

ROCKY MOUNTAIN CHOCOLATE FACTORY INC  
Form 10-Q  
July 15, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended May 31, 2014

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-14749

**Rocky Mountain Chocolate Factory, Inc.**

(Exact name of registrant as specified in its charter)

**Colorado**

**84-0910696**

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(State or other jurisdiction of incorporation  
or organization)

(I.R.S. Employer  
Identification No.)

265 Turner Drive, Durango, CO 81303

(Address of principal executive offices, including zip code)

(970) 259-0554

(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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer    Accelerated filer

Non-accelerated filer    Smaller reporting company   
(Do not check if a  
smaller reporting  
company)

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

On June 30, 2014, the registrant had outstanding 6,209,056 shares of its common stock, \$.03 par value.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.

FORM 10-Q

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**SIGNATURE**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

## ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

|  | Three Months Ended May<br>31, |             |
|--|-------------------------------|-------------|
|  | 2014                          | 2013        |
| <b>Revenues</b>  |                               |             |
| Sales  | \$7,851,051                   | \$8,178,689 |
| Franchise and royalty fees   | 2,471,155                     | 1,999,173   |
| Total revenues   | 10,322,206                    | 10,177,862  |
| <b>Costs and Expenses</b>  |                               |             |
| Cost of sales, exclusive of depreciation and amortization expense of \$89,628 and \$71,870, respectively | 4,833,471                     | 5,027,164   |
| Franchise costs  | 545,558                       | 478,810     |
| Sales and marketing  | 646,067                       | 505,437     |
| General and administrative   | 1,411,433                     | 1,270,704   |
| Retail operating   | 1,039,954                     | 840,962     |
| Depreciation and amortization  | 374,412                       | 235,756     |
| Restructuring and acquisition related charges  | 124,551                       | -           |
| Total costs and expenses   | 8,975,446                     | 8,358,833   |
| <b>Income from Operations</b>  | 1,346,760                     | 1,819,029   |
| <b>Other Income (Expense)</b>  |                               |             |
| Interest expense   | (61,333 )                     | -           |
| Interest income  | 12,509                        | 11,664      |
| Other Income (Expense), net  | (48,824 )                     | 11,664      |
| <b>Income Before Income Taxes</b>  | 1,297,936                     | 1,830,693   |
| <b>Income Tax Provision</b>  | 360,664                       | 584,154     |
| <b>Consolidated Net Income</b>   | \$937,272                     | \$1,246,539 |
| <b>Less: Net (loss) income attributable to non-controlling interest</b>                                  | 225,938                       | 67,232      |
| <b>Net Income attributable to RMCF</b>   | \$711,334                     | \$1,179,307 |

|  |           |           |
|--|-----------|-----------|
| <b>Basic Earnings per Common Share</b>                               | \$ .12    | \$ .19    |
| <b>Diluted Earnings per Common Share</b>                             | \$ .11    | \$ .19    |
| <b>Weighted Average Common Shares Outstanding</b>                    | 6,159,086 | 6,074,332 |
| <b>Dilutive Effect of Stock Options</b>                              | 329,192   | 237,416   |
| <b>Weighted Average Common Shares Outstanding, Assuming Dilution</b> | 6,488,278 | 6,311,748 |

The accompanying notes are an integral part of these consolidated financial statements.

## ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

|   | May 31,<br>2014<br>(unaudited) | February 28,<br>2014 |
|---|--------------------------------|----------------------|
| <b>Assets</b>   |                                |                      |
| <b>Current Assets</b>   |                                |                      |
| Cash and cash equivalents   | \$9,794,973                    | \$5,859,729          |
| Accounts receivable, less allowance for doubtful accounts of \$587,056 and \$543,683, respectively                        | 3,967,871                      | 5,347,752            |
| Notes receivable, current portion, less current portion of the valuation allowance of \$33,926 and \$33,047, respectively | 343,832                        | 357,360              |
| Refundable income taxes   | -                              | 160,890              |
| Inventories, less reserve for obsolete inventory of \$200,129 and \$204,068, respectively                                 | 4,217,089                      | 4,410,763            |
| Deferred income taxes   | 614,723                        | 538,871              |
| Other   | 372,797                        | 316,378              |
| Total current assets  | 19,311,285                     | 16,991,743           |
| <b>Property and Equipment, Net</b>  | 8,334,194                      | 8,488,198            |
| <b>Other Assets</b>   |                                |                      |
| Notes receivable, less current portion and valuation allowance of \$24,200 and \$24,200, respectively                     | 583,597                        | 509,784              |
| Goodwill, net   | 4,216,444                      | 4,216,444            |
| Franchise rights, net   | 6,405,699                      | 6,489,248            |
| Intangible assets, net  | 593,802                        | 602,183              |
| Other   | 153,775                        | 167,939              |
| Total other assets  | 11,953,317                     | 11,985,598           |
| <b>Total Assets</b>   | <b>\$39,598,796</b>            | <b>\$37,465,539</b>  |
| <b>Liabilities and Stockholders' Equity</b>   |                                |                      |
| <b>Current Liabilities</b>  |                                |                      |
| Current maturities of long term debt  | \$405,938                      | \$108,023            |
| Accounts payable  | 2,274,765                      | 1,971,530            |
| Accrued salaries and wages  | 702,378                        | 776,567              |
| Other accrued expenses  | 2,888,171                      | 2,627,872            |
| Dividend payable  | 682,090                        | 675,422              |
| Deferred income   | 1,779,148                      | 1,798,781            |
| Total current liabilities   | 8,732,490                      | 7,958,195            |
| <b>Long-Term Debt, Less Current Maturities</b>  | <b>5,994,062</b>               | <b>6,291,977</b>     |



|  |                     |                     |
|--|---------------------|---------------------|
| <b>Deferred Income Taxes</b>   | 1,056,176           | 1,050,489           |
| <b>Commitments and Contingencies</b>   |                     |                     |
| <b>Stockholders' Equity</b>  |                     |                     |
| Preferred stock, \$.10 par value; 250,000 authorized; 0 shares issued and outstanding                                      |                     |                     |
| Series A Junior Participating Preferred Stock, authorized 50,000 shares  | -                   | -                   |
| Undesignated series, authorized 200,000 shares   | -                   | -                   |
| Common stock, \$.03 par value, 100,000,000 shares authorized, 6,080,290 and 6,068,470 issued and outstanding, respectively | 186,025             | 184,206             |
| Additional paid-in capital   | 10,625,920          | 9,892,973           |
| Retained earnings  | 10,374,037          | 10,344,794          |
| Non-controlling interest in equity of subsidiary   | 2,630,086           | 1,742,905           |
| Total stockholders' equity   | 23,816,068          | 22,164,878          |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$39,598,796</b> | <b>\$37,465,539</b> |

The accompanying notes are an integral part of these consolidated financial statements.

## ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

|   | Three Months Ended<br>May 31, |             |
|---|-------------------------------|-------------|
|   | 2014                          | 2013        |
| <b>Cash Flows From Operating Activities</b>                                       |                               |             |
| Net income  | \$711,334                     | \$1,179,307 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                               |             |
| Depreciation and amortization   | 374,412                       | 235,756     |
| Provision for loss on accounts and notes receivable                               | 42,600                        | 70,709      |
| Provision for obsolete inventory  | 11,042                        | -           |
| Gain on sale of property and equipment  | (4,902 )                      | (2,600 )    |
| Expense recorded for stock based compensation                                     | 214,323                       | 142,808     |
| Deferred income taxes   | (70,165 )                     | (37,424 )   |
| Changes in operating assets and liabilities:                                      |                               |             |
| Accounts receivable   | 1,337,281                     | 446,607     |
| Inventories   | 355,877                       | 262,391     |
| Other current assets  | (59,475 )                     | (158,610 )  |
| Accounts payable  | 129,990                       | (968,459 )  |
| Accrued liabilities   | 347,000                       | (416,174 )  |
| Deferred income   | (19,633 )                     | 57,695      |
| Net cash provided by operating activities   | 3,369,684                     | 812,006     |
| <b>Cash Flows From Investing Activities</b>                                       |                               |             |
| Addition to notes receivable  | (165,246 )                    | (153,893 )  |
| Proceeds received on notes receivable   | 104,961                       | 47,704      |
| Proceeds from sale or distribution of assets                                      | -                             | 2,600       |
| Purchases of property and equipment   | (119,193 )                    | (57,795 )   |
| Other   | 1,240,681                     | 47,386      |
| Net cash provided by (used in) investing activities                               | 1,061,203                     | (113,998 )  |
| <b>Cash Flows From Financing Activities</b>                                       |                               |             |
| Tax benefit of stock awards   | 182,080                       | 20,276      |
| Dividends paid  | (675,423 )                    | (667,532 )  |
| Issuance of common stock, net   | (2,300 )                      | -           |
| Net cash used in financing activities   | (495,643 )                    | (647,256 )  |
| <b>Net Increase in Cash and Cash Equivalents</b>                                  | 3,935,244                     | 50,752      |
| <b>Cash and Cash Equivalents, Beginning of Period</b>                             | 5,859,729                     | 5,321,696   |
| <b>Cash and Cash Equivalents, End of Period</b>                                   | \$9,794,973                   | \$5,372,448 |

The accompanying notes are an integral part of these consolidated financial statements.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

NOTES TO INTERIM (UNAUDITED) CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

The accompanying consolidated financial statements include the accounts of Rocky Mountain Chocolate Factory, Inc. (“RMCF”), its wholly-owned subsidiary, Aspen Leaf Yogurt, LLC (“ALY”) and its 40%-owned subsidiary, U-Swirl, Inc. (“U-Swirl”), of which RMCF has financial control (collectively, the “Company”). All intercompany balances and transactions have been eliminated in consolidation. As of May 31, 2014, RMCF held approximately 40% of U-Swirl’s outstanding common stock. Additionally, RMCF has the right to acquire approximately 27,100,000 shares of U-Swirl’s common stock through the conversion of outstanding debt owed by U-Swirl to RMCF. If RMCF exercised this conversion right, RMCF would hold approximately 75% of U-Swirl’s common stock. Certain directors of RMCF constitute a majority of the directors of U-Swirl. Pursuant to a voting agreement among RMCF, ALY and certain shareholders of U-Swirl, the parties agree to vote their shares such that certain designees of RMCF shall constitute a majority of U-Swirl’s board of directors so long as RMCF or its affiliates own greater than 10% of U-Swirl’s outstanding common stock.

RMCF is an international franchisor, confectionery manufacturer and retail operator in the United States, Canada, Japan, South Korea, and the United Arab Emirates. RMCF manufactures an extensive line of premium chocolate candies and other confectionery products.

ALY was incorporated in the State of Colorado as Aspen Leaf Yogurt, Inc. on September 30, 2010 and organized through conversion as Aspen Leaf Yogurt, LLC on October 14, 2010. ALY was a franchisor and retail operator of self-serve frozen yogurt retail units until the sale of substantially all assets in January 2013. As of January 2013, the Company ceased to operate any Company-owned Aspen Leaf Yogurt locations, or sell and support franchise locations.

On January 14, 2013, Ulysses Asset Acquisition, LLC (“Newco”), a wholly-owned subsidiary of the Company formed in the State of Colorado on January 2, 2013, entered into an agreement to acquire substantially all of the franchise rights of YHI, Inc. and Yogurtini International, LLC (collectively, “Yogurtini”), which are the franchisors of self-serve frozen yogurt retail units branded as “Yogurtini.” In addition, on January 14, 2013, the Company entered into two agreements to sell all of its membership interests in Newco and substantially all of its assets in ALY to U-Swirl, Inc., a publicly traded company (OTCQB: SWRL), in exchange for a 60% controlling equity interest in U-Swirl, Inc.

U-Swirl, Inc. is in the business of offering consumers frozen desserts such as yogurt and sorbet. U-Swirl launched a national chain of self-serve frozen yogurt cafés called U-Swirl Frozen Yogurt and are franchising this concept. U-Swirl has built and operates cafés owned and operated by U-Swirl, Inc. (“Company-owned”) and franchises to others the right to own and operate U-Swirl cafés. It also franchises and operates self-serve frozen yogurt cafes under the names “Yogurtini,” “CherryBerry,” “Josie’s Frozen Yogurt,” “Yogli Mogli Frozen Yogurt,” “Fuzzy Peach Frozen Yogurt,” and “Aspen Leaf Yogurt” as a result of the transactions described above.

