

ROCKY MOUNTAIN CHOCOLATE FACTORY INC  
Form 10-Q  
October 12, 2012

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, 2012

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 (§ 232.405 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  Accelerated filer

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Non-accelerated filer  Smaller reporting  
company  X  
(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, 2012, the registrant had outstanding 6,050,279 shares of its common stock, \$.03 par value.

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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, |             | Six Months Ended August 31, |              |
|--|-------------------------------|-------------|-----------------------------|--------------|
|  | 2012                          | 2011        | 2012                        | 2011         |
| <b>Revenues</b>  |                               |             |                             |              |
| Sales  | \$6,230,144                   | \$6,003,619 | \$14,320,770                | \$13,214,105 |
| Franchise and royalty fees   | 1,499,693                     | 1,572,169   | 3,067,260                   | 2,999,607    |
| Total revenues   | 7,729,837                     | 7,575,788   | 17,388,030                  | 16,213,712   |
| <b>Costs and Expenses</b>  |                               |             |                             |              |
| Cost of sales, exclusive of depreciation and amortization expense of \$71,928, \$69,154, \$142,323 and \$138,565, respectively | 3,669,575                     | 3,577,614   | 8,691,811                   | 8,210,886    |
| Franchise costs  | 558,094                       | 514,826     | 1,102,520                   | 921,700      |
| Sales and marketing  | 408,805                       | 384,911     | 869,987                     | 825,130      |
| General and administrative   | 701,742                       | 717,036     | 1,541,838                   | 1,456,592    |
| Retail operating   | 893,260                       | 787,444     | 1,824,273                   | 1,638,550    |
| Depreciation and amortization  | 230,406                       | 190,261     | 467,546                     | 359,166      |
| Total costs and expenses   | 6,461,882                     | 6,172,092   | 14,497,975                  | 13,412,024   |
| Income from Operations   | 1,267,955                     | 1,403,696   | 2,890,055                   | 2,801,688    |
| Interest Income  | 11,487                        | 13,972      | 22,781                      | 30,859       |
| Income Before Income Taxes   | 1,279,442                     | 1,417,668   | 2,912,836                   | 2,832,547    |
| Provision for Income Taxes   | 450,660                       | 506,115     | 1,021,725                   | 1,001,335    |
| Net Income   | \$828,782                     | \$911,553   | \$1,891,111                 | \$1,831,212  |
| Basic Earnings per Common Share  | \$.14                         | \$.15       | \$.31                       | \$.30        |
| Diluted Earnings per Common Share  | \$.13                         | \$.14       | \$.30                       | \$.29        |
| <b>Weighted Average Common Shares</b>  |                               |             |                             |              |
| Outstanding  | 6,045,070                     | 6,105,744   | 6,102,257                   | 6,091,179    |
| Dilutive Effect of Stock Options   | 155,133                       | 193,419     | 153,226                     | 211,294      |
| Weighted Average Common Shares Outstanding, Assuming Dilution  | 6,200,203                     | 6,299,163   | 6,255,483                   | 6,302,473    |

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>2012<br>(unaudited) | February 29,<br>2012 |
|--|-----------------------------------|----------------------|
| <b>Assets</b>  |                                   |                      |
| <b>Current Assets</b>  |                                   |                      |
| Cash and cash equivalents  | \$3,762,812                       | \$4,125,444          |
| Accounts receivable, less allowance for doubtful accounts of \$612,757 and \$488,448, respectively     | 3,735,991                         | 4,078,158            |
| Notes receivable, current portion  | 264,245                           | 283,225              |
| Refundable income taxes  | -                                 | 724,911              |
| Inventories, less reserve for slow moving inventory of \$248,799 and \$249,500, respectively           | 4,446,095                         | 4,119,073            |
| Deferred income taxes  | 485,125                           | 487,274              |
| Other  | 446,083                           | 281,282              |
| <b>Total current assets</b>  | <b>13,140,351</b>                 | <b>14,099,367</b>    |
| Property and Equipment, Net  | 7,821,098                         | 8,515,644            |
| <b>Other Assets</b>  |                                   |                      |
| Notes receivable, less current portion and valuation allowance of \$102,453 and \$95,703, respectively | 269,720                           | 344,474              |
| Goodwill, net  | 1,046,944                         | 1,046,944            |
| Intangible assets, net   | 17,123                            | 22,111               |
| Other  | 142,308                           | 134,430              |
| <b>Total other assets</b>  | <b>1,476,095</b>                  | <b>1,547,959</b>     |
| <b>Total assets</b>  | <b>\$22,437,544</b>               | <b>\$24,162,970</b>  |
| <b>Liabilities and Stockholders' Equity</b>  |                                   |                      |
| <b>Current Liabilities</b>   |                                   |                      |
| Accounts payable   | \$917,833                         | \$1,355,818          |
| Accrued salaries and wages   | 340,991                           | 653,276              |
| Other accrued expenses   | 802,930                           | 760,860              |
| Dividend payable   | 665,530                           | 616,239              |
| Deferred income  | 174,000                           | 156,000              |
| <b>Total current liabilities</b>   | <b>2,901,284</b>                  | <b>3,542,193</b>     |
| Deferred Income Taxes  | 1,661,776                         | 1,884,957            |
| <b>Commitments and Contingencies</b>   |                                   |                      |
| <b>Stockholders' Equity</b>  |                                   |                      |
| Preferred stock, \$.10 par value; 250,000 authorized; -0- shares issued and outstanding                |                                   |                      |

