

ROCKY MOUNTAIN CHOCOLATE FACTORY INC

Form 10-K/A

November 05, 2004

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 2

(Mark One)

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

For the fiscal year ended February 29, 2004

OR

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

For the transition period from _____ to _____

Commission file number 0-14749

Rocky Mountain Chocolate Factory, Inc.

(Exact name of registrant as specified in its charter)

Colorado
(State of Incorporation)

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

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

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT
None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT
Common Stock, \$.03 par value

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b of the Act). Yes ☐ No ☒

On April 30, 2004, there were 4,283,510 shares of Common Stock outstanding. The aggregate market value of the Common Stock (based on the average of the closing bid and ask prices as quoted on the Nasdaq National Market System on April 30, 2004) held by non-affiliates was \$26,705,481.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement furnished to stockholders in connection with the 2004 Annual Meeting of Stockholders (the "Proxy Statement") are incorporated by reference in Part III of this Report. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the close of the registrant's fiscal year.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC. FORM 10-K

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EXPLANATORY NOTE

This Amendment No. 2 on Form 10-K/A is an amendment to the Rocky Mountain Chocolate Factory, Inc. (the Company) Annual Report on Form 10-K for the fiscal year ended February 29, 2004 (the 2004 Annual Report). The purpose of this Form 10-K/A is to replace, in its entirety, the previously filed Exhibit 10.14, with an identical Exhibit 10.14 that has been appropriately marked to indicate that certain information has been omitted from the exhibit pursuant to a confidential treatment request filed with the Commission, and to mark the Exhibit Index to indicate the same, in accordance with rules and regulations of the Commission. This Form 10-K/A does not update, modify, or amend any other disclosure.

PART I.

ITEM 1. BUSINESS

General

Founded in 1981 and incorporated in Colorado in 1982, Rocky Mountain Chocolate Factory, Inc. (the Company) is an international franchiser and confectionery manufacturer. The Company is headquartered in Durango, Colorado and manufactures an extensive line of premium chocolate candies and other confectionery products. As of March 31, 2004 there were 8 Company-owned and 252 franchised Rocky Mountain Chocolate Factory stores operating in 40 states, Canada, Guam and the United Arab Emirates.

Approximately 40% of the products sold at Rocky Mountain Chocolate Factory stores are prepared on the premises. The Company believes this in-store preparation creates a special store ambiance and the aroma and sight of products being made attracts foot traffic and assures customers that products are fresh.

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

The Company believes its manufacturing expertise and reputation for quality has facilitated the sale of selected products through new distribution channels. The Company is currently selling its products in a number of new distribution channel programs including wholesaling, fundraising, corporate sales, mail order and internet sales.

The Company's revenues are currently derived from three principal sources: (i) sales to franchisees and others of chocolates and other confectionery products manufactured by the Company (67-72-70%); (ii) sales at Company-owned stores of chocolates and other confectionery products (including product manufactured by the Company) (12-7-8%) and (iii) the collection of initial franchise fees and royalties from franchisees (21-21-22%). The figures in parentheses show the percentage of total revenues attributable to each source for fiscal years ended February 28 (29), 2004, 2003 and 2002, respectively.

According to the National Confectionery Association, the total U.S. candy market approximated \$24.0 billion of retail sales in 2001 with chocolate generating sales of approximately \$13.1 billion. According to the Department of Commerce, per capita consumption of chocolate in 2002 approached 13 pounds per year nationally and consumption of chocolate products increased approximately 5% compared to 2001.

In Fiscal 2001, the Company began phasing out its Rocky Mountain Chocolate Factory Company-owned store program. In Fiscal 2002, the Company sold to new or existing franchisees all Company-owned store locations with the exception of four Company-owned stores located in key markets in Colorado (the Colorado Stores). In Fiscal 2003, the Company foreclosed on four of the stores previously sold to a franchisee due to the franchisee's insolvency. The Company intends to retain the eight stores to test sales, marketing, design and operational initiatives.

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Business Strategy

The Company's objective is to build on its position as a leading international franchiser and manufacturer of high quality chocolate and other confectionery products. The Company continually seeks opportunities to profitably expand its business. To accomplish this objective, the Company employs a business strategy that includes the following elements:

Product Quality and Variety

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

Store Atmosphere and Ambiance

The Company seeks to establish an enjoyable and inviting atmosphere in each Rocky Mountain Chocolate Factory store. Each store prepares numerous products, including fudge, brittles and caramel apples, in the store. In-store preparation is designed both to be fun and entertaining for customers and to convey an image of freshness and homemade quality. The Company's design staff has developed easily replicable designs and specifications to ensure that the Rocky Mountain Chocolate Factory concept is consistently implemented throughout the system.

In February 2000, the Company retained a nationally recognized design firm to evaluate and update its existing store design. The objective of the store design project is threefold: (1) increase average revenue per unit thereby opening untapped real estate environments; (2) further emphasize the entertainment and freshness value of the Company's in-store confectionery factory; and (3) improve operational efficiency through optimal store layout. The Company completed the store redesign project and the testing of the new design in fiscal 2002. Through March 31, 2004, 59 stores incorporating the new design have been opened.

Site Selection

Careful selection of a site is critical to the success of a Rocky Mountain Chocolate Factory store. Many factors are considered by the Company in identifying suitable sites, including tenant mix, visibility, attractiveness, accessibility, level of foot traffic and occupancy costs. Final site selection occurs only after the Company's senior management has approved the site. The Company believes that the experience of its management team in evaluating a potential site is one of the Company's competitive strengths.