On January 17, 2014, U-Swirl entered into an Asset Purchase Agreement with CherryBerry, which was the franchisor of self-serve frozen yogurt cafés branded as “CherryBerry.” Pursuant to the CherryBerry Purchase Agreement, U-Swirl purchased certain assets of CherryBerry used in its business of franchising frozen yogurt cafés, including all of its franchise rights and one company-owned café. The assets were acquired for approximately \$4.25 million in cash and 4 million shares of U-Swirl common stock. U-Swirl also entered into an Asset Purchase Agreement with Yogli Mogli LLC, which was the franchisor of self-serve frozen yogurt cafés branded as “Yogli Mogli”. Pursuant to the Yogli Mogli Purchase Agreement, U-Swirl purchased certain assets of Yogli Mogli used in its business of franchising frozen yogurt cafés, including all of its franchise rights and four company-owned cafés. The assets were acquired for approximately \$2.15 million in cash and \$200,000 in shares of U-Swirl common stock. The Yogli Mogli Purchase Agreement contains customary representations and warranties, covenants and indemnification obligations.

On February 20, 2014 U-Swirl entered into an Asset Purchase Agreement to acquire the business assets of Fuzzy Peach Franchising, LLC. The acquisition of all intellectual property and worldwide franchise and license rights includes the rights associated with 17 Fuzzy Peach Frozen Yogurt stores. U-Swirl purchased the Fuzzy Peach Franchising, LLC assets for \$481,000 in cash paid at the time of closing, plus an earn-out that could increase the purchase price by up to another \$349,000 based upon royalty income generated by Fuzzy Peach stores over the next twelve months.

The Company’s revenues are currently derived from three principal sources: sales to franchisees and others of chocolates and other confectionery products manufactured by the Company; the collection of initial franchise fees, royalty and marketing fees from franchisees’ sales; and sales at Company-owned stores of chocolates, frozen yogurt, and other confectionery products.

The following table summarizes the number of stores operating under RMCF and its subsidiaries at May 31, 2014:

|  | Sold,<br>Not<br>Yet<br>Open | Open | Total |
|--|-----------------------------|------|-------|
| Rocky Mountain Chocolate Factory                       |                             |      |       |
| Company-owned stores                                   | -                           | 6    | 6     |
| Franchise stores – Domestic stores                     | 5                           | 206  | 211   |
| Franchise stores – Domestic kiosks                     | -                           | 6    | 6     |
| International License Stores                           | 1                           | 69   | 70    |
| Cold Stone Creamery – co-branded                       | 5                           | 65   | 70    |
| U-Swirl, Inc. Stores (Including all associated brands) |                             |      |       |
| Company-owned stores                                   | -                           | 11   | 11    |
| Company-owned stores – co-branded                      | -                           | 2    | 2     |
| Franchise stores – Domestic stores                     | -                           | 268  | 268   |
| Franchise stores – Domestic – co-branded               | -                           | 11   | 11    |
| International License Stores                           | -                           | 6    | 6     |
| Total  | 11                          | 650  | 661   |

#### Basis of Presentation

The accompanying consolidated financial statements have been prepared by the Company, without audit, and reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the consolidated financial statements reflect all adjustments (of a normal and recurring nature) which are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations for the three months ended May 31, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year.

These consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2014.

#### Subsequent Events

In June 2014, the Company entered into a definitive agreement to sell three company-owned cafés. The Company received a deposit of \$600,000 from the buyer in May 2014 to secure the rights to acquire the assets through a definitive agreement. These cafés were acquired in January 2014 as part of the Yogli Mogli Acquisition. The Company believes that the sale of these assets will approximate the preliminary value assigned to the assets and that the sale of the assets will not have a material impact on results of operations.

#### Stock-Based Compensation

At May 31, 2014, the Company had stock-based compensation plans for employees and non-employee directors that authorized the granting of stock awards, including stock options and restricted stock units.

The Company recognized \$214,323 of stock-based compensation expense during the three months ended May 31, 2014 compared with \$142,808 during the three months ended May 31, 2013. Compensation costs related to stock-based compensation are generally amortized over the vesting period.

The following table summarizes stock option transactions for common stock during the three months ended May 31, 2014 and 2013:

|  | Three Months Ended |           |
|--|--------------------|-----------|
|  | May 31,            |           |
|  | 2014               | 2013      |
| Outstanding stock options as of February 28:           | 155,880            | 270,945   |
| Granted  | -                  | -         |
| Exercised  | (133,240)          | -         |
| Cancelled/forfeited                                    | -                  | (88,725 ) |
| Outstanding stock options as of May 31:                | 22,640             | 182,220   |
| Weighted average exercise price                        | \$11.57            | \$7.93    |
| Weighted average remaining contractual term (in years) | 1.06               | 1.17      |

The following table summarizes non-vested restricted stock unit transactions for common stock during the three months ended May 31, 2014 and 2013:

|  | Three Months Ended |          |
|--|--------------------|----------|
|  | May 31,            |          |
|  | 2014               | 2013     |
| Outstanding non-vested restricted stock units as of February 28: | 295,040            | 57,030   |
| Granted  | -                  | 280,900  |
| Vested   | (7,820 )           | (7,820 ) |
| Cancelled/forfeited  | -                  | -        |
| Outstanding non-vested restricted stock units as of May 31:      | 287,220            | 330,110  |
| Weighted average grant date fair value                           | \$12.16            | \$11.78  |
| Weighted average remaining vesting period (in years)             | 4.84               | 5.17     |

During the three months ended May 31, 2014, the Company issued 4,000 fully vested, unrestricted shares of stock to non-employee directors compared with 4,000 fully vested, unrestricted shares of stock to non-employee directors in the three months ended May 31, 2013. In connection with these non-employee director stock issuances, the Company recognized \$47,480 and \$48,400 of stock-based compensation expense during the three-month period ended May 31, 2014 and 2013, respectively.

During the three months ended May 31, 2014, the Company recognized \$166,843 of stock-based compensation expense related to non-vested, non-forfeited restricted stock unit grants. The restricted stock units generally vest between 17% and 20% annually over a period of five to six years. Total unrecognized compensation expense of non-vested, non-forfeited restricted stock units, as of May 31, 2014, was \$2,981,018, which is expected to be



recognized over the weighted average period of 4.8 years.

No restricted stock units were granted during the three months ended May 31, 2014. During the three month period ended May 31, 2013, the Company granted 280,900 shares of restricted stock units with a grant date fair value of \$3,437,950 or \$12.24 per share. The restricted stock unit grants vest between 17% and 20% annually over a period of five to six years. There were no stock options awarded during the three months ended May 31, 2014 or 2013.

The Company recognized \$82,449 of U-Swirl, Inc. stock-based compensation expense during the three months ended May 31, 2014 compared with \$28,223 recognized during the three months ended May 31, 2013.

#### NOTE 2 - EARNINGS PER SHARE

Basic earnings per share is calculated using the weighted-average number of common shares outstanding. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options and restricted stock units. For the three months ended May 31, 2014 and 2013, 12,936 and 101,661 stock options were excluded, respectively, from the computation of earnings per share because their effect would have been anti-dilutive. Restricted stock units become dilutive within the period granted and remain dilutive until the units vest and are issued as common stock.

