

thatstockguy.NET

RMCF – Rocky Mountain Chocolate Factory

12/29/2008

WRITER: SIMON GIANNAKIS

Disclaimer & Disclosure: Please review our policy as outlined on our website thatstockguy.NET. As well note, the writer of the article and his direct family members do not currently hold a financial position in RMCF.

Intended Audience

Personal investors looking for steady dividend income and capital growth in the long run.

Summary Points to Take Away

- Current dividend yield is 7.3%, 21 consecutive quarters with a dividend. In order to bring the yield down to the S&P 500 historical yield of 2.5% - share price would have to appreciate to \$16.
- Strong cash production – CFO over last 4 quarters has been \$0.94, significant given that current share price is \$5.50.
- Majority of the stores are owned by the franchisee, translates into lower working capital requirements and less risk in instances of store failures for shareholders.
- Inexpensive forward P/E estimated at 7.4X earnings.
- No liquidity or solvency issues, important given the current state of lending practices
- Management is focused on rewarding the shareholders through dividends and stock buybacks.

Analysis

Rocky Mountain Chocolate Factory, Inc. is an international franchiser and confectionery manufacturer. Headquartered in Durango, CO, it manufactures an extensive line of premium chocolate candies and other confectionery products. The Company's revenues are 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.

High Dividend Yield

RMCF has paid out a dividend for 21 consecutive quarters (i.e. just over 5 years), which is an impressive track record that solidifies the stability of this dividend. Currently yielding 7.3% based on a share price of \$5.50 (market price at the time of this article), \$0.10 quarterly dividend. RMCF generates significant income returns to investors based on the current stock price. In order to bring the yield down to the S&P 500 historical yield of 2.5% - current share price would have to appreciate to \$16. Investors should keep a close eye on the dividend for the next quarter or two as RMCF is running on a low cash balance (Q2 2009 had \$400k in cash, while amount to be paid out in dividends for the quarters are \$600k); thus, not much room for error if RMCF were to run into consecutive quarters where CFO was negative. Overall this is not a critical concern as the business is producing cash – see below for Cash Flow analysis.

Making Cash

RMCF continues to produce strong levels of CFO, during last four quarters (Q2 2009 back to Q3 2008) – CFO of \$0.94 has been produced per share (making up 17% of the share price – assuming it is \$5.50). Strong performance considering Q2 was on the weaker side as CFO was only \$29k – but that was due to \$500k being paid off in short term debt; thus, was a good use of excess cash – which will not continue to eat up cash in the future as amount left as drawn down on their credit facility as of Q2 2008 was only \$150k. Given that RMCF only owns a fraction of the retail outlets – significant capital expenditures don't drain on the companies available CFO; thus, more cash to be distributed out to investors.

Franchisors Own the Majority of Stores

Based on theoretical franchise model – in most situations the patsy in the franchiser/franchisee relationship is the franchisee as they take on all the risk of making the retail outlet work and if performance is strong – the franchiser takes a big cut of it (ex. Royalties, purchasing RMCF goods, etc). In RMCF's situation – given that very few of the corporate stores/kiosks are corporate own, this bodes well for investors as they too take on less risk than if the company owned the retail stores themselves and instead profit off the hard work of the franchisees. Currently RMCF only owns 5 stores/kiosks out of 339 total retail outlets; thus, don't have a lot of cash tied up in lease deposits, furniture and fixtures, etc, which means more cash left over for the shareholders. Basically it comes down to – if the store goes bankrupt, franchisee suffers most of the loss, while if the store succeeds both the franchiser and franchisee receive some of the value created, so mostly upside for RMCF and their shareholders.

Inexpensive forward P/E

Next 4 quarters EPS will likely resemble that of the past 4 quarters due to the counterbalancing effect of 10 new franchises having been sold, but not opened as of Q2 2009 versus the fact that RMCF retail outlets are geared towards tourism (based on store location); thus, are cyclical in nature. Given present economic times that North American finds themselves in – individual store sales will likely suffer; thus, less cash flowing to RMCF. Based on the performance of the last 4 quarters – expected forward P/E is 7.4X earnings. Watch earnings – specifically Q3 2009, which would have entirely occurred during the low point of the current recession thus far – management indicated during the Q2 MD&A that slowing of the economy would be an issue.

No Liquidity Issues

Given the present rising costs of borrowing money – it's nice to see a company that has a sound financial structure in place. RMCF has no liquidity or solvency issues – short term liquidity seems intact given that it has a current ratio of 3.1 and current assets to total liabilities of 2.5. As well solvency shouldn't be a problem as RMCF has a \$5M credit line – which as of Q2 2009 only \$150k had been drawn down against. To put this credit line in perspective – based on current availability, there is enough cash for 8 quarters worth of dividends without considering contributions from operations.

Management Focuses on Rewarding Shareholders

Based on management's presentation during the earnings conference calls as well as their actions through consistent dividends and stock buybacks, management is focused on running a strong company as well as rewarding shareholders at the same time. In the past 4 quarters (ending Q2 2009) – RMCF has bought \$4.6M worth of shares, which reduces the shares outstanding and increases each investors effective stake in the company. Reason that operating cash runs low is management is focused on payout out a quarterly dividend as well as buying back shares to provide investors with not only income from the dividends, but capital gains from share appreciation. This is an important trait for a company's management to have as earnings can be squandered away on bad acquisitions, etc.

Where to go from here?

Overall based on the risks – may want to wait till Q3 results are reported to see if the company appears to be on pace to maintain its quarterly dividend of \$0.10 per share, but follow this stock closely. Rocky Mountain Chocolate Factory is a publicly traded company, ticker symbol is RMCF listed on the Nasdaq. Please consult your personal broker or financial planner before undertaking any investment activities.

Would love to hear your feedback – contact thatstockguy.NET@gmail.com .

Thanks,

Simon

Simon Giannakis is the founder and creator of thatstockguy.NET. He currently is a Senior Accountant within the Assurance and Advisory group at Deloitte & Touche LLP in Toronto, Ontario. He has a BBA degree from Wilfrid Laurier University and is currently pursuing both CA and CFA designations. Simon can be contacted through thatstockguy.net@gmail.com



thatstockguy.NET

