

ROCKY MOUNTAIN CHOCOLATE FACTORY INC  
Form 10-Q  
October 14, 2011

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 August 31, 2011

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, 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 (§ 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 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="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

(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  X

On September 30, 2011, the registrant had outstanding 6,126,007 shares of its common stock, \$.03 par value.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARY  
FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

|  | Three Months Ended August 31,<br>2011 | 2010        | Six Months Ended August 31,<br>2011 | 2010         |
|--|---------------------------------------|-------------|-------------------------------------|--------------|
| <b>Revenues</b>  |                                       |             |                                     |              |
| Sales  | \$6,003,619                           | \$5,126,923 | \$13,214,105                        | \$11,354,217 |
| Franchise and royalty fees   | 1,572,169                             | 1,499,341   | 2,999,607                           | 2,887,385    |
| Total revenues   | 7,575,788                             | 6,626,264   | 16,213,712                          | 14,241,602   |
| <b>Costs and Expenses</b>  |                                       |             |                                     |              |
| Cost of sales, exclusive of depreciation and amortization expense of \$69,154, \$82,302, \$138,565 and \$165,722, respectively | 3,577,614                             | 3,077,445   | 8,210,886                           | 7,126,343    |
| Franchise costs  | 514,826                               | 353,227     | 921,700                             | 713,297      |
| Sales and marketing  | 384,911                               | 358,794     | 825,130                             | 748,238      |
| General and administrative   | 717,036                               | 644,584     | 1,456,592                           | 1,312,355    |
| Retail operating   | 787,444                               | 579,670     | 1,638,550                           | 1,122,149    |
| Depreciation and amortization  | 190,261                               | 172,885     | 359,166                             | 341,342      |
| Total costs and expenses   | 6,172,092                             | 5,186,605   | 13,412,024                          | 11,363,724   |
| Income from Operations   | 1,403,696                             | 1,439,659   | 2,801,688                           | 2,877,878    |
| Interest Income  | 13,972                                | 16,138      | 30,859                              | 25,065       |
| Income Before Income Taxes   | 1,417,668                             | 1,455,797   | 2,832,547                           | 2,902,943    |
| Provision for Income Taxes   | 506,115                               | 512,155     | 1,001,335                           | 1,027,700    |
| Net Income   | \$911,553                             | \$943,642   | \$1,831,212                         | \$1,875,243  |
| Basic Earnings per Common Share  | \$.15                                 | \$.16       | \$.30                               | \$.31        |
| Diluted Earnings per Common Share  | \$.14                                 | \$.15       | \$.29                               | \$.30        |
| <b>Weighted Average Common Shares</b>  |                                       |             |                                     |              |
| Outstanding  | 6,105,744                             | 6,044,048   | 6,091,179                           | 6,037,015    |
| Dilutive Effect of Stock Options   | 193,419                               | 243,457     | 211,294                             | 232,772      |
| Weighted Average Common Shares Outstanding, Assuming Dilution  | 6,299,163                             | 6,287,505   | 6,302,473                           | 6,269,787    |

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS

|   | August 31,<br>2011<br>(unaudited) | February 28,<br>2011 |
|---|-----------------------------------|----------------------|
| Assets  |                                   |                      |
| Current Assets  |                                   |                      |
| Cash and cash equivalents   | \$4,065,000                       | \$3,344,490          |
| Accounts receivable, less allowance for doubtful accounts of \$464,572 and \$376,319 respectively     | 3,646,297                         | 4,823,257            |
| Notes receivable, current portion   | 374,269                           | 370,635              |
| Refundable income taxes   | 83,067                            | 119,888              |
| Inventories, less reserve for slow moving inventory of \$239,995 and \$246,631 respectively           | 4,591,961                         | 4,124,188            |
| Deferred income taxes   | 407,917                           | 445,194              |
| Other   | 413,762                           | 279,335              |
| Total current assets  | 13,582,273                        | 13,506,987           |
| Property and Equipment, Net   | 6,714,092                         | 6,275,406            |
| Other Assets  |                                   |                      |
| Notes receivable, less current portion and valuation allowance of \$25,000 and \$14,000, respectively | 436,868                           | 467,431              |
| Goodwill, net   | 1,046,944                         | 1,046,944            |
| Intangible assets, net  | 37,783                            | 59,218               |
| Other   | 103,416                           | 82,822               |
| Total other assets  | 1,625,011                         | 1,656,415            |
| Total assets  | \$21,921,376                      | \$21,438,808         |
| Liabilities and Stockholders' Equity  |                                   |                      |
| Current Liabilities   |                                   |                      |
| Accounts payable  | \$1,215,713                       | \$1,540,930          |
| Accrued salaries and wages  | 579,245                           | 547,539              |
| Other accrued expenses  | 686,479                           | 718,814              |
| Dividend payable  | 612,523                           | 606,998              |
| Deferred income   | 220,719                           | 261,410              |
| Total current liabilities   | 3,314,679                         | 3,675,691            |
| Deferred Income Taxes   | 1,043,102                         | 1,109,002            |
| Commitments and Contingencies   |                                   |                      |
| Stockholders' Equity  |                                   |                      |
| 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, 6,126,007 and 6,069,976 issued and outstanding | 183,780      | 182,099      |
| Additional paid-in capital   | 8,357,590    | 8,060,041    |
| Retained earnings  | 9,022,225    | 8,411,975    |
| Total stockholders' equity   | 17,563,595   | 16,654,115   |
| Total liabilities and stockholders' equity   | \$21,921,376 | \$21,438,808 |