## NOTE 3 – INVENTORIES

The Company held the following inventory at May 31, 2014 and February 28, 2014:

|                                  | May 31,<br>2014 | February<br>28, 2014 |
|----------------------------------|-----------------|----------------------|
| Ingredients and supplies         | \$2,651,648     | \$2,531,413          |
| Finished candy                   | 1,406,257       | 1,761,131            |
| U-Swirl, Inc. food and packaging | 159,184         | 118,219              |
| Total inventories                | \$4,217,089     | \$4,410,763          |

## NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment at May 31, 2013 and February 28, 2013 consists of the following:

|                               | May 31,<br>2014 | February 28,<br>2014 |
|-------------------------------|-----------------|----------------------|
| Land                          | \$513,618       | \$513,618            |
| Building                      | 4,775,466       | 4,775,466            |
| Machinery and equipment       | 10,578,325      | 9,518,832            |
| Furniture and fixtures        | 1,293,647       | 1,324,846            |
| Leasehold improvements        | 2,478,086       | 2,489,782            |
| Transportation equipment      | 415,235         | 394,508              |
| Capital work in progress      | -               | 967,937              |
|                               | 20,054,377      | 19,984,989           |
| Less accumulated depreciation | 11,720,183      | 11,496,791           |
| Property and equipment, net   | \$8,334,194     | \$8,488,198          |

## NOTE 5 - STOCKHOLDERS' EQUITY

Cash Dividend

The Company paid a quarterly cash dividend of \$0.11 per share of common stock on March 14, 2014 to shareholders of record on February 28, 2014. The Company paid a quarterly cash dividend of \$0.11 per share of common stock on June 13, 2014 to shareholders of record on June 3, 2014.

Future declaration of dividends will depend on, among other things, the Company's results of operations, capital requirements, financial condition and on such other factors as the Company's Board of Directors may in its discretion consider relevant and in the best long term interest of the shareholders.

NOTE 6 – SUPPLEMENTAL CASH FLOW INFORMATION

|   | Three Months Ended |            |
|---|--------------------|------------|
|   | May 31,            |            |
| Cash paid (received) for:                       | 2014               | 2013       |
| Interest, net                                   | \$47,093           | \$(8,606 ) |
| Income taxes                                    | 57,037             | 594,336    |
| Non-Cash Operating Activities Accrued Inventory | 173,245            | 215,703    |
| Non-Cash Financing Activities Dividend payable  | \$682,090          | \$668,832  |

## NOTE 7 - OPERATING SEGMENTS

The Company classifies its business interests into five reportable segments: Franchising, Manufacturing, Retail Stores, U-Swirl, Inc. operations and Other. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 to these consolidated financial statements and Note 1 to the Company's financial statements included in the Company's Annual Report on Form 10-K for the year ended February 28, 2013. The Company evaluates performance and allocates resources based on operating contribution, which excludes unallocated corporate general and administrative costs and income tax expense or benefit. The Company's reportable segments are strategic businesses that utilize common merchandising, distribution, and marketing functions, as well as common information systems and corporate administration. All inter-segment sales prices are market based. Each segment is managed separately because of the differences in required infrastructure and the difference in products and services:

## Three Months Ended

|                                   | Franchising  | Manufacturing | Retail     | U-Swirl,<br>Inc. | Other      | Total         |
|-----------------------------------|--------------|---------------|------------|------------------|------------|---------------|
| May 31, 2014                      |              |               |            |                  |            |               |
| Total revenues                    | \$ 1,448,264 | \$ 6,190,662  | \$ 502,791 | \$ 2,501,692     | \$ -       | \$ 10,643,409 |
| Intersegment revenues             | (613 )       | (320,590 )    | -          | -                | -          | (321,203 )    |
| Revenue from external customers   | 1,447,651    | 5,870,072     | 502,791    | 2,501,692        | -          | 10,322,206    |
| Segment profit (loss)             | 636,183      | 1,481,664     | (67,115 )  | 200,360          | (953,156 ) | 1,297,936     |
| Total assets                      | 1,256,360    | 11,103,741    | 1,254,183  | 17,345,621       | 8,638,891  | 39,598,796    |
| Capital expenditures              | -            | 61,105        | 16,088     | 39,673           | 2,327      | 119,193       |
| Total depreciation & amortization | 10,049       | 90,160        | 9,449      | 226,100          | 38,654     | 374,412       |

## Three Months Ended

|                                   | Franchising  | Manufacturing | Retail     | U-Swirl,<br>Inc. | Other      | Total         |
|-----------------------------------|--------------|---------------|------------|------------------|------------|---------------|
| May 31, 2013                      |              |               |            |                  |            |               |
| Total revenues                    | \$ 1,660,016 | \$ 6,726,056  | \$ 515,138 | \$ 1,717,406     | \$ -       | \$ 10,618,616 |
| Intersegment revenues             | -            | (440,754 )    | -          | -                | -          | (440,754 )    |
| Revenue from external customers   | 1,660,016    | 6,285,302     | 515,138    | 1,717,406        | -          | 10,177,862    |
| Segment profit (loss)             | 848,444      | 1,748,467     | (44,859 )  | 168,079          | (889,438 ) | 1,830,693     |
| Total assets                      | 1,334,534    | 10,035,858    | 1,277,606  | 3,357,523        | 7,465,193  | 23,470,714    |
| Capital expenditures              | 8,451        | 31,481        | 5,611      | -                | 12,252     | 57,795        |
| Total depreciation & amortization | 8,593        | 72,373        | 14,740     | 105,578          | 34,472     | 235,756       |

Revenue from one customer of the Company's Manufacturing segment represented approximately \$1.6 million of the Company's revenues from external customers during the three months ended May 31, 2014 compared to \$1.8 million during the three months ended May 31, 2013.

