

ROCKY MOUNTAIN CHOCOLATE FACTORY INC  
Form 10-K  
May 24, 2011

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

(Mark One)

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

For the fiscal year ended February 28, 2011

OR

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)

Securities Registered Pursuant To Section 12(b) Of The Act:

Title of each class	Name of each exchange on which registered
Common Stock \$.03 Par Value per Share	The NASDAQ Stock Market LLC
Preferred Stock Purchase Rights	The NASDAQ Stock Market LLC

Securities Registered Pursuant To Section 12(g) Of The Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes  No

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

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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 (§ 229.405 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(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 Act). Yes  No

On April 30, 2011, there were 6,073,976 shares of Common Stock outstanding. The aggregate market value of the Common Stock (based on the closing price as quoted on the Nasdaq Market on August 31, 2010) held by non-affiliates was \$36,036,701. For purposes of this calculation, shares of common stock held by each executive officer and director and by holders of more than 5% of the outstanding common stock have been excluded since those persons may under certain circumstances be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement furnished to stockholders in connection with the 2011 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference in Part III of this Report. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the close of the registrant's fiscal year ended February 28, 2011.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.  
FORM 10-K

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### Cautionary Note Regarding Forward Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These forward-looking statements involve various risks and uncertainties. The nature of our operations and the environment in which we operate subject us to changing economic, competitive, regulatory and technological conditions, risks and uncertainties. The statements, other than statements of historical fact, included in this report are forward-looking statements. Many of the forward-looking statements contained in this document may be identified by the use of forward-looking words such as “will,” “intend,” “believe,” “expect,” “anticipate,” “should,” “plan,” “estimate” and “potential,” or similar expressions. Factors which could cause results to differ include, but are not limited to: changes in the confectionery business environment, seasonality, consumer interest in our products, general economic conditions, 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 this report in Item 1A. These forward-looking statements apply only as of the date of this report. As such they should not be unduly relied upon for more current circumstances. 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.

## PART I.

### ITEM 1. BUSINESS

#### General

Founded in 1981 and incorporated in Colorado in 1982, Rocky Mountain Chocolate Factory, Inc. (the “Company”, and sometimes referred to herein with the pronouns “we,” “us,” or “our”) is an international franchisor and confectionery manufacturer. We are headquartered in Durango, Colorado and manufacture an extensive line of premium chocolate candies and other confectionery products. As of March 31, 2011, there were 12 Company-owned, 42 licensee-owned and 302 franchised Rocky Mountain Chocolate Factory stores operating in 37 states, Canada, and the United Arab Emirates.

Aspen Leaf Yogurt, LLC (“ALY”), a wholly-owned subsidiary of the Company, was incorporated in Colorado as Aspen Leaf Yogurt, Inc. on September 30, 2010 and reorganized as Aspen Leaf Yogurt, LLC on October 14, 2010 with the Company as the sole founding member. ALY is a franchisor and retail operator of self serve frozen yogurt retail locations. Since its inception, ALY has been developing franchise-related documents, negotiating leases for retail locations, developing vendor relationships and other organizational activities. As of February 28, 2011 there was one ALY Company-owned location, as of March 31, 2011, there were three Company-owned Aspen Leaf Yogurt stores operating in three states.

Approximately 55% of the products sold at Rocky Mountain Chocolate Factory stores are prepared on the premises. We believe this in-store preparation creates a special store ambiance, and the aroma and sight of products being made attracts foot traffic and assures customers that products are fresh.

Our principal competitive strengths lie in our brand name recognition, our reputation for the quality, variety and taste of our products, the special ambiance of our stores, our knowledge and experience in applying criteria for selection of new store locations, our expertise in the manufacture of chocolate candy products and the merchandising and marketing of chocolate and other candy products, and the control and training infrastructures we have implemented to assure consistent customer service and execution of successful practices and techniques at our stores.

We believe our manufacturing expertise and reputation for quality has facilitated the sale of selected products through specialty markets. We are currently selling our products in a select number of specialty markets including wholesaling, fundraising, corporate sales, mail order and internet sales.

