

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

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, 2011	2010	Six Months Ended August 31, 2011	2010
Revenues				
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
Costs and Expenses				
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
Weighted Average Common Shares				
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, 2011 (unaudited)	February 28, 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 August 31,	
	2011	2010
Cash Flows From Operating activities		
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
Cash Flows From Investing Activities		
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)
Cash Flows From Financing Activities		
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 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 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 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, 2011	February 28, 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 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 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
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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 Period	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated 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		295,000	197,682	295,000	197,682
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 or through our website at 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 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.