## NOTE 8 – GOODWILL AND INTANGIBLE ASSETS

Intangible assets at May 31, 2014 and February 28, 2014 consist of the following:

|   | Amortization<br>Period<br>(years) | May 31, 2014               |                             | February 28, 2014          |                             |
|---|-----------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|
|   |                                   | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Gross<br>Carrying<br>Value | Accumulated<br>Amortization |
| Intangible assets subject to amortization     |                                   |                            |                             |                            |                             |
| Store design                                  | 10                                | \$ 220,778                 | \$ 207,027                  | \$ 220,778                 | \$ 206,652                  |
| Packaging licenses                            | 3-5                               | 120,830                    | 120,830                     | 120,830                    | 120,830                     |
| Packaging design                              | 10                                | 430,973                    | 430,973                     | 430,973                    | 430,973                     |
| Trademark/Non competition agreements          | 5-20                              | 593,340                    | 13,289                      | 593,340                    | 5,283                       |
| Total   |                                   | 1,365,921                  | 772,119                     | 1,365,921                  | 763,738                     |
| Intangible assets not subject to amortization |                                   |                            |                             |                            |                             |
| Franchising segment-                          |                                   |                            |                             |                            |                             |
| Company stores goodwill                       |                                   | 1,099,328                  | 267,020                     | 1,099,328                  | 267,020                     |
| Franchising goodwill                          |                                   | 3,464,500                  | 197,682                     | 3,464,500                  | 197,682                     |
| Manufacturing segment-Goodwill                |                                   | 295,000                    | 197,682                     | 295,000                    | 197,682                     |
| Trademark                                     |                                   | 20,000                     | -                           | 20,000                     | -                           |
| Total Goodwill                                |                                   | 4,878,828                  | 662,384                     | 4,878,828                  | 662,384                     |
| Franchise Rights                              | 20                                | 6,580,034                  | 174,335                     | 6,580,034                  | 90,786                      |
| Total intangible assets                       |                                   | \$ 12,824,783              | \$ 1,608,838                | \$ 12,824,783              | \$ 1,516,908                |

Amortization expense related to intangible assets totaled \$91,930 and \$159 during the three months ended May 31, 2014 and 2013, respectively.

At May 31, 2014, annual amortization of intangible assets, based upon our existing intangible assets and current useful lives, is estimated to be the following:

|      |           |
|------|-----------|
| 2015 | \$282,057 |
| 2016 | 413,645   |
| 2017 | 459,218   |
| 2018 | 481,977   |

|            |             |
|------------|-------------|
| 2019       | 494,614     |
| Thereafter | 4,867,990   |
| Total      | \$6,999,501 |

NOTE 9 – RELATED PARTY TRANSACTIONS

The Company has entered into Franchise Agreements and a Development Agreement with a member of the Company's Board of Directors. The Director operates two ALY locations under the Franchise Agreements and the Development Agreement. As of May 31, 2014, the Company had receivables of approximately \$1,100 due from the Director associated with the director's ownership and operation of the two current ALY locations.

U-Swirl, Inc. was owed \$13,628 and \$11,989 as of May 31, 2014 and February 28, 2014, respectively, from a U-Swirl franchise that is owned and operated by the grandchildren of the Company's Chief Marketing Officer. The corporate secretary and treasurer of the franchise is also the Company's corporate secretary.

As of May 31, 2014 and February 28, 2014, U-Swirl, Inc. had deferred revenue of \$30,000 and \$30,000, respectively, from an area developer in which the Company's Chief Executive Officer and Chief Operating Officer have a minority interest.

NOTE 10 – RESTRUCTURING AND ACQUISITION RELATED CHARGES

On January 17, 2014, U-Swirl entered into an Asset Purchase Agreement with CherryBerry, which was the franchisor of self-serve frozen yogurt retail stores branded as “CherryBerry.” Pursuant to the CherryBerry Purchase Agreement, U-Swirl purchased certain assets of CherryBerry used in its business of franchising frozen yogurt stores, including all of its franchise rights and one company-owned store. On January 17, 2014 U-Swirl also entered into an Asset Purchase Agreement with Yogli Mogli, which was the franchisor of self-serve frozen yogurt retail stores branded as “Yogli Mogli”. Pursuant to the Yogli Mogli Purchase Agreement, U-Swirl purchased certain assets of Yogli Mogli used in its business of franchising frozen yogurt stores, including all of its franchise rights and four company-owned stores. On February 20, 2014 U-Swirl entered into an Asset Purchase Agreement to acquire the business assets of Fuzzy Peach Franchising, LLC. The acquisition of all intellectual property and worldwide franchise and license rights includes the rights associated with 17 Fuzzy Peach Frozen Yogurt stores. Associated with these transactions, the Company recorded net restructuring charges of \$124,551 during the three months ended May 31, 2014.

Restructuring and acquisition charges incurred were comprised of the following for the three months ended May 31:

|                                     | 2014           |
|-------------------------------------|----------------|
| Professional fees                   | \$ 104,876     |
| Severance/transitional compensation | 16,550         |
| Other                               | 3,125          |
| <br>Total                           | <br>\$ 124,551 |



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Cautionary Note Regarding Forward-Looking Statements

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements and related notes of the Company included elsewhere in this report. The statements included in this report other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, and include statements regarding our cash flow, dividends, operating income and future growth. Many of the forward-looking statements contained in this document may be identified by the use of forward-looking words such as "will," "believe," "expect," "anticipate," "estimate," and "potential," or similar expressions. Factors which could cause results to differ include, but are not limited to: changes in the confectionery business environment, seasonality, consumer interest in our products, general economic conditions, the success of U-Swirl, Inc., receptiveness of our products internationally, consumer trends, costs and availability of raw materials, competition, the success of our co-branding strategy and the effect of government regulations. Government regulations which we and our franchisees either are or may be subject to and which could cause results to differ from forward-looking statements include, but are not limited to: local, state and federal laws regarding health, sanitation, safety, building and fire codes, franchising, employment, manufacturing, packaging and distribution of food products and motor carriers. For a detailed discussion of the risks and uncertainties that may cause our actual results to differ from the forward-looking statements contained herein, please see the "Risk Factors" contained in our Annual Report on Form 10-K for the fiscal year ended February 28, 2014 which can be viewed at the SEC's website at [www.sec.gov](http://www.sec.gov) or through our website at [www.rmcf.com](http://www.rmcf.com). These forward-looking statements apply only as of the date of this report. Readers are cautioned not to place undue reliance on the forward-looking statements in this Quarterly Report on Form 10-Q. Except as required by law, we are not obligated to release publicly any revisions to these forward-looking statements that might reflect events or circumstances occurring after the date of this report or those that might reflect the occurrence of unanticipated events.*

*Unless otherwise specified, the "Company," "we," "us" or "our" refers to Rocky Mountain Chocolate Factory, Inc. and its consolidated subsidiaries.*

### Overview

We are a product-based international franchisor, confectionery manufacturer and retail operator. Our revenues and profitability are derived principally from our franchised/licensed system of retail stores that feature chocolate, frozen yogurt, and other confectionery products. We also sell our candy in selected locations outside our system of retail stores and license the use of our brand with certain consumer products. We own and operate nineteen retail units as a laboratory to test marketing, design and operational initiatives.