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|  |              |              |
|--|--------------|--------------|
| 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, 6,050,279 and 6,162,389 issued and outstanding | 181,508      | 184,872      |
| Additional paid-in capital   | 7,304,921    | 8,712,743    |
| Retained earnings  | 10,388,055   | 9,838,205    |
| Total stockholders' equity   | 17,874,484   | 18,735,820   |
| Total liabilities and stockholders' equity   | \$22,437,544 | \$24,162,970 |

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, |                    |
|--|--------------------------------|--------------------|
|  | 2012                           | 2011               |
| <b>Cash Flows From Operating activities</b>  |                                |                    |
| Net income   | \$1,891,111                    | \$1,831,212        |
| <b>Adjustments to reconcile net income to net cash Provided by operating activities:</b> |                                |                    |
| Depreciation and amortization  | 467,546                        | 359,166            |
| Provision for obsolete inventory   | 30,000                         | 30,000             |
| Asset impairment and store closure losses  | (17,000 )                      | -                  |
| Provision for loss on accounts and notes receivable                                      | 139,000                        | 100,000            |
| Loss (gain) on sale of property and equipment  | (28,870 )                      | 23,354             |
| Expense recorded for stock compensation  | 229,900                        | 254,230            |
| Deferred income taxes  | (221,032 )                     | (28,623 )          |
| <b>Changes in operating assets and liabilities:</b>                                      |                                |                    |
| Accounts receivable  | 209,917                        | 1,087,960          |
| Inventories  | (147,205 )                     | (497,773 )         |
| Other current assets   | (167,431 )                     | (137,869 )         |
| Accounts payable   | (517,321 )                     | 1,632              |
| Accrued liabilities  | 454,696                        | 36,191             |
| Deferred income  | 18,000                         | (40,691 )          |
| Net cash provided by operating activities  | 2,341,311                      | 3,018,789          |
| <b>Cash Flows From Investing Activities</b>  |                                |                    |
| Addition to notes receivable   | (36,215 )                      | (99,144 )          |
| Proceeds received on notes receivable  | 123,199                        | 115,073            |
| Proceeds from sale or distribution of assets   | 668,000                        | 52,800             |
| Purchases of property and equipment  | (517,413 )                     | (1,190,356 )       |
| (Increase) decrease in other assets  | (8,458 )                       | (6,216 )           |
| Net cash provided by (used) in investing activities                                      | 229,113                        | (1,127,843 )       |
| <b>Cash Flows From Financing Activities</b>  |                                |                    |
| Repurchase of common stock   | (1,715,352 )                   | -                  |
| Issuance of common stock   | 22,224                         | 36,715             |
| Tax benefit of stock awards  | 52,042                         | 8,285              |
| Dividends paid   | (1,291,970 )                   | (1,215,436 )       |
| Net cash used in financing activities  | (2,933,056 )                   | (1,170,436 )       |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>                              | <b>(362,632 )</b>              | <b>720,510</b>     |
| <b>Cash and Cash Equivalents, Beginning of Period</b>                                    | <b>4,125,444</b>               | <b>3,344,490</b>   |
| <b>Cash and Cash Equivalents, End of Period</b>  | <b>\$3,762,812</b>             | <b>\$4,065,000</b> |

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, Japan 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, 2012:

|   | Sold, Not Yet |            |            |
|---|---------------|------------|------------|
|   | Open          | Open       | Total      |
| <b>Rocky Mountain Chocolate Factory</b> |               |            |            |
| Company-owned stores                    | -             | 7          | 7          |
| Franchise stores – Domestic stores      | 4             | 228        | 232        |
| Franchise stores – Domestic kiosks      | -             | 8          | 8          |
| Franchise units – International         | -             | 60         | 60         |
| Cold Stone Creamery – co-branded        | 3             | 53         | 56         |
| <b>Aspen Leaf Yogurt Stores</b>         |               |            |            |
| Company-owned stores                    | -             | 8          | 8          |
| Franchise stores – Domestic stores      | 4             | 5          | 9          |
| <b>Total</b>                            | <b>11</b>     | <b>369</b> | <b>380</b> |

**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 (“GAAP”) for interim financial reporting and Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP 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 three and six months ended August 31, 2012 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 29, 2012.

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

## Stock-Based Compensation

At August 31, 2012, the Company had stock-based compensation plans for employees and non-employee directors that authorized the granting of stock awards.

The Company recognized \$94,867 and \$229,900 of stock-based compensation expense during the three and six-month periods ended August 31, 2012, respectively, compared to \$97,997 and \$254,230 during the three and six-month periods ended August 31, 2011, 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, 2012 and August 31, 2011:

|   | Six Months Ended<br>August 31, |          |
|---|--------------------------------|----------|
|   | 2012                           | 2011     |
| Outstanding stock options as of February 28 or 29:        | 307,088                        | 341,890  |
| Granted   | -                              | 12,936   |
| Exercised   | (3,000 )                       | (8,731 ) |
| Cancelled/forfeited                                       | (14,952 )                      | (1,575 ) |
| Outstanding stock options as of August 31:                | 289,136                        | 344,520  |
| Weighted average exercise price                           | \$ 10.67                       | \$ 10.11 |
| Weighted average remaining contractual term<br>(in years) | 2.32                           | 2.97     |

