of \$0.86 and vests immediately. Options issued to the above officers totaled 52,000 shares or 54.7% of total options issued. Options issued during 2004 were issued on December 2, 2003 with a fair market issue price of \$0.46 and vests as follows: 1/3 in 12 months, 1/3 24 months and 1/3 in 36 months from the issue date. Options issued to the above officers totaled 48,500 or 42.2% of options granted in 2004. Options issued in 2003 consisted of grants to Officers totaling 201,336, or 67.1% of total options granted in 2003. The fair market issue price

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was \$0.065 and vested as follows: 1/3 immediate, 1/3 in 12 months and 1/3 in 24 months.

\* See Item 13 November 18, 2005 8k

### Indemnification of Directors and Officers -----

The Company's Certificate of Incorporation limits personal liability for breach of fiduciary duty by its directors to the fullest extent permitted by the Delaware General Corporation Law (the "Delaware Law"). Such Certificate eliminates the personal liability of directors to the Company and its shareholders for damages occasioned by breach of fiduciary duty, except for liability based on breach of the director's duty of loyalty to the Company, liability for acts omissions not made in good faith, liability for acts or omissions involving intentional misconduct, liability based on payments or improper dividends, liability based on violation of state securities laws, and liability for acts occurring prior to the date such provision was added. Any amendment to or repeal of such provisions in the Company's Articles of Incorporation shall not adversely affect any right or protection of a director of the Company for with respect to any acts or omissions of such director occurring prior to such amendment or repeal.

In addition to the Delaware Law, the Company's Bylaws provide that officers and directors of the Company have the right to indemnification from the Company for liability arising out of certain actions to the fullest extent permissible by law. Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to directors, officers or persons controlling the Company pursuant to such indemnification provisions, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is therefore unenforceable.

### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth as of February 16, 2006 the record and beneficial ownership of Common Stock held by (i) each person who is known to the Company to be the beneficial owner of more than 5% of the Common Stock of the Company; (ii) each current director; (iii) each "named executive officer" (as defined in Regulation S-B, Item 402 under the Securities Act of 1933); and (iv) all executive officers and directors of the Company as a group. Securities reported as "beneficially owned" include those for which the named persons may exercise voting power or investment power, alone or with others. Voting power and investment power are not shared with others unless so stated. The number and percent of shares of Common Stock of the Company beneficially owned by each such person as of February 16, 2006 includes the number of shares, which such person has the right to acquire within sixty (60) days after such date. All shares have been adjusted for a 4:1 stock dividend as of January 20, 2003.

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Name and Address	Shares
Michael W. Evans 500 Lake Cook Road, Suite 475 Deerfield, IL 60015	2,860,485 (1) (2) (3) (4)
Michael K. Murtaugh 500 Lake Cook Road, Suite 475 Deerfield, IL 60015	2,781,783 (1) (2) (4) (5)
Holdings Investment, LLC 220 DeWindt Road Winnetka, IL 60093	2,096,195 (1) (6)
Jeffrey M. Gorden 500 Lake Cook Road, Suite 475 Deerfield, IL 60015	81,667 (7)
John J. Bracken * 500 Lake Cook Road, Suite 475 Deerfield, IL 60015	64,628 (8)
Steven G. Feldman 750 Estate Drive, Suite 104 Deerfield, IL 60015	30,000 (9)
James A. Lentz 1415 College Lane South Wheaton, IL 60187	24,932 (10)
All executive officers and directors as a group (6 persons)	3,747,300 (1) (2) (3) (4) (5) (6) (7) (8) (9) (10)

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\* See Item 13 November 18, 2005 8k

- (1) Includes all shares held of record by Holdings Investments, LLC. Messrs. Evans and Murtaugh are members and managers of the LLC and together control all voting power of the stock owned by the LLC.
- (2) Includes 20,000 stock options fully exercisable as of 2/16/06.
- (3) Includes 3,500 shares inherited by spouse
- (4) Includes 22,222 shares held by children
- (5) Includes 2,540 shares held by 401 (k) trust.
- (6) Mr. Thomas F. Pick has beneficial ownership of 25.18% of Holdings Investment, LLC, which is the equivalent of 527,884 shares of BAB, Inc. Common stock.
- (7) Includes 2,000 stock options fully exercisable as of 2/16/06.
- (8) Includes 2,800 shares held by 401 (k) trust.
- (9) Includes 20,000 stock options fully exercisable as of 2/16/06.
- (10) Includes 10,000 stock options fully exercisable as of 2/16/06.

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The following information relates to certain relationships and transactions between the Company and related parties, including officers and directors of the Company. It is the Company's policy that it will not enter into any transactions

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with officers, directors or beneficial owners of more than 5% of the Company's Common Stock, or any entity controlled by or under common control with any such person, on terms less favorable to the Company than could be obtained from unaffiliated third parties and all such transactions require the consent of the majority of disinterested members of the Board of Directors.

Management believes that the following transactions were effected on terms no less favorable to the Company than could have been realized in arm's length transactions with unaffiliated parties.

