

ROCKY MOUNTAIN CHOCOLATE FACTORY INC  
Form 10-Q  
January 14, 2015  
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 November 30, 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**  
(State or other jurisdiction (I.R.S. Employer Identification No.)  
of incorporation or organization)

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 January 14, 2015, the registrant had outstanding 6,092,626 shares of its common stock, \$.03 par value.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

FORM 10-Q

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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 November 30,		Nine Months Ended November 30,	
	2014	2013	2014	2013
<b>Revenues</b>				
Sales	\$8,583,981	\$7,801,296	\$23,108,761	\$22,666,134
Franchise and royalty fees	1,977,581	1,478,698	7,232,455	5,454,883
Total revenues	10,561,562	9,279,994	30,341,216	28,121,017
<b>Costs and Expenses</b>				
Cost of sales, exclusive of depreciation and amortization expense of \$102,179, \$72,102, \$292,632 and \$214,425, respectively	5,527,876	5,061,615	14,229,018	13,789,705
Franchise costs	558,560	510,145	1,623,505	1,508,604
Sales and marketing	608,536	555,833	1,838,395	1,523,991
General and administrative	1,230,495	1,146,214	3,816,996	3,625,033
Retail operating	724,608	803,338	2,697,163	2,588,313
Depreciation and amortization	357,865	198,466	1,097,404	670,219
Restructuring and acquisition related charges	-	-	709,212	-
Total costs and expenses	9,007,940	8,275,611	26,011,693	23,705,865
<b>Income from Operations</b>	1,553,622	1,004,383	4,329,523	4,415,152
<b>Other Income (Expense)</b>				
Interest expense	(60,666 )	-	(183,333 )	-
Interest income	16,208	16,702	43,274	43,690
Other Income (Expense), net	(44,458 )	16,702	(140,059 )	43,690
<b>Income Before Income Taxes</b>	1,509,164	1,021,085	4,189,464	4,458,842
<b>Income Tax Provision</b>	554,500	406,886	1,368,165	1,501,608

<b>Consolidated Net Income</b>	\$954,664	\$614,199	\$2,821,299	\$2,957,234
<b>Less: Net income (loss) attributable to non-controlling interest</b>	(7,714 )	(84,975 )	270,231	50,969
<b>Net Income attributable to RMCF</b>	\$962,378	\$699,174	\$2,551,068	\$2,906,265
<b>Basic Earnings per Common Share</b>	\$.16	\$.11	\$.41	\$.48
<b>Diluted Earnings per Common Share</b>	\$.15	\$.11	\$.40	\$.45
<b>Weighted Average Common Shares Outstanding</b>	6,162,829	6,115,860	6,171,327	6,094,529
<b>Dilutive Effect of Stock Options and Restricted Stock Units</b>	218,027	364,692	265,153	329,927
<b>Weighted Average Common Shares Outstanding, Assuming Dilution</b>	6,380,856	6,480,552	6,436,480	6,424,456

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

## ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

	November 30, 2014 (unaudited)	February 28, 2014
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$7,860,305	\$5,859,729
Accounts receivable, less allowance for doubtful accounts of \$702,994 and \$543,683, respectively	4,826,180	5,347,752
Notes receivable, current portion, less current portion of the valuation allowance of \$5,962 and \$33,047, respectively	341,130	357,360
Refundable income taxes	-	160,890
Inventories, less reserve for slow moving inventory of \$207,186 and \$204,068, respectively	5,045,790	4,410,763
Deferred income taxes	743,056	538,871
Other	281,773	316,378
Total current assets	19,098,234	16,991,743
<b>Property and Equipment, Net</b>	6,853,888	8,488,198
<b>Other Assets</b>		
Notes receivable, less current portion and valuation allowance of \$41,300 and \$24,200, respectively	802,619	509,784
Goodwill, net	4,130,444	4,216,444
Franchise Rights, net	6,238,602	6,489,248
Intangible assets, net	577,039	602,183
Other	169,623	167,939
Total other assets	11,918,327	11,985,598
<b>Total Assets</b>	<b>\$37,870,449</b>	<b>\$37,465,539</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Current maturities of long term debt	\$1,010,317	\$108,023
Accounts payable	2,020,961	1,971,530
Accrued salaries and wages	677,230	776,567
Other accrued expenses	2,844,958	2,627,872
Dividend payable	671,901	675,422
Deferred income	1,342,275	1,798,781
Total current liabilities	8,567,642	7,958,195

<b>Long-Term Debt, Less Current Maturities</b>	5,389,683	6,291,977
<b>Deferred Income Taxes</b>	1,004,599	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, 6,104,394 and 6,140,200 issued and outstanding, respectively	183,132	184,206
Additional paid-in capital	9,120,300	9,892,973
Retained earnings	10,859,472	10,344,794
Non-controlling interest in equity of subsidiary	2,745,621	1,742,905
Total stockholders' equity	22,908,525	22,164,878
<b>Total liabilities and stockholders' equity</b>	<b>\$37,870,449</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)

	Nine Months Ended November 30,	
	2014	2013
<b>Cash Flows From Operating activities</b>		
Net income	\$2,821,299	\$2,957,234
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,097,404	670,219
Provision for obsolete inventory	33,251	32,936
Asset impairment and store closure losses	178,000	-
Provision for loss on accounts and notes receivable	192,137	212,400
Gain on sale of property and equipment	(6,524 )	(907 )
Expense recorded for stock compensation	700,526	488,638
Deferred income taxes	(250,075 )	4,303
Changes in operating assets and liabilities:		
Accounts receivable	307,530	(613,566 )
Inventories	(208,403 )	(36,687 )
Other current assets	23,649	(211,981 )
Accounts payable	(190,245 )	(1,050,447)
Accrued liabilities	278,639	(896,897 )
Deferred income	(491,115 )	25,502
Net cash provided by operating activities	4,486,073	1,580,747
<b>Cash Flows From Investing Activities</b>		
Addition to notes receivable	(163,396 )	(684,098 )
Proceeds received on notes receivable	383,208	231,614
Proceeds from sale or distribution of assets	531,345	2,600
Purchases of property and equipment	(446,166 )	(1,112,431)
Increase in other assets	(8,786 )	(7,352 )
Net cash provided by (used) in investing activities	296,205	(1,569,667)
<b>Cash Flows From Financing Activities</b>		
Repurchase of common stock	(1,904,829)	-
Issuance of common stock	69,599	14,816
Proceeds from issuance of common stock in subsidiary	892,895	-
Tax benefit of stock awards	200,544	68,832
Dividends paid	(2,039,911)	(2,009,108)
Net cash used in financing activities	(2,781,702)	(1,925,460)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>2,000,576</b>	<b>(1,914,380)</b>

