

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

(Mark One)

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

For the quarterly period ended August 31, 2006

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 check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and larger accelerated filer" in Rule 12b of the Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange act). Yes  No .

On September 29, 2006 the registrant had outstanding 6,082,457 shares of its common stock, \$.03 par value.

The exhibit index is located on page 20.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.

FORM 10-Q

TABLE OF CONTENTS

	Page No.
PART I.	FINANCIAL INFORMATION
Item 1.	Financial Statements 3-10
	Statements of Income 3
	Balance Sheets 4
	Statements of Cash Flows 5
	Notes to Interim Financial Statements 6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations 11
Item 3.	Quantitative and Qualitative Disclosures About Market Risk 18
Item 4.	Controls and Procedures 18
PART II.	OTHER INFORMATION
Item 1.	Legal Proceedings 19
Item 1A.	Risk Factors 19
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds 19
Item 3.	Defaults Upon Senior Securities 19
Item 4.	Submission of Matters to a Vote of Security Holders 19
Item 5.	Other Information 19
Item 6.	Exhibits 20
SIGNATURES	21

**PART I. FINANCIAL INFORMATION**

## Item 1. Financial Statements

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

	Three Months Ended August 31, 2006	2005	Six Months Ended August 31, 2006	2005
<b>Revenues</b>				
Sales	\$ 5,238,115	\$ 5,109,738	\$ 10,587,272	\$ 9,141,268
Franchise and royalty fees	1,541,454	1,473,422	2,960,709	2,808,693
Total revenues	6,779,569	6,583,160	13,547,981	11,949,961
<b>Costs and Expenses</b>				
Cost of sales	3,166,734	3,017,913	6,503,129	5,415,512
Franchise costs	384,082	306,704	716,615	645,053
Sales and marketing	353,538	284,911	704,752	590,660
General and administrative	586,429	507,023	1,219,314	1,035,967
Retail operating	403,393	473,546	812,204	862,474
Depreciation and amortization	225,764	204,257	461,445	413,865
Total costs and expenses	5,119,940	4,794,354	10,417,459	8,963,531
<b>Income from Operations</b>	1,659,629	1,788,806	3,130,522	2,986,430
<b>Other Income (Expense)</b>				
Interest expense	-	-	-	(19,652)
Interest income	12,061	17,527	37,214	49,500
Total other, net	12,061	17,527	37,214	29,848
<b>Income Before Income Taxes</b>	1,671,690	1,806,333	3,167,736	3,016,278
<b>Provision for Income Taxes</b>	631,900	682,795	1,197,405	1,140,155
<b>Net Income</b>	\$ 1,039,790	\$ 1,123,538	\$ 1,970,331	\$ 1,876,123
<b>Basic Earnings per Common Share</b>	\$ .17	\$ .18	\$ .32	\$ .30
<b>Diluted Earnings per Common Share</b>	\$ .17	\$ .17	\$ .31	\$ .28
<b>Weighted Average Common Shares Outstanding</b>	6,079,077	6,270,974	6,153,611	6,218,478
<b>Dilutive Effect of Stock Options</b>	217,699	469,741	236,030	490,423
<b>Weighted Average Common Shares Outstanding, Assuming Dilution</b>	6,296,776	6,740,715	6,389,641	6,708,901

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.  
BALANCE SHEETS

	August 31, 2006 (unaudited)	February 28, 2006
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 743,047	\$ 3,489,750
Accounts receivable, less allowance for doubtful accounts of \$42,567 and \$46,920 respectively	3,219,064	3,296,690
Notes receivable	92,300	116,997
Inventories, less reserve for slow moving inventory of \$78,120 and \$61,032, respectively	4,141,334	2,938,234
Deferred income taxes	117,715	117,715
Other	486,895	481,091
Total current assets	8,800,355	10,440,477
<b>Property and Equipment, Net</b>	<b>6,277,082</b>	<b>6,698,604</b>
<b>Other Assets</b>		
Notes receivable, less valuation allowance of \$52,005	241,930	278,741
Goodwill, net	1,133,751	1,133,751
Intangible assets, net	365,914	402,469
Other	166,196	103,438
Total other assets	1,907,791	1,918,399
Total assets	\$16,985,228	\$19,057,480
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 1,247,217	\$ 1,145,410
Accrued salaries and wages	384,938	507,480
Other accrued expenses	932,668	750,733
Dividend payable	487,829	504,150
Total current liabilities	3,052,652	2,907,773
<b>Deferred Income Taxes</b>	<b>663,889</b>	<b>663,889</b>
<b>Commitments and Contingencies</b>		
<b>Stockholders' Equity</b>		
Common stock, \$.03 par value, 100,000,000 shares authorized, 6,080,307 and 6,281,920 issued and outstanding	182,409	188,458
Additional paid-in capital	7,167,013	10,372,530
Retained earnings	5,919,265	4,924,830
Total stockholders' equity	13,268,687	15,485,818
Total liabilities and stockholders' equity	\$16,985,228	\$19,057,480