Our revenues are currently derived from three principal sources: (i) sales to franchisees and other third parties of chocolates and other confectionery products manufactured by us (69-71-72%); (ii) sales at Company-owned stores of chocolates and other confectionery products (including products manufactured by us) (12-10-7%) and (iii) the collection of initial franchise fees and royalties from franchisees (19-19-21%). Our revenues are derived from domestic (97-97-97%) and international (3-3-3%) sources. The figures in parentheses show the percentage of total revenues attributable to each source for fiscal years ended February 28, 2011, 2010 and 2009, respectively.

According to the National Confectioners Association, the total U.S. candy market approximated \$29.3 billion of retail sales in 2009 with chocolate generating sales of approximately \$16.9 billion. According to the Department of Commerce, per capita consumption of chocolate in 2009 was approximately 14 pounds per year nationally and was approximately unchanged when compared to 2008

### Business Strategy

Our objective is to build on our position as a leading international franchisor and manufacturer of high quality chocolate and other confectionery products. We continually seek opportunities to profitably expand our business. To accomplish this objective, we employ a business strategy that includes the following elements:

### Product Quality and Variety

We maintain gourmet taste and quality of our chocolate candies by using only the finest chocolate and other wholesome ingredients. We use our own proprietary recipes, primarily developed by our master candy makers. A typical Rocky Mountain Chocolate Factory store offers up to 100 of our chocolate candies throughout the year and as many as 200, including many packaged candies, during the holiday seasons. Individual stores also offer numerous varieties of premium fudge and gourmet caramel apples, as well as other products prepared in the store from Company recipes.

### Store Atmosphere and Ambiance

We seek to establish an enjoyable and inviting atmosphere in each of our stores. Each store prepares numerous products, including fudge, barks and caramel apples, in the store. In-store preparation is designed both to be fun and entertaining for customers and to convey an image of freshness and homemade quality. Our design staff has developed easily replicable designs and specifications to ensure that the Rocky Mountain Chocolate Factory concept is consistently implemented at each store.

We have evaluated and updated our store design from our original Victorian concept to a more contemporary design, through our own testing and the input of a nationally recognized design firm. The objective of store design is threefold: (1) increase average revenue per unit thereby opening untapped real estate environments; (2) further emphasize the entertainment and freshness value of our in-store confectionery factory; and (3) improve operational efficiency through optimal store layout. Nearly all domestic stores in operation incorporate elements of the new design.

### Site Selection



Careful selection of a site is critical to the success of our stores. We consider many factors in identifying suitable sites, including tenant mix, visibility, attractiveness, accessibility, level of foot traffic and occupancy costs. Final site selection occurs only after our senior management has approved the site. We believe that the experience of our management team in evaluating a potential site is one of our competitive strengths.

#### Customer Service Commitment

We emphasize excellence in customer service and seek to employ and to sell franchises to motivated and energetic people. We also foster enthusiasm for our customer service philosophy and the Rocky Mountain Chocolate Factory concept through our bi-annual franchisee convention, regional meetings and other frequent contacts with our franchisees.

### Increase Same Store Retail Sales at Existing Locations

We seek to increase profitability of our store system through increasing sales at existing store locations. Changes in system wide domestic same store retail sales are as follows:

2007	0.3	%
2008	(0.9)	%
2009	(5.4)	%
2010	(2.9)	%
2011	0.6	%

We believe that the negative trend in FY 2008, FY 2009 and FY 2010 was due to the global economic recession that significantly impacted retailing, in general, and regional shopping mall customer traffic, in particular, throughout the United States during all of 2008, 2009 and the first three quarters of FY 2010 resulting in the worst economic and retail environment in our history. We experienced a decrease in same store sales of (6.7%) in our fiscal first quarter of 2010 followed by decreases in same store sales of (4.6%) and (3.2%) in our fiscal second and third quarters and an increase of 1.4% in our fiscal fourth quarter of 2010 compared with the same periods in FY 2009. The negative trend reversed slightly in FY 2011 and we experienced a 0.6% increase in same store sales though we still believe that the retail environment will continue to be challenging and has not significantly recovered from the effects of the economic environment.