Customer Service Commitment

The Company emphasizes excellence in customer service and seeks to employ and to sell franchises to motivated and energetic people. The Company also fosters enthusiasm for its customer service philosophy and the Rocky Mountain Chocolate Factory concept through its annual franchisee convention, regional meetings and other frequent contacts with its franchisees.

Increase Same Store Retail Sales at Existing Locations

The Company seeks to increase profitability of its store system through increasing sales at existing store locations. Changes in system wide same store retail sales are as follows:

2000	(4.3%)
2001	(3.9%)
2002	0.0%
2003	(3.4%)
2004	(0.6%)

The Company believes that its same store sales growth was positively impacted by the sale of Beanie Babies (stuffed animals manufactured by Ty Inc.) and related products in fiscal 1999 because many of the Company's retail stores capitalized on this extraordinary trend during this time period. In fiscal 2000 and 2001, however, the demand for Beanie Babies decreased significantly, and the Company believes this decreased demand is the primary reason for negative comparable store sales in fiscal 2000 and 2001. As expected, this trend reversed in fiscal 2002. The Company believes that the negative trend in fiscal 2003 and through the third fiscal quarter

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of 2004 was due to the overall weak economy and retail environment, especially in tourist areas where many of the stores operate. The Company experienced positive same store sales of 5.4% in its fiscal fourth quarter of 2004 and believes the positive trend is due primarily to a recovery in the United States economy.

The Company feels that same store retail sales growth can be accelerated through store redesign to provide a more attractive and effective retail sales environment while retaining the Rocky Mountain Chocolate Factory store ambiance and theme.

In February 2000, the Company retained a nationally recognized packaging design firm to completely redesign the packaging featured in the Company's retail stores. The Company has designed a contemporary and coordinated line of packaged products that capture and convey the freshness, fun and excitement of the Rocky Mountain Chocolate Factory retail store experience. The Company completed the packaging redesign project during 2002. Testing of the new designs has yielded positive results. The Company believes that the successful launch of new packaging will have a positive future impact on same store sales.

Increase Same Store Pounds Purchased by Existing Locations

In fiscal 2004, the Company experienced a same store pounds purchased decline of 1.7%. The decline in same store pounds purchased from the factory continued what appears to be a trend of a shift in sales mix toward store-made products and away from factory-made products. The Company is in the process of adding new products and focusing its existing product lines in an effort to control this trend.

Enhanced Operating Efficiencies

The Company seeks to improve its profitability by controlling costs and increasing the efficiency of its operations. Efforts in the last several years include the purchase of additional automated factory equipment, implementation of a comprehensive MRP II forecasting, planning, scheduling and reporting system, implementation of alternative manufacturing strategies and installation of enhanced Point-of-Sale (POS) systems in all of its Company-owned and eighty-six of its franchised stores through March 31, 2004. These measures have significantly improved the Company's ability to deliver its products to its stores safely, quickly and cost-effectively and impact store operations. Additionally, the divestiture of substantially all of the Company-owned stores has reduced the Company's exposure to real estate risk, improved the Company's operating margins and allowed the Company to increase its focus on franchising.

Expansion Strategy

Key elements of the Company's expansion strategy include:

Unit Growth

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

High Traffic Environments

The Company currently establishes franchised stores in the following environments: factory outlet malls, tourist environments, regional malls, street fronts and other entertainment oriented environments. The Company, over the last several years, has had a particular focus on factory outlet mall locations. Although each of these environments has a number of attractive features, including a high level of foot traffic, the factory outlet mall environment has historically offered the best combination of tenant mix, customer spending characteristics and favorable occupancy costs. The Company is optimistic that its exciting new store design will allow it to target untapped potential of the over 1,200 regional malls in the United States. The Company has established a business relationship with most of the major developers in the United States and believes that these relationships provide it with the opportunity to take advantage of attractive sites in new and existing real estate environments.

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Name Recognition and New Market Penetration

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

Store Concept

The Company seeks to establish a fun and inviting atmosphere in its Rocky Mountain Chocolate Factory store locations. Unlike most other confectionery stores, each Rocky Mountain Chocolate Factory store prepares certain products, including fudge and caramel apples, in the store. Customers can observe store personnel making fudge from start to finish, including the mixing of ingredients in old-fashioned copper kettles and the cooling of the fudge on large marble tables, and are often invited to sample the store's products. The Company believes that an average of approximately 40% of the revenues of franchised stores are generated by sales of products prepared on the premises. The Company believes the in-store preparation and aroma of its products enhance the ambiance at Rocky Mountain Chocolate Factory stores, are fun and entertaining for its customers and convey an image of freshness and homemade quality.

The majority of existing Rocky Mountain Chocolate Factory stores have a distinctive country Victorian decor, which further enhances their friendly and enjoyable atmosphere. Each store includes finely crafted wood cabinetry, copper and brass accents, etched mirrors and large marble tables on which fudge and other products are made. To ensure that all stores conform to the Rocky Mountain Chocolate Factory image, the Company's design staff provides working drawings and specifications and approves the construction plans for each new store. The Company also controls the signage and building materials that may be used in the stores.

In fiscal 2002, the Company launched its new store design concept intended specifically for high foot traffic regional shopping malls. The new store design concept is modern with crisp and clean site lines and an even stronger emphasis on the Company's unique upscale kitchen. Based on encouraging results, the Company is requiring that all new Rocky Mountain Chocolate Factory stores incorporate the new design concept.