<b>Cash and Cash Equivalents, Beginning of Period</b>	5,859,729	5,321,696
<b>Cash and Cash Equivalents, End of Period</b>	\$7,860,305	\$3,407,316

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 unaudited consolidated financial statements include the accounts of Rocky Mountain Chocolate Factory, Inc. (“RMCF”), its wholly-owned subsidiary, Aspen Leaf Yogurt, LLC (“ALY”) and its 39%-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 November 30, 2014, RMCF held approximately 39% of U-Swirl’s outstanding common stock and this percentage of ownership is the consolidated interest recognized by RMCF and the remaining 61% is the amount of net income attributable to non-RMCF shareholders. Additionally, RMCF has the right to acquire approximately 25,400,000 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 71% of U-Swirl’s common stock. Certain directors of RMCF constitute all 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, Saudi Arabia and the United Arab Emirates. RMCF manufactures an extensive line of premium chocolate candies and other confectionery products.

ALY was a franchisor and retail operator of self-serve frozen yogurt retail units until the sale of substantially all of its assets in January 2013 to U-Swirl. As of January 2013, RMCF ceased to operate any company-owned Aspen Leaf Yogurt locations, or sell and support franchise locations.

On January 14, 2013, RMCF, through a newly formed wholly-owned subsidiary of RMCF (“Newco”), 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, a publicly traded company (OTCQB: SWRL), in exchange for a 60% controlling equity interest in U-Swirl. 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 are franchising this concept. U-Swirl operates cafés owned and operated by U-Swirl (“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.”

On January 17, 2014, U-Swirl entered into an Asset Purchase Agreement with CherryBerry, a franchisor of self-serve frozen yogurt cafés branded as “CherryBerry,” pursuant to which 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. On January 17, 2014, U-Swirl also entered into an Asset Purchase Agreement with Yogli Mogli LLC, a franchisor of self-serve frozen yogurt cafés branded as “Yogli Mogli,” pursuant to which 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. On February 20, 2014, U-Swirl entered into an Asset Purchase Agreement to acquire the business assets of Fuzzy Peach Franchising, LLC, including the acquisition of all intellectual property and worldwide franchise and license rights associated with 17 Fuzzy Peach Frozen Yogurt stores. The assets were acquired for \$481,000 in cash, plus an earn-out that could increase the purchase price by up to an additional \$349,000 in cash based upon royalty income generated by Fuzzy Peach stores in the twelve months following the acquisition.

The Company’s revenues are currently derived from three principal sources: sales to franchisees and others of chocolates and other confectionery products manufactured by RMCF; 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 November 30, 2014:

	Sold, Not Yet Open	Open	Total
Rocky Mountain Chocolate Factory			
Company-owned stores	-	5	5
Franchise stores – Domestic stores	4	203	207
Franchise stores – Domestic kiosks	-	5	5
International License Stores	1	73	74
Cold Stone Creamery – co-branded	10	66	76
U-Swirl (Including all associated brands)			
Company-owned stores	-	6	6
Company-owned stores – co-branded	-	3	3
Franchise stores – Domestic stores	2	236	238
Franchise stores – Domestic – co-branded	3	11	14
International License Stores	1	6	7
Total	21	614	635

#### Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by the Company, 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. Certain amounts previously presented for prior periods have been reclassified to conform to the current presentation. The reclassifications had no effect on net income, working capital or equity previously reported. 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 nine months ended November 30, 2014 are not necessarily indicative of the results to be expected for the entire fiscal year.

These unaudited 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

On January 13, 2015, the Company announced that its Board of Directors has authorized the repurchase of up to \$3.0 million of the Company's outstanding common stock in the open market, or in private transactions, whenever deemed appropriate by management. The Company also announced that its Board of Directors has declared a fourth quarter FY2015 cash dividend of \$0.12 per common share outstanding. The cash dividend will be payable March 13, 2015 to shareholders of record at the close of business February 27, 2015. The fourth quarter FY2015 cash dividend of \$0.12 represents a 9 percent increase over the previous cash dividend of \$0.11 per share.

## Stock-Based Compensation

At November 30, 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 \$166,842 and \$548,008 of stock-based compensation expense during the three and nine-month periods ended November 30, 2014, respectively, compared to \$166,664 and \$435,126 during the three and nine-month periods ended November 30, 2013, respectively. 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 nine months ended November 30, 2014 and 2013:

	Nine Months Ended	
	2014	2013
Outstanding stock options as of February 28:	155,880	270,945
Granted	-	-
Exercised	(142,944)	(2,000 )
Cancelled/forfeited	-	(88,725 )
Outstanding stock options as of November 30:	12,936	180,220
Weighted average exercise price	\$14.70	\$7.93
Weighted average remaining contractual term (in years)	1.29	.67

The following table summarizes non-vested restricted stock unit transactions for common stock during the nine months ended November 30, 2014 and 2013:

	Nine Months Ended November 30,	
	2014	2013
Outstanding non-vested restricted stock units as of February 28:	295,040	57,030
Granted	-	280,900
Vested	(56,199 )	(41,390 )
Cancelled/forfeited	-	(1,500 )
Outstanding non-vested restricted stock units as of November 30:	238,841	295,040
Weighted average grant date fair value	\$12.14	\$12.09
Weighted average remaining vesting period (in years)	4.33	5.24

During the nine months ended November 30, 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 nine months ended November 30, 2013. There were no unrestricted shares of stock issued during the three-month periods ended November 30, 2014 or November 30, 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 nine-month periods ended November 30, 2014 and 2013, respectively.

