ROCKY MOUNTAIN CHOCOLATE FACTORY INC
Form 10-Q
October 15, 2002

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

(Mark One)

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

For the quarterly period ended August 31, 2002

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

For the transition period from ________ to ________

Commission file number 0-14749

Rocky Mountain Chocolate Factory, Inc.
(Exact name of registrant as specified in its charter)

Colorado
(State of incorporation)

84-0910696
(I.R.S. Employer Identification No.)

265 Turner Drive, Durango, CO 81303
(Address of principal executive offices)

(970) 259-0554
(Registrant's telephone number, including area code)

Indicate by checkmark 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 X No ___.

On October 11, 2002 the registrant had outstanding 2,498,790 shares of its common stock, $.03 par value.

The exhibit index is located on page 17.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended August 31, 2002	2001	Six Months End 2002
REVENUES			
Sales	$ 3,976,609	$ 3,648,005	$ 6,927,411
Franchise and royalty fees	1,089,751	1,041,686	2,111,288
Total revenues	5,066,360	4,689,691	9,038,699
COSTS AND EXPENSES			
Cost of sales	2,499,463	2,124,770	4,236,405
Franchise costs	306,852	362,722	598,883
Sales and marketing	323,159	323,385	636,972
General and administrative	498,127	408,472	966,099
Retail operating	213,997	218,751	412,597
Depreciation and amortization	205,939	229,325	411,985
Total costs and expenses	4,047,537	3,667,425	7,262,941
INCOME FROM OPERATIONS	1,018,823	1,022,266	1,775,758
OTHER INCOME (EXPENSE)			
Interest expense	(88,140)	(125,003)	(173,688)
Interest income	59,412	80,185	126,657
Other, net	(28,728)	(44,818)	(47,031)
INCOME BEFORE INCOME TAXES	990,095	977,448	1,728,727
PROVISION FOR INCOME TAXES	374,255	369,475	653,460
NET INCOME	$ 615,840	$ 607,973	$ 1,075,267
BASIC EARNINGS PER COMMON SHARE	$ .25	$ .25	$ .43
DILUTED EARNINGS PER COMMON SHARE	$ .23	$ .23	$ .39
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	2,498,699	2,464,219	2,491,693
DILUTIVE EFFECT OF EMPLOYEE STOCK OPTIONS	207,378	150,249	245,601
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING, ASSUMING DILUTION	2,706,077	2,614,468	2,737,294

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
BALANCE SHEETS

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ASSETS	(unaud
CURRENT ASSETS	
Cash and cash equivalents	$ 1
Accounts receivable, less allowance for doubtful accounts of $63,247 and $73,269	3,0
Notes receivable	7
Inventories	3,8
Deferred income taxes	1
Other	4
Total current assets	8,3
PROPERTY AND EQUIPMENT, NET	5,7
OTHER ASSETS	
Notes receivable, less valuation allowance of $275,690 and $225,689	2,2
Intangible Assets, net	1,3
Other	
Total other assets	3,7
Total assets	$ 17,8
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Current maturities of long-term debt	$ 1,1
Line of credit	5
Accounts payable	9
Accrued salaries and wages	6
Other accrued expenses	3
Total current liabilities	3,5
LONG-TERM DEBT, LESS CURRENT MATURITIES	3,7
DEFERRED GAIN ON SALE OF ASSETS	3
DEFERRED INCOME TAXES	1
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY	
Common stock, $.03 par value, 7,250,000 shares authorized, 2,498,790 and 2,474,640 issued and outstanding	
Additional paid-in capital	2,6
Retained earnings	7,3
Less notes receivable from employees and directors	
Total stockholders' equity	10,0
Total liabilities and stockholders' equity	$ 17,8