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

Kiosk Concept

In fiscal 2002, the Company opened its first full service retail kiosk concept. The kiosk is a vehicle for retail environments where in-line real estate is unavailable or build-out costs and/or rent factors do not meet the Company's financial criteria. The kiosk, which is approximately 250 square feet, incorporates the Company's trademark cooking area where caramel apples, fudge and other popular confections are prepared in front of customers using traditional cooking utensils. The kiosk also includes the Company's core product and gifting lines in order to provide the customer with a full Rocky Mountain Chocolate Factory experience.

The Company believes the kiosk concept enhances its franchise opportunity by providing more flexibility in support of existing franchisees' expansion programs and allows new franchisees that otherwise would not qualify for an in-line location an opportunity to join the Rocky Mountain Chocolate Factory system.

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Products and Packaging

The Company typically produces approximately 300 chocolate candies and other confectionery products, using proprietary recipes developed primarily by the Company's master candy maker. These products include many varieties of clusters, caramels, creams, mints and truffles. The Company continues to engage in a major effort to expand its product line by developing additional exciting and attractive new products. During the Christmas, Easter and Valentine's Day holiday seasons, the Company may make as many as 100 additional items, including many candies offered in packages specially designed for the holidays. A typical Rocky Mountain Chocolate Factory store offers up to 100 of these candies throughout the year and up to an additional 100 during holiday seasons. Individual stores also offer more than 15 premium fudges and other products prepared in the store. The Company believes that approximately 50% of the revenues of Rocky Mountain Chocolate Factory stores are generated by products manufactured at the Company's factory, 40% by products made in the store using Company recipes and ingredients purchased from the Company or approved suppliers and the remaining 10% by products, such as ice cream, coffee and other sundries, purchased from approved suppliers.

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

Chocolate candies manufactured by the Company are sold at prices ranging from \$12.90 to \$20.25 per pound, with an average price of \$16.60 per pound. Franchisees set their own retail prices, though the Company does recommend prices for all of its products.

Operating Environment

The Company currently establishes Rocky Mountain Chocolate Factory stores in four primary environments: factory outlet malls, tourist areas, regional malls and street fronts. Each of these environments has a number of attractive features, including high levels of foot traffic.

Factory Outlet Malls

There are approximately 230 factory outlet malls in the United States, and as of February 29, 2004, there were Rocky Mountain Chocolate Factory stores in approximately 75 of these malls in over 30 states. The Company has established business relationships with most of the major outlet mall developers in the United States. Although not all factory outlet malls provide desirable locations for the Company's stores, management believes the Company's relationships with these developers will provide it with the opportunity to take advantage of attractive sites in new and existing outlet malls.

Tourist Areas and Street Fronts

As of February 29, 2004, there were approximately 70 Rocky Mountain Chocolate Factory stores in locations considered to be tourist areas, including Fisherman's Wharf in San Francisco, California and the Riverwalk in San Antonio, Texas. Tourist areas are very attractive locations because they offer high levels of foot traffic and favorable customer spending characteristics, and greatly increase the Company's visibility and name recognition. The Company believes significant opportunities exist to expand into additional tourist areas with high levels of foot traffic.

Regional Malls

There are approximately 1,130 regional malls in the United States, and as of February 29, 2004, there were Rocky Mountain Chocolate Factory stores in approximately 40 of these malls, including locations in the Mall of America in Bloomington, Minnesota; Escondido, California; Fort Collins, Colorado; and West Palm Beach, Florida. Although often providing favorable levels of foot traffic, regional malls typically involve more expensive rent structures and competing food and beverage concepts. The Company's new store concept is designed to unlock the potential of the regional mall environment.

The Company believes there are a number of other environments that have the characteristics necessary for the successful operation of Rocky Mountain Chocolate Factory stores such as airports and sports arenas. Three franchised Rocky Mountain Chocolate Factory stores exist at airport locations: two at Denver International Airport and one at Vancouver International Airport in Canada.

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Franchising Program

General

The Company's franchising philosophy is one of service and commitment to its franchise system, and the Company continuously seeks to improve its franchise support services. The Company's concept has consistently been rated as an outstanding franchise opportunity by publications and organizations rating such opportunities. In February 2003, Rocky Mountain Chocolate Factory was rated the number one franchise opportunity in the candy category by Entrepreneur Magazine. As of March 31, 2004, there were 252 franchised stores in the Rocky Mountain Chocolate Factory system.

Franchisee Sourcing and Selection

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

In fiscal 1992, the Company entered into a franchise development agreement covering Canada with Immaculate Confections, Ltd. of Vancouver, British Columbia. Pursuant to this agreement, Immaculate Confections purchased the exclusive right to franchise and operate Rocky Mountain Chocolate Factory stores in Canada. Immaculate Confections, as of March 31, 2004, operated 28 stores under the agreement.

In fiscal 2000, the Company entered into a franchise development agreement covering the Gulf Cooperation Council States of United Arab Emirates, Qatar, Bahrain, Saudi Arabia, Kuwait and Oman with Al Muhairy Group of United Arab Emirates. Pursuant to this agreement, Al Muhairy Group purchased the exclusive right to franchise and operate Rocky Mountain Chocolate Factory stores in the Gulf Cooperation Council States. Al Muhairy Group, as of March 31, 2004, operated 2 stores under this agreement.