During the three and nine month periods ended November 30, 2014, the Company recognized \$166,843 and \$500,528, respectively, of stock-based compensation expense related to non-vested, non-forfeited restricted stock unit grants. The restricted stock unit grants generally vest between 17% and 20% annually over a period of five to six years. During the three and nine month periods ended November 30, 2014, 0 and 56,199 restricted stock units vested and were issued as common stock, respectively compared with 0 and 41,390 issued in the three and nine month periods ended November 31, 2013, respectively. Total unrecognized compensation expense of non-vested, non-forfeited shares granted as of November 30, 2014 was \$2,647,333, which is expected to be recognized over the weighted-average period of 4.3 years.

The Company recognized \$0 and \$152,518 of stock-based compensation expense for U-Swirl during the three and nine months ended November 30, 2014, respectively, compared with \$11,987 and \$53,512 recognized during the three and nine month months ended November 30, 2013, respectively.

#### New Accounting Pronouncements

In May 2014, FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers*,” which supersedes the revenue recognition requirements in “*Revenue Recognition (Topic 605)*,” and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the new standard.

In August 2014, the FASB issued ASU 2014-15, “*Presentation of Financial Statements—Going Concern*.” This guidance requires management to evaluate whether there are conditions or events that raise substantial doubt about an entity's ability to continue as a going concern. If such conditions or events exist, disclosures are required that enable users of the financial statements to understand the nature of the conditions or events, management's evaluation of the circumstances and management's plans to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. We will be required to perform an annual assessment of our ability to continue as a going concern when this standard becomes effective for us in the first quarter of our fiscal year ended February 28, 2017. The adoption of this guidance is not expected to impact our financial position, results, operations or cash flows.

#### 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 stock issuable through stock options and restricted stock units. For the three months ended November 30, 2014, there were 12,936 stock options excluded from the computation of earnings per share, compared with 12,936 stock options excluded from the computation of earnings per share for the three months ended November 30, 2013 because their effect would have been anti-dilutive. For the nine months ended November 30, 2014 and 2013, 12,936 and 42,511 stock options, respectively, were excluded 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

Inventories consist of the following:

	November 30, 2014	February 28, 2014
Ingredients and supplies	\$2,921,023	\$2,531,413
Finished candy	2,026,932	1,761,131
U-Swirl, Inc. food and packaging	97,835	118,219
Total inventories	\$5,045,790	\$4,410,763

## NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

	November 30, 2014	February 28, 2014
Land	\$513,618	\$513,618
Building	4,775,466	4,775,466
Machinery and equipment	10,377,939	9,518,832
Furniture and fixtures	1,193,224	1,324,846
Leasehold improvements	1,993,738	2,489,782
Transportation equipment	394,666	394,508
Capital work in progress	-	967,937
Impairment provision of long-lived assets	(243,000 )	-
	19,005,651	19,984,989
Less accumulated depreciation	12,151,763	11,496,791
Property and equipment, net	\$6,853,888	\$8,488,198

## NOTE 5 - STOCKHOLDERS' EQUITY

Stock Repurchases

In 2014, the Board of Directors of the Company authorized a plan to purchase up to \$3.0 million of the Company's common stock in the open market or in private transactions, whenever deemed appropriate by management. Between July 15, 2014 and July 31, 2014, the Company repurchased 55,000 shares under the plan at an average price of \$12.58 per share. Between September 26, 2014 and November 28, 2014, the Company repurchased 99,511 shares under the plan at an average price of \$12.19 per share. As of November 30, 2014, approximately \$1,095,000 remains available under the plan for further stock repurchases.

#### 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. The Company paid a quarterly cash dividend of \$0.11 per share of common stock on September 12, 2014 to shareholders of record on September 2, 2014. The Company declared a quarterly cash dividend of \$0.11 per share of common stock on November 11, 2014 payable on December 12, 2014 to shareholders of record on November 28, 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

	Nine Months Ended November 30,	
	2014	2013
Cash paid (received) for:		
Interest	\$143,806	\$(34,637 )
Income taxes	1,112,040	2,090,170
Non-Cash Operating Activities		
Accrued Inventory	477,176	452,707
Non-Cash Financing Activities		
Dividend Payable	\$671,901	\$672,745
Sale of assets and inventory to buyers for notes receivable:		
Long-lived assets	446,353	-
Inventory	17,301	-
Accounts receivable	17,043	-
Other assets	10,858	-

## NOTE 7 - OPERATING SEGMENTS

The Company classifies its business interests into five reportable segments: Franchising, Manufacturing, Retail Stores, U-Swirl, Inc. 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 financial statements and Note 1 to the Company's financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2014. 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

November 30, 2014

	Franchising	Manufacturing	Retail	U-Swirl, Inc.	Other	Total
Total revenues	\$1,244,732	\$7,994,116	\$350,261	\$1,430,397	\$-	\$11,019,506
Intersegment revenues	(1,407 )	(456,537 )	-	-	-	(457,944 )
Revenue from external customers	1,243,325	7,537,579	350,261	1,430,397	-	10,561,562
Segment profit (loss)	438,160	2,189,548	(94,387 )	(100,978 )	(923,179 )	1,509,164
Total assets	1,115,716	12,878,192	1,166,851	15,284,436	7,425,254	37,870,449
Capital expenditures	22,050	28,414	658	(7,505 )	4,526	48,143
Total depreciation & amortization	10,661	102,699	6,083	199,787	38,635	\$357,865