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

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

|   | Six Months Ended<br>August 31, |              |
|---|--------------------------------|--------------|
|   | 2011                           | 2010         |
| <b>Cash Flows From Operating activities</b>                                       |                                |              |
| Net income  | \$1,831,212                    | \$1,875,243  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |              |
| Depreciation and amortization   | 359,166                        | 341,342      |
| Provision for obsolete inventory  | 30,000                         | 30,000       |
| Provision for loss on accounts and notes receivable                               | 100,000                        | 85,000       |
| Loss (gain) on sale of property and equipment                                     | 23,354                         | (8,592 )     |
| Expense recorded for stock compensation   | 254,230                        | 218,286      |
| Deferred income taxes   | (28,623 )                      | 15,661       |
| Changes in operating assets and liabilities:                                      |                                |              |
| Accounts receivable   | 1,087,960                      | 770,628      |
| Inventories   | (497,773 )                     | (914,511 )   |
| Other current assets  | (137,869 )                     | (187,931 )   |
| Accounts payable  | 1,632                          | 36,900       |
| Accrued liabilities   | 36,191                         | (415,398 )   |
| Deferred income   | (40,691 )                      | 59,500       |
| Net cash provided by operating activities   | 3,018,789                      | 1,906,128    |
| <b>Cash Flows From Investing Activities</b>                                       |                                |              |
| Addition to notes receivable  | (99,144 )                      | (441,811 )   |
| Proceeds received on notes receivable   | 115,073                        | 54,968       |
| Proceeds from sale or distribution of assets                                      | 52,800                         | 25,500       |
| Purchases of property and equipment   | (1,190,356 )                   | (314,946 )   |
| (Increase) decrease in other assets   | (6,216 )                       | 3,364        |
| Net cash used in investing activities   | (1,127,843 )                   | (672,925 )   |
| <b>Cash Flows From Financing Activities</b>                                       |                                |              |
| Issuance of common stock  | 36,715                         | -            |
| Tax benefit of stock awards   | 8,285                          | -            |
| Dividends paid  | (1,215,436 )                   | (1,205,787 ) |
| Net cash used in financing activities   | (1,170,436 )                   | (1,205,787 ) |
| Net Increase (Decrease) in Cash and Cash Equivalents                              | 720,510                        | 27,416       |
| Cash and Cash Equivalents, Beginning of Period                                    | 3,344,490                      | 3,743,092    |
| Cash and Cash Equivalents, End of Period  | \$4,065,000                    | \$3,770,508  |

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. AND SUBSIDIARY  
NOTES TO INTERIM (UNAUDITED) CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

## Nature of Operations

The accompanying consolidated financial statements include the accounts of Rocky Mountain Chocolate Factory, Inc. and its wholly-owned subsidiary, Aspen Leaf Yogurt, LLC (collectively, the “Company”). All intercompany balances and transactions have been eliminated in consolidation.

Rocky Mountain Chocolate Factory, Inc. (“RMCF”) is an international franchisor, confectionery manufacturer and retail operator in the United States, Canada and the United Arab Emirates. RMCF manufactures an extensive line of premium chocolate candies and other confectionery products.

Aspen Leaf Yogurt, LLC (“ALY”) was incorporated in the state of Colorado as Aspen Leaf Yogurt, Inc. on September 30, 2010 and organized through conversion as Aspen Leaf Yogurt, LLC on October 14, 2010. ALY is a franchisor and retail operator of self-serve frozen yogurt retail units.

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, frozen yogurt, and other confectionery products. The following table summarizes the number of stores operating under RMCF and ALY at August 31, 2011:

|                                    | Sold, Not Yet Open | Open | Total |
|------------------------------------|--------------------|------|-------|
| Rocky Mountain Chocolate Factory   |                    |      |       |
| Company-owned stores               | -                  | 8    | 8     |
| Franchise stores – Domestic stores | 5                  | 240  | 245   |
| Franchise stores – Domestic kiosks | -                  | 8    | 8     |
| Franchise units – International    | -                  | 58   | 58    |
| Cold Stone Creamery – co-branded   | 2                  | 45   | 47    |
| Aspen Leaf Yogurt Stores           |                    |      |       |
| Company-owned stores               | 3                  | 4    | 7     |
| Franchise stores – Domestic stores | 1                  | 3    | 4     |
| Total                              | 11                 | 366  | 377   |

## Basis of Presentation

The accompanying unaudited 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 financial 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 presented. The results of operations for the six months ended August 31, 2011 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 audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2011.

## NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION - CONTINUED

## Stock-Based Compensation

At August 31, 2011, the Company had stock-based compensation plans for employees and non-employee directors that authorized the granting of stock awards.

The Company recognized \$97,997 and \$254,230 of stock-based compensation expense during the three and six-month periods ended August 31, 2011, respectively, compared to \$100,107 and \$218,286 during the three and six-month periods ended August 31, 2010, 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 six months ended August 31, 2011 and August 31, 2010:

|  | Six Months Ended<br>August 31, |          |
|--|--------------------------------|----------|
|  | 2011                           | 2010     |
| Outstanding stock options as of February 28:           | 341,890                        | 367,762  |
| Granted  | 12,936                         | -        |
| Exercised  | (8,731 )                       | -        |
| Cancelled/forfeited                                    | (1,575 )                       | (9,702 ) |
| Outstanding stock options as of August 31:             | 344,520                        | 358,060  |
| Weighted average exercise price                        | \$10.11                        | \$9.81   |
| Weighted average remaining contractual term (in years) | 2.97                           | 3.70     |

The following table summarizes non-vested restricted stock unit transactions for common stock during the six months ended August 31, 2011 and August 31, 2010:

|  | Six Months Ended<br>August 31, |           |
|--|--------------------------------|-----------|
|  | 2011                           | 2010      |
| Outstanding non-vested restricted stock units as of February 28: | 141,260                        | 129,280   |
| Granted  | 4,540                          | 44,300    |
| Vested   | (43,300 )                      | (32,320 ) |
| Cancelled/forfeited  | -                              | -         |
| Outstanding non-vested restricted stock units as of August 31:   | 102,500                        | 141,260   |
| Weighted average grant date fair value                           | \$9.19                         | \$9.17    |
| Weighted average remaining vesting period (in years)             | 2.49                           | 3.46      |

During the six months ended August 31, 2011, the Company issued 4,000 fully-vested, unrestricted shares of stock and awarded 12,936 shares stock options to non-employee directors compared with 4,000 fully-vested, unrestricted shares of stock and -0- shares of stock options issued to non-employee directors in the six months ended August 31, 2010. There were no unrestricted shares or stock options issued during the three-month periods ended August 31, 2011 or August 31, 2010. In connection with these non-employee director stock issuances, the Company recognized \$52,886 and \$38,000 of stock-based compensation expense during the six-month periods ended August 31, 2011 and 2010, respectively.