Training and Support

Each domestic franchisee owner/operator and each store manager for a domestic franchisee is required to complete a 7-day comprehensive training program in store operations and management. The Company has established a training center at its Durango headquarters in the form of a full-sized replica of a properly configured and merchandised Rocky Mountain Chocolate Factory store. Topics covered in the training course include the Company's philosophy of store operation and management, customer service, merchandising, pricing, cooking, inventory and cost control, quality standards, record keeping, labor scheduling and personnel management. Training is based on standard operating policies and procedures contained in an operations manual provided to all franchisees, which the franchisee is required to follow by terms of the franchise agreement. Additionally, and importantly, trainees are provided with a complete orientation to Company operations by working in key factory operational areas and by meeting with each member of the senior management of the Company. Training continues through the opening of the store, where Company field consultants assist and guide the franchisee in all areas of operation.

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

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

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Quality Standards and Control

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

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

The Franchise Agreement: Terms and Conditions

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

Under the current form of domestic Rocky Mountain Chocolate Factory franchise agreement, franchisees pay the Company (i) an initial franchise fee of \$19,500 for each store, (ii) royalties equal to 5% of monthly gross sales, and (iii) a marketing fee equal to 1% of monthly gross sales. Franchisees are generally granted exclusive territory with respect to the operation of Rocky Mountain Chocolate Factory stores only in the immediate vicinity of their stores. Chocolate products not made on the premises by franchisees must be purchased from the Company or approved suppliers. The franchise agreements require franchisees to comply with the Company's procedures of operation and food quality specifications, to permit inspections and audits by the Company and to remodel stores to conform with standards in effect. The Company may terminate the franchise agreement upon the failure of the franchisee to comply with the conditions of the agreement and upon the occurrence of certain events, such as insolvency or bankruptcy of the franchisee or the commission by the franchisee of any unlawful or deceptive practice, which in the judgment of the Company is likely to adversely affect the Rocky Mountain Chocolate Factory system. The Company's ability to terminate franchise agreements pursuant to such provisions is subject to applicable bankruptcy and state laws and regulations. See Business Regulation.

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

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

Franchise Financing

The Company does not provide prospective franchisees with financing for their stores, but has developed relationships with several sources of franchisee financing to whom it will refer franchisees. Typically, franchisees have obtained their own sources of such financing and have not required the Company's assistance.

Company Store Program

As of March 31 2004, there were 8 Company-owned Rocky Mountain Chocolate Factory stores. Company-owned stores provide a training ground for Company-owned store personnel and district managers and a controllable testing ground for new products and promotions, operating and training methods and merchandising techniques.

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

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Manufacturing Operations

General

The Company manufactures its chocolate candies at its factory in Durango, Colorado. All products are produced consistent with the Company's philosophy of using only the finest, highest quality ingredients with no artificial preservatives to achieve its marketing motto of *the Peak of Perfection in Handmade Chocolate®*.

It has always been the belief of management that the Company should control the manufacturing of its own chocolate products. By controlling manufacturing, the Company can better maintain its high product quality standards, offer unique, proprietary products, manage costs, control production and shipment schedules and potentially pursue new or under-utilized distribution channels.

Manufacturing Processes

The manufacturing process primarily involves cooking or preparing candy centers, including nuts, caramel, peanut butter, creams and jellies, and then coating them with chocolate or other toppings. All of these processes are conducted in carefully controlled temperature ranges, and the Company employs strict quality control procedures at every stage of the manufacturing process. The Company uses a combination of manual and automated processes at its factory. Although the Company believes that it is currently preferable to perform certain manufacturing processes, such as dipping of some large pieces, by hand, automation increases the speed and efficiency of the manufacturing process. The Company has from time to time automated processes formerly performed by hand where it has become cost-effective for the Company to do so without compromising product quality or appearance.

The Company seeks to ensure the freshness of products sold in Rocky Mountain Chocolate Factory stores with frequent shipments. Most Rocky Mountain Chocolate Factory stores do not have significant space for the storage of inventory, and the Company encourages franchisees and store managers to order only the quantities that they can reasonably expect to sell within approximately two to four weeks. For these reasons, the Company generally does not have a significant backlog of orders.

Ingredients

The principal ingredients used by the Company are chocolate, nuts, sugar, corn syrup, cream and butter. The factory receives shipments of ingredients daily. To ensure the consistency of its products, the Company buys ingredients from a limited number of reliable suppliers. In order to assure a continuous supply of chocolate and certain nuts, the Company frequently enters into purchase contracts of between six to eighteen months for these products. 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. The Company has one or more alternative sources for all essential ingredients and therefore believes that the loss of any supplier would not have a material adverse effect on the Company and its results of operations. The Company currently also purchases small amounts of finished candy from third parties on a private label basis for sale in Rocky Mountain Chocolate Factory stores.

Trucking Operations

The Company operates eight trucks and ships a substantial portion of its products from the factory on its own fleet. The Company's trucking operations enable it to deliver its products to the stores quickly and cost-effectively. In addition, the Company back-hauls its own ingredients and supplies, as well as product from third parties, on return trips as a basis for increasing trucking program economics.

Marketing

The Company relies primarily on in-store promotion and point-of-purchase materials to promote the sale of its products. The monthly marketing fees collected from franchisees are used by the Company to develop new packaging and in-store promotion and point-of-purchase materials, and to create and update the Company's local store marketing handbooks.