The following table summarizes non-vested restricted stock unit transactions for common stock during the six months ended August 31, 2012 and August 31, 2011:

|   | Six Months Ended<br>August 31, |           |
|---|--------------------------------|-----------|
|   | 2012                           | 2011      |
| Outstanding non-vested restricted stock units as of February<br>28 or 29: | 101,980                        | 141,260   |
| Granted   | -                              | 4,540     |
| Vested  | (44,190 )                      | (43,300 ) |
| Cancelled/forfeited   | (560 )                         | -         |
| Outstanding non-vested restricted stock units as of August<br>31:         | 57,230                         | 102,500   |
| Weighted average grant date fair value                                    | \$ 9.22                        | \$ 9.19   |
| Weighted average remaining vesting period (in years)                      | 1.63                           | 2.49      |

During the six months ended August 31, 2012, the Company issued 4,000 fully-vested, unrestricted shares of stock to non-employee directors compared with 4,000 fully-vested, unrestricted shares of stock and 12,936 shares of stock options issued to non-employee directors in the six months ended August 31, 2011. There were no unrestricted shares or stock options issued during the three-month periods ended August 31, 2012 or August 31, 2011. In connection

with these non-employee director stock issuances, the Company recognized \$37,200 and \$52,886 of stock-based compensation expense during the six-month periods ended August 31, 2012 and 2011, respectively.

During the three and six month periods ended August 31, 2012, the Company recognized \$94,867 and \$192,700, 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, 2012, 33,770 and 44,190 restricted stock units vested and were issued as common stock, respectively. Total unrecognized compensation expense of non-vested, non-forfeited shares

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

granted as of August 31, 2012 was \$473,545, which is expected to be recognized over the weighted-average period of 1.6 years.

There were no stock options awarded during the six months ended August 31, 2012. The weighted-average fair value of stock options awarded during the six months ended August 31, 2011 was \$0.89.

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 |                    |   |
|-------------------------------------|------------------|--------------------|---|
|                                     | 2012             | August 31,<br>2011 |   |
| Expected dividend yield             | n/a              | 3.87               | % |
| Expected stock price volatility     | n/a              | 27                 | % |
| Risk-free interest rate             | n/a              | 2.0                | % |
| Expected life of options (in years) | n/a              | 5                  |   |

## 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, 2012 and 2011, 101,661 and 118,810 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, 2012 and 2011, 103,449 and 119,024 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,<br>2012 | February 29,<br>2012 |
|--------------------------|--------------------|----------------------|
| Ingredients and supplies | \$2,443,073        | \$2,484,796          |
| Finished candy           | 2,003,022          | 1,634,277            |
| Total inventories        | \$4,446,095        | \$4,119,073          |

## NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

|      | August 31,<br>2012 | February 29,<br>2012 |
|------|--------------------|----------------------|
| Land | \$513,618          | \$513,618            |

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|                               |             |             |
|-------------------------------|-------------|-------------|
| Building                      | 4,742,905   | 4,700,905   |
| Machinery and equipment       | 8,655,720   | 8,580,960   |
| Furniture and fixtures        | 1,448,943   | 1,614,484   |
| Leasehold improvements        | 1,814,118   | 2,064,345   |
| Transportation equipment      | 362,413     | 360,582     |
|                               | 17,537,717  | 17,834,894  |
| Less accumulated depreciation | 9,716,619   | 9,319,250   |
| Property and equipment, net   | \$7,821,098 | \$8,515,644 |

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## NOTE 5 - STOCKHOLDERS' EQUITY

## Stock Repurchases

On February 19, 2008, the Company announced the plan to purchase up to \$3.0 million of its common stock in the open market or in private transactions, whenever deemed appropriate by management. Between May 1, 2012 and May 31, 2012, the Company repurchased 33,800 shares under the plan at an average price of \$10.73 per share. Between June 1, 2012 and June 30, 2012, the Company repurchased 129,500 shares under the plan at an average price of \$10.45 per share.

## Cash Dividend

The Company paid a quarterly cash dividend of \$0.10 per share of common stock on March 16, 2012 to shareholders of record on March 2, 2012. The Company paid a quarterly cash dividend of \$0.11 per share of common stock on June 8, 2012 to shareholders of record May 24, 2012. The Company declared a quarterly cash dividend of \$0.11 per share of common stock on August 23, 2012 payable on September 14, 2012 to shareholders of record on September 4, 2012.

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, |             |
|---|--------------------------------|-------------|
|   | 2012                           | 2011        |
| Cash paid (received) for:                       |                                |             |
| Interest  | \$(23,134 )                    | \$(35,379 ) |
| Income taxes                                    | \$453,580                      | \$984,852   |
| Non-Cash Operating Activities Accrued Inventory | 209,817                        | 338,014     |
| Non-Cash Financing Activities Dividend Payable  | \$665,531                      | \$612,523   |