During the three and six month periods ended August 31, 2011, the Company recognized \$97,997 and \$201,344, respectively, of stock-based compensation expense related to non-vested, non-forfeited restricted stock unit grants. The restricted stock unit grants generally vest 20% annually over a period of five years. During the three and six month periods ended August 31, 2011, 32,320 and 43,300 restricted stock units vested and were issued as common stock, respectively. Total unrecognized compensation expense of non-vested, non-forfeited shares granted as of August 31, 2011 was \$879,368, which is expected to be recognized over the weighted-average period of 2.5 years.

## NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION - CONTINUED

The weighted-average fair value of stock options granted during the six months ended August 31, 2011 was \$0.89 per share and there were no options granted during the six months ended August 31, 2010.

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model utilizing the following weighted-average assumptions:

|                                 | Six Months Ended<br>August 31, |      |
|---------------------------------|--------------------------------|------|
|                                 | 2011                           | 2010 |
| Expected dividend yield         | 3.87%                          | n/a  |
| Expected stock price volatility | 27%                            | n/a  |
| Risk-free interest rate         | 2.0%                           | n/a  |
| Expected life of options        | 5 years                        | n/a  |

## NOTE 2 - EARNINGS PER SHARE

Basic earnings per share is calculated using the weighted-average number of common shares outstanding. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options and restricted stock units. For the three months ended August 31, 2011 and 2010, 118,810 and 116,004 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, 2011 and 2010, 119,024 and 120,855 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:

|                          | August 31, 2011 | February 28, 2011 |
|--------------------------|-----------------|-------------------|
| Ingredients and supplies | \$ 2,586,973    | \$ 2,403,045      |
| Finished candy           | 2,004,989       | 1,721,143         |
| Total inventories        | \$ 4,591,961    | \$ 4,124,188      |

## NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

|                          | August 31,<br>2011 | February 28,<br>2011 |
|--------------------------|--------------------|----------------------|
| Land                     | \$513,618          | \$513,618            |
| Building                 | 4,694,340          | 4,691,792            |
| Machinery and equipment  | 7,828,615          | 7,810,606            |
| Furniture and fixtures   | 1,166,328          | 1,076,019            |
| Leasehold improvements   | 1,140,049          | 803,131              |
| Transportation equipment | 320,556            | 358,721              |

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|                               |             |             |
|-------------------------------|-------------|-------------|
|                               | 15,663,506  | 15,253,887  |
| Less accumulated depreciation | 8,949,414   | 8,978,481   |
| Property and equipment, net   | \$6,714,092 | \$6,275,406 |

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## NOTE 5 - STOCKHOLDERS' EQUITY

## Cash Dividend

The Company paid a quarterly cash dividend of \$0.10 per share of common stock on March 11, 2011 to shareholders of record on February 25, 2011. The Company declared a quarterly cash dividend of \$0.10 per share of common stock on August 25, 2011 payable on September 16, 2011 to shareholders of record on September 6, 2011.

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

|   | Six Months Ended<br>August 31, |             |
|---|--------------------------------|-------------|
|   | 2011                           | 2010        |
| Cash paid (received) for:                             |                                |             |
| Interest  | \$(35,379 )                    | \$(25,065 ) |
| Income taxes  | \$984,852                      | \$1,302,678 |
| Non-Cash Financing Activities                         |                                |             |
| Dividend Payable                                      | \$612,523                      | \$606,351   |
| Fair value of assets acquired in business combination |                                |             |
| Store assets  | \$-                            | \$63,198    |
| Accrued Capital Expenditures                          | \$326,849                      | \$-         |

## NOTE 7 - OPERATING SEGMENTS

The Company classifies its business interests into three reportable segments: Franchising, Manufacturing and Retail Stores. 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, 2011. 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<br>August 31, 2011 | Franchising | Manufacturing | Retail      | Other      | Total       |
|---------------------------------------|-------------|---------------|-------------|------------|-------------|
| Total revenues                        | \$1,572,169 | \$4,940,999   | \$1,566,809 | \$-        | \$8,079,977 |
| Intersegment revenues                 | -           | (504,188 )    | -           | -          | (504,188 )  |
| Revenue from external customers       | 1,572,169   | 4,436,811     | 1,566,809   | -          | 7,575,789   |
| Segment profit (loss)                 | 739,560     | 1,277,758     | 125,582     | (725,231 ) | 1,417,669   |
| Total assets                          | 1,491,798   | 10,738,663    | 3,281,040   | 6,409,875  | 21,921,376  |
| Capital expenditures                  | -           | 69,707        | 36,542      | 39,467     | 145,716     |
| Total depreciation & amortization     | 15,603      | 74,140        | 64,690      | 35,827     | 190,260     |