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

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

	Six Months Ended August 31, 2002	Six Months Ended August 31, 2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,075,267	$ 958,808
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	411,985	453,683
Provision for doubtful accounts	50,000	62,046
Provision for inventory loss	--	62,000
(Gain) Loss on sale of property and equipment	(87)	(124,646)
Changes in operating assets and liabilities:		
Accounts receivable	(209,392)	(383,929)
Refundable income taxes	--	37,574
Inventories	(764,890)	(646,677)
Other assets	(169,052)	(178,753)
Accounts payable	251,273	(173,961)
Accrued liabilities	(368,837)	37,276
Net cash provided by operating activities	276,267	103,421
CASH FLOWS FROM INVESTING ACTIVITIES		
Addition to notes receivable	(210,504)	(355,053)
Proceeds from sale of assets	960	181,100
Purchases of property and equipment	(154,326)	(450,491)
Increase in other assets	(71,422)	(87,563)
Net cash used in investing activities	(435,292)	(712,007)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	--	6,027,429
Payments on long-term debt	(601,870)	(4,576,548)
Proceeds from line of credit	1,900,000	5,775,000
Payments on line of credit	(1,340,000)	(6,185,030)
Repurchase of stock	--	(558,261)
Costs of stock split	(14,010)	--
Reduction of loan from officer	39,999	48,750
Proceeds from exercise of stock options	117,516	16,000
Net cash provided by financing activities	101,635	547,340
NET DECREASE IN CASH AND CASH EQUIVALENTS	(57,390)	(61,246)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	165,472	87,301
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 108,082	$ 26,055

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS

NOTE 1 - NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Rocky Mountain Chocolate Factory, Inc. is an international franchiser, confectionery manufacturer and retail operator in the United States, Guam, Canada and the United Arab Emirates. The Company manufactures an extensive line of premium chocolate candies and other confectionery products. 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 and other confectionery products.

Basis of Presentation

The accompanying financial statements have been prepared by the Company, without audit, and reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods. The 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. The results of operations for the six months ended August 31, 2002 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 financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended February 28, 2002.

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. For the six months ended August 31, 2002 and 2001, 35,666 and 66,500 stock options were excluded from the computation of earnings per share because their effect would have been anti-dilutive.

NOTE 3 - INVENTORIES

Inventories consist of the following:

	August 31, 2002	February 28, 2002
Ingredients and supplies	$1,744,976	$1,538,107
Finished candy	2,147,004	1,588,983
	$3,891,980	$3,127,090

NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

	August 31, 2002	February 28, 2002
Land	$ 513,618	$ 513,618
Building	3,838,936	3,772,807
Machinery and equipment	6,588,738	6,512,836
Furniture and fixtures	594,042	592,677
Leasehold improvements	419,289	418,403
Transportation equipment	188,874	188,874
	12,143,497	11,999,215
Less accumulated depreciation	6,375,705	6,015,309
Property and equipment, net	$ 5,767,792	$ 5,983,906

NOTE 5 - STOCKHOLDERS' EQUITY

Stock Split

On January 28, 2002 the Board of Directors approved a four-for-three stock split payable March 4, 2002 to shareholders of record at the close of business on February 11, 2002. Shareholders received one additional share of Common Stock for every three shares owned prior to the record date and $18,560 was reclassified from additional paid-in capital to common stock for the par value of the additional shares. Immediately prior to the split there were 1,855,918 shares outstanding. Subsequent to the split there were 2,474,640 shares outstanding. All share and per share data have been restated in all periods presented to give effect to the stock split.

Stock Repurchases

Between March 6, 2001 and September 28, 2001, the Company repurchased 123,355 Company shares at an average price of $5.07 per share. Of the shares repurchased during this time period, 25,333 were repurchased from employees.

On May 15, 1998, the Company purchased 448,000 shares and certain of its directors and executive officers purchased 138,667 shares of the Company's issued and outstanding common stock at $3.8625 per share from La Salle National Bank of Chicago, Illinois, which obtained these shares through foreclosure from certain shareholders unrelated to any transactions of the Company. The Company loaned certain officers and directors the funds to acquire 53,333 of the 138,667 shares purchased by them. The loans were secured by the related shares, bore interest payable annually at 7.5% and were due May 15, 2003. These loans were paid in full in May, 2002.