The most important factors in continued growth in our earnings are ongoing unit growth, increased same-store sales and increased same-store pounds purchased from the factory. Historically, unit growth has more than offset decreases in same-store sales and same-store pounds purchased.

Our ability to successfully achieve expansion of our Rocky Mountain Chocolate Factory and frozen yogurt franchise systems depends on many factors not within our control, including the availability of suitable sites for new store establishment, the availability of adequate financing options and the availability of qualified franchisees to support such expansion.

Efforts to reverse the decline in same-store pounds purchased from the factory by franchised stores and to increase total factory sales depend on many factors, including new store openings, same-store sales, and the receptivity of our franchise system to our product introductions and promotional programs.

In January 2013, Ulysses Asset Acquisition, LLC (“Newco”), a wholly-owned subsidiary formed in the State of Colorado on January 2, 2013, entered into an agreement to acquire substantially all of the assets of YHI, Inc. and Yogurtini International, LLC (collectively, “Yogurtini”), which are the franchisors of self-serve frozen yogurt retail units branded as “Yogurtini.” In addition, we entered into two agreements to sell all of our membership interests in Newco and substantially all of our assets in Aspen Leaf Yogurt, LLC to U-Swirl, Inc., a publicly traded company (QTCQB: SWRL), in exchange for a 60% controlling equity interest in U-Swirl, Inc. Upon completion of these transactions, we ceased to operate any Company-owned Aspen Leaf Yogurt locations or sell and support franchise locations. U-Swirl is in the business of offering consumers frozen desserts such as yogurt and sorbet. U-Swirl launched a national chain of self-serve frozen yogurt cafés called U-Swirl Frozen Yogurt and is franchising this concept. U-Swirl has built and operates cafés owned and operated by U-Swirl and franchises to others the right to own and operate U-Swirl cafés. In January 2014 and February 2014, U-Swirl acquired the franchise systems of self-serve frozen yogurt retail units branded as “CherryBerry,” “Yogli Mogli Frozen Yogurt” and “Fuzzy Peach Frozen Yogurt.” U-Swirl also operates self-serve frozen yogurt retail units branded as “Josie’s Frozen Yogurt.” As of May 31, 2014, we own approximately 40% of U-Swirl’s outstanding common stock, and the results of U-Swirl are consolidated in our results. We believe that the acquisition of a controlling interest in U-Swirl, Inc. will provide us with the ability to reverse operating losses incurred by the development and operation of Aspen Leaf Yogurt, LLC and provide an opportunity to continue to expand our presence in the self-serve frozen yogurt industry. Our ability to execute on this strategy is dependant upon continued expansion of the franchise network of U-Swirl, Inc. and the success of their franchisees.

## Results of Operations

### Three Months Ended May 31, 2014 Compared to the Three Months Ended May 31, 2013

Basic earnings per share decreased 36.8% from \$.19 during the three months ended May 31, 2013 to \$.12 during the three months ended May 31, 2014. Revenues increased by \$144,300 in the three months ended May 31, 2014 compared to the three months ended May 31, 2013. This increase in revenues was due primarily to an increase in franchise related revenue, partially offset by a decline in factory sales resulting from a decrease in shipments of product to customers outside our network of franchised retail stores. Operating income decreased 25.2% from \$1.82 million for the three months ended May 31, 2013 to \$1.36 million for the three months ended May 31, 2014. Net income decreased 39.2% from \$1.18 million in the three months ended May 31, 2013 to \$717,000 in the three months ended May 31, 2014. The decrease in operating income and net income was due primarily to a decrease in franchise fees, a decrease in factory revenues and a decrease in factory margins partially offset by an increase in net income associated with U-Swirl's operations.

| Revenues<br>(\$'s in thousands) | Three Months Ended |            | \$          | %     | %  |
|---------------------------------|--------------------|------------|-------------|-------|----|
|                                 | May 31,<br>2014    | 2013       |             |       |    |
| Factory sales                   | \$5,870.0          | \$6,285.4  | \$( 415.4 ) | (6.6  | %) |
| Retail sales                    | 1,981.0            | 1,893.3    | 87.7        | 4.6   | %  |
| Franchise fees                  | 57.4               | 276.4      | ( 219.0 )   | (79.2 | %) |
| Royalty and marketing fees      | 2,413.8            | 1,722.8    | 691.0       | 40.1  | %  |
| Total                           | \$10,322.2         | \$10,177.9 | \$144.3     | 1.4   | %  |

#### Factory Sales

The decrease in factory sales for the three months ended May 31, 2014 versus the three months ended May 31, 2013 was primarily due to a 10.8% decrease in shipments of product to customers outside our network of franchised retail stores, a 6.2% decrease in the average number of domestic Rocky Mountain Chocolate Factory franchised stores in operation and a 4.9% decrease in same-store pounds purchased by our network of franchise stores. We believe that the decrease in purchases by franchise and specialty market customers was primarily the result of weather adversely affecting our customers, resulting in excess retail inventories at the end of the fourth quarter of the prior fiscal year.

#### Retail Sales

The increase in retail sales was primarily due to changes in retail units in operation, primarily as a result of the acquisition of a controlling interest in U-Swirl, Inc. Same store sales at all Company-owned stores and cafés decreased 2.7% in the three months ended May 31, 2014 compared to the three months ended May 31, 2013.

#### Royalties, Marketing Fees and Franchise Fees

The increase in royalties and marketing fees from the three months ended May 31, 2013 to the three months ended May 31, 2014 resulted from a 72.1% increase in domestic franchise stores in operation from the three months ended May 31, 2013 compared to the three months ended May 31, 2014, primarily as a result of U-Swirl's acquisition of CherryBerry, Yogli Mogli and Fuzzy Peach franchise systems in January 2014 and February 2014 and the associated increase in franchise revenues due to such acquisitions. This increase was partially offset by a decrease in the number of domestic Rocky Mountain Chocolate Factory franchises in operation. The average number of domestic Rocky Mountain Chocolate Factory franchise stores in operation decreased from 226 in the three months ended May 31, 2013 to 212 during the three months ended May 31, 2014. Franchise fee revenues decreased as a result of the license fees associated with the license agreements for the development and franchising of Rocky Mountain Chocolate Factory stores in South Korea and the Kingdom of Saudi Arabia being recognized in the three months ended May 31, 2013 and no international license fees being recognized in the three months ended May 31, 2014.