## NOTE 7 - OPERATING SEGMENTS - CONTINUED

Three Months Ended  
August 31, 2010

|                                   |              |              |            |            |              |
|-----------------------------------|--------------|--------------|------------|------------|--------------|
| Total revenues                    | \$ 1,499,341 | \$ 4,669,056 | \$ 922,659 | \$ -       | \$ 7,091,056 |
| Intersegment revenues             | -            | (464,792 )   | -          | -          | (464,792 )   |
| Revenue from external customers   | 1,499,341    | 4,204,264    | 922,659    | -          | 6,626,264    |
| Segment profit (loss)             | 851,892      | 1,307,853    | (37,303 )  | (666,645 ) | 1,455,797    |
| Total assets                      | 1,535,636    | 10,130,134   | 1,789,257  | 5,971,430  | 19,426,457   |
| Capital expenditures              | 2,767        | 57,304       | 23,113     | 132,045    | 215,229      |
| Total depreciation & amortization | 19,555       | 87,139       | 27,992     | 38,199     | 172,885      |

Six Months Ended  
August 31, 2011

|  | Franchising | Manufacturing | Retail | Other | Total |
|--|-------------|---------------|--------|-------|-------|
|--|-------------|---------------|--------|-------|-------|

|                                   |              |               |              |              |               |
|-----------------------------------|--------------|---------------|--------------|--------------|---------------|
| Total revenues                    | \$ 2,999,607 | \$ 11,354,055 | \$ 2,944,698 | \$ -         | \$ 17,298,360 |
| Intersegment revenues             | -            | (1,084,648 )  | -            | -            | (1,084,648 )  |
| Revenue from external customers   | 2,999,607    | 10,269,407    | 2,944,698    | -            | 16,213,712    |
| Segment profit (loss)             | 1,381,735    | 2,906,217     | 18,154       | (1,473,559 ) | 2,832,547     |
| Total assets                      | 1,491,798    | 10,738,663    | 3,281,040    | 6,409,875    | 21,921,376    |
| Capital expenditures              | 1,442        | 110,658       | 902,852      | 175,404      | 1,190,356     |
| Total depreciation & amortization | 34,556       | 148,164       | 109,090      | 67,356       | 359,166       |

Six Months Ended  
August 31, 2010

|                                   |              |               |              |              |               |
|-----------------------------------|--------------|---------------|--------------|--------------|---------------|
| Total revenues                    | \$ 2,887,385 | \$ 10,612,796 | \$ 1,736,158 | \$ -         | \$ 15,236,339 |
| Intersegment revenues             | -            | (994,737 )    | -            | -            | (994,737 )    |
| Revenue from external customers   | 2,887,385    | 9,618,059     | 1,736,158    | -            | 14,241,602    |
| Segment profit (loss)             | 1,510,660    | 2,875,615     | (111,242 )   | (1,372,091 ) | 2,902,942     |
| Total assets                      | 1,535,636    | 10,130,134    | 1,789,257    | 5,971,430    | 19,426,457    |
| Capital expenditures              | 3,523        | 110,761       | 29,260       | 171,402      | 314,946       |
| Total depreciation & amortization | 39,667       | 175,728       | 49,738       | 76,209       | 341,342       |

Revenue from one customer of the Company's Manufacturing segment represented approximately \$1.9 million of the Company's revenues from external customers during the six months ended August 31, 2011 compared to \$1.4 million during the six months ended August 31, 2010.

## NOTE 8 – GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following:

August 31, 2011

February 28, 2011



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|   | Amortization<br>Period | Gross Carrying<br>Value | Accumulated<br>Amortization | Gross Carrying<br>Value | Accumulated<br>Amortization |
|---|------------------------|-------------------------|-----------------------------|-------------------------|-----------------------------|
| Intangible assets subject to amortization     |                        |                         |                             |                         |                             |
| Store design                                  | 10 Years               | \$ 205,777              | \$ 197,431                  | \$ 205,777              | \$ 190,646                  |
| Packaging licenses                            | 3-5 Years              | 120,830                 | 120,830                     | 120,830                 | 120,830                     |
| Packaging design                              | 10 Years               | 430,973                 | 420,289                     | 430,973                 | 399,989                     |
| Aspen Leaf Yogurt                             |                        |                         |                             |                         |                             |
| Design  | 5 Years                | 19,740                  | 987                         | 13,103                  | -                           |
| Total   |                        | 777,320                 | 739,537                     | 770,683                 | 711,465                     |
| Intangible assets not subject to amortization |                        |                         |                             |                         |                             |
| Franchising segment-                          |                        |                         |                             |                         |                             |
| Company stores goodwill                       |                        | 1,099,328               | 267,020                     | 1,099,328               | 267,020                     |
| Franchising goodwill                          |                        | 295,000                 | 197,682                     | 295,000                 | 197,682                     |
| M a n u f a c t u r i n g segment-Goodwill    |                        |                         |                             |                         |                             |
| Trademark                                     |                        | 20,000                  | -                           | 20,000                  | -                           |
| Total Goodwill                                |                        | 1,709,328               | 662,384                     | 1,709,328               | 662,384                     |
| Total intangible assets                       |                        | \$ 2,486,648            | \$ 1,401,921                | \$ 2,480,011            | \$ 1,373,849                |

## NOTE 8 – GOODWILL AND INTANGIBLE ASSETS - CONTINUED

Amortization expense related to intangible assets totaled \$33,055 and \$28,072 during the six months ended August 31, 2010 and 2011, respectively. The aggregate estimated amortization expense for intangible assets remaining as of August 31, 2011 is as follows:

|                          |          |
|--------------------------|----------|
| Remainder of fiscal 2012 | \$6,600  |
| 2013                     | 8,600    |
| 2014                     | 4,000    |
| 2015                     | 4,000    |
| 2016                     | 4,000    |
| Thereafter               | 10,583   |
| Total                    | \$37,783 |

## NOTE 9 – RELATED PARTY TRANSACTIONS

The Company has entered into Franchise Agreements and a Development Agreement with a member of the Company's Board of Directors. The Director operates two Aspen Leaf Yogurt locations under the Franchise Agreements and the Development Agreement provides for certain incentives if five locations are secured prior to February 1, 2013.

