

NOBLE ROMANS INC
Form 10-Q
November 13, 2018

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018

Commission file number: 0-11104

NOBLE ROMAN'S, INC.
(Exact name of registrant as specified in its charter)

Indiana 35-1281154
(State or other jurisdiction of organization) (I.R.S. Employer Identification No.)

One Virginia Avenue, Suite 300 46204
Indianapolis, Indiana
(Address of principal executive offices) (Zip Code)

(317) 634-3377
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
Emerging Growth Company

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

Indicate by check mark whether the registrant is a shell company(as defined in Rule 12b-2 of the Exchange Act). Yes No

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As of November 9, 2018, there were 21,583,032 shares of Common Stock, no par value, outstanding.

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

The following unaudited condensed consolidated financial statements are included herein:

Condensed consolidated balance sheets as of December 31, 2017 and September 30, 2018 (unaudited)	Page 3
Condensed consolidated statements of operations for the three-month and nine-month periods ended September 30, 2017 and 2018 (unaudited)	Page 4
Condensed consolidated statements of changes in stockholders' equity for the nine-month period ended September 30, 2018 (unaudited)	Page 5
Condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2017 and 2018 (unaudited)	Page 6
Notes to condensed consolidated financial statements (unaudited)	Page 7

Noble Roman's, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

Assets	December 31, 2017	September 30, 2018
Current assets:		
Cash	\$461,068	\$232,399
Accounts receivable - net	1,796,757	1,847,683
Inventories	779,989	836,468
Prepaid expenses	680,326	743,658
Total current assets	3,718,140	3,660,208
Property and equipment:		
Equipment	2,533,848	3,066,711
Leasehold improvements	581,197	1,268,769
Construction and equipment in progress	558,602	90,691
	3,673,647	4,426,171
Less accumulated depreciation and amortization	1,372,821	1,530,183
Net property and equipment	2,300,826	2,895,988
Deferred tax asset	5,735,504	5,653,872
Deferred contract cost	-	592,160
Goodwill	278,466	278,466
Other assets including long-term portion of receivables-net	6,851,697	6,055,630
Total assets	\$18,884,633	\$19,136,323
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of term loan payable to bank	\$754,173	\$871,429
Accounts payable and accrued expenses	674,600	589,380
Total current liabilities	1,428,773	1,460,809
Long-term obligations:		
Term loans payable to bank (net of current portion)	4,246,375	4,091,887
Convertible notes payable	1,131,982	1,531,502
Deferred contract income	-	592,160
Derivative warrant liability	503,851	-
Derivative conversion liability	925,561	-
Total long-term liabilities	6,807,769	6,215,549
Stockholders' equity:		
Common stock – no par value (40,000,000 shares authorized, 20,783,032 issued and outstanding as of December 31, 2017 and 21,583,032 issued and outstanding as of September 30, 2018)	24,322,885	24,739,482
Accumulated deficit	(13,674,794)	(13,279,517)

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Total stockholders' equity	10,648,091	11,459,965
Total liabilities and stockholders' equity	\$18,884,633	\$19,136,323

See accompanying notes to condensed consolidated financial statements (unaudited).

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Noble Roman's, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Three-Months Ended September 30,		Nine-Months Ended September 30,	
	2017	2018	2017	2018
Revenue:				
Royalties and fees	\$1,733,956	\$1,656,074	\$5,062,549	\$4,831,305
Administrative fees and other	10,992	26,548	34,933	47,177
Restaurant revenue - Craft Pizza & Pub	457,133	1,308,890	1,223,351	3,663,255
Restaurant revenue - non-traditional	310,840	283,135	871,192	862,777
Total revenue	2,512,921	3,274,647	7,192,025	9,404,514
Operating expenses:				
Salaries and wages	216,432	245,581	698,326	774,397
Trade show expense	126,361	121,200	371,472	365,739
Travel expense	37,589	23,945	146,017	76,515
Other operating expenses	222,045	282,742	649,778	791,055
Restaurant expenses - Craft Pizza & Pub	347,342	1,048,566	902,459	2,877,957
Restaurant expenses - non-traditional	307,583	279,079	855,980	851,766
Depreciation and amortization	60,127	125,399	171,890	298,155
General and administrative	434,532	434,458	1,246,620	1,252,781
Total expenses	1,757,011	2,560,970	5,042,542	7,288,365
Operating income	760,910	713,676	2,149,483	2,116,149
Interest	601,192	172,639	1,220,945	486,292
Adjust valuation of receivables	350,000	1,295,805	350,000	1,295,805
Change in fair value of derivatives	929,810	-	632,537	-
Income (loss) before income taxes from continuing operations	(1,120,092)	(754,768)	(53,999)	334,052
Income tax expense (benefit)	(72,388)	(192,489)	220,089	81,632
Net income (loss) from continuing operations	(1,047,704)	(562,279)	(274,088)	252,420
Loss from discontinued operations net of tax benefits \$79,228 for 2017	(129,037)	-	(129,037)	-
Net income(loss)	\$(1,176,741)	\$(562,279)	\$(403,125)	\$252,420
Earnings per share - basic				
Net income (loss) from continuing operations	\$(.05)	\$(.03)	\$(.01)	\$.01
Net loss from discontinued operations net of tax benefit	(.01)		(.01)	
Net income (loss)	(.06)	(.03)	(.02)	.01
Weighted average number of common shares outstanding	20,783,032	21,428,684	20,783,032	21,153,728
Diluted earnings per share:				
Net income (loss) from continuing operations	\$(.04)	\$(.02)	\$(.01)	\$.01
Net loss from discontinued operations net of tax benefit	(.01)		(.01)	