## Three Months Ended

November 30, 2013

	Franchising	Manufacturing	Retail	U-Swirl, Inc.	Other	Total
Total revenues	\$1,181,577	\$7,128,169	\$436,755	\$1,039,498	\$-	\$9,785,999
Intersegment revenues	-	(506,005 )	-	-	-	(506,005 )
Revenue from external customers	1,181,577	6,622,164	436,755	1,039,498	-	9,279,994
Segment profit (loss)	351,215	1,850,702	(124,432 )	(197,616 )	(858,784 )	1,021,085
Total assets	1,091,984	12,345,986	1,327,840	3,586,150	5,890,240	24,242,200
Capital expenditures	30,430	590,234	(16,483 )	74,118	26,077	704,376
Total depreciation & amortization	\$9,534	\$74,338	\$14,698	\$61,318	\$38,578	\$198,466

Nine Months Ended

November 30, 2014

	Franchising	Manufacturing	Retail	U-Swirl, Inc.	Other	Total
Total revenues	\$4,290,060	\$ 19,331,459	\$ 1,445,444	\$6,424,909	\$-	\$31,491,872
Intersegment revenues	(2,917 )	(1,147,739 )	-	-	-	(1,150,656 )
Revenue from external customers	4,287,143	18,183,720	1,445,444	6,424,909	-	30,341,216
Segment profit (loss)	1,922,482	5,045,608	(129,726 )	131,461	(2,780,361)	4,189,464
Total assets	1,115,716	12,878,192	1,166,851	15,284,436	7,425,254	37,870,449
Capital expenditures	28,753	295,188	34,511	55,847	31,867	446,166
Total depreciation & amortization	31,393	294,204	23,224	632,622	115,961	\$1,097,404

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Nine Months Ended

November 30, 2013

	Franchising	Manufacturing	Retail	U-Swirl, Inc.	Other	Total
Total revenues	\$4,379,618	\$ 19,085,028	\$ 1,588,282	\$4,449,364	\$-	\$29,502,292
Intersegment revenues	-	(1,381,275 )	-	-	-	(1,381,275 )
Revenue from external customers	4,379,618	17,703,753	1,588,282	4,449,364	-	28,121,017
Segment profit (loss)	1,956,513	5,160,089	(150,823 )	130,255	(2,637,190)	4,458,844
Total assets	1,091,984	12,345,986	1,327,840	3,586,150	5,890,240	24,242,200
Capital expenditures	45,959	786,343	295	137,868	141,965	1,112,430
Total depreciation & amortization	\$27,432	\$ 219,730	\$44,093	\$272,266	\$106,698	670,219

Revenue from one customer of the Company's Manufacturing segment represented approximately \$2.9 million, or 9.6 percent, of the Company's revenues from external customers during the nine months ended November 30, 2014 compared to \$2.6 million, or 9.2 percent of the Company's revenues from external customers during the nine months ended November 30, 2013.

## NOTE 8 – GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following:

	Amortization Period (years)	November 30, 2014		February 28, 2014	
		Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Intangible assets subject to amortization					
Store design	10	\$ 220,778	\$ 207,777	\$ 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	29,302	593,340	5,283
Franchise Rights	20	6,580,034	341,432	6,580,034	90,786
Total		7,945,955	1,130,314	7,945,955	854,524
Intangible assets not subject to amortization					
Franchising segment- Company stores goodwill		1,013,328	267,020	1,099,328	267,020

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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	4,792,828	662,384	4,878,828	662,384
Total Intangible Assets	\$ 12,738,783	\$ 1,792,698	\$ 12,824,783	\$ 1,516,908

Amortization expense related to intangible assets totaled \$275,790 and \$977 during the nine months ended November 30, 2014 and 2013, respectively.

At November 30, 2014, annual amortization of intangible assets, based upon our existing intangible assets and current useful lives, is estimated to be the following:

2015	\$98,197
2016	413,645
2017	459,218
2018	481,977
2019	494,614
Thereafter	4,867,990
Total	\$6,815,641

## NOTE 9 – RESTRUCTURING AND ACQUISITION RELATED CHARGES

In connection with the acquisitions of the assets of CherryBerry, Yogli Mogli and Fuzzy Peach Franchising, LLC, the Company recorded net restructuring charges of \$124,551 during the nine months ended November 30, 2014 associated with these acquisitions. Primarily these charges were the result of professional fees for due diligence, valuation, audit and other activities in connection with these acquisitions. See Note 1 for a description of the acquisitions of CherryBerry, Yogli Mogli and Fuzzy Peach Franchising, LLC.

On September 4, 2014, Ulderico Conte, Henry E. Cartwright and Terry A. Cartwright resigned as directors of U-Swirl, Inc. In addition, Messrs. Conte, H. Cartwright and T. Cartwright resigned as officers of U-Swirl, Inc. Also on September 4, 2014, the U-Swirl Board of Directors appointed Bryan J. Merryman as the Chairman of the Board, replacing Franklin E. Crail. Mr. Merryman currently serves as the Chief Operating Officer and Chief Financial Officer of RMCF.

In connection with these management changes, U-Swirl announced an operational restructuring designed to enhance U-Swirl's operating efficiencies, improve its franchise support capabilities, and rationalize its cost structure. This restructuring resulted in expense associated with termination of the employment agreements with the named officers, severance payments for other employees and expense associated with the impairment of certain long-lived leasehold improvement, property and equipment. The Company recorded restructuring charges of \$584,661 during the nine months ended November 30, 2014 associated with this operational restructuring.