As of August 31, 2011, the Company had receivables of approximately \$34,500 due from the Director associated with the director's ownership and operation of two current franchise locations.

## NOTE 10 – RECENT ACCOUNTING PRONOUNCEMENTS

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-08, Intangibles-Goodwill and Other (ASC Topic 350) - Testing Goodwill for Impairment. ASU No. 2011-08 is intended to simplify goodwill impairment testing by adding a qualitative review step to assess whether the required quantitative impairment analysis that exists today is necessary. ASU No. 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU No. 2011-08 is effective for us beginning in fiscal 2013 and earlier adoption is permitted. We are currently evaluating the impact of our pending adoption of ASU 2011-08 on our consolidated financial statements.

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

2.

## 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 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 included in this report other than statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, and include statements regarding our cash flow, dividends, operating income and future growth. Many of the forward-looking statements contained in this document may be identified by the use of forward-looking words such as "will," "believe," "expect," "anticipate,"

"estimate" and "potential," or similar expressions. Factors which could cause results to differ include, but are not limited to: changes in the confectionery business environment, seasonality, consumer interest in our products, general economic conditions, consumer trends, costs and availability of raw materials, competition and the effect of government regulation. Government regulation which the Company 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, 2011 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. 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.

## Overview

We are a product-based international franchisor, confectionery manufacturer and retail operator. Our revenues and profitability are derived principally from our franchised 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 to build brand awareness. We own and operate twelve 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 Aspen Leaf 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.

As a result, the actual results realized by us could differ materially from the results discussed in or contemplated by the forward-looking statements made herein. Readers are cautioned not to place undue reliance on the forward-looking statements in this Quarterly Report on Form 10-Q.

## Results of Operations

### Three Months Ended August 31, 2011 Compared to the Three Months Ended August 31, 2010

Basic earnings per share decreased 6.3% from \$.16 in the three months ended August 31, 2010 to \$.15 in the same period of the current year. Revenues increased 14.3% from \$6.6 million in the second quarter of fiscal 2011 to \$7.6 million in the same period of fiscal 2012. Operating income decreased 2.5% from \$1.44 million in the second quarter of fiscal 2011 to \$1.40 million in the second quarter of fiscal 2012. Net income decreased 3.4% from \$944,000 in the second quarter of fiscal 2011 to \$912,000 in the second quarter of fiscal 2012. The decrease in operating income and net income for the second quarter of fiscal 2012 compared to the same period in fiscal 2011 was due primarily to an increase in operating expenses.

| (\$'s in thousands)        | Three Months Ended |           | Change  | % Change |   |
|----------------------------|--------------------|-----------|---------|----------|---|
|                            | 2011               | 2010      |         |          |   |
| Factory sales              | \$4,539.4          | \$4,204.2 | \$335.2 | 8.0      | % |
| Retail sales               | 1,464.2            | 922.7     | 541.5   | 58.7     | % |
| Franchise fees             | 143.3              | 52.5      | 90.8    | 173.0    | % |
| Royalty and Marketing fees | 1,428.9            | 1,446.9   | (18.0)  | (1.2)    | % |
| Total                      | \$7,575.8          | \$6,626.3 | \$949.5 | 14.3     | % |

### Factory Sales

The increase in factory sales for the three months ended August 31, 2011 versus the three months ended August 31, 2010 was primarily due to a 104.8% increase in shipments of product to customers outside our network of franchised retail stores as a result of a single customer placing orders in the second quarter of the current year whereas such customer placed its order in the third quarter of the prior year and a 4.0% increase in sales to domestic franchised and licensed stores. These increases were partially offset by a 4.6% decrease in same-store pounds purchased by our network of franchised stores.

### Retail Sales

The increase in retail sales was primarily due to an increase in the average number of Company-owned stores in operation as a result of the opening of four Company-owned Aspen Leaf Yogurt locations between December 2010 and April 2011, partially offset by the sale of three Company-owned Rocky Mountain Chocolate Factory locations. Same store sales at Company-owned stores increased 4.1% in the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011.

### Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees declined 1.2% in the three months ended August 31, 2011 compared with the same period of fiscal 2011 as a result of a decrease in same store sales at franchise locations and a decrease in domestic franchise units, partially offset by an increase in royalties from licensed locations. Same store sales at franchise locations decreased 1.9% during the second quarter of fiscal 2012 compared to the same period in the prior year. Average licensed locations in operation increased from 28 units in the second quarter of fiscal 2011 to 44 units in the same period of fiscal 2012. This increase was offset by a decrease in the average number of domestic units in operation from 257 in the second quarter of fiscal 2011 to 247 in the same period of fiscal 2012. The increase in franchise fee revenue during the second quarter of fiscal 2012, compared with the prior year period was the result of an increase in domestic franchise opening from 2 during the three months ended August 31, 2010 to 5 openings during the three months ended August 31, 2011.