## 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 29, 2012. 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, 2012

|                       | Franchising  | Manufacturing | Retail       | Other | Total        |
|-----------------------|--------------|---------------|--------------|-------|--------------|
| Total revenues        | \$ 1,499,692 | \$ 5,080,496  | \$ 1,660,068 | \$ -  | \$ 8,240,256 |
| Intersegment revenues | -            | (510,419 )    | -            | -     | (510,419 )   |



|                                      |           |            |           |            |            |
|--------------------------------------|-----------|------------|-----------|------------|------------|
| R e v e n u e f r o m                |           |            |           |            |            |
| external customers                   | 1,499,692 | 4,570,077  | 1,660,068 | -          | 7,729,837  |
| Segment profit (loss)                | 628,016   | 1,344,529  | 64,829    | (757,932 ) | 1,279,442  |
| Total assets                         | 1,530,306 | 10,620,818 | 4,385,447 | 5,900,973  | 22,437,544 |
| Capital expenditures                 | 16,468    | 117,833    | 80,888    | 49,372     | 264,561    |
| Total depreciation &<br>amortization | 9,713     | 72,840     | 109,047   | 38,806     | 230,406    |

## NOTE 7 - OPERATING SEGMENTS - CONTINUED

Three Months Ended  
August 31, 2011

|                                   |             |             |             |            |             |
|-----------------------------------|-------------|-------------|-------------|------------|-------------|
| 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     |

Six Months Ended  
August 31, 2012

|                                   | Franchising | Manufacturing | Retail      | Other        | Total        |
|-----------------------------------|-------------|---------------|-------------|--------------|--------------|
| Total revenues                    | \$3,067,260 | \$ 12,036,927 | \$3,337,349 | \$-          | \$18,441,536 |
| Intersegment revenues             | -           | (1,053,506 )  | -           | -            | (1,053,506 ) |
| Revenue from external customers   | 3,067,260   | 10,983,421    | 3,337,349   | -            | 17,388,030   |
| Segment profit (loss)             | 1,296,951   | 3,162,796     | 77,463      | (1,624,374 ) | 2,912,836    |
| Total assets                      | 1,530,306   | 10,620,818    | 4,385,447   | 5,900,973    | 22,437,544   |
| Capital expenditures              | 24,007      | 170,255       | 241,746     | 81,405       | 517,413      |
| Total depreciation & amortization | 21,093      | 144,177       | 225,828     | 76,448       | 467,546      |

Six Months Ended  
August 31, 2011

|                                   |             |               |             |              |              |
|-----------------------------------|-------------|---------------|-------------|--------------|--------------|
| 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      |

Revenue from one customer of the Company's Manufacturing segment represented approximately \$2.2 million of the Company's revenues from external customers during the six months ended August 31, 2012 compared to \$1.9 million during the six months ended August 31, 2011.

## NOTE 8 – GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following:

|  | Amortization<br>Period<br>(in years) | Gross<br>Carrying<br>Value | August 31, 2012             |                            | February 29, 2012           |                            |
|--|--------------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|----------------------------|
|  |                                      |                            | Accumulated<br>Amortization | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Gross<br>Carrying<br>Value |
| Intangible assets subject to<br>amortization |                                      |                            |                             |                            |                             |                            |

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|   |     |              |              |              |              |
|---|-----|--------------|--------------|--------------|--------------|
| Store design                                  | 10  | \$ 205,777   | \$ 203,459   | 205,777      | 200,445      |
| Packaging licenses                            | 3-5 | 120,830      | 120,830      | 120,830      | 120,830      |
| Packaging design                              | 10  | 430,973      | 430,973      | 430,973      | 430,973      |
| Aspen Leaf Yogurt                             |     |              |              |              |              |
| Design  | 5   | 19,740       | 4,935        | 19,740       | 2,961        |
| Total   |     | 777,320      | 760,197      | 777,320      | 755,209      |
| 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      |
| Manufacturing                                 |     |              |              |              |              |
| 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 | \$ 1,422,581 | \$ 2,486,648 | \$ 1,417,593 |

#### NOTE 8 – GOODWILL AND INTANGIBLE ASSETS - CONTINUED

Amortization expense related to intangible assets totaled \$4,988 and \$28,072 during the six months ended August 31, 2012 and 2011, respectively. As of August 31, 2012, \$17,123 net intangible assets subject to amortization remained to be amortized through May 2016.

#### 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 ALY locations under the Franchise Agreements and the Development Agreement.

As of August 31, 2012, the Company had receivables of approximately \$6,600 due from such director associated with the director's ownership and operation of the two current ALY locations.

Our President and Chief Executive Officer has members of his immediate family with ownership interests in retail marketing businesses. These businesses have, on occasion, provided services to the Company and may provide services in the future. As of August 31, 2012, the Company had incurred expenses of \$7,500 and there was \$1,050 recorded to accounts payable that related to these businesses. Transactions with these businesses have been immaterial to our results of operations.

#### NOTE 10 – FRANCHISE FEE REVENUE RECOGNITION

Franchise fee revenue is recognized upon the opening of a franchise location. During the six months ended August 31, 2011, three Aspen Leaf Yogurt franchise locations opened and \$78,500 of franchise fee revenue was recognized associated with these openings. During the three months ended November 30, 2011, the franchise fee for ALY was reduced and a decrease to revenue of \$54,500 was recorded associated with locations previously opened during the six months ended August 31, 2011. The change to ALY franchise fees was the result of the Company's continued evaluation of the self-serve yogurt franchise environment and its desire to remain competitive among many franchise offerings. There was no change to the Rocky Mountain Chocolate Factory franchise fee or the Company's franchise fee revenue recognition policy.