| Costs and Expenses<br>(\$'s in thousands) | Three Months<br>Ended<br>May 31, |           | \$<br>Change | %      |        |
|---|----------------------------------|-----------|--------------|--------|--------|
|   | 2014                             | 2013      |              | Change | Change |
| Cost of sales – factory adjusted          | \$4,181.1                        | \$4,377.2 | \$( 196.1 )  | (4.5   | %)     |
| Cost of sales - retail                    | 652.4                            | 650.0     | 2.4          | .4     | %      |
| Franchise costs                           | 545.6                            | 478.8     | 66.8         | 14.0   | %      |
| Sales and marketing                       | 646.1                            | 505.4     | 140.7        | 27.8   | %      |
| General and administrative                | 1,411.4                          | 1,270.7   | 140.7        | 11.1   | %      |
| Retail operating                          | 1,040.0                          | 841.0     | 199.0        | 23.7   | %      |
| Total                                     | \$8,476.6                        | \$8,123.1 | \$353.5      | 4.4    | %      |

| Adjusted Gross Margin<br>(\$'s in thousands) | Three Months<br>Ended<br>May 31, |           | \$<br>Change | %      |        |
|--|----------------------------------|-----------|--------------|--------|--------|
|  | 2014                             | 2013      |              | Change | Change |
| Factory adjusted gross margin                | \$1,688.9                        | \$1,908.2 | \$( 219.3 )  | (11.5  | %)     |
| Retail                                       | 1,328.6                          | 1,243.3   | 85.3         | 6.9    | %      |
| Total  | \$3,017.5                        | \$3,151.5 | \$( 134.0 )  | - 4.3  | %      |

| Adjusted Gross Margin<br>(Percent) | Three<br>Months<br>Ended<br>May 31, |       | %    | %      |        |    |
|------------------------------------|-------------------------------------|-------|------|--------|--------|----|
|                                    | 2014                                | 2013  |      | Change | Change |    |
| Factory adjusted gross margin      | 28.8%                               | 30.4% | (1.6 | %)     | (5.3   | %) |
| Retail                             | 67.1%                               | 65.7% | 1.4  | %      | 2.1    | %  |
| Total                              | 38.4%                               | 38.5% | (0.1 | %)     | (0.3   | %) |

Adjusted gross margin and factory adjusted gross margin are non-GAAP measures. Adjusted gross margin is equal to the sum of our factory adjusted gross margin plus our retail gross margin calculated in accordance with GAAP. Factory adjusted gross margin is equal to factory gross margin minus depreciation and amortization expense. We believe adjusted gross margin and factory adjusted gross margin are helpful in understanding our past performance as a supplement to gross margin, factory gross margin and other performance measures calculated in conformity with GAAP. We believe that adjusted gross margin and factory adjusted gross margin are useful to investors because they provide a measure of operating performance and our ability to generate cash that is unaffected by non-cash accounting measures. Additionally, we use adjusted gross margin and factory adjusted gross margin rather than gross margin and factory gross margin to make incremental pricing decisions. Adjusted gross margin and factory adjusted gross margin have limitations as analytical tools because they exclude the impact of depreciation and amortization expense and you should not consider it in isolation or as a substitute for any measure reported under GAAP. Our use of capital assets makes depreciation and amortization expense a necessary element of our costs and our ability to generate income. Due to these limitations, we use adjusted gross margin and factory adjusted gross margin as measures of performance only

in conjunction with GAAP measures of performance such as gross margin and factory gross margin. The following table provides a reconciliation of factory adjusted gross margin to factory gross margin, the most comparable performance measure under GAAP:

| (\$'s in thousands)                 | <b>Three Months<br/>Ended<br/>May 31,</b> |             |
|-------------------------------------|---|-------------|
|                                     | <b>2014</b>                               | <b>2013</b> |
| Factory adjusted gross margin       | \$1,688.9                                 | \$1,908.2   |
| Less: depreciation and amortization | 89.6                                      | 71.9        |
| Factory GAAP gross margin           | \$1,599.3                                 | \$1,836.3   |

#### Cost of Sales

Factory margins decreased 160 basis points in the three months ended May 31, 2014 compared to the three months ended May 31, 2013 due primarily to a decline in manufacturing efficiencies associated with 14.3% lower production volume and increased costs of certain materials in the three months ended May 31, 2014 compared to the three months ended May 31, 2013. The increase in Company-owned store margin is due primarily to an increase in U-Swirl units in operation and associated higher margins during the three months ended May 31, 2014.

### Franchise Costs

The increase in franchise costs in the three months ended May 31, 2014 versus the three months ended May 31, 2013 is due primarily to an increase in franchise costs associated with supporting the additional U-Swirl franchise units acquired through business acquisitions in the prior year. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs decreased to 22.1% in the three months ended May 31, 2014 from 23.9% in the three months ended May 31, 2013. This decrease as a percentage of royalty, marketing and franchise fees is primarily a result of lower franchise costs and higher franchise and royalty revenues.

### Sales and Marketing

The increase in sales and marketing costs for the three months ended May 31, 2014 compared to the three months ended May 31, 2013 is primarily due to increased marketing-related compensation costs and an increase in marketing costs associated with U-Swirl franchise locations.

### General and Administrative

The increase in general and administrative costs for the three months ended May 31, 2014 compared to the three months ended May 31, 2013 is due primarily to the consolidation of U-Swirl general and administrative costs. For the three months ended May 31, 2014, approximately \$548,000 of U-Swirl general and administrative costs were consolidated within our results, compared with \$406,000 in the three months ended May 31, 2013. As a percentage of total revenues, general and administrative expenses increased to 13.5% in the three months ended May 31, 2014 compared to 12.5% in the three months ended May 31, 2013.

### Retail Operating Expenses

The increase in retail operating expenses for the three months ended May 31, 2014 compared to the three months ended May 31, 2013 was due primarily to changes in units in operation, resulting from the acquisition of six Company owned locations in the prior year. This increase was partially offset by the closure of five underperforming locations in the prior year. Retail operating expenses, as a percentage of retail sales, increased from 44.4% in the three months ended May 31, 2013 to 52.5% in the three months ended May 31, 2014.

## Depreciation and Amortization

Depreciation and amortization of \$374,000 in the three months ended May 31, 2014 increased 58.8% from \$236,000 incurred in the three months ended May 31, 2013. This increase was the result of additional Company-owned store and factory assets in service and an increase in amortization related to intangible assets acquired in the prior fiscal year.

## Other Income

Net interest expense was \$48,800 in the three months ended May 31, 2014 compared to net interest income of \$11,700 realized in the three months ended May 31, 2013. This change was the result of interest expense associated with a promissory note entered into in January 2014 to fund business acquisitions.