### Costs and Expenses

| (\$'s in thousands)              | Three months ended |           |         | %      |   |
|----------------------------------|--------------------|-----------|---------|--------|---|
|                                  | 2011               | 2010      | Change  | Change |   |
| Cost of sales – factory adjusted | \$3,017.0          | \$2,737.9 | \$279.1 | 10.2   | % |
| Cost of sales - retail           | 560.6              | 339.5     | 221.1   | 65.1   | % |
| Franchise costs                  | 514.8              | 353.2     | 161.6   | 45.8   | % |
| Sales and marketing              | 384.9              | 358.8     | 26.1    | 7.3    | % |
| General and administrative       | 717.0              | 644.6     | 72.4    | 11.2   | % |
| Retail operating                 | 787.4              | 579.7     | 207.7   | 35.8   | % |
| Total                            | \$5,981.7          | \$5,013.7 | \$968.0 | 19.3   | % |

### Adjusted gross margin

| (\$'s in thousands)           | Three months ended |           |         | %      |   |
|-------------------------------|--------------------|-----------|---------|--------|---|
|                               | 2011               | 2010      | Change  | Change |   |
| Factory adjusted gross margin | \$1,522.4          | \$1,466.3 | \$56.1  | 3.8    | % |
| Retail                        | 903.6              | 583.2     | 320.4   | 54.9   | % |
| Total                         | \$2,426.0          | \$2,049.5 | \$376.5 | 18.4   | % |

(Percent)

|                               |      |   |      |   |      |    |      |    |
|-------------------------------|------|---|------|---|------|----|------|----|
| Factory adjusted gross margin | 33.5 | % | 34.9 | % | (1.4 | %) | (4.0 | %) |
| Retail                        | 61.7 | % | 63.2 | % | (1.5 | %) | (2.4 | %) |
| Total                         | 40.4 | % | 40.0 | % | 0.4  | %) | 1.0  | %) |

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Adjusted gross margin is equal to gross margin minus depreciation and amortization expense. We believe adjusted gross margin is helpful in understanding our past performance as a supplement to gross margin and other performance measures calculated in conformity with accounting principles generally accepted in the United States ("GAAP"). We believe that adjusted gross margin is useful to investors because it provides 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 rather than gross margin to make incremental pricing decisions. Adjusted gross margin has limitations as an analytical tool because it excludes 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 as a measure of performance only in conjunction with GAAP measures of performance such as gross margin. The following table provides a reconciliation of adjusted gross margin to gross margin, the most comparable performance measure under GAAP:

| (\$'s in thousands)                 | Three Months Ended<br>August 31, |            |
|-------------------------------------|----------------------------------|------------|
|                                     | 2011                             | 2010       |
| Factory adjusted gross margin       | \$ 1,522.4                       | \$ 1,466.3 |
| Less: Depreciation and Amortization | 69.0                             | 82.3       |
| Factory GAAP gross margin           | \$ 1,453.4                       | \$ 1,384.0 |

#### Costs and Expenses

##### Cost of Sales

Factory margins decreased 140 basis points in the three months ended August 31, 2011 compared to the three months ended August 31, 2010 due primarily to a product mix shift resulting from a large holiday order occurring in the second quarter of fiscal 2012, compared to the third quarter in the prior fiscal year, and an increase in fuel and transportation related costs. The decrease in Company-owned store margin is due primarily to costs associated with Aspen Leaf Yogurt promotions, a change in the number of Company-owned stores in operation, and the associated change in product mix.

##### Franchise Costs

The increase in franchise costs in the three months ended August 31, 2011 versus the three months ended August 31, 2010 is due primarily to an increase in compensation related costs associated with additional franchise personnel and expenses associated with the continued site selection and the development of Aspen Leaf Yogurt. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 32.7% in the three months ended August 31, 2011 from 23.6% in the three months ended August 31, 2010. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of a 45.8% increase in franchise costs.

##### Sales and Marketing

The increase in sales and marketing expense for the second quarter of fiscal 2012 compared to the same period in fiscal 2011 is due primarily to an increase in marketing costs associated with Aspen Leaf Yogurt franchise and Company-owned locations.

##### General and Administrative

The increase in general and administrative costs for the second quarter of fiscal 2012 compared to the same period in fiscal 2011 is due primarily to costs associated with site selection and the development of Aspen Leaf Yogurt. As a

percentage of total revenues, general and administrative expense decreased to 9.5% in the second quarter of fiscal 2012 compared to 9.7% in the same period of fiscal 2011.

#### Retail Operating Expenses

The increase in retail operating expenses for the three months ended August 31, 2011 compared to the three months ended August 31, 2010 was due primarily to an increase in the average number of Company-owned stores in operation as a result of the opening of four Company-owned Aspen Leaf Yogurt locations, partially offset by the sale of three Company-owned Rocky Mountain Chocolate Factory locations during the quarter. Retail operating expenses, as a percentage of retail sales, decreased from 62.8% in the second quarter of fiscal 2011 to 53.8% in the same period of fiscal 2012.



## Depreciation and Amortization

Depreciation and amortization of \$190,000 in the second quarter of fiscal 2012 increased 10.1% from \$173,000 incurred in the same period of fiscal 2011 due to additional depreciable assets acquired by us as a result of an increase in the number of Company-owned stores in operation, partially offset by certain assets becoming fully depreciated.

## Interest Income

Interest income of \$14,000 realized in the second quarter of fiscal 2012 represents a decrease of \$2,100 from the \$16,100 realized in the same period of fiscal 2011.

## Income Tax Expense

Our effective income tax rate in the second quarter of fiscal 2012 was 35.7% which is an increase of 0.5% compared to the same period of fiscal 2011.

## Six Months Ended August 31, 2011 Compared to the Six Months Ended August 31, 2010

Basic earnings per share decreased 3.2% from \$.31 for the six months ended August 31, 2010 to \$—.30 for the same period of fiscal 2012. Revenues increased 13.8% to \$16.2 million for the six months ended August 31, 2011 compared to \$14.2 million in the same period of fiscal 2011. Operating income decreased 2.6% from \$2.9 million in the six months ended August 31, 2010 to \$2.8 million in the same period of fiscal 2012. Net income decreased 2.3% from \$1.9 million in the six months ended August 31, 2010 to \$1.8 million in the same period of fiscal 2012. The decrease in operating income and net income for the six months ended August 31, 2011 compared to the same period in the prior year was due primarily to an increase in revenues, more than offset by an increase in operating expenses.