#### 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 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 and retail trends, costs and availability of raw materials, competition, the success of our co-branding agreement with Cold Stone Creamery Brands, the success of our international expansion efforts, the success of the Aspen Leaf Yogurt concept and the effect

of government regulation. 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 29, 2012 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. Readers are cautioned not to place undue reliance on the forward-looking statements in this report. 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 fifteen 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.

In April 2012, we entered into a Master Licensing Agreement for the development and franchising of new Rocky Mountain Chocolate Factory stores in Japan. The agreement requires at least ten new stores to open each year for the next ten years, for a total minimum of 100 stores to be opened in Japan by the expiration of the initial term of the agreement. We believe that international opportunities may create a favorable expansion strategy and reduce dependence on domestic franchise openings to achieve growth. As of September 30, 2012 three stores were operating under the agreement.

## Results of Operations

### Three Months Ended August 31, 2012 Compared to the Three Months Ended August 31, 2011

Basic earnings per share decreased 6.7% from \$.15 in the three months ended August 31, 2011 to \$.14 in the same period of the current year. Revenues increased 2.0% from \$7.6 million in the three months ended August 31, 2011 to \$7.7 million in the same period of the current year. Operating income decreased 9.7% from \$1.40 million in the three months ended August 31, 2011 to \$1.27 million in the same period of the current year. Net income decreased 9.1% from \$912,000 in the three months ended August 31, 2011 to \$829,000 in the same period of the current year. The decrease in operating income and net income for the three months ended August 31, 2012 compared to the same period in the prior year was due primarily to an operating loss of approximately \$172,000 associated with the retail operations and franchise support of Aspen Leaf Yogurt.

| (\$'s in thousands)        | Three Months Ended |           |         | % Change |   |
|----------------------------|--------------------|-----------|---------|----------|---|
|                            | 2012               | 2011      | Change  |          |   |
| Factory sales              | \$4,673.2          | \$4,539.4 | \$133.8 | 2.9      | % |
| Retail sales               | 1,556.9            | 1,464.2   | 92.7    | 6.3      | % |
| Franchise fees             | 35.2               | 143.3     | (108.1) | (75.4)   | % |
| Royalty and Marketing fees | 1,464.5            | 1,428.9   | 35.6    | 2.5      | % |
| Total                      | \$7,729.8          | \$7,575.8 | \$154.0 | 2.0      | % |



### Factory Sales

The increase in factory sales for the three months ended August 31, 2012 versus the three months ended August 31, 2011 was primarily due to an increase in shipments of product to international franchisees and Cold Stone Creamery co-branded licensed locations. These increases were partially offset by a 1.3% decrease in same-store pounds purchased by our network of domestic 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. The average number of Company owned units in operation increased from 13 during the three months ended August 31, 2011 to 17 units in the same period of the current year. The increase in average Company-owned units in operation and the resulting increase in retail sales was partially offset by a decrease in Company-owned same-store sales. Same-store sales at Company-owned stores decreased by 15.8% in the three months ended August 31, 2012 compared to the three months ended August 31, 2011. We believe the decline in same-store sales was primarily the result of the grand opening effect of Aspen Leaf Yogurt locations and the resulting revenues associated with these openings in the prior year.

### Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees increased 2.5% in the three months ended August 31, 2012 compared with the same period of the prior year as a result of an increase in royalties based on the Company's purchase-based royalty structure, an increase in royalties from co-branded locations and an increase in same-store sales, partially offset by a decrease in domestic franchise units. Same store sales at franchise locations increased 1.1% during the three months ended August 31, 2012 compared to the same period in the prior year. Average licensed locations in operation increased from 44 units in the three months ended August 31, 2011 to 53 units in the same period of the current year. The average number of domestic units in operation decreased from 247 in the three months ended August 31, 2011 to 238 in the same period of the current year. The decrease in franchise fee revenue during the three months ended August 31, 2012, compared with the prior year period was the result of a decrease in domestic franchise openings from 5 during the three months ended August 31, 2011 to 2 openings during the three months ended August 31, 2012.

### Costs and Expenses

| (\$'s in thousands)              | Three months ended |           | Change  | % Change |   |
|----------------------------------|--------------------|-----------|---------|----------|---|
|                                  | 2012               | 2011      |         |          |   |
| Cost of sales – factory adjusted | \$3,068.6          | \$3,017.0 | \$51.6  | 1.7      | % |
| Cost of sales - retail           | 601.0              | 560.6     | 40.4    | 7.2      | % |
| Franchise costs                  | 558.1              | 514.8     | 43.3    | 8.4      | % |
| Sales and marketing              | 408.8              | 384.9     | 23.9    | 6.2      | % |
| General and administrative       | 701.7              | 717.0     | (15.3)  | (2.1)    | % |
| Retail operating                 | 893.3              | 787.4     | 105.9   | 13.4     | % |
| Total                            | \$6,231.5          | \$5,981.7 | \$249.8 | 4.2      | % |

### Adjusted gross margin

| (\$'s in thousands)           | Three months ended |           | Change | % Change |   |
|-------------------------------|--------------------|-----------|--------|----------|---|
|                               | 2012               | 2011      |        |          |   |
| Factory adjusted gross margin | \$1,604.6          | \$1,522.4 | \$82.2 | 5.4      | % |
| Retail                        | 955.9              | 903.6     | 52.3   | 5.8      | % |