NOTE 6 - SUPPLEMENTAL CASH FLOW INFORMATION

Six Months Ended

Cash paid for:	August 31, 2002	2001
Interest	$ 173,191	$ 255,153
Income taxes	671,730	$ 300,234
Non-Cash Financing Activities		
Company financed sales of retail store assets	$ 230,317	$1,039,500

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NOTE 7 - OPERATING SEGMENTS

The Company classifies its business interests into two reportable segments: Franchising and Manufacturing. Previously the Company segregated Retail as a third reportable segment. The Company has phased out its Company-owned store program to four remaining stores. The remaining stores provide an environment for testing new products and promotions, operating and training methods and merchandising techniques. Company management evaluates these stores in relation to their contribution to franchising efforts. The previously reported Retail segment is now included in the Franchising segment and all previously reported periods have been restated. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 to the Company's financial statements included in the Company's annual report on Form 10-K for the year ended February 28, 2002. 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, 2002	Franchising	Manufacturing	Other	Total
Total revenues	$ 1,476,774	$ 3,805,268	$ --	$ 5,282,042
Intersegment revenues	--	(215,682)	--	(215,682)
Revenue from external customers	1,476,774	3,589,586	--	5,066,360
Segment profit (loss)	516,979	1,049,171	(576,055)	990,095
Total assets	2,018,023	10,500,869	5,335,837	17,854,729
Capital expenditures	8,832	84,114	4,934	97,880
Total depreciation & amortization	50,631	106,108	49,200	205,939
Three Months Ended August 31, 2001				
Total revenues	$ 1,425,329	$ 3,570,164	$ --	$ 4,995,493
Intersegment revenues	--	(305,802)	--	(305,802)
Revenue from external customers	1,425,329	3,264,362	--	4,689,691
Segment profit (loss)	383,568	1,098,370	(504,490)	977,448

Total assets	2,073,784	9,784,662	4,955,457	16,813,903
Capital expenditures	8,605	55,743	43,853	108,201
Total depreciation & amortization	66,010	112,114	51,201	229,325

Six Months Ended August 31, 2002	Franchising	Manufacturing	Other	Total
Total revenues	$ 2,820,061	$ 6,615,488	$ --	$ 9,435,549
Intersegment revenues	--	(396,850)	--	(396,850)
Revenue from external customers	2,820,061	6,218,638	--	9,038,699
Segment profit (loss)	954,614	1,885,643	(1,111,530)	1,728,727
Total assets	2,018,023	10,500,869	5,335,837	17,854,729
Capital expenditures	41,571	95,114	17,641	154,326
Total depreciation & amortization	101,263	212,322	98,400	411,985
Six Months Ended August 31, 2001				
Total revenues	$ 3,072,556	$ 6,437,231	$ --	$ 9,509,787
Intersegment revenues	--	(587,322)	--	(587,322)
Revenue from external customers	3,072,556	5,849,909	--	8,922,465
Segment profit (loss)	829,520	1,860,382	(1,148,409)	1,541,493
Total assets	2,073,784	9,784,662	4,955,457	16,813,903
Capital expenditures	53,936	119,606	276,949	450,491
Total depreciation & amortization	133,436	219,945	100,302	453,683

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NOTE 8 - STORE SALES

In connection with the Company's plans to phase out its Company-owned stores, the Company sold ten Company-owned stores in fiscal 2002 resulting in sales proceeds consisting of cash and notes receivable of approximately $1.2 million and recognized and deferred gains of approximately $124,000 and $386,000, respectively.

In connection with the Company's plans to phase out its Company-owned stores, the Company sold eighteen Company-owned stores in fiscal 2001 resulting in sales proceeds consisting of cash and notes receivable of approximately $2.3 million and recognized and deferred gains of approximately $542,000 and $193,000, respectively.

At August 31, 2002, the Company has $3,260,000 of notes receivable outstanding. The notes require monthly payments and bear interest at rates ranging from 7.25% to 12.5%. The notes mature through February 2006 and are secured by the assets of the sold stores.

Of the notes receivable outstanding at August 31, 2002, $2,478,000 are from a single franchisee. These notes require variable monthly payments, bear interest at rates ranging from 7.25% to 12.0% and mature in February 2005. During fiscal

2002 the Company adjusted the repayment schedule of these notes to correspond to the franchisee's store operating cycles. The Company also financed an additional $300,000 of inventory and wrote-off $189,000 of the notes receivable. During fiscal 2003 the Company financed $230,000 for an additional store for the franchisee.

NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS

Effective March 1, 2002 the Company adopted Statement of Financial Accounting Standards No. 141 (SFAS 141), Business Combinations, SFAS 142, Goodwill and Intangible Assets and SFAS 144, Accounting for Impairment or Disposal of Long-Lived Assets. In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 146 (SFAS 146), Accounting for Costs Associated with Exit or Disposal Activities.

SFAS 142 revised the accounting for purchased goodwill and intangible assets. Under SFAS 142, goodwill and intangible assets with indefinite lives will no longer be amortized, will be tested for impairment annually and also in the event of an impairment indicator, and must be assigned to reporting units for purposes of impairment testing and segment reporting.

The Company has historically amortized goodwill on the straight-line method over ten to twenty-five years. Beginning March 1, 2002, quarterly and annual goodwill amortization is no longer recognized. The Company completed a transitional fair value based impairment test of goodwill as of March 1, 2002. There were no impairment losses resulting from the transitional testing. The Company has two reports units with goodwill - Franchising and Manufacturing - which also are reportable segments. There were no changes to carrying amounts of goodwill for the six months ended August 31, 2002.

Intangible assets consist of the following:

		August 31, 2002 (unaudited)		
	Amortization Period	Gross Carrying Value	Accumulated Amortization	C
Intangible assets subject to amortization				
Store design	10 Years	$ 173,391	$ 14,468	$
Packaging licenses	5 Years	95,831	45,027	
Packaging design	10 Years	399,753	26,812	
Total		668,975	86,307	
Intangible assets not subject to amortization				
Franchising segment-Goodwill		1,235,000	534,529	1
Manufacturing segment-Goodwill		295,000	197,682	
Total Goodwill		1,530,000	732,211	1
Total intangible assets		$2,198,975	$ 818,518	$2

Amortization expense related to intangible assets totaled $42,263 and $12,837 during the six months ended August 31, 2002 and 2001. The aggregate estimated amortization expense for intangible assets remaining as of August 31, 2002 is as follows:

Remainder of fiscal	2003	$ 45,668
	2004	87,200
	2005	52,200
	2006	52,200
	2007	52,200
Thereafter		293,200
Total		$582,668

Net income and earnings per share for the six months ended August 31, 2002 and 2001 adjusted to exclude goodwill amortization is as follows:

	Three months ended August 31,		Six Months ended August 31,	
	2002	2001	2002	2001
Reported net income	$615,840	$607,973	$1,075,267	$958,808
Goodwill amortization, net of tax	--	18,288	--	36,576
Adjusted net income	$615,840	$626,261	$1,075,267	$995,384
Basic earnings per share:				
Reported net income	$ .25	$ .25	$ .43	$ .39
Goodwill amortization, net of tax	--	--	--	.01
Adjusted net income	$ .25	$ .25	$ .43	$ .40
Diluted earnings per share:				
Reported net income	$ .23	$ .23	$ .39	$ .37
Goodwill amortization, net of tax	--	.01	--	.01
Adjusted net income	$ .23	$ .24	$ .39	$ .38

SFAS 141 eliminates the pooling method of accounting for business combinations initiated after June 30, 2001. In addition, SFAS 141 addresses the accounting for intangible assets and goodwill acquired in a business combination. This portion of SFAS 141 is effective for business combinations completed after June 30, 2001. The implementation of this standard did not have an effect on the Company's financial position, results of operations or cash flows.

SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The implementation of this standard did not have an effect on the Company's financial position, results of operations or cash flows.

SFAS 146 nullifies FASB Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). It requires that a liability be recognized for those costs only when the liability is incurred, that is, when it meets the definition of a liability in the Financial Accounting Standards Board's conceptual framework. SFAS No. 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with earlier adoption encouraged. The Company does not expect SFAS 146 to have a material effect on the Company's financial position or results of operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the financial condition and results of operations of the Company should be read in conjunction with the unaudited financial statements and related Notes of the Company included elsewhere in this report. This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties.