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Net income (loss)	(.05)	(.02)	(.02)	.02
Weighted average number of common shares outstanding	25,792,995	26,294,754	25,657,464	26,294,754

See accompanying notes to condensed consolidated financial statements (unaudited).

Noble Roman's, Inc. and Subsidiaries
 Condensed Consolidated Statements of Changes in
 Stockholders' Equity
 (Unaudited)

Common Stock

	Shares	Amount	Accumulated Deficit	Total
Balance at December 31, 2017	20,783,032	\$24,322,885	\$(13,674,794)	\$10,648,091
Remove derivatives in accordance with ASU 2017-11			142,857	142,857
Net income for nine months ended September 30, 2018			252,420	252,420
Amortization of value of employee stock options		16,597		16,597
Conversion of convertible note to common stock	800,000	400,000	-	400,000
Balance at September 30, 2018	21,583,032	\$24,739,482	\$(13,279,517)	\$11,459,965

See accompanying notes to condensed consolidated financial statements (unaudited).

Noble Roman's, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
OPERATING ACTIVITIES	2017	2018
Net income (loss)	\$(403,125)	\$252,420
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	444,410	433,139
Deferred income taxes	140,862	81,632
Other non-cash expenses	24,526	-
Change in fair value of derivatives	632,537	-
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(548,387)	(50,925)
Inventories	27,535	(56,479)
Prepaid expenses	(18,222)	(63,332)
Other assets including long-term portion of receivables	(557,527)	812,526
Increase (decrease) in:		
Accounts payable and accrued expenses	276,392	(40,220)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	19,001	1,368,761
 INVESTING ACTIVITIES		
Purchase of property and equipment	(341,023)	(1,125,886)
NET CASH USED IN INVESTING ACTIVITIES	(341,023)	(1,125,886)
 FINANCING ACTIVITIES		
Payment of principal - BMO term loans	(1,366,454)	-
Payment of principal - Super G Funding, LLC loan	(2,066,282)	-
Payment of principal - Kingsway America loan	(600,000)	-
Net payment of officers loans	(310,000)	-
Net proceeds from First Financial term loans	4,114,790	500,000
Payment of principal - First Financial Bank	-	(594,434)
Additional loan closing cost	-	(332,110)
Net proceeds from convertible notes payable	647,119	-
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	419,173	(426,544)
DISCONTINUED OPERATIONS		
Payment of obligations from discontinued operations	(193,265)	(45,000)
 Decrease in cash	(96,114)	(228,669)
Cash at beginning of period	477,928	461,068
Cash at end of period	\$381,814	\$232,399

Supplemental schedule of investing and financing activities

Cash paid for interest \$911,488 \$367,905

See accompanying notes to condensed consolidated financial statements (unaudited).

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1 - The accompanying unaudited interim condensed consolidated financial statements, included herein, have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated statements have been prepared in accordance with the Company's accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and should be read in conjunction with the audited consolidated financial statements and the notes thereto included in that report. Unless the context indicates otherwise, references to the "Company" mean Noble Roman's, Inc. and its subsidiaries.

In the opinion of the management of the Company, the information contained herein reflects all adjustments necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition as of the dates indicated, which adjustments are of a normal recurring nature. The results for the three-month and nine-month periods ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year ending December 31, 2018.