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|                               |           |   |           |   |         |    |      |    |
|-------------------------------|-----------|---|-----------|---|---------|----|------|----|
| Total                         | \$2,560.5 |   | \$2,426.0 |   | \$134.5 |    | 5.5  | %  |
| (Percent)                     |           |   |           |   |         |    |      |    |
| Factory adjusted gross margin | 34.3      | % | 33.5      | % | 0.8     | %  | 2.4  | %  |
| Retail                        | 61.4      | % | 61.7      | % | (0.3    | %) | (0.5 | %) |
| Total                         | 41.1      | % | 40.4      | % | 0.7     | %  | 1.7  | %  |

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Adjusted gross margin, a non-GAAP measure, is equal to the sum of our factory adjusted gross margin plus our retail gross margin calculated in accordance with GAAP. Factory adjusted gross margin is equal to factory 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 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 factory adjusted gross margin to factory gross margin, the most comparable performance measure under GAAP:

| (\$'s in thousands)                 | Three Months Ended<br>August 31, |            |
|-------------------------------------|----------------------------------|------------|
|                                     | 2012                             | 2011       |
| Factory adjusted gross margin       | \$ 1,604.6                       | \$ 1,522.4 |
| Less: Depreciation and Amortization | 71.9                             | 69.0       |
| Factory GAAP gross margin           | \$ 1,532.7                       | \$ 1,453.4 |

#### Costs and Expenses

##### Cost of Sales

Factory margins increased 80 basis points in the three months ended August 31, 2012 compared to the three months ended August 31, 2011 due primarily to an increase in the average selling price of products to domestic franchise units. The slight decrease in Company-owned store margin is due primarily to a change in product mix.

##### Franchise Costs

The increase in franchise costs in the three months ended August 31, 2012 versus the three months ended August 31, 2011 is due primarily to an increase in costs associated with support and development of the Company's international development initiative. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 37.2% in the three months ended August 31, 2012 from 32.7% in the three months ended August 31, 2011. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of a 75.4% decrease in franchise fee revenue as a result of fewer franchise store openings in the three months ended August 31, 2012.

##### Sales and Marketing

The increase in sales and marketing expense for the three months ended August 31, 2012 compared to the same period in the prior year is due primarily to an increase in marketing-related compensation and benefit costs.

##### General and Administrative

The decrease in general and administrative costs for the three months ended August 31, 2012 compared to the same period in the prior year is due primarily to lower costs associated with Aspen Leaf Yogurt site selection. As a percentage of total revenues, general and administrative expense decreased to 9.1% in the three months ended August 31, 2012 compared to 9.5% in the same period of the prior year.

### Retail Operating Expenses

The increase in retail operating expense was primarily due to an increase in the average number of Company-owned stores in operation. The average number of Company owned units in operation increased from 13 during the three months ended August 31, 2011 to 17 units in the same period of the current year. Retail operating expenses, as a percentage of retail sales, increased from 53.8% in the three months ended August 31, 2011 to 57.4% in the same period of the current year.

### Depreciation and Amortization

Depreciation and amortization of \$230,000 in the three months ended August 31, 2012 increased 21.1% from \$190,000 incurred in the three months ended August 31, 2011, due to additional depreciable assets acquired by us as a result of an increase in the number of Company-owned stores in operation and the associated depreciation of those assets.

### Interest Income

Interest income of \$11,500 realized in the three months ended August 31, 2012 represents a decrease of \$2,500 from the \$14,000 realized in the three months ended August 31, 2011.

### Income Tax Expense

Our effective income tax rate for the three months ended August 31, 2012 was 35.2%, compared to 35.7% for the three months ended August 31, 2011.

### Six Months Ended August 31, 2012 Compared to the Six Months Ended August 31, 2011

Basic earnings per share increased 3.3% from \$.30 for the six months ended August 31, 2011 to \$—.31 for the same period of the current year. Revenues increased 7.2% to \$17.4 million for the six months ended August 31, 2012 compared to \$16.2 million in the same period of the prior year. Operating income increased 3.2% from \$2.8 million in the six months ended August 31, 2011 to \$2.9 million in the same period of the current year. Net income increased 3.3% from \$1.8 million in the six months ended August 31, 2011 to \$1.9 million in the same period of the current year. The increase in operating income and net income for the six months ended August 31, 2012 compared to the same period in the prior year was due primarily to an increase in revenues, partially offset by an increase in operating expenses and an operating loss of approximately \$272,000 associated with the retail operations and franchise support of Aspen Leaf Yogurt.

### Revenues

| (\$'s in thousands)        | Six Months Ended<br>August 31, |            | Change  | %<br>Change |   |
|----------------------------|--------------------------------|------------|---------|-------------|---|
|                            | 2012                           | 2011       |         |             |   |
| Factory sales              | \$11,161.8                     | \$10,372.0 | \$789.8 | 7.6         | % |
| Retail sales               | 3,158.9                        | 2,842.1    | 316.8   | 11.1        | % |
| Franchise fees             | 159.1                          | 249.8      | (90.7)  | (36.3)      | % |
| Royalty and marketing fees | 2,908.2                        | 2,749.8    | 158.4   | 5.8         | % |
| Total                      | \$17,388.0                     | \$16,213.7 | 1,174.3 | 7.2         | % |

### Factory Sales

The increase in factory sales for the six months ended August 31, 2012 versus the six months ended August 31, 2011 was primarily due to an 11.4% increase in shipments of product to customers outside our network of franchised retail stores and a 6.6% increase in sales to domestic and international franchised and licensed stores. These increases were partially offset by a 3.6% decrease in the average number of domestic Rocky Mountain Chocolate Factory franchised stores in operation and a 2.7% decline in same-store pounds purchased by our network of franchised stores.

