ROCKY MOUNTAIN CHOCOLATE FACTORY INC
Form 10-Q
October 05, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2006

o **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

(State of incorporation)

84-0910696

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

265 Turner Drive, Durango, CO 81303

(Address of principal executive offices)

(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and larger accelerated filer in Rule 12b of the Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

On September 29, 2006 the registrant had outstanding 6,082,457 shares of its common stock, $.03 par value.

The exhibit index is located on page 20.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
FORM 10-Q
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
STATEMENTS OF INCOME
(unaudited)

	Three Months Ended August 31, 2006	Three Months Ended August 31, 2005	Six Months Ended August 31, 2006	Six Months Ended August 31, 2005
Revenues				
Sales	$5,238,115	$5,109,738	$10,587,272	$ 9,141,268
Franchise and royalty fees	1,541,454	1,473,422	2,960,709	2,808,693
Total revenues	6,779,569	6,583,160	13,547,981	11,949,961
Costs and Expenses				
Cost of sales	3,166,734	3,017,913	6,503,129	5,415,512
Franchise costs	384,082	306,704	716,615	645,053
Sales and marketing	353,538	284,911	704,752	590,660
General and administrative	586,429	507,023	1,219,314	1,035,967
Retail operating	403,393	473,546	812,204	862,474
Depreciation and amortization	225,764	204,257	461,445	413,865
Total costs and expenses	5,119,940	4,794,354	10,417,459	8,963,531
Income from Operations	1,659,629	1,788,806	3,130,522	2,986,430
Other Income (Expense)				
Interest expense				(19,652)
Interest income	12,061	17,527	37,214	49,500
Total other, net	12,061	17,527	37,214	29,848
Income Before Income Taxes	1,671,690	1,806,333	3,167,736	3,016,278
Provision for Income Taxes	631,900	682,795	1,197,405	1,140,155
Net Income	$1,039,790	$1,123,538	$ 1,970,331	$ 1,876,123
Basic Earnings per Common Share	$ .17	$ .18	$ .32	$ .30
Diluted Earnings per Common Share	$ .17	$ .17	$ .31	$ .28
Weighted Average Common Shares Outstanding	6,079,077	6,270,974	6,153,611	6,218,478
Dilutive Effect of Stock Options	217,699	469,741	236,030	490,423
Weighted Average Common Shares Outstanding, Assuming Dilution	6,296,776	6,740,715	6,389,641	6,708,901

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

Table of Contents

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
BALANCE SHEETS

	August 31, 2006 (unaudited)	February 28, 2006
Assets		
Current Assets		
Cash and cash equivalents	$ 743,047	$ 3,489,750
Accounts receivable, less allowance for doubtful accounts of $42,567 and $46,920 respectively	3,219,064	3,296,690
Notes receivable	92,300	116,997
Inventories, less reserve for slow moving inventory of $78,120 and $61,032, respectively	4,141,334	2,938,234
Deferred income taxes	117,715	117,715
Other	486,895	481,091
Total current assets	8,800,355	10,440,477
Property and Equipment, Net	6,277,082	6,698,604
Other Assets		
Notes receivable, less valuation allowance of $52,005	241,930	278,741
Goodwill, net	1,133,751	1,133,751
Intangible assets, net	365,914	402,469
Other	166,196	103,438
Total other assets	1,907,791	1,918,399
Total assets	$16,985,228	$19,057,480
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 1,247,217	$ 1,145,410
Accrued salaries and wages	384,938	507,480
Other accrued expenses	932,668	750,733
Dividend payable	487,829	504,150
Total current liabilities	3,052,652	2,907,773
Deferred Income Taxes	663,889	663,889
Commitments and Contingencies		
Stockholders Equity		
Common stock, $.03 par value, 100,000,000 shares authorized, 6,080,307 and 6,281,920 issued and outstanding	182,409	188,458
Additional paid-in capital	7,167,013	10,372,530
Retained earnings	5,919,265	4,924,830
Total stockholders equity	13,268,687	15,485,818
Total liabilities and stockholders equity	$16,985,228	$19,057,480