Note 2 – Royalties and fees included initial franchise fees of \$42,000 and \$164,000 for the three-month and nine-month periods ended September 30, 2017, and \$97,000 and \$217,000 for the three-month and nine-month periods ended September 30, 2018, respectively. Royalties and fees included equipment commissions of \$16,000 and \$34,000 for the three-month and nine-month periods ended September 30, 2017, and \$22,000 and \$63,000 for the three-month and nine-month periods ended September 30, 2018, respectively. Royalties and fees, less initial franchise fees and equipment commissions, were \$1.7 million and \$4.9 million for the respective three-month and nine-month periods ended September 30, 2017, and \$1.5 million and \$4.5 million for the respective three-month and nine-month periods ended September 30, 2018. Most of the cost for the services required to be performed by the Company are incurred prior to the franchise fee income being recorded, which is based on a contractual liability of the franchisee.

In accordance with Accounting Standards Update ("ASU") 2014-09, the Company adopted revenue and expense recognition as described in ASU 2014-09 effective January 2018. Initial franchise fees and related contract costs are deferred and amortized on a straight-line basis over the term of the franchise agreement, generally five to 10 years.

The effect to comparable periods within the financial statements is not material as the initial franchise fee for the non-traditional franchise is intended to defray the initial contract costs, and the franchisee fees and contract costs initially incurred and paid approximate the relative amortized franchise fees and contract costs for those same periods.

The deferred contract income and costs both approximated \$592,000 on September 30, 2018.

At December 31, 2017 and September 30, 2018, the Company reported net accounts receivable from franchisees of \$7.8 million and \$6.9 million, respectively, which were both net of allowances of \$1.5 million.

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There were 2,854 franchises/licenses in operation on December 31, 2017 and 2,886 franchises/licenses in operation on September 30, 2018. During the nine-month period ended September 30, 2018, there were 47 new outlets opened and 15 outlets closed. In the ordinary course, grocery stores from time to time add our licensed products, remove them and may subsequently re-offer them. Therefore, it is unknown how many of the 2,122 licensed grocery store units included in the counts above have left the system.

Note 3 - The following table sets forth the calculation of basic and diluted earnings per share for the three-month and nine-month periods ended September 30, 2017:

Three Months Ended September 30, 2017

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Net loss	\$(1,176,741)	20,783,032	\$(.06)
Effect of dilutive securities			
Options and warrants		209,963	
Convertible notes	60,000	4,800,000	
Dilutive earnings per share	\$(1,116,741)	25,792,995	\$(.04)
Net loss			

Nine Months Ended September 30,
2017

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Net loss	\$(403,125)	20,783,032	\$(.02)
Effect of dilutive securities			
Options and warrants		209,963	
Convertible notes	131,303	4,664,469	
Dilutive earnings per share	\$(271,822)	25,657,464	\$(.01)
Net loss			

The following table sets forth the calculation of basic and diluted earnings per share for the three-month and nine-month periods ended September 30, 2018:

Three Months Ended September 30, 2018

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Net loss	\$(562,279)	21,428,684	\$(.03)

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Effect of dilutive securities			
Options and warrants		711,722	
Convertible notes	51,929	4,154,348	
Dilutive earnings per share	\$(510,350)	26,294,754	\$(.02)
Net loss			

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Nine Months Ended September 30, 2018

	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Net income	\$252,420	21,153,728	\$.01
Effect of dilutive securities			
Options and warrants		711,722	
Convertible notes	166,099	4,429,304	
Dilutive earnings per share			
Net income	\$418,519	26,294,754	\$.02

Note 4 – In 2016 and 2017, the Company conducted a private placement (the "Offering") of convertible notes ("Notes") and warrants ("Warrants") in which it issued \$2.4 million principal amount of Notes and Warrants to purchase up to 2.4 million shares of the Company's common stock at an exercise price of \$1.00 per share subject to adjustment. The accounting treatment of derivative financial instruments formerly required that the Company record these instruments at their fair values as of the inception date of the agreement and at fair value as of each subsequent balance sheet date. Any change in fair value was recorded as non-operating, non-cash income or expense for each reporting period at each balance sheet date. The Company reassessed the classification of its derivative instruments at each balance sheet date. If the classification changed as a result of events during the period, the contract was reclassified as of the date of the event that caused the reclassification.

In July 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-11, which simplifies the accounting for certain accounting instruments with down round features. This update changed the classification analysis of certain equity-linked financial instruments such as warrants and embedded conversion features such that a down round feature is disregarded when assessing whether the instrument is indexed to an entity's own stock. As a result of this change in the quarter ended March 31, 2018, the Company removed all of the derivative accounting from its financial statements resulting in a gain of \$142,857 recognized as a cumulative adjustment to retained earnings on January 1, 2018.

Placement agent fees and other origination cost of the Notes are deducted from the carrying value o