## Revenues

| (\$'s in thousands)        | Six Months Ended<br>August 31, |                    |                   |             |          |
|----------------------------|--------------------------------|--------------------|-------------------|-------------|----------|
|                            | 2011                           | 2010               | Change            | %           |          |
| Factory sales              | \$ 10,372.0                    | \$ 9,618.0         | \$ 754.0          | 7.8         | %        |
| Retail sales               | 2,842.1                        | 1,736.2            | 1,105.9           | 63.7        | %        |
| Franchise fees             | 249.8                          | 129.5              | 120.3             | 92.9        | %        |
| Royalty and marketing fees | 2,749.8                        | 2,757.9            | (8.1 )            | (0.3        | %)       |
| <b>Total</b>               | <b>\$ 16,213.7</b>             | <b>\$ 14,241.6</b> | <b>\$ 1,972.1</b> | <b>13.8</b> | <b>%</b> |

## Factory Sales

The increase in factory sales for the first six months ended August 31, 2011 compared to the same period in fiscal 2011 was primarily due to a 24.3% increase in shipments of product to customers outside our network of franchised retail stores and a 3.9% increase in purchases by our network of franchised and licensed retail stores. Same store pounds purchased for the six months ended August 31, 2011 decreased 2.5% compared to the same period in fiscal 2011.

## Retail Sales

The increase in retail sales resulted primarily from an increase in the average number of Company-owned stores in operation from 12 in the first six months ended August 31, 2010 to 14 in the same period of the current year. Same store retail sales at Company-owned locations increased 4.1% in the six months ended August 31, 2011 compared to the same period in the prior year.

Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees were approximately unchanged during the six months ended August 31, 2011 compared to the same period of fiscal 2011 as a result of an increase in the number of Cold Stone Creamery co-branded locations in operation, offset by a decline in same-store sales and a decrease in the average number of domestic franchise units in operation. The average number of domestic franchise units in operation decreased 4.6% from 259 in the six months ended August 31, 2010 to 247 during the same period in the current year. Franchise fee revenues during the six months ended August 31, 2011 increased as a result of an increase in the number of domestic franchise store openings relative to the number of licensed location openings. During the six months ended August 31, 2011, there were 9 domestic franchise store openings compared with 4 in the same period of the prior year, this was partially offset by a decrease in licensed location openings from 11 during the six months ended August 31, 2010 to 5 during the six months ended August 31, 2011.

## Costs and Expenses

| (\$'s in thousands)              | Six months ended   |            |           | %      |   |
|----------------------------------|--------------------|------------|-----------|--------|---|
|                                  | August 31,<br>2011 | 2010       | Change    | Change |   |
| Cost of sales – factory adjusted | \$7,087.8          | \$6,470.1  | \$617.7   | 9.5    | % |
| Cost of sales - retail           | 1,123.1            | 656.2      | 466.9     | 71.2   | % |
| Franchise costs                  | 921.7              | 713.3      | 208.4     | 29.2   | % |
| Sales and marketing              | 825.1              | 748.2      | 76.9      | 10.3   | % |
| General and administrative       | 1,456.6            | 1,312.4    | 144.2     | 11.0   | % |
| Retail operating                 | 1,638.6            | 1,122.1    | 516.5     | 46.0   | % |
| Total                            | \$13,052.9         | \$11,022.3 | \$2,030.6 | 18.4   | % |

## Adjusted gross margin

| (\$'s in thousands) | Six months ended   |           |         | %      |   |
|---------------------|--------------------|-----------|---------|--------|---|
|                     | August 31,<br>2011 | 2010      | Change  | Change |   |
| Factory             | \$3,284.2          | \$3,147.9 | \$136.3 | 4.3    | % |
| Retail              | 1,719.0            | 1,080.0   | 639     | 59.2   | % |
| Total               | \$5,003.2          | \$4,227.9 | \$775.3 | 18.3   | % |

## (Percent)

|         |      |   |      |   |      |    |      |    |
|---------|------|---|------|---|------|----|------|----|
| Factory | 31.7 | % | 32.7 | % | (1.0 | %) | (3.1 | %) |
| Retail  | 60.5 | % | 62.2 | % | (1.7 | %) | (2.7 | %) |
| Total   | 37.9 | % | 37.2 | % | 0.7  | %  | 1.9  | %  |

Adjusted gross margin is equal to gross margin minus depreciation and amortization expense. We believe adjusted gross margin is helpful in understanding our past performance as a supplement to gross margin and other performance measures calculated in conformity with accounting principles generally accepted in the United States ("GAAP"). We believe that adjusted gross margin is useful to investors because it provides 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 rather than gross margin to make incremental pricing decisions. Adjusted gross margin has limitations as an analytical tool because it excludes 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 as a measure of performance only in conjunction with GAAP measures of performance such as gross margin. The following table provides a reconciliation of adjusted gross margin to gross margin, the most comparable performance measure under GAAP:

| (\$'s in thousands)                 | Six Months Ended   |            |
|-------------------------------------|--------------------|------------|
|                                     | August 31,<br>2011 | 2010       |
| Factory adjusted gross margin       | \$ 3,284.2         | \$ 3,147.9 |
| Less: Depreciation and Amortization | 138.5              | 165.7      |
| Factory GAAP gross margin           | \$ 3,145.7         | \$ 2,982.2 |

## Costs and Expenses

## Cost of Sales

Factory margins decreased 100 basis points for the first six months ended August 31, 2011 compared to the same period in the six months ended August 31, 2010 due primarily to an increase in fuel and transportation related costs and a product mix shift resulting from a large holiday order occurring in the second quarter of fiscal 2012, whereas such order occurred in the third quarter during the prior fiscal year. The decrease in Company-owned store margin is due primarily to costs associated with Aspen Leaf Yogurt grand openings, a change in the number of Company-owned stores in operation, and the associated change in product mix.