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

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

	Six Months Ended August 31,	
	2006	2005
<b>Cash Flows From Operating activities</b>		
Net income	\$ 1,970,331	\$ 1,876,123
Adjustments to reconcile net income to net cash		
Provided by operating activities:		
Depreciation and amortization	461,445	413,865
Provision for obsolete inventory	30,000	15,000
(Gain) loss on sale of property and equipment	76,273	(1,390)
Expense recorded for stock options	201,269	-
Changes in operating assets and liabilities:		
Accounts receivable	77,626	(361,266)
Refundable income taxes	-	364,630
Inventories	(1,233,100)	(1,023,726)
Other current assets	(3,596)	(257,965)
Accounts payable	101,807	(399,345)
Accrued liabilities	61,593	(287,274)
Net cash provided by operating activities	1,743,648	338,652
<b>Cash Flows From Investing Activities</b>		
Proceeds received on notes receivable	61,508	126,484
Proceeds from sale of assets	(16,012)	4,708
Purchases of property and equipment	(119,640)	(826,897)
Decrease in other assets	4,667	4,742
Net cash used in investing activities	(69,477)	(690,963)
<b>Cash Flows From Financing Activities</b>		
Payments on long-term debt	-	(1,665,084)
Repurchase and redemption of common stock	(3,764,914)	(245,995)
Dividends paid	(992,217)	(835,968)
Costs of stock dividend or stock split	-	(8,902)
Proceeds from exercise of stock options	336,257	868,859
Net cash used in financing activities	(4,420,874)	(1,887,090)
<b>Net Decrease in Cash and Cash Equivalents</b>	(2,746,703)	(2,239,401)
<b>Cash and Cash Equivalents, Beginning of Period</b>	3,489,750	4,438,876
<b>Cash and Cash Equivalents, End of Period</b>	\$743,047	\$ 2,199,475

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. The following table summarizes the number of RMCF stores at August 31, 2006:

	Sold, Not Yet Open	Open	Total
Company owned stores	-	7	7
Company owned kiosks	-	-	-
Franchise stores - Domestic stores	21	243	264
Franchise Stores - Domestic kiosks	2	20	22
Franchise units - International	-	36	36
	23	306	329

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, 2006 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, 2006.

Stock-Based Compensation

At August 31, 2006, the Company had stock-based compensation plans for employees and nonemployee directors which authorized the granting of stock options.

Prior to March 1, 2006, the Company accounted for the plans under the measurement and recognition provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, permitted under Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). As a result, employee stock option-based compensation was included as a pro forma disclosure in the Notes to the Company's Financial Statements for prior year periods.

Effective March 1, 2006, the Company adopted the recognition provisions of Statement of Financial Accounting Standard No. 123R, "Share-Based Payment" ("SFAS No. 123R"), using the modified-prospective transition method. Under this transition method, compensation cost in 2006 includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested, as of March 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (2) all share-based payments

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

granted subsequent to March 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Results for the prior periods have not been restated.

The Company did not issue stock options and recorded \$0 related equity-based compensation expense during the three and six month periods ended August 31, 2006. Compensation costs related to share-based compensation are generally amortized over the vesting period in selling, general and administrative expenses in the statement of operations.

On February 21, 2006, the Company accelerated the vesting of all outstanding stock options and recognized a share-based compensation charge related to this acceleration. The Company recognized an additional share-based compensation charge of \$131,000 for the three months ended August 31, 2006 related to this acceleration due to changes in certain estimates and assumptions related to employee turnover since the acceleration date. Adjustments in future periods may be necessary as actual results could differ from these estimates and assumptions.

Prior to adopting SFAS No. 123R, the Company presented all benefits from tax deductions arising from equity-based compensation as a non-cash transaction in the Statement of Cash Flows. SFAS No. 123R requires that the tax benefits in excess of the compensation cost recognized for those exercised options be classified as cash provided by financing activities. No excess tax benefit was included in net cash provided by financing activities for the second quarter ended August 31, 2006.

The weighted-average fair value of stock options granted during the six-month periods ended August 31, 2006 and August 31, 2005 was \$0 and \$4.16 per share, respectively. As of August 31, 2006, there was \$0 (before any related tax benefit) of unrecognized compensation cost related to non-vested share-based compensation that is expected to be recognized over the remainder of fiscal 2007.