### Retail Sales

The increase in retail sales resulted primarily from an increase in the average number of Company-owned stores in operation from 14 in the six months ended August 31, 2011 to 18 in the same period of the current year. The increase in average Company-owned units in operation and the resulting increase in retail sales was partially offset by a decrease in Company-owned same-store sales. Same-store retail sales at Company-owned locations decreased 0.4% in the six months ended August 31, 2012 compared to the same period in the prior year.

## Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees increased 5.8% in the six months ended August 31, 2012 compared with the same period of the prior year as a result of an increase in royalties based on the Company's purchase based royalty structure, an increase in same store sales and an increase in royalties from co-branded locations, partially offset by a decrease in domestic franchise units. Same store sales at franchise locations increased 1.1% during the six months ended August 31, 2012 compared to the same period in the prior year. Average licensed locations in operation increased from 43 units in six months ended August 31, 2011 to 52 units in the same period of the current year. The average number of domestic units in operation decreased from 247 in the six months ended August 31, 2011 to 238 in the same period of the current year. The decrease in franchise fee revenue during the six months ended August 31, 2012, compared with the prior year period was the result of a decrease in domestic franchise opening from 9 during the six months ended August 31, 2011 to 4 openings during the six months ended August 31, 2012, partially offset by an increase in international license fees.

## Costs and Expenses

| (\$'s in thousands)              | Six months ended |                    | Change  | % Change |   |
|----------------------------------|------------------|--------------------|---------|----------|---|
|                                  | 2012             | August 31,<br>2011 |         |          |   |
| Cost of sales – factory adjusted | \$7,500.8        | \$7,087.8          | \$413.0 | 5.8      | % |
| Cost of sales - retail           | 1,191.0          | 1,123.1            | 67.9    | 6.0      | % |
| Franchise costs                  | 1,102.5          | 921.7              | 180.8   | 19.6     | % |
| Sales and marketing              | 870.0            | 825.1              | 44.9    | 5.4      | % |
| General and administrative       | 1,541.8          | 1,456.6            | 85.2    | 5.8      | % |
| Retail operating                 | 1,824.3          | 1,638.6            | 185.7   | 11.3     | % |
| Total                            | \$14,030.4       | \$13,052.9         | \$977.5 | 7.5      | % |

## Adjusted gross margin

| (\$'s in thousands) | Six months ended |                    | Change  | % Change |   |
|---------------------|------------------|--------------------|---------|----------|---|
|                     | 2012             | August 31,<br>2011 |         |          |   |
| Factory             | \$3,661.0        | \$3,284.2          | \$376.8 | 11.5     | % |
| Retail              | 1,967.9          | 1,719.0            | 248.9   | 14.5     | % |
| Total               | \$5,628.9        | \$5,003.2          | \$625.7 | 12.5     | % |

## (Percent)

|         |      |   |      |   |     |   |     |   |
|---------|------|---|------|---|-----|---|-----|---|
| Factory | 32.8 | % | 31.7 | % | 1.1 | % | 3.5 | % |
| Retail  | 62.3 | % | 60.5 | % | 1.8 | % | 3.0 | % |
| Total   | 39.3 | % | 37.9 | % | 1.4 | % | 3.7 | % |

Adjusted gross margin, a non-GAAP measure, is equal to the sum of our factory adjusted gross margin plus our retail gross margin calculated in accordance with GAAP. Factory adjusted gross margin is equal to factory 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 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 factory adjusted gross margin to factory gross margin, the most comparable performance measure under GAAP:

| (\$'s in thousands)                 | Six Months Ended |            |
|-------------------------------------|------------------|------------|
|                                     | August 31,       |            |
|                                     | 2012             | 2011       |
| Factory adjusted gross margin       | \$ 3,661.0       | \$ 3,284.2 |
| Less: Depreciation and Amortization | 142.3            | 138.5      |
| Factory GAAP gross margin           | \$ 3,518.7       | \$ 3,145.7 |

## Costs and Expenses

### Cost of Sales

Factory margins increased 110 basis points for the six months ended August 31, 2012 compared to the six months ended August 31, 2011 due primarily to an increase in the average selling price of products to domestic franchise units. The increase in Company-owned store margin is due primarily to lower 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, 2012 compared to the six months ended August 31, 2011 is due primarily to an increase in travel and support costs associated with our international development initiative and an increase in franchise opportunity advertising costs. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 35.9% in the six months ended August 31, 2012 from 30.7% in the six months ended August 31, 2011. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of higher franchise costs relative to revenues as discussed above.

### Sales and Marketing

The increase in sales and marketing expense for the six months ended August 31, 2012 compared to the same period in the prior year is due primarily to an increase in marketing-related compensation and benefit costs.

### General and Administrative

The increase in general and administrative costs for the six months ended August 31, 2012 compared to the six months ended August 31, 2011 is due primarily to an increase in travel costs associated with our international development initiative and an increase in expense associated with our analysis of doubtful accounts and notes receivable. As a percentage of total revenues, general and administrative expenses was approximately unchanged at 8.9% in the six months ended August 31, 2012 compared to 9.0% in the same period of the prior year.