The Company focuses on local store marketing efforts by providing customizable marketing materials, including advertisements, coupons, flyers and mail order catalogs generated by its in-house Creative Services department. The department works directly with franchisees to implement local store marketing programs.

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The Company aggressively seeks low cost, high return publicity opportunities through participation in local and regional events, sponsorships and charitable causes. The Company has not historically and does not intend to engage in national advertising in the near future.

Competition

The retailing of confectionery products is highly competitive. The Company and its franchisees compete with numerous businesses that offer confectionery products. Many of these competitors have greater name recognition and financial, marketing and other resources than the Company. In addition, there is intense competition among retailers for real estate sites, store personnel and qualified franchisees. Competitive market conditions could adversely affect the Company and its results of operations and its ability to expand successfully.

The Company believes that its principal competitive strengths lie in its name recognition and its reputation for the quality, value, variety and taste of its products and the special ambiance of its stores; its knowledge and experience in applying criteria for selection of new store locations; its expertise in merchandising and marketing of chocolate and other candy products; and the control and training infrastructures it has implemented to assure execution of successful practices and techniques at its store locations. In addition, by controlling the manufacturing of its own chocolate products, the Company can better maintain its high product quality standards for those products, offer proprietary products, manage costs, control production and shipment schedules and pursue new or under-utilized distribution channels.

Trade Name and Trademarks

The trade name *Rocky Mountain Chocolate Factory*[®], the phrases, *The Peak of Perfection in Handmade Chocolates*[®], *America's Chocolatier*[®], *The World's Chocolatier*[®] as well as all other trademarks, service marks, symbols, slogans, emblems, logos and designs used in the Rocky Mountain Chocolate Factory system, are proprietary rights of the Company. All of the foregoing are believed to be of material importance to the Company's business. The registration for the trademark *Rocky Mountain Chocolate Factory* has been granted in the United States and Canada. Applications have been filed to register the Rocky Mountain Chocolate Factory trademark and/or obtained in certain foreign countries.

The Company has not attempted to obtain patent protection for the proprietary recipes developed by the Company's master candy-maker and is relying upon its ability to maintain the confidentiality of those recipes.

Employees

At February 29, 2004, the Company employed approximately 159 people. Most employees, with the exception of store, factory and corporate management, are paid on an hourly basis. The Company also employs some people on a temporary basis during peak periods of store and factory operations. The Company seeks to assure that participatory management processes, mutual respect and professionalism and high performance expectations for the employee exist throughout the organization.

The Company believes that it provides working conditions, wages and benefits that compare favorably with those of its competitors. The Company's employees are not covered by a collective bargaining agreement. The Company considers its employee relations to be good.

Executive Officers

The executive officers of the Company and their ages at April 15, 2004 are as follows:

Name	Age	Position
Franklin E. Crail	62	Chairman of the Board, President and Director
Bryan J. Merryman	43	Chief Operating Officer, Chief Financial Officer, Treasurer and Director
Gregory L. Pope	37	Sr. Vice President Franchise Development and Operations
Edward L. Dudley	40	Sr. Vice President Sales and Marketing
William K. Jobson	48	Chief Information Officer
Jay B. Haws	54	Vice President Creative Services
Virginia M. Perez	66	Corporate Secretary

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Mr. Crail co-founded the first Rocky Mountain Chocolate Factory store in May 1981. Since the incorporation of the Company in November 1982, he has served as its President and a Director. He was elected Chairman of the Board in March 1986. Prior to founding the Company, Mr. Crail was co-founder and president of CNI Data Processing, Inc., a software firm which developed automated billing systems for the cable television industry.

Mr. Merryman joined the Company in December 1997 as Vice President Finance and Chief Financial Officer. Since April 1999 Mr. Merryman has also served the Company as the Chief Operating Officer and as a Director, and since January 2000 as its Treasurer. Prior to joining the Company, Mr. Merryman was a principal in Knightsbridge Holdings, Inc. (a leveraged buyout firm) from January 1997 to December 1997. Mr. Merryman also served as Chief Financial Officer of Super Shops, Inc., a retailer and manufacturer of aftermarket auto parts from July 1996 to November 1997 and was employed for more than eleven years by Deloitte and Touche LLP, most recently as a senior manager.

Mr. Pope became Sr. Vice President of Franchise Development and Operations in May 2004. Since joining the Company in October 1990, he has served in various positions including store manager, new store opener and franchise field consultant. In March 1996 he became Director of Franchise Development and Support. In June 2001 he became Vice President of Franchise Development, a position he held until he was promoted to his present position.

Mr. Dudley joined the Company in January 1997 to spearhead the Company's newly formed Product Sales Development function as Vice President Sales and Marketing, with the goal of increasing the Company's factory and retail sales. He was promoted to Senior Vice President in June 2001. During his 10 year career with Baxter Healthcare Corporation, Mr. Dudley served in a number of senior marketing and sales management capacities, including most recently that of Director, Distribution Services from March 1996 to January 1997. Mr. Dudley holds B.S. degrees in Finance and Accounting from the University of Colorado.

Mr. Jobson joined the Company in July 1998 as Director of Information Technology. In June 2001, he was promoted to Chief Information Officer, a position created to enhance the Company's strategic focus on information and information technology. From July 1995 to July 1998, Mr. Jobson worked for ADAC Laboratories in Durango, Colorado, a leading provider of diagnostic imaging and information systems solutions in the healthcare industry, as Manager of Technical Services and before that, Regional Manager.