	Three Months ended August 31,		Six Months Ended August 31,	
	2006	2005	2006	2005
Net Income - as reported	\$1,040	\$1,124	\$1,970	\$1,876
Add: Stock-based compensation expense included in reported net income, net of tax	-	-	-	-
Deduct: Stock-based compensation expense determined under fair value based method, net of tax	-	40	-	80
Net Income - pro forma	1,040	1,084	1,970	1,796
Basic Earnings per Share-as reported	.17	.18	.32	.30
Diluted Earnings per Share-as reported	.17	.17	.31	.28
Basic Earnings per Share-pro forma	.17	.17	.32	.29
Diluted Earnings per Share-pro forma	.17	.16	.31	.27

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 three months ended August 31, 2006 and 2005, 146,560 and zero stock options, respectively, were excluded from the computation of earnings per share because their effect would have been anti-dilutive. For the six months ended August 31, 2006 and 2005, 141,940 and zero stock options, respectively, 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, 2006	February 28, 2006
Ingredients and supplies	\$ 1,744,539	\$ 1,507,193
Finished candy	2,396,795	1,431,041
	\$ 4,141,334	\$ 2,938,234

NOTE 4 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following:

	August 31, 2006	February 28, 2006
Land	\$ 513,618	\$ 513,618
Building	4,717,230	4,705,242
Machinery and equipment	6,296,229	6,252,011
Furniture and fixtures	752,745	817,137
Leasehold improvements	590,979	641,637
Transportation equipment	331,640	331,640
	13,202,441	13,261,285
Less accumulated depreciation	6,925,359	6,562,681
Property and equipment, net	\$ 6,277,082	\$ 6,698,604

NOTE 5 - STOCKHOLDERS' EQUITY

Stock Dividend

On February 15, 2005 the Board of Directors declared a 5 percent stock dividend payable on March 10, 2005 to shareholders of record as of February 28, 2005. Shareholders received one additional share of Common Stock for every twenty shares owned prior to the record date. Subsequent to the dividend there were 4,602,135 shares outstanding.

Stock Split

On May 18, 2005 the Board of Directors approved a four-for-three stock split payable June 13, 2005 to shareholders of record at the close of business on May 31, 2005. Shareholders received one additional share of common stock for every three shares owned prior to the record date. Immediately prior to the split there were 4,639,244 shares outstanding. Subsequent to the split there were 6,186,007 shares outstanding.

All share and per share data have been restated in all years presented to give effect to the stock dividends and stock splits.

Stock Repurchases

Between June 30, 2006 and August 25, 2006 the Company repurchased 42,699 shares at an average price of \$13.63 per share. Between March 24, 2006 and May 18, 2006 the Company repurchased 224,213 shares at an average price of \$14.20 per share. Between October 7, 2005 and February 3, 2006 the Company repurchased 176,599 Company shares at an average price of \$15.36 per share. Between April 18 and April 20, 2005 the Company repurchased 17,647 shares at an average price of \$13.94 per share. Between March 11, 2004 and June 14, 2004 the Company repurchased 125,216 Company shares at an average price of \$6.74 per share.

Cash Dividend

The Company paid a quarterly cash dividend of \$0.08 per common share on March 16, 2006 and June 16, 2006 to shareholders of record on March 8, 2006 and June 2, 2006, respectively. On August 16, 2006 the Company declared a quarterly cash dividend of \$0.08 per common share payable on September 15, 2006 to shareholders of record on September 1, 2006.

The Company paid a quarterly cash dividend of \$0.0675 per common share on March 16, 2005, June 16, 2005 and September 16, 2005 to shareholders of record on March 11, 2005, June 3, 2005 and September 1, 2005 respectively. The Company paid a quarterly cash dividend of \$0.07 per common share on December 16, 2005 to shareholders of record on December 1, 2005.

Future declaration of dividends will depend on, among other things, the Company's results of operations, capital requirements, financial condition and on such other factors as the Company's Board of Directors may in its discretion consider relevant and in the best long term interest of the shareholders.