The Company's ability to successfully achieve expansion of its Rocky Mountain Chocolate Factory franchise system depends on many factors not within the Company's control including the availability of suitable sites for new store establishment 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 not within the Company's control, including the receptivity of its franchise system to its product introductions and promotional programs.

As of August 31, 2002, the Company has notes receivable of approximately $2.5 million outstanding from a single franchisee. The franchisee is delinquent in payment of principal and interest but is working with the Company to make payment. The notes are collateralized by the franchisee's underlying store assets, certain of which are now under Company control and which are being offered for sale to satisfy the debt. Recovery of the net carrying value of these notes is dependent upon, among other factors, the ability of the Company and the franchisee to sell certain of these assets at prices equivalent to those historically received by the Company and franchisees in comparable sales, the proceeds of which will be applied to amounts due under the notes. Whether these assets can be sold at these estimated fair market values depends on factors not within the control of the franchisee or the Company. Although there is no assurance that these stores will be sold, based on internal analysis by the Company, it believes that they will be sold at such prices within the next six to twelve months.

As a result, the actual results realized by the Company could differ materially from results discussed in or contemplated by the forward-looking statements made herein including seasonality, consumer interest in the Company's products, general economic conditions, consumer trends, costs and availability of raw materials, competition and the effect of government regulation. Words or phrases such as "will," "anticipate," "expect," "believe," "intend," "estimate," "project," "plan" or similar expressions are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on the forward-looking statements made in this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

THREE MONTHS ENDED AUGUST 31, 2002 COMPARED TO THE THREE MONTHS ENDED AUGUST 31, 2001

Net income was $616,000 for the three months ended August 31, 2002, or $.25 per basic share, versus $608,000, or $.25 per basic share, for the three months ended August 31, 2001.

($'s in thousands)	Three Months Ended August 31, 2002	2001	Change	% Change
Factory sales	$3,589.5	$3,264.3	$325.2	10.0%
Retail sales	387.1	383.7	3.4	0.9%
Franchise fees	80.5	116.1	(35.6)	(30.7%)
Royalty and Marketing fees	1,009.3	925.6	83.7	9.0%
Total	$5,066.4	$4,689.7	$376.7	8.0%

Factory Sales

Factory sales increased $325,000 or 10.0%, to $3.6 million in the second quarter of fiscal 2003, compared to $3.3 million in the second quarter of fiscal 2002. The increase in factory sales was due primarily to an increase of 103% in factory sales to customers outside the Company's system of franchised retail stores and an increase in the number of franchised stores in operation in the second quarter of fiscal 2003 versus the second quarter of 2002. These increases were partially offset by a decrease of 4.6% in same store pounds purchased by the franchise system.

Retail Sales

Retail sales increased $3,400 or 0.9%, to $387,000 in the second quarter of fiscal 2003 compared to $384,000 in the second quarter of fiscal 2002.

Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees increased $84,000, or 9.0%, to $1.0 million in the second quarter of fiscal 2003, compared to $926,000 in the second quarter of fiscal 2002. This increase resulted from growth in the average number of franchised stores in operation in the second quarter of fiscal 2003 versus the same period last year. Same store sales were down at franchised stores by 3.8%. Franchise fee revenues decreased in the second quarter of fiscal 2003 due to a decrease in the number of franchises sold versus the second quarter of fiscal 2002.

Costs and Expenses

Cost of Sales

Cost of sales as a percentage of sales increased to 62.9% in the second quarter of fiscal 2003 from 58.2% in the second quarter of fiscal 2002. The increase resulted from increased factory sales, which generate lower margins than retail sales, and a decrease in factory margins to 34.3% in fiscal 2003 from 39.7% in the second quarter of fiscal 2002. The decrease in factory margins is due primarily to decreased production efficiencies due to lower than planned production levels, decreased trucking contribution due to lower than planned shipping volume and increased commodity costs. Company-owned store margins for the second quarter of 2003 increased to 63.4% compared to 59.7% in the second quarter of fiscal 2002 due to changes in mix of product sold.