Mr. Haws joined the Company in August 1991 as Vice President of Creative Services. Since 1981, Mr. Haws had been closely associated with the Company both as a franchisee and marketing/graphic design consultant. From 1986 to 1991 he operated two Rocky Mountain Chocolate Factory franchises located in San Francisco, California. From 1983 to 1989 he served as Vice President of Marketing for Image Group, Inc., a marketing communications firm based in Northern California. Concurrently, Mr. Haws was co-owner of two other Rocky Mountain Chocolate Factory franchises located in Sacramento, and Walnut Creek California. From 1973 to 1983 he was principal of Jay Haws and Associates, an advertising and graphic design agency. Mr. Haws holds a B.A. in graphics design and communication from California State University.

Ms. Perez joined the Company in June 1996 and has served as the Company's corporate secretary since February, 1997. From 1992 until joining the Company, she was employed by Huettig & Schromm, Inc., a property management and development firm in Palo Alto, California as executive assistant to the president and owner. Huettig & Schromm developed, owned and managed over 1,000,000 square feet of office space in business parks and office buildings on the San Francisco peninsula. Ms. Perez is a paralegal and has held various administrative positions during her career including executive assistant to the Chairman and owner of Sunset Magazine & Books, Inc.

Seasonal Factors

The Company's sales and earnings are seasonal, with significantly higher sales and earnings occurring during the Christmas holiday and summer vacation seasons than at other times of the year, which causes fluctuations in the Company's quarterly results of operations. In addition, quarterly results have been, and in the future are likely to be, affected by the timing of new store openings and the sale 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 the results that may be achieved in other quarters or for a full fiscal year.

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Regulation

Each of the Company-owned and franchised stores is subject to licensing and regulation by the health, sanitation, safety, building and fire agencies in the state or municipality where located. Difficulties or failures in obtaining the required licensing or approvals could delay or prevent the opening of new stores. New stores must also comply with landlord and developer criteria.

Many states have laws regulating franchise operations, including registration and disclosure requirements in the offer and sale of franchises. The Company is also subject to the Federal Trade Commission regulations relating to disclosure requirements in the sale of franchises and ongoing disclosure obligations.

Additionally, certain states have enacted and others may enact laws and regulations governing the termination or non-renewal of franchises and other aspects of the franchise relationship that are intended to protect franchisees. Although these laws and regulations, and related court decisions, may limit the Company's ability to terminate franchises and alter franchise agreements, the Company does not believe that such laws or decisions will have a material adverse effect on its franchise operations. However, the laws applicable to franchise operations and relationships continue to develop, and the Company is unable to predict the effect on its intended operations of additional requirements or restrictions that may be enacted or of court decisions that may be adverse to franchisers.

Federal and state environmental regulations have not had a material impact on the Company's operations but more stringent and varied requirements of local governmental bodies with respect to zoning, land use and environmental factors could delay construction of new stores.

Companies engaged in the manufacturing, packaging and distribution of food products are subject to extensive regulation by various governmental agencies. A finding of a failure to comply with one or more regulations could result in the imposition of sanctions, including the closing of all or a portion of the Company's facilities for an indeterminate period of time.

The Company's product labeling is subject to and complies with the Nutrition Labeling and Education Act of 1990.

The Company provides a limited amount of trucking services to third parties, to fill available space on the Company's trucks. The Company's trucking operations are subject to various federal and state regulations, including regulations of the Federal Highway Administration and other federal and state agencies applicable to motor carriers, safety requirements of the Department of Transportation relating to interstate transportation and federal, state and Canadian provincial regulations governing matters such as vehicle weight and dimensions.

The Company believes it is operating in substantial compliance with all applicable laws and regulations.

ITEM 2. PROPERTIES

The Company's manufacturing operations and corporate headquarters are located at its 58,000 square foot manufacturing facility, which it owns, in Durango, Colorado. During fiscal 2004, the Company's factory produced approximately 1.80 million pounds of chocolate candies, a 4.8% increase from the approximately 1.72 million pounds produced in fiscal 2003. The factory has the capacity to produce approximately 3.5 million pounds per year. In January 1998, the Company acquired a two-acre parcel adjacent to its factory to ensure the availability of adequate space to expand the factory as volume demands.

As of March 31, 2004, all of the 8 Company-owned stores were occupied pursuant to non-cancelable leases of five to ten years having varying expiration dates from August 2005 to October 2008, most of which contain optional five-year renewal rights. The Company does not deem any individual store lease to be significant in relation to its overall operations.

The Company acts as primary lessee of some franchised store premises, which it then subleases to franchisees, but the majority of existing locations are leased by the franchisee directly. Current Company policy is not to act as primary lessee on any further franchised locations. At March 31, 2004, the Company was the primary lessee at 11 of its 252 franchised stores. The subleases for such stores are on the same terms as the Company's leases of the premises. For information as to the amount of the Company's rental obligations under leases on both Company-owned and franchised stores, see Note 5 of Notes to financial statements.

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ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Part II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) Market Information

The Company's Common Stock trades on the National Market System of The Nasdaq Stock Market under the trading symbol RMCF. On May 4, 2004 the Board of Directors declared a 10 percent stock dividend payable on May 27, 2004 to shareholders of record as of May 13, 2004. On December 17, 2003 the Board of Directors declared a three-for-two stock split payable on February 2, 2004 to shareholders of record on January 20, 2004. On January 28, 2002 the Board of Directors declared a four-for-three stock split payable on March 4, 2002 to shareholders of record on February 11, 2002.