Total restructuring and acquisition charges incurred were comprised of the following for the nine months ended November 30, 2014:

Professional fees	\$	186,011
Severance/transitional compensation		212,027
Leasehold improvements, property and equipment impairment of long-lived assets		243,000
Acceleration of restricted stock unit vesting		65,049
Other		3,125
Total	\$	709,212

## NOTE 10 – SALE OR DISTRIBUTION OF ASSETS

During the nine months ended November 30, 2014, the Company sold one Company-owned Rocky Mountain Chocolate Factory location and four U-Swirl Company-owned cafés. These locations were sold for a combination of cash and notes receivable. Additionally, the Company began the process of closing the U-Swirl, Inc. corporate offices in Henderson, Nevada and to market for sale an additional U-Swirl Company-owned café. Associated with this asset disposal activity, the Company recorded the following in the nine months ended November 30, 2014:

Cash received on asset sales	\$525,000
Notes receivable	431,244



## NOTE 11 – NOTE PAYABLE

The Company's long-term debt is comprised of a promissory note with Wells Fargo Bank, NA used to finance the Company's business acquisitions (unpaid balance as of November 30, 2014, \$6.4 million).

As of November 30, 2014 and February 28, 2014, notes payable consisted of the following:

	November 30, 2014	February 28, 2014
Promissory note	\$6,400,000	\$6,400,000
Less: current maturities	(1,010,317)	(108,023 )
Long-term obligations	\$5,389,683	\$6,291,977

The following table summarizes annual maturities of our notes payable as of November 30, 2014:

	Amount
2015	\$108,000
2016	1,209,000
2017	1,256,000
2018	1,304,000
Thereafter	2,523,000
Total minimum payments	6,400,000
Less: current maturities	(1,010,317)
Long-term obligations	\$5,389,683

## 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 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," "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, which includes its 39% owned subsidiary, U-Swirl, Inc.*

### 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 fourteen 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, we, through a newly formed wholly-owned subsidiary of the Company (“Newco”), 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, in January 2013, 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. (“U-Swirl”), a publicly traded company (OTCQB: SWRL), in exchange for a 60% controlling equity interest in U-Swirl. 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 acquired self-serve frozen yogurt retail units branded as “Josie’s Frozen Yogurt.” As of November 30, 2014, we own approximately 39% of U-Swirl’s outstanding common stock, and the results of U-Swirl are consolidated in our results.

On November 10, 2014, we entered into an Agreement and Plan of Merger (the “Reorganization Agreement”) with Rocky Mountain Chocolate Factory, Inc., a Delaware corporation and wholly-owned subsidiary of the Company (“Newco”) and RKB Merger Corp., a Colorado corporation and wholly-owned subsidiary of Newco (“MergerCo”), pursuant to which our organizational structure would be reorganized into a holding company structure. Pursuant to the Reorganization Agreement, the Company will merge with MergerCo, with the Company surviving as a wholly-owned subsidiary of Newco (the “Reorganization”). Upon completion of the Reorganization, Newco, a Delaware corporation, would, in effect, replace the Company, a Colorado corporation, as the publicly held corporation traded on the NASDAQ Global Select Market under the symbol “RMCF”, and the holders of the Company’s common stock would hold the same number of shares and same ownership percentage of Newco after the Reorganization as they held of the Company immediately prior to the Reorganization. The Reorganization is subject to shareholder approval at the upcoming annual meeting of shareholders to be held on February 19, 2015. If approved by the Company’s shareholders, we expect that the Reorganization would be completed on or about March 1, 2015. If the Reorganization is completed, we will be subject to a Delaware franchise tax of approximately \$99,000 per year.

## Results of Operations

### Three Months Ended November 30, 2014 Compared to the Three Months Ended November 30, 2013

Basic earnings per share increased 45.5% from \$.11 in the three months ended November 30, 2013 to \$.16 in the three months ended November 30, 2014. Revenues increased 13.8% from \$9.3 million in the three months ended November 30, 2013 to \$10.6 million in the three months ended November 30, 2014. Operating income increased 54.7% from \$1.0 million in the three months ended November 30, 2013 to \$1.6 million in the three months ended November 30, 2014. Net income increased 37.6% from \$699,000 in the three months ended November 30, 2013 to \$962,000 in the three months ended November 30, 2014. The increase in revenues, operating income and net income was primarily the result of an increase in factory sales, an increase in royalty and marketing fees resulting from the U-Swirl acquisition of franchise rights in fiscal year 2014 and an increase in franchise fees as a result of international license agreements.

Revenues (\$'s in thousands)	Three Months Ended		\$	%	
	November 30, 2014	2013			
Factory sales	\$7,537.6	\$6,622.1	\$915.5	13.8	%
Retail sales	1,046.3	1,179.2	( 132.9 )	(11.3%)	
Franchise fees	275.1	52.7	222.4	422.0	%
Royalty and Marketing fees	1,702.6	1,426.0	276.6	19.4	%
Total	\$10,561.6	\$9,280.0	\$1,281.6	13.8	%

### Factory Sales

The increase in factory sales for the three months ended November 30, 2014 versus the three months ended November 30, 2013 was primarily due to a 105.4% increase in shipments of product to customers outside our network of franchise retail locations and a 0.3% increase in same-store pounds purchased by our network of domestic franchised stores, partially offset by a 5.1% decrease in shipments to our system of franchise retail locations, the result of a 5.8% decline in domestic Rocky Mountain Chocolate Factory units in operation. Same store sales at domestic Rocky Mountain Chocolate Factory locations increased 1.9% in the three months ended November 30, 2014, compared with the three months ended November 30, 2013.

#### Retail Sales

The decrease in retail sales was primarily due to increased performance of Company-owned locations acquired or commencing operation during the prior fiscal year offset by the closure or sales of certain under-performing locations. Same store sales at Company-owned stores increased 2.8% in the three months ended November 30, 2014 compared to the three months ended November 30, 2013.

#### Royalties, Marketing Fees and Franchise Fees

The increase in royalties and marketing fees from the three months ended November 30, 2013 to the three months ended November 30, 2014 resulted from a 60.7% increase in domestic franchise stores in operation from the three months ended November 30, 2013 compared to the three months ended November 30, 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 223 in the three months ended November 30, 2013 to 210 during the three months ended November 30, 2014. Franchise fees increased 422% during the three months ended November 30, 2014 compared to the three months ended November 30, 2013. This increase in franchise fees was the result of the execution of two international master license agreements in the three months ended November 30, 2014 compared with no master license agreements in the three months ended November 30, 2013.