## Income Tax Expense

Our effective income tax rate for the three months ended May 31, 2014 was 27.8%, compared to 31.9% for the three months ended May 31, 2013. The decrease of 4.1% was primarily the result of the consolidation of the U-Swirl net operating income. There was no income tax expense recognized on U-Swirl income before income taxes for the three months ended May 31, 2014. U-Swirl has significant net operating loss carryovers. In accordance with section 382 of the Internal Revenue Code, deductibility of U-Swirl's U.S. net operating loss carryovers may be subject to annual limitation in the event of a change in control. We have performed a preliminary evaluation as to whether a change in control has taken place, and have concluded that there was a change of control with respect to the net operating losses of U-Swirl when the Company acquired a 60% ownership interest in January 2013. Our effective income tax rate may increase in future periods, or for the full year as a result of estimates related to the income tax liability arising from the income before income taxes of U-Swirl.

## Liquidity and Capital Resources

As of May 31, 2014, working capital was \$10.6 million, compared with \$9.0 million as of February 28, 2014, an increase of \$1.6 million. The increase in working capital was primarily due to positive operating results.

Cash and cash equivalent balances increased \$3.94 million from \$5.86 million as of February 28, 2014 to \$9.79 million as of May 31, 2014 as a result of cash flow generated by operating activities. Our current ratio was 2.2 to 1 at May 31, 2014 in comparison with 2.1 to 1 at February 28, 2014. We monitor current and anticipated future levels of cash and cash equivalents in relation to anticipated operating, financing and investing requirements.





We have a \$5.0 million (\$5.0 million available as of May 31, 2014) working capital line of credit collateralized by substantially all of our assets with the exception of our retail store assets. Additionally, the line of credit is subject to various financial ratio and leverage covenants. As of May 31, 2014, we were in compliance with all such covenants. The line is subject to renewal on July 31, 2014. As of May 31, 2014, no amount was outstanding under this line of credit.

The Company's long-term debt is comprised of a promissory note used to finance the Company's business acquisitions (unpaid balance as of May 31, 2014, \$6.4 million). Additionally, the promissory note is subject to various financial ratio and leverage covenants. As of May 31, 2014, we were in compliance with all such covenants.

We believe cash flows generated by operating activities and available financing will be sufficient to fund our operations at least through the end of fiscal 2015.

#### **Off-Balance Sheet Arrangements**

As of May 31, 2014 we had no off-balance sheet arrangements or obligations.

#### **Impact of Inflation**

Inflationary factors such as increases in the costs of ingredients and labor directly affect our operations. Most of our leases provide for cost-of-living adjustments and require us to pay taxes, insurance and maintenance expenses, all of which are subject to inflation. Additionally, our future lease costs for new facilities may include potentially escalating costs of real estate and construction. There is no assurance that we will be able to pass on increased costs to our customers.

Depreciation expense is based on the historical cost to us of fixed assets, and is therefore potentially less than it would be if it were based on current replacement cost. While property and equipment acquired in prior years will ultimately have to be replaced at higher prices, it is expected that replacement will be a gradual process over many years.

#### **Seasonality**

We are subject to seasonal fluctuations in sales, which cause fluctuations in quarterly results of operations. Historically, the strongest sales of our confectionary products have occurred during the Christmas holiday through Mother's Day. We believe the strongest sales of frozen yogurt products will occur during the summer months. In addition, quarterly results have been, and in the future are likely to be, affected by the timing of new store openings and sales of franchises. Because of the seasonality of our business and the impact of new store openings and sales of franchises, results for any quarter are not necessarily indicative of results that may be achieved in other quarters or for a full fiscal year.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We do not engage in commodity futures trading or hedging activities and do not enter into derivative financial instrument transactions for trading or other speculative purposes. We also do not engage in transactions in foreign currencies or in interest rate swap transactions that could expose us to market risk. However, we are exposed to some commodity price and interest rate risks.

We frequently enter into purchase contracts of between six to eighteen months for chocolate and certain nuts. These contracts permit us to purchase the specified commodity at a fixed price on an as-needed basis during the term of the contract. Because prices for these products may fluctuate, we may benefit if prices rise during the terms of these contracts, but we may be required to pay above-market prices if prices fall and we are unable to renegotiate the terms of the contract. As of May 31, 2014, based on future contractual obligations for ingredients, we estimate that a 10.0% change in the prices of contracted ingredients would result in a \$33,000 favorable or unfavorable price benefit resulting from our contracts.

We have a \$5.0 million bank line of credit that bears interest at a variable rate. As of May 31, 2014, no amount was outstanding under the line of credit. We do not believe that we are exposed to any material interest rate risk related to this credit facility.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) that are designed to ensure that material information relating to us is made known to the officers who certify as to our financial reports and to other members of senior management and the Board of Directors. These disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports that are filed or submitted under the Exchange Act, are recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include,

without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management, with the participation of our CEO and CFO, has evaluated the effectiveness, as of May 31, 2014, of our disclosure controls and procedures. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of May 31, 2014.

### **Changes in Internal Control over Financial Reporting**

During the three months ended May 31, 2014, we began offering U-Swirl support services related to information technology and financial reporting services. Through the offering of these services, we believe we have enhanced our internal control over financial reporting and improved the consistency of internal controls throughout our consolidated financial reporting. Except for the activities described above, there were no changes in our internal control over financial reporting that occurred during the quarter ended May 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

We are not currently involved in any material legal proceedings other than routine litigation incidental to our business.

### **Item 1A. Risk Factors**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended February 28, 2014. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended February 28, 2014.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

### **Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

- 3.1 Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K of the Registrant for the year ended February 28, 2009)
  - 3.2 Articles of Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K of the Registrant filed on May 22, 2009)
  - 3.3 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K of the Registrant filed on December 14, 2007)
  - 31.1\* Certification of Chief Executive Officer Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002
  - 31.2\* Certification of Chief Financial Officer Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002
  - 32.1\*\* Certification of Chief Executive Officer Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002
  - 32.2\*\* Certification of Chief Financial Officer Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002
- 101.INS \*XBRL Instance Document
- 101.SCH \*XBRL Taxonomy Extension Schema Document
- 101.CAL \*XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF \*XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB \*XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE \*XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed  
herewith.

\*\*  
Furnished  
herewith.

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.

(Registrant)

Date: July 15, 2014 /s/ Bryan J. Merryman  
Bryan J. Merryman, Chief Operating Officer,  
Chief Financial Officer, Treasurer and Director