Franchise Costs

Franchise costs decreased 15.4% from $363,000 in the second quarter of fiscal

2002 to $307,000 in the second quarter of fiscal 2003. The decrease is due primarily to more focused advertising. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs decreased to 28.2% in the second quarter of fiscal 2003 from 34.8% in the second quarter of fiscal 2002. This decrease as a percentage of royalty, marketing and franchise fees is the combined result of decreased franchise costs and increased revenue.

Sales and Marketing

Sales and Marketing expenses of 323,000 in the second quarter of fiscal 2003 were comparable to the second quarter of fiscal 2002.

General and Administrative

General and administrative expenses increased 21.9% to $498,000 in the second quarter of fiscal 2003 from $408,000 in the second quarter of fiscal 2002 primarily due to increased professional fees and personnel costs. As a percentage of total revenues, general and administrative expenses increased to 9.8% in fiscal 2003 compared to 8.7% in fiscal 2002.

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Retail Operating Expenses

Retail operating expenses decreased 2.2% from $219,000 in the second quarter of fiscal 2002 to $214,000 in the second quarter of fiscal 2003. This decrease was due primarily to a decrease in administration costs for Company-owned stores. Retail operating expenses, as a percentage of retail sales, decreased from 57.0% in the second quarter of fiscal 2002 to 55.3% in the second quarter of fiscal 2003 due to more efficient operations.

Depreciation and Amortization

Depreciation and amortization decreased 10.2% to $206,000 in the second quarter of fiscal 2003 from $229,000 in the second quarter of fiscal 2002. The decrease in depreciation and amortization is due primarily to suspension of amortization expense ($29,000 quarterly) for goodwill beginning March 1, 2002. Goodwill has historically been amortized on the straight-line method over ten to twenty-five years. In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 142 (SFAS 142), Goodwill and Intangible Assets, which revised the accounting for purchased goodwill and intangible assets. Under SFAS 142, goodwill and intangible assets with indefinite lives are no longer amortized, but will be tested for impairment annually, and also in the event of an impairment indicator. SFAS 142 is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS 142 on March 1, 2002.

Other Expense

Other expense of $29,000 incurred in the second quarter of fiscal 2003 decreased 35.9% from the $45,000 incurred in the second quarter of fiscal 2002 due primarily to lower interest expense on lower average outstanding amounts of and rates on debt.

Income Tax Expense

The Company's effective income tax rate in the second quarter of fiscal 2003 was 37.8%, which is approximately the same rate as the second quarter of fiscal 2002.

SIX MONTHS ENDED AUGUST 31, 2002 COMPARED TO THE SIX MONTHS ENDED AUGUST 31, 2001

Net income was $1,075,000 for the six months ended August 31, 2002, or $.43 per basic share, versus $959,000, or $.39 per basic share, for the six months ended August 31, 2001.

Revenues

	Six Months Ended August 31,			%
($'s in thousands)	2002	2001	Change	Change
Factory sales	$6,218.6	$5,849.9	$368.7	6.3%
Retail sales	708.8	961.5	(252.7)	(26.3%)
Franchise fees	236.5	403.2	(166.7)	(41.3%)
Royalty and Marketing fees	1,874.8	1,707.9	166.9	9.8%
Total	$9,038.7	$8,922.5	$116.2	1.3%

Factory Sales

Factory sales increased $369,000, or 6.3%, to $6.2 million in the first six months of fiscal 2003, compared to $5.8 million in the first six months of fiscal 2002. The increase in factory sales was due primarily to an increase of 85% in factory sales to customers outside the Company's system of franchised retail stores and an increase in the number of franchised stores in operation in the second quarter of fiscal 2003 versus the second quarter of 2002. These increases were partially offset by a decrease of 7.2% in same store pounds purchased by the franchise system.

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Retail Sales

Retail sales decreased $253,000, or 26.3%, to $709,000 in the first six months of fiscal 2003 compared to $962,000 in the first six months of fiscal 2002. This decrease resulted from a decrease in the average number of stores in operation in the first six months of fiscal 2003 (4) versus the same period last year (6). The decrease in the average number of stores in operation is due to completion of the Company's plan to convert its Company-owned stores to franchise-owned stores.