### Franchise Costs

The increase in franchise costs for the six months ended August 31, 2011 compared to the same six months ended August 31, 2010 is due primarily to an increase in compensation related costs associated with additional franchise personnel, costs associated with site selection and the development of Aspen Leaf Yogurt. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 30.7% in the six months ended August 31, 2011 from 24.7% in the six months ended August 31, 2010. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of higher franchise costs relative to revenues.

### Sales and Marketing

The increase in sales and marketing expense for the six months ended August 31, 2011 compared to the six months ended August 31, 2010 is due to increased advertising, related to new regional advertising initiatives, increased marketing related compensation costs and costs associated with Aspen Leaf Yogurt franchise and Company-owned locations.

### General and Administrative

The increase in general and administrative expense for the first six months ended August 31, 2011 compared to the six months ended August 31, 2010 is due to costs associated with site selection and the development of Aspen Leaf Yogurt, an increase in the allowance for doubtful accounts and stock-based compensation expense. As a percentage of total revenues, general and administrative expenses decreased to 9.0% in the first six months of fiscal 2012 compared to 9.2% in the same period of fiscal 2011.

### Retail Operating Expenses

The increase in retail operating expenses was due to an increase in the average number of Company-owned stores in operation as a result of the opening of four Company-owned Aspen Leaf Yogurt locations between December 2010 and April 2011, partially offset by the sale of three Company-owned Rocky Mountain Chocolate Factory locations during the second quarter. For the six months ended August 31, 2011 an operating loss of approximately \$56,000 was incurred related to the opening and operation of Aspen Leaf Yogurt locations. Retail operating expenses, as a percentage of retail sales, decreased from 64.6% in the first six months of fiscal 2011 to 57.7% in the same period of fiscal 2012.

### Depreciation and Amortization

Depreciation and amortization of \$359,000 in the six months ended August 31, 2011 increased 5.2% from \$341,000 incurred in the six months ended August 31, 2010 due to an increase in the number of Company-owned stores in operation partially offset by certain assets becoming fully depreciated.

### Interest Income

Interest income of \$31,000 realized in the six months ended August 31, 2011 represents an increase of \$6,000 from the \$25,000 realized in the same period of the prior year due to higher average outstanding cash balances and an increase in interest income realized related to notes receivable.

### Income Tax Expense

Our effective income tax rate in the six months ended August 31, was 35.4% and was unchanged from the same period in the prior fiscal year.



## Liquidity and Capital Resources

As of August 31, 2011, working capital was \$10.3 million, compared with \$9.8 million as of February 28, 2011, an increase of \$500,000. The change in working capital was due primarily to operating results.

Cash and cash equivalent balances increased from \$3.3 million as of February 28, 2011 to \$4.1 million as of August 31, 2011 as a result of cash flows provided by operating activities greater than cash flows used by financing and investing activities. Our current ratio was 4.10 to 1 at August 31, 2011 in comparison with 3.67 to 1 at February 28, 2011. 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 million (\$5 million available as of August 31, 2011) working capital line of credit collateralized by substantially all of our assets with the exception of our retail store assets. The line is subject to renewal in July 2012.

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 2012.

## 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 products have occurred during the Christmas holiday and summer vacation seasons. 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

The Company does not engage in commodity futures trading or hedging activities and does not enter into derivative financial instrument transactions for trading or other speculative purposes. The Company also does not engage in transactions in foreign currencies or in interest rate swap transactions that could expose the Company to market risk. However, the Company is exposed to some commodity price and interest rate risks.

The Company frequently enters into purchase contracts of between six to eighteen months for chocolate and certain nuts. These contracts permit the Company 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, the Company may benefit if prices rise during the terms of these contracts, but it may be required to pay above-market prices if prices fall and it is unable

to renegotiate the terms of the contracts. As of August 31, 2011, based on future contractual obligations for chocolate products, we estimate that a 10.0% change in the prices of cocoa would result in a \$22,000 favorable or unfavorable price benefit resulting from our contracts.

As of August 31, 2011, the Company had no long-term debt. The Company has a \$5.0 million bank line of credit that bears interest at a variable rate. As of August 31, 2011, no amount was outstanding under the line of credit. The Company does not believe that it is exposed to any material interest rate risk related to the line of credit.



The Chief Financial Officer and Chief Operating Officer of the Company have primary responsibility over the Company's long-term and short-term debt and for determining the timing and duration of commodity purchase contracts and negotiating the terms and conditions of those contracts.

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 Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management, with the participation of our CEO and CFO, has evaluated the effectiveness, as of August 31, 2011, of our disclosure controls and procedures. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of August 31, 2011.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended August 31, 2011, that has materially affected, or is reasonably likely to materially affect, our 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, 2011. 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, 2011.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Reserved

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| Item 5. | Other Information   |
|         | None  |
| Item 6. | Exhibits  |
| 3.1     | Articles of Incorporation of the Registrant, as amended, incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K of the Registrant for the year ended February 28, 2011  |
| 3.2     | By-laws of the Registrant, as amended on December 11, 2007, incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of the Registrant filed on December 14, 2007   |
| 10.1    | *Promissory Note dated August 4, 2011 in the amount of \$5,000,000 between Wells Fargo Bank and the Registrant  |
| 31.1    | *Certification Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002, Chief Executive Officer   |
| 31.2    | *Certification Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002, Chief Financial Officer   |
| 32.1    | **Certification Furnished Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002, Chief Executive Officer  |
| 32.2    | **Certification Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002, Chief Financial Officer  |
| 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.   |
|         | ***Furnished with this report. In accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed “furnished” and not “filed” or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not “filed” |

for the purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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: October 14, 2011

/s/ Bryan J. Merryman  
Bryan J. Merryman, Chief Operating Officer,  
Chief Financial Officer, Treasurer and  
Director