### Retail Operating Expenses

The increase in retail operating expense was primarily due to an increase in the average number of Company-owned stores in operation during the six months ended August 31, 2012 compared with the same period of the prior year. The average number of Company owned units in operation increased from 14 during the six months ended August 31, 2011 to 18 units in the same period of the current year. Retail operating expenses, as a percentage of retail sales, was approximately unchanged from 57.7% in the six months ended August 31, 2011 to 57.8% in the same period of the current year.

### Depreciation and Amortization

Depreciation and amortization of \$468,000 in the six months ended August 31, 2012 increased 30.2% from \$359,000 incurred in the six months ended August 31, 2011 due to an increase in the number of Company-owned stores in operation and the associated depreciation of those assets.

### Interest Income



Interest income of \$23,000 realized in the six months ended August 31, 2012 represents a decrease of \$8,000 from the \$31,000 realized in the same period of the prior year due to lower balances of notes receivable.

#### Income Tax Expense

Our effective income tax rate in the six months ended August 31, 2012 was 35.1% and was approximately unchanged from 35.4% in the same period in the prior year.

## Liquidity and Capital Resources

As of August 31, 2012, working capital was \$10.2 million, compared with \$10.6 million as of February 29, 2012, a decrease of \$400,000. The change in working capital was due primarily to operating results being offset by the repurchase of stock and payment of cash dividends.

Cash and cash equivalent balances decreased from \$4.1 million as of February 29, 2012 to \$3.8 million as of August 31, 2012 as a result of repurchase and share retirement of \$1.7 million partially offset by cash flows provided by operating activities. Our current ratio was 4.53 to 1 at August 31, 2012 in comparison with 3.98 to 1 at February 29, 2012. We monitor current and anticipated future levels of cash and cash equivalents in relation to anticipated operating, financing and investing requirements.

We have a \$5.0 million (no amount was outstanding as of August 31, 2012) working capital line of credit collateralized by substantially all of our assets with the exception of our retail store assets. Additionally, the line of credit is subject to various financial ratio and leverage covenants. As of August 31, 2012, we were in compliance with all such covenants. The line was subject to renewal on July 31, 2012. The line was renewed on September 24, 2012.

In November 2011, we executed a promissory note for \$2.5 million in order to establish a line of credit for the funding of the potential expansion of Company-owned Aspen Leaf Yogurt locations. The line of credit is guaranteed by us and is collateralized by our land, building and improvements. We may draw from the line of credit until November 1, 2013 to fund new Aspen Leaf Yogurt store openings. After November 1, 2013, any amount outstanding will be repaid over the 48 month period subsequent to November 1, 2013. Interest on borrowings is at 4.75% per annum. As of August 31, 2012, no amount was outstanding under this promissory note.

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 2013.

## 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

We do not engage in commodity futures trading or hedging activities and do not enter into derivative financial instrument transactions for trading or other speculative purposes. We also do not engage in transactions in foreign currencies or in interest rate swap transactions that could expose us to market risk. However, we are exposed to some commodity price and interest rate risks.

We frequently enter into purchase contracts of between six to eighteen months for chocolate and certain nuts. These contracts permit us 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, we may benefit if prices rise during the terms of these contracts, but we may be required to pay above-market prices if prices fall and we are unable to renegotiate the terms of the contract. As of August 31, 2012, based on future contractual obligations for chocolate products, we estimate that a 10.0% change in the prices of cocoa would result in an \$125,000 favorable or unfavorable price benefit resulting from our contracts.

We have a \$5.0 million bank line of credit that bears interest at a variable rate and a \$2.5 million promissory note that allows draws until November 1, 2013 and bears interest at 4.75% per annum. As of August 31, 2012, no amount was outstanding under the line of credit or the promissory note. We do not believe that we are exposed to any material interest rate risk related to these credit facilities.

#### 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 Exchange 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, 2012, 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, 2012.

##### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended August 31, 2012, that have materially affected, or are 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 29, 2012. 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 29, 2012.

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

Issuer Purchases of Equity Securities

| Period                     | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|----------------------------|--------------------------------------|----------------------------------|--|--|
| June 1 – June 30, 2012     | 129,500                              | \$10.45                          | 129,500  | \$1,288,515  |
| July 1, - July 31, 2012    | -                                    | -                                | -  | \$1,288,515  |
| August 1 – August 31, 2012 | -                                    | -                                | -  | \$1,288,515  |
| Total                      | 129,500                              | \$10.45                          | 129,500  | \$1,288,515  |

(1) On February 19, 2008, we announced the plan to repurchase up to \$3,000,000 of our common stock in the open market or in private transactions, whenever deemed appropriate by management. The plan will only expire once the designated amounts are reached and the plan is completed.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

- 3.1 Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K of the Registrant for the year ended February 28, 2009)
- 3.2 Articles of Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K of the Registrant filed on May 22, 2009)
- 3.3 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K of the Registrant filed on December 14, 2007)
- 31.1\* Certification of Chief Executive Officer Filed Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002
- 31.2\* Certification of Chief Financial Officer Filed Pursuant To Section 302 of The Sarbanes-Oxley Act of 2002
- 32.1\*\* Certification of Chief Executive Officer Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002
- 32.2\*\* Certification of Chief Financial Officer Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002
- 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

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\* 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 12, 2012

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