Royalties, Marketing Fees and Franchise Fees

Royalties and marketing fees increased $167,000, or 9.8% to $1.9 million in the first six months of fiscal 2003, compared to $1.7 million in the first six months of fiscal 2002. This increase resulted from growth in the average number of franchised stores in operation in the first six months of fiscal 2003 versus the same period last year. Same store sales decreased minimally at franchised stores by 2.3%. Franchise fee revenues decreased in the first six months of fiscal 2003 due to a decrease in the number of franchises sold versus the first six months of fiscal 2002.

Costs and Expenses

Cost of Sales

Cost of sales as a percentage of sales increased to 61.2% in the first six months of fiscal 2003 from 58.9% in the first six months of fiscal 2002. This increase resulted from increased factory sales, which generate lower margins than retail sales, and a decrease in factory margins to 36.1% in fiscal 2003 from 38.1% in fiscal 2002. The decrease in factory margins is due primarily to decreased production efficiencies due to lower than planned production levels, decreased trucking contribution due to lower than planned shipping volumes and increased commodity costs. Company-owned store margins for the first six months of 2003 improved to 62.5% compared to 59.3% in the first six months of fiscal 2002 due to changes in mix of product sold.

Franchise Costs

Franchise costs decreased 12.5% from $684,000 in the first six months of fiscal 2002 to $599,000 in the first six months of fiscal 2003. The decrease is due primarily to more focused advertising and lower personnel costs. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs decreased to 28.4% in the first six months of fiscal 2003 from 32.4% in the first six months of fiscal 2002. This decrease as a percentage of royalty, marketing and franchise fees is primarily a result of decreased franchise costs.

Sales and Marketing

Sales and Marketing increased 4.3% to $637,000 in the first six months of fiscal 2003 from $611,000 in the first six months of fiscal 2002. The increase is due primarily to increased personnel costs in support of franchisee marketing efforts.

General and Administrative

General and administrative expenses increased 4.5% to $966,000 in the first six months of fiscal 2002 from $925,000 in the first six months of fiscal 2002. The increase is due primarily to increased professional fees. As a percentage of total revenues, general and administrative expenses increased to 10.7% in fiscal 2003 compared to 10.4% in fiscal 2002. This increase, as a percentage of total revenues, resulted from increased general and administrative costs and a 1.3% increase in total revenues.

Retail Operating Expenses

Retail operating expenses decreased from $578,000 in the first six months of fiscal 2002 to $413,000 in the first six months of fiscal 2003, representing a decrease of 28.6%. This decrease was due primarily to a decrease in the average number of stores in operation during the first six months of fiscal 2003 (4) versus the first six months of fiscal 2002(6). Retail operating expenses, as a percentage of retail sales, decreased from 60.0% in the first six months of fiscal 2002 to 58.2% in the first six months of fiscal 2003 due to a change in mix of stores in operation and related seasonality.

Depreciation and Amortization

Depreciation and amortization decreased 9.2% to $412,000 in the first six months of fiscal 2003 from $454,000 in the first six months of fiscal 2002. The decrease in depreciation and amortization is due primarily to suspension of amortization expense ($29,000 quarterly) for goodwill beginning March 1, 2002.

Goodwill has historically been amortized on the straight-line method over ten to twenty-five years. In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 142 (SFAS 142), Goodwill and Intangible Assets, which revised the accounting for purchased goodwill and intangible assets. Under SFAS 142, goodwill and intangible assets with indefinite lives are no longer amortized, but will be tested for impairment annually, and also in the event of an impairment indicator. SFAS 142 is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS 142 on March 1, 2002.

Other Expense

Other expense of $47,000 incurred in the first six months of fiscal 2003 represents a 60.6% decline from the $119,000 incurred in the first six months of fiscal 2002 due primarily to lower interest expense on lower average outstanding amounts of and rates on debt.

Income Tax Expense

The Company's effective income tax rate in the first six months of fiscal 2003 was 37.8%, which is approximately the same rate as the first six months of fiscal 2002.

LIQUIDITY AND CAPITAL RESOURCES

As of August 31, 2002, working capital was $4.8 million, compared with $3.9 million as of February 28, 2002, an increase of $0.9 million. The increase in working capital was primarily due to operating results.