We have designed a contemporary and coordinated line of packaged products that capture and convey the freshness, fun and excitement of the Rocky Mountain Chocolate Factory retail store experience. We also believe that the successful launch of new packaging has had a positive impact on same store sales.

### Increase Same Store Pounds Purchased by Existing Locations

In FY 2011, same store pounds purchased by franchisees decreased 0.6% compared to the prior fiscal year. We continue to add new products and focus our existing product lines in an effort to increase same store pounds purchased by existing locations. We believe the decrease in same store pounds purchased was due in part to a product mix shift from factory-made products to products made in the store such as caramel apples and we believe the decline in same store pounds purchased contrary to the slight increase in same store sales is primarily a result of the United States recession and the resulting financial pressure the recession has created for our system of franchise-owned stores.

### Enhanced Operating Efficiencies

We seek to improve our profitability by controlling costs and increasing the efficiency of our operations. Efforts in the last several years include: the purchase of additional automated factory equipment, implementation of a comprehensive Advanced Planning and Scheduling (APS) system, implementation of alternative manufacturing strategies and installation of enhanced Point-of-Sale (POS) systems in all of our Company-owned and 166 of our franchised stores through March 31, 2011. These measures have significantly improved our ability to deliver our products to our stores safely, quickly and cost-effectively and impact store operations.

### Expansion Strategy

We are continually exploring opportunities to grow our brand and expand our business. Key elements of our expansion strategy include:

### Unit Growth

The cornerstone of our growth strategy is to aggressively pursue unit growth opportunities in locations where we have traditionally been successful, to pursue new and developing real estate environments for franchisees which appear promising based on early sales results, and to improve and expand the retail store concept, such that previously untapped and unfeasible environments (such as most regional centers) generate sufficient revenue to support a successful Rocky Mountain Chocolate Factory location.

#### High Traffic Environments

We currently establish franchised stores in the following environments: outlet centers, tourist environments, regional centers, street fronts, airports and other entertainment-oriented environments. Over the last several years, we have had a particular focus on regional center locations. We are optimistic that our exciting store design will allow us to

continue targeting the over 1,400 regional centers in the United States. We have established a business relationship with most of the major developers in the United States and believe that these relationships provide us with the opportunity to take advantage of attractive sites in new and existing real estate environments.

#### Name Recognition and New Market Penetration

We believe the visibility of our stores and the high foot traffic at many of our locations has generated strong name recognition of Rocky Mountain Chocolate Factory and demand for our franchises. The Rocky Mountain Chocolate Factory system has historically been concentrated in the western and Rocky Mountain region of the United States, but recent growth has generated a gradual easterly momentum as new stores have been opened in the eastern half of the country. This growth has further increased our name recognition and demand for our franchises. Distribution of Rocky Mountain Chocolate Factory products through specialty markets also increases name recognition and brand awareness in areas of the country in which we have not previously had a significant presence. We believe that by distributing selected Rocky Mountain Chocolate Factory products through specialty markets increases our name brand recognition and will improve and benefit our entire store system.

We seek to establish a fun and inviting atmosphere in our Rocky Mountain Chocolate Factory store locations. Unlike most other confectionery stores, each Rocky Mountain Chocolate Factory store prepares certain products, including fudge and caramel apples, in the store. Customers can observe store personnel making fudge from start to finish, including the mixing of ingredients in old-fashioned copper kettles and the cooling of the fudge on large granite or marble tables, and are often invited to sample the store's products. An average of approximately 55% of the revenues of franchised stores is generated by sales of products prepared on the premises. We believe the in-store preparation and aroma of our products enhance the ambiance at Rocky Mountain Chocolate Factory stores, are fun and entertaining for our customers and convey an image of freshness and homemade quality.

To ensure that all stores conform to the Rocky Mountain Chocolate Factory image, our design staff provides working drawings and specifications and approves the construction plans for each new store. We also control the signage and building materials that may be used in the stores.

In FY 2002, we launched our revised store design concept intended specifically for high foot traffic regional shopping centers. The revised store design concept is modern with crisp and clean site lines and an even stronger emphasis on our unique upscale kitchen. We are requiring that all new Rocky Mountain Chocolate Factory stores incorporate the revised store design concept. We also require that key elements of the revised store design concept be incorporated into existing store design upon renewal of the Franchise Agreement, or transfer in store ownership.