Costs and Expenses (\$'s in thousands)	Three Months Ended November 30,		\$ Change	% Change	
	2014	2013			
Cost of sales – factory adjusted	\$5,134.6	\$4,582.1	\$552.5	12.1	%
Cost of sales - retail	393.3	479.5	( 86.2 )	(18.0)	%
Franchise costs	558.6	510.1	48.5	9.5	%
Sales and marketing	608.5	555.8	52.7	9.5	%
General and administrative	1,230.5	1,146.2	84.3	7.4	%
Retail operating	724.6	803.4	( 78.8 )	(9.8)	%
Total	\$8,650.1	\$8,077.1	\$573.0	7.1	%

Adjusted Gross Margin (\$'s in thousands)	Three Months Ended November 30,		\$ Change	% Change	
	2014	2013			
Factory adjusted gross margin	\$2,403.0	\$2,040.0	\$363.0	17.8	%
Retail	653.0	699.7	( 46.7 )	(6.7)	%
Total	\$3,056.0	\$2,739.7	\$316.3	11.5	%

Adjusted Gross Margin (Percent)	Three Months Ended November 30,		% Change	% Change	
	2014	2013			
Factory adjusted gross margin	31.9%	30.8%	1.1	%	3.6
Retail	62.4%	59.3%	3.1	%	5.2
Total	35.6%	35.1%	0.5	%	1.4

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)	Three Months Ended November 30,	
	2014	2013
Factory adjusted gross margin	\$2,403.0	\$2,040.0
Less: Depreciation and Amortization	102.2	73.8
Factory GAAP gross margin	\$2,300.8	\$1,966.2

#### Cost of Sales

Factory margins increased 110 basis points in the three months ended November 30, 2014 compared to the three months ended November 30, 2013 due primarily to a shift in product mix to higher margins products and a decrease in transportation costs, partially offset by the increased costs of certain raw materials. The decrease in Company-owned store margin is due primarily to the increase in U-Swirl units in operation during the previously year and associated lower margins at U-Swirl units during the three months ended November 30, 2014.

### Franchise Costs

Franchise costs increased 9.5% in the three months ended November 30, 2014 compared to the three months ended November 30, 2013 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 28.2% in the three months ended November 30, 2014 from 34.5% in the three months ended November 30, 2013. This decrease is primarily a result of higher franchise and royalty revenues during the three months ended November 30, 2014.

### Sales and Marketing

The increase in sales and marketing costs for the three months ended November 30, 2014 compared to the three months ended November 30, 2013 is primarily due to an increase in marketing costs associated with the increased U-Swirl franchise locations.

### General and Administrative

The increase in general and administrative costs for the three months ended November 30, 2014 compared to the three months ended November 30, 2013 is due primarily to the consolidation of U-Swirl general and administrative costs. For the three months ended November 30, 2014, approximately \$391,000 of U-Swirl general and administrative costs were consolidated within our results, compared with \$316,000 in the three months ended November 30, 2013. As a percentage of total revenues, general and administrative expenses decreased to 11.7% in the three months ended November 30, 2014 compared to 12.4% in the three months ended November 30, 2013.

### Retail Operating Expenses

The decrease in retail operating expense was primarily due to a decrease in the average number of Company-owned stores in operation. The average number of Company-owned stores in operation decreased from 18 during the three months ended November 30, 2013 to 14 units in the three months ended November 30, 2014 as a result of the closing or sale of Company-owned stores. Retail operating expenses, as a percentage of retail sales, increased from 68.1% in the three months ended November 30, 2013 to 69.3% in the three months ended November 30, 2014. This increase is primarily the result of the change in units in operation from the prior year.



## Depreciation and Amortization

Depreciation and amortization of \$358,000 in the three months ended November 30, 2014 increased 80.3% from \$198,000 incurred in the three months ended November 30, 2013. This increase was the result of additional 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 \$44,500 in the three months ended November 30, 2014 compared to net interest income of \$16,700 realized in the three months ended November 30, 2013. This change was the result of increased 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 November 30, 2014 was 36.7%, compared to 39.8% for the three months ended November 30, 2013. The decrease of 3.1% was primarily the result of the consolidation of a lower U-Swirl net operating loss. During the three months ended November 30, 2014 and November 30, 2013 there was no income tax benefit recognized on the U-Swirl net loss. 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.

## **Nine Months Ended November 30, 2014 Compared to the Nine Months Ended November 30, 2013**

Basic earnings per share decreased 14.6% from \$.48 for the nine months ended November 30, 2013 to \$.41 for the nine months ended November 30, 2014. Revenues increased 7.9% to \$30.3 million for the nine months ended November 30, 2014 compared to \$28.1 million in the nine months ended November 30, 2013. Operating income decreased 1.9% from \$4.4 million in the nine months ended November 30, 2013 to \$4.3 million in the nine months ended November 30, 2014. Net income decreased 12.2% from \$2.9 million in the nine months ended November 30, 2013 to \$2.6 million in the nine months ended November 30, 2014. The decrease in operating income and net income was due primarily to restructuring and acquisition related charges associated with the restructuring and business acquisitions of U-Swirl.



Revenues	Nine Months Ended			
	November 30,		\$	%
(\$'s in thousands)	2014	2013	Change	Change
Factory sales	\$18,183.6	\$17,703.7	\$479.9	2.7 %
Retail sales	4,925.0	4,962.4	( 37.4 )	(0.8% )
Franchise fees	480.4	390.9	89.5	22.9 %
Royalty and marketing fees	6,752.2	5,064.0	1,688.2	33.3 %
Total	\$30,341.2	\$28,121.0	\$2,220.2	7.9 %

### Factory Sales

The increase in factory sales for the nine months ended November 30, 2014 versus the nine months ended November 30, 2013 was primarily due to a 33.2% increase in shipments of product to customers outside our network of franchised retail stores, partially offset by a 2.1% decrease in same-store pounds purchased by our network of franchised stores and a 6.2% decrease in the average number of domestic Rocky Mountain Chocolate Factory franchised stores in operation.