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended August 31, 2006	Six Months Ended August 31, 2005
Cash Flows From Operating activities		
Net income	$ 1,970,331	$ 1,876,123
Adjustments to reconcile net income to net cash Provided by operating activities:		
Depreciation and amortization	461,445	413,865
Provision for obsolete inventory	30,000	15,000
(Gain) loss on sale of property and equipment	76,273	(1,390)
Expense recorded for stock options	201,269	
Changes in operating assets and liabilities:		
Accounts receivable	77,626	(361,266)
Refundable income taxes		364,630
Inventories	(1,233,100)	(1,023,726)
Other current assets	(3,596)	(257,965)
Accounts payable	101,807	(399,345)
Accrued liabilities	61,593	(287,274)
Net cash provided by operating activities	1,743,648	338,652
Cash Flows From Investing Activities		
Proceeds received on notes receivable	61,508	126,484
Proceeds from sale of assets	(16,012)	4,708
Purchases of property and equipment	(119,640)	(826,897)
Decrease in other assets	4,667	4,742
Net cash used in investing activities	(69,477)	(690,963)
Cash Flows From Financing Activities		
Payments on long-term debt		(1,665,084)
Repurchase and redemption of common stock	(3,764,914)	(245,995)
Dividends paid	(992,217)	(835,968)
Costs of stock dividend or stock split		(8,902)
Proceeds from exercise of stock options	336,257	868,859
Net cash used in financing activities	(4,420,874)	(1,887,090)
Net Decrease in Cash and Cash Equivalents	(2,746,703)	(2,239,401)
Cash and Cash Equivalents, Beginning of Period	3,489,750	4,438,876
Cash and Cash Equivalents, End of Period	$ 743,047	$ 2,199,475

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

5

Table of Contents

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Rocky Mountain Chocolate Factory, Inc. is an international franchiser, confectionery manufacturer and retail operator in the United States, Guam, Canada and the United Arab Emirates. The Company manufactures an extensive line of premium chocolate candies and other confectionery products. 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 and royalties from franchisees sales; and sales at Company-owned stores of chocolates and other confectionery products. The following table summarizes the number of RMCF stores at August 31, 2006:

	Sold, Not Yet Open	Open	Total
Company owned stores		7	7
Company owned kiosks			
Franchise stores Domestic stores	21	243	264
Franchise Stores Domestic kiosks	2	20	22
Franchise units International		36	36
	23	306	329

Basis of Presentation

The accompanying 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. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the 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. The results of operations for the six months ended August 31, 2006 are not necessarily indicative of the results to be expected for the entire fiscal year.

These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended February 28, 2006.

Stock-Based Compensation

At August 31, 2006, the Company had stock-based compensation plans for employees and nonemployee directors which authorized the granting of stock options.

Prior to March 1, 2006, the Company accounted for the plans under the measurement and recognition provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, permitted under Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). As a result, employee stock option-based compensation was included as a pro forma disclosure in the Notes to the Company s Financial Statements for prior year periods.

Effective March 1, 2006, the Company adopted the recognition provisions of Statement of Financial Accounting Standard No. 123R, Share-Based Payment (SFAS No. 123R), using the modified-prospective transition method. Under this transition method, compensation cost in 2006 includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested, as of March 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (2) all share-based payments

Table of Contents

NOTE 1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION CONTINUED

granted subsequent to March 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Results for the prior periods have not been restated.

The Company did not issue stock options and recorded $0 related equity-based compensation expense during the three and six month periods ended August 31, 2006. Compensation costs related to share-based compensation are generally amortized over the vesting period in selling, general and administrative expenses in the statement of operations.

On February 21, 2006, the Company accelerated the vesting of all outstanding stock options and recognized a share-based compensation charge related to this acceleration. The Company recognized an additional share-based compensation charge of $131,000 for the three months ended August 31, 2006 related to this acceleration due to changes in certain estimates and assumptions related to employee turnover since the acceleration date. Adjustments in future periods may be necessary as actual results could differ from these estimates and assumptions.

Prior to adopting SFAS No. 123R, the Company presented all benefits from tax deductions arising from equity-based compensation as a non-cash transaction in the Statement of Cash Flows. SFAS No. 123R requires that the tax benefits in excess of the compensation cost recognized for those exercised options be classified as cash provided by financing activities. No excess tax benefit was included in net cash provided by financing activities for the second quarter ended August 31, 2006.

The weighted-average fair value of stock options granted during the six-month periods ended August 31, 2006 and August 31, 2005 was $0 and $4.16 per share, respectively. As of August 31, 2006, there was $0 (before any related tax benefit) of unrecognized compensation cost related to non-vested share-based compensation that is expected to be recognized over the remainder of fiscal 2007.