The average store size is approximately 1,000 square feet, approximately 650 square feet of which is selling space. Most stores are open seven days a week. Typical hours are 10 a.m. to 9 p.m., Monday through Saturday, and 12 noon to 6 p.m. on Sundays. Store hours in tourist areas may vary depending upon the tourist season.

On January 26, 2007, we began testing co-branded locations with a variety of strategic partners. Co-branding a location is a potential vehicle to possibly exploit retail environments that would not typically support a stand alone Rocky Mountain Chocolate Factory store. Co-branding can also be used to more efficiently manage rent structure, payroll and other operating costs in environments that have not historically supported stand alone Rocky Mountain Chocolate Factory stores. Our co-branded partner's franchisees currently operate 49 locations.

We are still in the testing and evaluation stage of our co-branding strategy and believe that if this strategy proves financially viable it could represent a significant future growth opportunity for us.

#### Products and Packaging

We produce approximately 300 chocolate candies and other confectionery products, using proprietary recipes developed primarily by our master candy makers. These products include many varieties of clusters, caramels, creams, mints and truffles. We continue to engage in a major effort to expand our product line by developing additional exciting and attractive new products. During the Christmas, Easter and Valentine's Day holiday seasons, we may make as many as 100 additional items, including many candies offered in packages specially designed for the holidays. A typical Rocky Mountain Chocolate Factory store offers up to 100 of these candies throughout the year and up to an additional 100 during holiday seasons. Individual stores also offer more than 15 premium fudges and other products prepared in the store. On

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average, approximately 40% of the revenues of Rocky Mountain Chocolate Factory stores are generated by products manufactured at our factory, 55% by products made in individual stores using our recipes and ingredients purchased from us or approved suppliers and the remaining 5% by products, such as ice cream, coffee and other sundries, purchased from approved suppliers.

We use only the finest chocolates, nut meats and other wholesome ingredients in our candies and continually strive to offer new confectionery items in order to maintain the excitement and appeal of our products. We develop special packaging for the Christmas, Valentine's Day and Easter holidays, and customers can have their purchases packaged in decorative boxes and fancy tins throughout the year.

Chocolate candies that we manufacture are sold at prices ranging from \$16.50 to \$30.00 per pound, with an average price of \$19.43 per pound. Franchisees set their own retail prices, though we do recommend prices for all of our products.

### Operating Environment

We currently establish Rocky Mountain Chocolate Factory stores in six primary environments: regional centers, tourist areas, outlet centers, street fronts, airports and other entertainment-oriented shopping centers. Each of these environments has a number of attractive features, including high levels of foot traffic. Rocky Mountain Chocolate Factory domestic franchise locations in operation as of February 28, 2011 include:

Regional Centers	25.4	%
Outlet Centers	23.0	%
Festival/Community Centers	19.4	%
Tourist Areas	15.7	%
Street Fronts	8.9	%
Airports	4.4	%
Other	3.2	%

### Regional Centers

As of February 28, 2011, there were Rocky Mountain Chocolate Factory stores in approximately 63 regional centers, including a location in the Mall of America in Bloomington, Minnesota. Although often providing favorable levels of foot traffic, regional centers typically involve more expensive rent structures and competing food and beverage concepts. Our existing store concept is designed to unlock the potential of the regional center environment.

### Outlet Centers

We have established business relationships with most of the major outlet center developers in the United States. Although not all factory outlet centers provide desirable locations for our stores, management believes that our relationships with these developers will provide us with the opportunity to take advantage of attractive sites in new and existing outlet centers.

### Tourist Areas, Street Fronts and Other Entertainment-Oriented Shopping Centers

As of February 28, 2011, there were approximately 39 Rocky Mountain Chocolate Factory stores in locations considered to be tourist areas, including Fisherman's Wharf in San Francisco, California and the Riverwalk in San Antonio, Texas. Tourist areas are very attractive locations because they offer high levels of foot traffic and favorable

customer spending characteristics, and greatly increase our visibility and name recognition. We believe significant opportunities exist to expand into additional tourist areas with high levels of foot traffic.