The Company declared this dividend and these stock splits because the Company felt that its Common Stock lacked sufficient shares and related liquidity to satisfy an increasing number of investors interested in purchasing the Company's Common Stock. All of the following items in Item 5. have been adjusted, where necessary, for the effects of the dividend and splits.

Between October 3, 2003 and February 19, 2004 the Company repurchased 120,285 Company shares at an average price of \$7.56 per share. In March 2004 the Company repurchased 31,440 Company shares at an average price of \$8.68 per share.

Between March 6, 2001 and September 28, 2001, the Company repurchased 203,535 Company shares at an average price of \$3.07 per share. Of the shares repurchased during this period, 41,800 were repurchased from employees.

The Company made these purchases because the Company felt that its Common Stock was undervalued and that such purchases would therefore be in the best interest of the Company and its stockholders.

The table below sets forth high and low price information for the Common Stock for each quarter of fiscal years 2004 and 2003, and dividend information.

Fiscal Year Ended February 29, 2004	Dividends		
	HIGH	LOW	declared
Fourth Quarter	\$9.64	\$7.04	.0545
Third Quarter	7.88	5.88	.0492

Second Quarter	6.06	4.61	.0455
First Quarter	5.00	3.71	

		Dividends	
Fiscal Year Ended February 28, 2003	HIGH	LOW	declared
Fourth Quarter	\$6.22	\$3.39	
Third Quarter	5.81	4.24	
Second Quarter	6.97	4.61	
First Quarter	9.82	5.68	

On April 30, 2004 the closing price for the Common Stock was \$9.16.

(b) Holders

On April 30, 2004 there were approximately 420 record holders of the Company's Common Stock. The Company believes that there are more than 800 beneficial owners of its Common Stock.

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The selected financial data presented below for the fiscal years ended February 28 or 29, 2000 through 2004, are derived from the Financial Statements of the Company, which have been audited by Ehrhardt Keefe Steiner & Hottman PC or Grant Thornton LLP, independent certified public accountants. The selected financial data should be read in conjunction with the Financial Statements and related Notes thereto included elsewhere in this Report and Management's Discussion and Analysis of Financial Condition and Results of Operations.

(Amounts in thousands, except per share data)	YEARS ENDED FEBRUARY 28 or 29,				
	2004	2003	2002	2001	2000
Selected Statement of Operations Data					
Total revenues	\$21,133	\$19,461	\$19,439	\$22,572	\$24,647
Operating income	3,779	1,496	3,370	3,105	2,662
Net income	\$ 2,319	\$ 852	\$ 1,995	\$ 1,556	\$ 1,057
Basic Earnings per Common Share	\$.55	\$.21	\$.49	\$.35	\$.19
Diluted Earnings per Common Share	\$.52	\$.19	\$.46	\$.35	\$.18
Weighted average common shares outstanding	4,181	4,117	4,081	4,457	5,677
Weighted average common shares outstanding, assuming dilution	4,503	4,464	4,350	4,469	5,713
Selected Balance Sheet Data					
Working capital	\$ 6,394	\$ 4,765	\$ 3,940	\$ 1,249	\$ 1,589
Total assets	17,967	16,084	16,795	15,042	16,440
Long-term debt	1,986	3,073	4,325	3,297	3,774
Stockholders' equity	11,590	9,891	8,821	7,062	8,433

**ITEM 7. 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 audited 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 Annual Report on Form 10-K contain forward-looking statements that involve risks and uncertainties.

The Company is a product-based international franchiser. The Company's revenues and profitability are derived principally from its franchised system of retail stores that feature chocolate and other confectionery products. The Company also sells its candy in selected locations outside its system of retail stores to build brand awareness. The Company operates eight retail units as a laboratory to test marketing, design and operational initiatives.

The Company is subject to seasonal fluctuations in sales because of the location of its franchisees, which have traditionally been located in resort or tourist locations. As the Company expands its geographical diversity to include regional malls, it has seen some moderation to its seasonal sales mix. Seasonal fluctuation in sales 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. Additionally, 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.

The most important factors in continued growth in the Company's 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.

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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 depends on many factors not within the Company's control including the receptivity of its franchise system of its product introductions and promotional programs.

As a result, the actual results realized by the Company could differ materially from the results discussed in or contemplated by the forward-looking statements made herein. 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 in this Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosures. Estimates and assumptions include, but are not limited to, the carrying value of accounts and notes receivable from franchisees, inventories, the useful lives of fixed assets, goodwill, and other intangible assets, income taxes, contingencies and litigation. The Company bases its estimates on analyses, of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe that the following represent our more critical estimates and assumptions used in the preparation of our financial statements, although not all inclusive.

Accounts and Notes Receivable The Company records an allowance for credit losses based on estimates of customers ability to pay and collateral value, as applicable. If the financial condition of our customers or collateral were to deteriorate, additional allowances may be required.

Revenue Recognition The Company recognizes revenue on sales of products to franchisees and other customers at the time of shipment. Franchise fee revenue is recognized upon completion of all significant initial services provided to the franchisee and upon satisfaction of all material conditions of the franchise agreement. The initial \$5,000 portion of the fee is recognized upon signing of the franchise agreement. The balance of the fee is recognized upon the franchisee's commitment to a property lease. The Company also recognizes a royalty fee of five percent (5%) and a marketing and promotion fee of one percent (1%) of the Rocky Mountain Chocolate Factory franchised stores' gross retail sales. Sales of products at retail stores are recognized at the time of sale.