	Three Months ended August 31,		Six Months Ended August 31,	
	2006	2005	2006	2005
Net Income as reported	$ 1,040	$ 1,124	$ 1,970	$ 1,876
Add: Stock-based compensation expense included in reported net income, net of tax				
Deduct: Stock-based compensation expense determined under fair value based method, net of tax		40		80
Net Income pro forma	1,040	1,084	1,970	1,796
Basic Earnings per Share-as reported	.17	.18	.32	.30
Diluted Earnings per Share-as reported	.17	.17	.31	.28
Basic Earnings per Share-pro forma	.17	.17	.32	.29
Diluted Earnings per Share-pro forma	.17	.16	.31	.27

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. For the three months ended August 31, 2006 and 2005, 146,560 and zero stock options, respectively, were excluded from the computation of earnings per share because their effect would have been anti-dilutive. For the six months ended August 31, 2006 and 2005, 141,940 and zero stock options, respectively, were excluded from the computation of earnings per share because their effect would have been anti-dilutive.

NOTE 3 INVENTORIES

Inventories consist of the following:

	August 31, 2006	February 28, 2006
Ingredients and supplies	$ 1,744,539	$ 1,507,193
Finished candy	2,396,795	1,431,041

	$4,141,334	$ 2,938,234

Table of Contents

NOTE 4 PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

	August 31, 2006	February 28, 2006
Land	$ 513,618	$ 513,618
Building	4,717,230	4,705,242
Machinery and equipment	6,296,229	6,252,011
Furniture and fixtures	752,745	817,137
Leasehold improvements	590,979	641,637
Transportation equipment	331,640	331,640
	13,202,441	13,261,285
Less accumulated depreciation	6,925,359	6,562,681
Property and equipment, net	$ 6,277,082	$ 6,698,604

NOTE 5 STOCKHOLDERS EQUITY

Stock Dividend

On February 15, 2005 the Board of Directors declared a 5 percent stock dividend payable on March 10, 2005 to shareholders of record as of February 28, 2005. Shareholders received one additional share of Common Stock for every twenty shares owned prior to the record date. Subsequent to the dividend there were 4,602,135 shares outstanding.

Stock Split

On May 18, 2005 the Board of Directors approved a four-for-three stock split payable June 13, 2005 to shareholders of record at the close of business on May 31, 2005. Shareholders received one additional share of common stock for every three shares owned prior to the record date. Immediately prior to the split there were 4,639,244 shares outstanding. Subsequent to the split there were 6,186,007 shares outstanding.

All share and per share data have been restated in all years presented to give effect to the stock dividends and stock splits.

Stock Repurchases

Between June 30, 2006 and August 25, 2006 the Company repurchased 42,699 shares at an average price of $13.63 per share. Between March 24, 2006 and May 18, 2006 the Company repurchased 224,213 shares at an average price of $14.20 per share. Between October 7, 2005 and February 3, 2006 the Company repurchased 176,599 Company shares at an average price of $15.36 per share. Between April 18 and April 20, 2005 the Company repurchased 17,647 shares at an average price of $13.94 per share. Between March 11, 2004 and June 14, 2004 the Company repurchased 125,216 Company shares at an average price of $6.74 per share.

Cash Dividend

The Company paid a quarterly cash dividend of $0.08 per common share on March 16, 2006 and June 16, 2006 to shareholders of record on March 8, 2006 and June 2, 2006, respectively. On August 16, 2006 the Company declared a quarterly cash dividend of $0.08 per common share payable on September 15, 2006 to shareholders of record on September 1, 2006.

The Company paid a quarterly cash dividend of $0.0675 per common share on March 16, 2005, June 16, 2005 and September 16, 2005 to shareholders of record on March 11, 2005, June 3, 2005 and September 1, 2005 respectively. The Company paid a quarterly cash dividend of $0.07 per common share on December 16, 2005 to shareholders of record on December 1, 2005.

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.