#### Other Environments

We believe there are a number of other environments that have the characteristics necessary for the successful operation of Rocky Mountain Chocolate Factory stores such as airports and sports arenas. Thirteen franchised Rocky Mountain Chocolate Factory stores exist at airport locations: two at Atlanta International (Hartsfield-Jackson), two at Denver International Airport, one at Charlotte International Airport, two at Chicago O'Hare International Airport; one at Houston George Bush Intercontinental Airport, one at Minneapolis International Airport, one at Salt Lake City International Airport, one at Dallas Fort Worth International Airport; one at Edmonton International Airport, and one at Toronto Pearson International Airport.

## Franchising Program

### General

Our franchising philosophy is one of service and commitment to our franchise system, and we continuously seek to improve our franchise support services. Our concept has consistently been rated as an outstanding franchise opportunity by publications and organizations rating such opportunities. In January 2011, Rocky Mountain Chocolate Factory was rated the number one franchise opportunity in the candy category by Entrepreneur Magazine. As of March 31, 2011, there were 302 franchised stores in the Rocky Mountain Chocolate Factory system.

### Franchisee Sourcing and Selection

The majority of new franchises are awarded to persons referred by existing franchisees, to interested consumers who have visited Rocky Mountain Chocolate Factory stores and to existing franchisees. We also advertise for new franchisees in national and regional newspapers as suitable potential store locations come to our attention. Franchisees are approved by us on the basis of the applicant's net worth and liquidity, together with an assessment of work ethic and personality compatibility with our operating philosophy.

In FY 1992, we entered into a franchise development agreement covering Canada with Immaculate Confections, Ltd. of Vancouver, British Columbia. Pursuant to this agreement, Immaculate Confections purchased the exclusive right to franchise and operate Rocky Mountain Chocolate Factory stores in Canada. As of March 31, 2011, Immaculate Confections operated 52 stores under this agreement.

In FY 2000, we entered into a franchise development agreement covering the Gulf Cooperation Council States of United Arab Emirates, Qatar, Bahrain, Saudi Arabia, Kuwait and Oman with Al Muhairy Group of United Arab Emirates. Pursuant to this agreement, Al Muhairy Group purchased the exclusive right to franchise and operate Rocky Mountain Chocolate Factory stores in the Gulf Cooperation Council States. As of March 31, 2011, Al Muhairy Group operated 4 stores under this agreement.

On August 18, 2009, we entered into a definitive Master License Agreement with Kahala Franchise Corp. Under the terms of the agreement, select current and future Cold Stone Creamery franchise stores are anticipated to be co-branded with both the Rocky Mountain Chocolate Factory and the Cold Stone Creamery brands. Locations developed or modified under the agreement are subject to the approval of both parties. Locations developed or modified under the agreement will remain franchisees of Cold Stone Creamery and will be licensed to offer the Rocky Mountain Chocolate Factory brand. The agreement runs until the date upon which the last co-branded store ceases to be open for business or unless earlier terminated by an event of either party's default. As of March 31, 2011, Cold Stone Creamery franchisees operated 42 stores under this agreement.

### Training and Support

Each domestic franchisee owner/operator and each store manager for a domestic franchisee is required to complete a comprehensive training program in store operations and management. We have established a training center at our Durango headquarters in the form of a full-sized replica of a properly configured and merchandised Rocky Mountain Chocolate Factory store. Topics covered in the training course include our philosophy of store operation and management, customer service, merchandising, pricing, cooking, inventory and cost control, quality standards, record keeping, labor scheduling and personnel management. Training is based on standard operating policies and procedures contained in an operations manual provided to all franchisees, which the franchisee is required to follow by terms of the franchise agreement. Additionally, and importantly, trainees are provided with a complete orientation to our operations by working in key factory operational areas and by meeting with members of our senior management.



Our operating objectives include providing knowledge and expertise in merchandising, marketing and customer service to all front-line store level employees to maximize their skills and ensure that they are fully versed in our proven techniques.