### Retail Sales

The decrease in retail sales was primarily due to increased performance of Company-owned locations acquired or commencing operation during the prior fiscal year, offset by the closure or sale of certain under-performing locations. Same store sales at all Company-owned stores and cafés decreased 0.2% in the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013.

### Royalties, Marketing Fees and Franchise Fees

The increase in royalties and marketing fees from the nine months ended November 30, 2013 to the nine months ended November 30, 2014 resulted from a 61.2% increase in domestic franchise stores in operation from the nine months ended November 30, 2013 compared to the nine months ended November 30, 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 225 in the nine months ended November 30, 2013 to 211 during the nine months ended November 30, 2014. Franchise fee revenues increased as a result of the sale of three Company-owned U-Swirl Cafés and the associated franchise fees recognized in the nine months ended November 30, 2014 and no sales of Company-owned cafés and similar fees being recognized in the nine months ended November 30, 2013.

Costs and Expenses (\$'s in thousands)	Nine Months Ended November 30,		\$ Change	% Change	
	2014	2013			
Cost of sales – factory adjusted	\$12,530.5	\$12,036.8	\$493.7	4.1	%
Cost of sales - retail	1,698.5	1,752.9	( 54.4 )	(3.1	%)
Franchise costs	1,623.5	1,508.6	114.9	7.6	%
Sales and marketing	1,838.4	1,524.0	314.4	20.6	%
General and administrative	3,817.0	3,625.0	192.0	5.3	%
Retail operating	2,697.2	2,588.3	108.9	4.2	%
Total	\$24,205.1	\$23,035.6	\$1,169.5	5.1	%

Adjusted gross margin (\$'s in thousands)	Nine Months Ended November 30,		\$ Change	% Change	
	2014	2013			
Factory adjusted gross margin	\$5,653.1	\$5,666.9	\$( 13.8 )	(0.2%	)
Retail	3,226.5	3,209.5	17.0	0.5	%
Total	\$8,879.6	\$8,876.4	\$3.2	0.0	%

Adjusted Gross Margin	Nine Months Ended			
	November 30,		%	%
(Percent)	2014	2013	Change	Change
Factory adjusted gross margin	31.1%	32.0%	(0.9% )	(2.8% )
Retail	65.5%	64.7%	0.8 %	1.2 %
Total	38.4%	39.2%	(0.8% )	(2.0% )

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)	Nine Months Ended	
	November 30, 2014	2013
Factory adjusted gross margin	\$5,653.1	\$5,666.9
Less: Depreciation and Amortization	292.6	218.2
Factory GAAP gross margin	\$5,360.5	\$5,448.7

Costs and Expenses

Cost of Sales

Factory margins decreased 90 basis points in the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013 due primarily to the increased costs of certain raw materials and a decline in manufacturing efficiencies associated with 2.3% lower production volume in the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013. Company-owned store margins increased 80 basis points in the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013.

#### Franchise Costs

The increase in franchise costs in the nine months ended November 30, 2014 versus the nine months ended November 30, 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 22.4% in the nine months ended November 30, 2014 from 27.7% in the nine months ended November 30, 2013. This decrease as a percentage of royalty, marketing and franchise fees is primarily a result of higher franchise and royalty revenues.

#### Sales and Marketing

The increase in sales and marketing costs for the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013 is primarily due to an increase in marketing costs associated with the increased U-Swirl franchise locations compared to the prior year.

#### General and Administrative

The increase in general and administrative costs for the nine months ended November 30, 2014 compared to the nine months ended November 30, 2013 is due primarily to the consolidation of U-Swirl's general and administrative costs and an increase in compensation related expenses. For the nine months ended November 30, 2014, approximately \$1,378,700 of U-Swirl general and administrative costs were consolidated within our results, compared with \$1,031,000 in the nine months ended November 30, 2013. As a percentage of total revenues, general and administrative expenses decreased to 12.6% in the nine months ended November 30, 2014 compared to 12.9% in the same period of the prior year.

### Retail Operating Expenses

The increase in retail operating expenses for the nine months ended November 30, 2014 compared to the nine months ended November 30, 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 offset by the closure of five underperforming locations in the prior year and the sale of four Company-owned locations in the nine months ended November 30, 2014. Retail operating expenses, as a percentage of retail sales, increased from 52.2% in the nine months ended November 30, 2013 to 54.8% in the nine months ended November 30, 2014.

### Depreciation and Amortization

Depreciation and amortization of \$1,097,000 in the nine months ended November 30, 2014 increased 63.7% from \$670,000 incurred in the nine months ended November 30, 2013 due to additional depreciable assets in service. This increase was the result of additional 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 \$140,000 in the nine months ended November 30, 2014 compared to net interest income of \$44,000 realized in the nine months ended November 30, 2013. This change was the result of an increase in outstanding debt from a promissory note entered into in January 2014 to fund business acquisitions.

### Income Tax Expense

Our effective income tax rate for the nine months ended November 30, 2014 was 32.7%, compared to 33.7% for the nine months ended November 30, 2013. The decrease of 1.0% was primarily the result of the consolidation of the U-Swirl, Inc. net operating income and associated provision for income taxes. U-Swirl, Inc. has significant net operating loss carryovers and no income tax expense was recognized in the nine months ended November 30, 2014 or November 30, 2013. In accordance with Section 382 of the Internal Revenue Code, deductibility of U-Swirl, Inc.'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, Inc. when the Company acquired its 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, Inc.

## Liquidity and Capital Resources

As of November 30, 2014, working capital was \$10.5 million, compared with \$9.0 million as of February 28, 2014, an increase of \$1.5 million. The change in working capital was due primarily to operating results less the payment of dividends, an increase in notes receivable and the purchase of equipment.