Table of Contents

NOTE 6 SUPPLEMENTAL CASH FLOW INFORMATION

	Six Months Ended August 31, 2006	Six Months Ended August 31, 2005
Cash paid (received) for:		
Interest	$	$ 19,872
Income taxes	1,060,033	362,166
Non-Cash Financing Activities		
Dividend Payable	$ (16,321)	$ 13,151
Issue stock for services	(15,822)	
Fair value of assets received upon settlement of note and accounts receivable		
Store to be operated	$	$200,000
Inventory		3,815
Note receivable		153,780

NOTE 7 OPERATING SEGMENTS

The Company classifies its business interests into two reportable segments: Franchising and Manufacturing. The Company s retail stores provide an environment for testing consumer behavior, various pricing strategies, new products and promotions, operating and training methods and merchandising techniques. All Company-owned retail stores are evaluated by management in relation to their contribution to franchising efforts and are included in the Franchising segment. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in 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, 2006. 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 August 31, 2006	Franchising	Manufacturing	Other	Total
Total revenues	$2,272,393	$ 4,979,486	$	$ 7,251,879
Intersegment revenues		(472,310)		(472,310)
Revenue from external customers	2,272,393	4,507,176		6,779,569
Segment profit (loss)	791,766	1,468,867	(588,943)	1,671,690
Total assets	2,735,143	10,979,924	3,270,161	16,985,228
Capital expenditures	9,739	48,098	6,805	64,642
Total depreciation & amortization	61,185	110,954	53,625	225,764
Three Months Ended August 31, 2005				
Total revenues	$2,289,054	$ 4,727,268	$	$ 7,016,322
Intersegment revenues		(433,162)		(433,162)
Revenue from external customers	2,289,054	4,294,106		6,583,160
Segment profit (loss)	899,964	1,435,248	(528,879)	1,806,333
Total assets	3,092,933	10,386,916	4,996,868	18,476,717
Capital expenditures	12,720	250,918	138,957	402,595
Total depreciation & amortization	68,345	97,438	38,474	204,257

9

Table of Contents

NOTE 7 OPERATING SEGMENTS CONTINUED

Six Months Ended August 31, 2006	Franchising	Manufacturing	Other	Total
Total revenues	$ 4,335,243	$ 10,133,365	$	$ 14,468,608
Intersegment revenues		(920,627)		(920,627)
Revenue from external customers	4,335,243	9,212,738		13,547,981
Segment profit (loss)	1,468,125	2,917,685	(1,218,074)	3,167,736
Total assets	2,735,143	10,979,924	3,270,161	16,985,228
Capital expenditures	22,803	71,811	25,026	119,640
Total depreciation & amortization	123,687	225,451	112,307	461,445
Six Months Ended August 31, 2005				
Total revenues	$ 4,266,084	$ 8,457,943	$	$ 12,724,027
Intersegment revenues		(774,066)		(774,066)
Revenue from external customers	4,266,084	7,683,877		11,949,961
Segment profit (loss)	1,607,943	2,507,267	(1,098,932)	3,016,278
Total assets	3,092,933	10,386,916	4,996,868	18,476,717
Capital expenditures	83,602	544,577	198,718	826,897
Total depreciation & amortization	128,019	194,379	91,467	413,865

NOTE 8 GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following:

		August 31, 2006		February 28, 2006	
	Amortization Period	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Intangible assets subject to amortization					
Store design	10 Years	$ 205,777	95,648	$ 205,777	$ 85,093
Packaging licenses	3-5 Years	120,830	101,664	120,830	99,164
Packaging design	10 Years	430,973	194,354	430,973	170,854
Total		757,580	391,666	757,580	355,111
Intangible assets not subject to amortization					
Franchising segment-					
Company stores goodwill		1,275,962	336,847	1,275,962	336,847
Franchising goodwill		295,000	197,682	295,000	197,682
Manufacturing segment-Goodwill		295,000	197,682	295,000	197,682
Total Goodwill		1,865,962	732,211	1,865,962	732,211
Total intangible assets		$2,623,542	$1,123,877	$2,623,542	$1,087,322

Amortization expense related to intangible assets totaled $36,555 and $36,346 during the six months ended August 31, 2006 and 2005, respectively. The aggregate estimated amortization expense for intangible assets remaining as of

August 31, 2006 is as follows:

Remainder of fiscal 2007	$ 36,600
2008	73,100
2009	73,100
2010	73,100
2011	64,400
Thereafter	45,614
Total	$365,914

NOTE 9 STORE PURCHASE

Effective May 1, 2005 the Company financed a note in the amount of $153,780 and took possession of a previously financed franchise store and related inventory in satisfaction of $357,595 of notes and accounts receivable. The Company currently intends to retain and operate the store.

Table of Contents

NOTE 10 RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross versus Net Presentation). Taxes within the scope of EITF Issue No. 06-3 include any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales taxes, use taxes, value-added taxes, and some excise taxes. The EITF concluded that the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements. The