We provide ongoing support to franchisees through our field consultants, who maintain regular and frequent communication with the stores by phone and by site visits. The field consultants also review and discuss with the franchisee, store operating results and provide advice and guidance in improving store profitability and in developing and executing store marketing and merchandising programs. We have developed a handbook containing a "pre-packaged" local store marketing plan, which allows franchisees to implement cost-effective promotional programs that have proven successful in other Rocky Mountain Chocolate Factory stores.

## Quality Standards and Control

The franchise agreement for Rocky Mountain Chocolate Factory franchisees requires compliance with our procedures of operation and food quality specifications and permits audits and inspections by us.

Operating standards for Rocky Mountain Chocolate Factory stores are set forth in operating manuals. These manuals cover general operations, factory ordering, merchandising, advertising and accounting procedures. Through their regular visits to franchised stores, our field consultants audit performance and adherence to our standards. We have the right to terminate any franchise agreement for non-compliance with our operating standards. Products sold at the stores and ingredients used in the preparation of products approved for on-site preparation must be purchased from us or from approved suppliers.

## The Franchise Agreement: Terms and Conditions

The domestic offer and sale of Rocky Mountain Chocolate Factory franchises is made pursuant to the Franchise Disclosure Document prepared in accordance with federal and state laws and regulations. States that regulate the sale and operation of franchises require a franchiser to register or file certain notices with the state authorities prior to offering and selling franchises in those states.

Under the current form of domestic Rocky Mountain Chocolate Factory and Aspen Leaf Yogurt franchise agreements, franchisees pay us (i) an initial franchise fee for each store, (ii) royalties based on monthly gross sales, and (iii) a marketing fee based on monthly gross sales. Franchisees are generally granted exclusive territory with respect to the operation of Rocky Mountain Chocolate Factory or Aspen Leaf Yogurt stores only in the immediate vicinity of their stores. Chocolate and yogurt products not made on the premises by franchisees must be purchased from us or approved suppliers. The franchise agreements require franchisees to comply with our procedures of operation and food quality specifications, to permit inspections and audits by us and to remodel stores to conform with standards then in effect. We may terminate the franchise agreement upon the failure of the franchisee to comply with the conditions of the agreement and upon the occurrence of certain events, such as insolvency or bankruptcy of the franchisee or the commission by the franchisee of any unlawful or deceptive practice, which in our judgment is likely to adversely affect the Rocky Mountain Chocolate Factory system. Our ability to terminate franchise agreements pursuant to such provisions is subject to applicable bankruptcy and state laws and regulations. See "Business - Regulation."

The agreements prohibit the transfer or assignment of any interest in a franchise without our prior written consent. The agreements also give us a right of first refusal to purchase any interest in a franchise if a proposed transfer would result in a change of control of that franchise. The refusal right, if exercised, would allow us to purchase the interest proposed to be transferred under the same terms and conditions and for the same price as offered by the proposed transferee.

The term of each franchise agreement is ten years, and franchisees have the right to renew for one additional ten-year term.

## Franchise Financing

We do not provide prospective franchisees with financing for their stores, but we have developed relationships with several sources of franchisee financing to whom we will refer franchisees. Typically, franchisees have obtained their own sources of such financing and have not required our assistance.

## Licensee Financing

During FY 2011, we began a program to finance the remodel costs of a select number of co-branded licensed Cold Stone Creamery locations. The financing was provided to existing Cold Stone Creamery franchisees that were required to meet a number of financial qualifications prior to approval. At February 28, 2011, approximately \$466,000 was included in notes receivable as a result of this program.

#### Company Store Program

As of March 31, 2011 there were 12 Company-owned Rocky Mountain Chocolate Factory stores and 3 Company-owned Aspen Leaf Yogurt stores. Company-owned stores provide a training ground for Company-owned store personnel and district managers and a controllable testing ground for new

products and promotions, operating and training methods and merchandising techniques, which may then be incorporated into the franchise store operations.

Managers of Company-owned stores are required to comply with all Company operating standards and undergo training and receive support from us similar to the training and support provided to franchisees. See "Franchising Program-Training and Support" and "Franchising Program-Quality Standards and Control."

#### Manufacturing Operations

#### General