Cash and cash equivalent balances decreased from $165,000 as of February 28, 2002 to $108,000 as of August 31, 2002 as a result of cash flows used by investing activities in excess of cash flows provided by financing and operating activities. The Company's current ratio was 2.37 to 1 at August 31, 2002 in comparison with 2.27 to 1 at February 28, 2002.

The Company's long-term debt is comprised primarily of a real estate mortgage facility used to finance the Company's factory expansion (unpaid balance as of August 31, 2002 of $2.0 million), and chattel mortgage notes (unpaid balance as of August 31, 2002 of $2.9 million) used to fund the fiscal 1996 and 1997 Company-owned store expansion and improve and automate the Company's factory infrastructure.

The Company has a $2.5 million ($1.9 million available as of August 31, 2002) working capital line of credit collateralized by substantially all of the Company's assets with the exception of the Company's retail store assets. The line is subject to renewal in July, 2003.

The Company believes cash flows generated by operating activities and available financing will be sufficient to fund the Company's operations at least through the end of fiscal 2003.

IMPACT OF INFLATION

Inflationary factors such as increases in the costs of ingredients and labor directly affect the Company's operations. Most of the Company's leases provide for cost-of-living adjustments and require the Company to pay taxes, insurance and maintenance expenses, all of which are subject to inflation. Additionally the Company's future lease costs for new facilities may include potentially escalating costs of real estate and construction. There is no assurance that the Company will be able to pass on increased costs to its customers.

Depreciation expense is based on the historical cost to the Company of its 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

The Company is subject to seasonal fluctuations in sales, which cause fluctuations in quarterly results of operations. Historically, the strongest sales of the Company's 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 the Company's business and the impact of new store openings and sales of franchises, results for any quarter are not necessarily indicative of results that may be achieved in other quarters or for a full fiscal year.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

The Company frequently enters into purchase contracts of between six to eighteen months for chocolate and certain nuts. These contracts permit the Company to purchase the specified commodity at a fixed price on an as-needed basis during the term of the contract. Because prices for these products may fluctuate, the Company may benefit if prices rise during the terms of these contracts, but it may be required to pay above-market prices if prices fall and it is unable to renegotiate the terms of the contract.

As of August 31, 2002, none of the Company's long-term debt was subject to a variable interest rate. The Company also has a $2.5 million bank line of credit that bears interest at a variable rate. As of August 31, 2002, $560,000 was outstanding under the line of credit. The Company does not believe that it is exposed to any material interest rate risk related to its long-term debt or the line of credit.

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

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures within 90 days of the filing date of this quarterly report, and, based on their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
The Company is not currently involved in any legal proceedings that are material to the Company's business or financial condition.

Item 2. Changes in Securities and Use of Proceeds
None

Item 3. Defaults Upon Senior Securities
None

Item 4. Submission of Matters to a Vote of Security Holders
The 2002 Annual Meeting of the Shareholders of the Company was held in Durango, Colorado on July 19, 2002.

The matter voted on by the stockholders was the election of Franklin E. Crail, Bryan J. Merryman, Gerald A. Kien, Lee N. Mortenson, Fred M. Trainor and Clyde Wm. Engle as directors of the Company. No nominee received less than 98.8% of the shares voted.

Item 5. Other Information
None

Item 6. Exhibits and Reports on Form 8-K
A. Exhibits
99.1 Certification Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002, Chief Executive Officer

99.2 Certification Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002, Chief Financial Officer

B. Reports on Form 8-K
None

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
(Registrant)

Date: October 14, 2002

/s/ Bryan J. Merryman

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

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Certifications:

I, Franklin E. Crail, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rocky Mountain Chocolate Factory, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's

internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 14, 2002 /s/ Franklin E. Crail

Franklin E. Crail, President, Chief Executive Officer and Chairman of the Board of Directors

Certifications:

I, Bryan J. Merryman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rocky Mountain Chocolate Factory, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
   d) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

c) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 14, 2002

/s/ Bryan J. Merryman

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

EXHIBIT INDEX

Exhibit No.	Description
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99.2	Certification Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002, Chief Financial Officer