Inventories The Company will write down inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Goodwill Goodwill consists of the excess of purchase price over the fair market value of acquired assets and liabilities. Effective March 1, 2002, under SFAS 142 all goodwill with indefinite lives is no longer subject to amortization. SFAS 142 requires that an impairment test be conducted annually or in the event of an impairment indicator. Our transition test conducted in fiscal 2004 showed no impairment of our goodwill.

Other accounting estimates inherent in the preparation of the Company's financial statements include estimates associated with its evaluation of the recoverability of deferred tax assets, as well as those used in the determination of liabilities related to litigation and taxation. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, and product mix. The Company constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Historically, actual results have not significantly deviated from those determined using the estimates described above.

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As discussed in Note 5 to the financial statements, the Company is involved in litigation incidental to its business, the disposition of which is expected to have no material effect on the Company's financial position or results of operations. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in the Company's assumptions related to these proceedings.

Results of Operations**Fiscal 2004 Compared To Fiscal 2003**

Results Summary

Basic earnings per share increased 161.9% from \$.21 in fiscal 2003 to \$.55 in fiscal 2004. Revenues increased 8.6% from fiscal 2003 to fiscal 2004. Operating income increased 152.5% from \$1.5 million in fiscal 2003 to \$3.7 million in fiscal 2004. Net income increased 172.1% from \$0.9 million in fiscal 2003 to \$2.3 million in fiscal 2004. The increase in earnings per share, operating income, and net income in fiscal 2004 from 2003 was due primarily to the insolvency of a single franchisee and the related provision for loss on accounts and notes receivable and related foreclosure costs in the prior fiscal year. Increased revenue and cost containment initiatives also contributed to the improvement.

Revenues

(\$ s in thousands)	2004	2003	Change	% Change
Factory sales	\$14,103.4	\$13,905.6	197.8	1.4%
Retail sales	2,564.8	1,398.8	1,166.0	83.4%
Royalty and marketing fees	3,875.9	3,768.4	107.5	2.9%
Franchise fees	588.7	388.7	200.0	51.5%
Total	\$21,132.8	\$19,461.5	1,671.3	8.6%

Factory Sales

This increase in factory sales was due to an increase in the number of franchised stores in operation to 251 in fiscal 2004 from 222 in fiscal 2003. This increase was partially offset by a decrease in same store pounds purchased from the factory by franchised stores of 1.7% and a decrease in factory sales to customers outside the Company's system of franchised retail stores of 25.7%.

Retail Sales

This increase in retail sales resulted primarily from an increase in the average number of Company-owned stores from 4 during fiscal 2003 to 8 during fiscal 2004, plus a 3.2% increase in same store sales.

In fiscal 2002, the Company completed phasing out its Rocky Mountain Chocolate Factory Company-owned store program. The Company sold to new or existing franchisees all viable Company-owned store locations with the exception of four Company-owned stores located in key markets in Colorado. The Colorado Stores were excluded because these stores are used to test sales, marketing, design and operational initiatives. In Fiscal 2003, the Company foreclosed on four of the stores previously sold to a franchisee due to the franchisee's insolvency. The Company initially planned to operate one such retail outlet as a Company-owned store and sell three stores to other franchisees. However, management's intentions changed in the second quarter of 2004 and the Company intends to retain and

operate these stores to gain further insight into retail activity and operations outside of Colorado tourist areas.

Royalties, Marketing Fees and Franchise Fees

This increase in royalties and marketing fees resulted from growth in the average number of domestic units in operation from 202 in fiscal 2003 to 205 in fiscal 2004 partially offset by a decrease in same store sales of 0.7%. Of the thirty-six domestic stores that opened in fiscal 2004, fifteen opened in the fourth quarter. Franchise fee revenues increased due to an increase in the number of franchises sold.

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Costs and Expenses

(\$ s in thousands)	2004	2003	Change	% Change
Cost of sales factory	\$ 9,579.9	\$ 9,451.3	\$ 128.6	1.4%
Cost of sales retail	955.5	545.3	410.2	75.2%
Franchise costs	1,135.7	1,245.8	(110.1)	(8.8%)
Sales and marketing	1,220.5	1,441.1	(220.6)	(15.3%)
General and administrative	2,235.5	1,967.1	268.4	13.6%
Retail operating	1,430.1	832.6	597.5	71.8%
Total	\$16,557.2	\$15,483.2	\$1,074.0	6.9%

Gross margin

(\$ s in thousands)	2004	2003	Change	% Change
Factory	\$4,523.5	\$4,454.3	\$ 69.2	1.6%
Retail	1,609.3	853.5	755.8	88.6%
Total	\$6,132.8	\$5,307.8	\$825.0	15.5%
(Percent)				
Factory	32.1%	32.0%	0.1%	0.3%
Retail	62.7%	61.0%	1.7%	2.8%
Total	36.8%	34.7%	2.1%	6.1%

Cost of Sales

Factory margins were approximately the same in fiscal 2004 when compared to fiscal 2003. Improvement in Company-owned store margin is due to changes in mix of product sold. The Company anticipates improvement in factory margins in fiscal 2005 due to increased production efficiencies.

Franchise Costs

The decrease in franchise costs is due primarily to a planned reduction in expenditures. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs decreased to 25.4% in fiscal 2004 from 30.0% in fiscal 2003. Th