Cash and cash equivalent balances increased \$2.0 million from \$5.86 million as of February 28, 2014 to \$7.86 million as of November 30, 2014 as a result of cash flow generated by operating activities. Net cash provided by operating activities increased from \$1.58 million during the nine months ended November 30, 2013 to \$4.49 million in the nine months November 30, 2014. This increase was primarily the result of a greater reduction in accounts receivable and lower accounts payable and accrued liabilities at February 28, 2014 compared to February 28, 2013. Our current ratio was 2.2 to 1 at November 30, 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 (no amount was outstanding as of November 30, 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 November 30, 2014, we were in compliance with all such covenants. The line is subject to renewal on July 31, 2015.

The Company's current long-term debt is comprised of a promissory note used to finance the Company's business acquisitions (unpaid balance as of November 30, 2014 was \$6.4 million. The note allows the Company to borrow up to a maximum of \$7.0 million to finance business acquisitions and bears interest at a fixed annual rate of 3.75%. Additionally, the promissory note is subject to various financial ratio and leverage covenants. As of November 30, 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.



## **Stock Repurchase Plan Authorizations**

We continue to evaluate options to maximize the returns on our cash and maintain an appropriate capital structure, including, among other alternatives, repurchases of our common stock. In July 2015, our Board of Directors authorized the repurchase up to \$3.0 million of our common stock. The number, price, structure and timing of the repurchases, if any, will be at our sole discretion and future repurchases will be evaluated by us depending on market conditions, liquidity needs and other factors. Share repurchases may be made in the open market, block trades or in privately negotiated transactions. The repurchase authorization does not have an expiration date and does not oblige us to acquire any particular amount of our common stock. The Board of Directors may suspend, modify or terminate the repurchase program at any time without prior notice.

Between July 15, 2014 and July 31, 2014, we repurchased 55,000 shares under the repurchase plan at an average price of \$12.58 per share. Between September 26, 2014 and November 30, 2014, we repurchased 99,511 shares under the repurchase plan at an average price of \$12.19 per share. As of November 30, 2014, approximately \$1,095,200 remains available under the repurchase plan for further stock repurchases.

## **New Accounting Pronouncements**

In May 2014, FASB issued ASU No. 2014-09, “*Revenue from Contracts with Customers*,” which supersedes the revenue recognition requirements in “*Revenue Recognition (Topic 605)*,” and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the new standard.

In August 2014, the FASB issued ASU 2014-15, “*Presentation of Financial Statements—Going Concern*.” This guidance requires management to evaluate whether there are conditions or events that raise substantial doubt about an entity's ability to continue as a going concern. If such conditions or events exist, disclosures are required that enable users of the financial statements to understand the nature of the conditions or events, management's evaluation of the circumstances and management's plans to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. We will be required to perform an annual assessment of our ability to continue as a going concern when this standard becomes effective for us in the first quarter of our fiscal year ended February 28, 2017. The adoption of this guidance is not expected to impact our financial position, results, operations or cash flows.

## **Off-Balance Sheet Arrangements**

As of November 30, 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 our 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 November 30, 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 \$22,000 favorable or unfavorable price benefit or cost, respectively, resulting from our purchase contracts.

We have a \$5.0 million bank line of credit that bears interest at a variable rate. As of November 30, 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.

We have a \$7.0 million promissory note with interest at a fixed rate or 3.75% annually. As of November 30, 2014, \$6.4 million was outstanding under the note. We do not believe that we are exposed to any material interest rate risk related to this promissory note.

#### **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.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Exchange Act. Based upon this evaluation as of November 30, 2014, our management has concluded that those disclosure controls and procedures are effective.

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

There were no changes in our internal control over financial reporting that occurred during the quarter ended November 30, 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***Issuer Purchases of Equity Securities*

<b>Period</b>	<b>Total Number of Shares (or Units) Purchased (1)</b>	<b>Average Price Paid per Share (or Unit) (1)</b>	<b>Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)</b>
September 1, 2014-September 30, 2014	23,000	\$ 12.47	23,000	\$ 2,021,300
October 1, 2014-October 31, 2014	49,800	\$ 11.97	49,800	\$ 1,424,900
November 1, 2014-November 30, 2014	26,711	\$ 12.35	26,711	\$ 1,095,200
<b>Total</b>	<b>99,511</b>	<b>\$ 12.19</b>	<b>99,511</b>	<b>\$ 1,095,200</b>

On July 15, 2014, we announced that our Board of Directors had approved the repurchase of up to \$3.0 million shares of our common stock. Between September 1, 2014 and November 30, 2014, we repurchased 99,511 shares under the repurchase plan at an average price of \$12.19. The number, price, structure and timing of the repurchases, if any, will be at our sole discretion and future repurchases will be evaluated by us depending on (1) market conditions, liquidity needs and other factors. The stock repurchases may be made in the open market, block trades or privately negotiated transactions. The primary purpose of the share repurchase program is to allow us the flexibility to repurchase our common stock to return value to stockholders. The repurchase authorization does not have an expiration date and does not oblige us to acquire any particular amount of our common stock. Our Board of Directors may suspend, modify or terminate the repurchase program at any time without prior notice.



**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**

2.1 Agreement and Plan of Merger, dated November 10, 2014, among Rocky Mountain Chocolate Factory, Inc., Colorado corporation, Rocky Mountain Chocolate Factory, Inc., a Delaware corporation, and RKB Merger Corp. (incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K of the Registrant filed on November 10, 2014)

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)

10.1 Stock Purchase Agreement, dated October 28, 2014, between Rocky Mountain Chocolate Factory, Inc. and Franklin E. Crail (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K of the Registrant filed on October 28, 2014)

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.

## Signatures

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: January 14, 2015 /s/ Bryan J. Merryman  
Bryan J. Merryman, Chief Operating Officer,  
Chief Financial Officer, Treasurer and Director