### Executive Officers and Directors

-----

Michael K. Murtaugh, the Company's Vice President and General Counsel, was the sole stockholder of Bagel One, Inc., which owned and operated a Big Apple Bagels franchise store in Illinois. A note receivable owed by Bagel One, Inc. to Systems, guaranteed by Mr. Murtaugh, effective March 2000 in the amount of \$30,025 for a term of 6 years bearing 9% interest, had an outstanding balance at November 30, 2005 of \$2,244 and there are no payments in arrears.

### ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

#### REPORTS ON FORM 8-K

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11/18/05: Mr. John J. Bracken, Vice President of Operations of BAB, Inc. will be retiring and leaving the Company effective November 18, 2005.

10/07/05: On October 7, 2005, the Board of Directors of BAB, Inc. approved a \$0.02 per share semi-annual cash dividend and a special \$0.06 per share cash dividend, payable January 3, 2006 to shareholders of record as of December 7, 2005.

5/13/05: On May 12, 2005, the Board of Directors of BAB, Inc. authorized \$0.02 per share semi-annual cash dividend payable June 21, 2005 to shareholders of record as of May 31, 2005.

1/14/05: On November 2, 2004 BAB, Inc. Board of Directors approved a \$0.02 per share semi-annual cash dividend and a \$0.06 per share special dividend to common stockholders. The dividend is payable January 7, 2005 to stockholders of record as of December 17, 2004.

[i] Incorporated by reference to the Company's Registration Statement on Form SB-2, effective November 27, 1995 (Commission File No. 33-98060C)

[ii] Incorporated by reference to the Company's Registration Statement on Form 10-SB/A filed October 12, 2000 (Commission File No. 0-31555)

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Board of Directors, upon recommendation of the Audit Committee, appointed the firm Altschuler, Melvoin & Glasser LLP ("AM&G") certified public accountants

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for 2005.

AM&G had at the time a relationship with American Express Tax and Business Services, Inc. (TBS) from which it leased auditing staff who were full time, permanent employees of TBS and through which its partners provided non-audit services. As a result of this arrangement, AM&G had no full time employees and therefore, none of the audit services performed were provided by permanent full-time employees of AM&G. Effective October 1, 2005, TBS was acquired by RSM McGladry, Inc. (RSM) and AM&G's relationship with TBS has been replaced with a similar relationship with RSM. AM&G manages and supervises the audit and audit staff, and is exclusively responsible for the opinion rendered in connection with its examination.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES (Continued)

Audit fees relate to audit work performed on the financial statements as well as work that generally only the independent auditor can reasonably be expected to provide including discussions surrounding the proper application of financial accounting and/or reporting standards and reviews of the financial statements included in quarterly reports filed on Form 10-Q. Fees billed from AM&G during the years ended November 30, 2005 and 2004 for professional audit services rendered amounted to \$71,000 and \$12,000, respectively.

Tax compliance services were provided by TBS for which fees amounted to \$24,000 as of November 30, 2005 and there were no fees for the year ended November 30, 2004. Tax compliance services for 2005 will be provided by RSM.

During the years ended November 30, 2005 and November 30, 2004, AM&G and TBS did not perform any management consulting services for the Company.

Previous to the engagement of AM&G and TBS on May 31, 2004, Blackman Kallick Bartelstein LLP ("Blackman Kallick") served the Company as certified public accountants. Fees billed for professional audit services rendered by Blackman Kallick were \$4,000 in 2005 and \$87,000 in 2004. Fees billed for professional audit services by AM&G amounted to \$12,000 in 2004. Fees billed for tax compliance services rendered by Blackman Kallick were \$18,000 in 2004. During the years ended November 30, 2005 and 2004, Blackman Kallick did not perform any management consulting services for the Company.

### Preapproval of Policies and Procedures by Audit Committee

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The accountants provide a quote for services to the Audit Committee before work begins for the fiscal year. After discussion, the Audit Committee then makes a recommendation to the Board of Directors on whether to accept the proposal.

### Percentage of Services Approved by Audit Committee

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All services were approved by the Audit Committee

### INDEX TO EXHIBITS

INDEX NUMBER	DESCRIPTION
21.1	List of Subsidiaries of the Company
31.1, 31.2	Section 302 of the Sarbanes-Oxley Act of 2002

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32.1, 32.2

Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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In accordance with Section 13 of the Exchange Act, the Registrant has duly caused this report on Form 10-KSB to be signed on its behalf by the undersigned, thereunto duly authorized.

BAB, INC.

Dated: February 28, 2006

By /s/ Michael W. Evans

Michael W. Evans, Chief Executive Officer and President (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report on Form 10-KSB has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Dated: February 28, 2006

By /s/ Michael W. Evans

Michael W. Evans, Chief Executive Officer and President (Principal Executive Officer)

Dated: February 28, 2006

/s/ Michael K. Murtaugh

Michael K. Murtaugh, Director and Vice President/General Counsel and Secretary

Dated: February 28, 2006

/s/ Jeffrey M. Gorden

Jeffrey M. Gorden, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

Dated: February 28, 2006

/s/ Steven G. Feldman

Steven G. Feldman, Director

Dated: February 28, 2006

/s/ James A. Lentz

James A. Lentz, Director