## NOTE 6 - SUPPLEMENTAL CASH FLOW INFORMATION

Six Months Ended  
August 31,

Cash paid (received) for:	2006	2005
Interest	\$ -	\$ 19,872
Income taxes	1,060,033	362,166
Non-Cash Financing Activities		
Dividend Payable	(\$ 16,321)	\$ 13,151
Issue stock for services	( 15,822)	-
Fair value of assets received upon settlement of note and accounts receivable		
Store to be operated	\$ -	\$ 200,000
Inventory	-	3,815
Note receivable	-	153,780

## NOTE 7 - OPERATING SEGMENTS

The Company classifies its business interests into two reportable segments: Franchising and Manufacturing. The Company's retail stores provide an environment for testing consumer behavior, various pricing strategies, new products and promotions, operating and training methods and merchandising techniques. All Company-owned retail stores are evaluated by management in relation to their contribution to franchising efforts and are included in the Franchising segment. 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, 2006. 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, 2006	Franchising	Manufacturing	Other	Total
Total revenues	\$ 2,272,393	\$ 4,979,486	\$ -	\$ 7,251,879
Intersegment revenues	-	(472,310)	-	(472,310)
Revenue from external customers	2,272,393	4,507,176	-	6,779,569
Segment profit (loss)	791,766	1,468,867	(588,943)	1,671,690
Total assets	2,735,143	10,979,924	3,270,161	16,985,228
Capital expenditures	9,739	48,098	6,805	64,642
Total depreciation & amortization	61,185	110,954	53,625	225,764
Three Months Ended August 31, 2005				
Total revenues	\$ 2,289,054	\$ 4,727,268	\$ -	\$ 7,016,322
Intersegment revenues	-	(433,162)	-	(433,162)
Revenue from external customers	2,289,054	4,294,106	-	6,583,160
Segment profit (loss)	899,964	1,435,248	(528,879)	1,806,333
Total assets	3,092,933	10,386,916	4,996,868	18,476,717
Capital expenditures	12,720	250,918	138,957	402,595
Total depreciation & amortization	68,345	97,438	38,474	204,257

NOTE 7 - OPERATING SEGMENTS - CONTINUED

Six Months Ended August 31, 2006	Franchising	Manufacturing	Other	Total
Total revenues	\$ 4,335,243	\$ 10,133,365	\$ -	\$ 14,468,608
Intersegment revenues	-	(920,627)	-	(920,627)
Revenue from external customers	4,335,243	9,212,738	-	13,547,981
Segment profit (loss)	1,468,125	2,917,685	(1,218,074)	3,167,736
Total assets	2,735,143	10,979,924	3,270,161	16,985,228
Capital expenditures	22,803	71,811	25,026	119,640
Total depreciation & amortization	123,687	225,451	112,307	461,445
Six Months Ended August 31, 2005				
Total revenues	\$4,266,084	\$8,457,943	\$ -	\$12,724,027
Intersegment revenues	-	(774,066)	-	(774,066)
Revenue from external customers	4,266,084	7,683,877	-	11,949,961
Segment profit (loss)	1,607,943	2,507,267	(1,098,932)	3,016,278
Total assets	3,092,933	10,386,916	4,996,868	18,476,717
Capital expenditures	83,602	544,577	198,718	826,897
Total depreciation & amortization	128,019	194,379	91,467	413,865

NOTE 8 - GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following:

	Amortization Period	August 31, 2006		February 28, 2006	
		Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Intangible assets subject to amortization					
Store design	10 Years	\$ 205,777	95,648	\$ 205,777	\$ 85,093
Packaging licenses	3-5 Years	120,830	101,664	120,830	99,164
Packaging design	10 Years	430,973	194,354	430,973	170,854
Total		757,580	391,666	757,580	355,111
Intangible assets not subject to amortization					
Franchising segment-					
Company stores goodwill		1,275,962	336,847	1,275,962	336,847
Franchising goodwill		295,000	197,682	295,000	197,682
Manufacturing segment-Goodwill					
Total Goodwill		1,865,962	732,211	1,865,962	732,211
Total intangible assets		\$ 2,623,542	\$ 1,123,877	\$ 2,623,542	\$ 1,087,322

Amortization expense related to intangible assets totaled \$36,555 and \$36,346 during the six months ended August 31, 2006 and 2005, respectively. The aggregate estimated amortization expense for intangible assets remaining as of August 31, 2006 is as follows:

Remainder of fiscal 2007	\$ 36,600
2008	73,100
2009	73,100
2010	73,100
2011	64,400
Thereafter	45,614
Total	\$365,914

NOTE 9 - STORE PURCHASE

Effective May 1, 2005 the Company financed a note in the amount of \$153,780 and took possession of a previously financed franchise store and related inventory in satisfaction of \$357,595 of notes and accounts receivable. The Company currently intends to retain and operate the store.

## NOTE 10 - RECENT ACCOUNTING PRONOUNCEMENTS

In March 2006, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross versus Net Presentation). Taxes within the scope of EITF Issue No. 06-3 include any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales taxes, use taxes, value-added taxes, and some excise taxes. The EITF concluded that the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements. The Company's policy is to exclude all such taxes from revenue. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of EITF 06-3 will not have any effect on the Company's financial statements.

In July 2006, the FASB issued Interpretation 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes," an interpretation of SFAS No. 109, "Accounting for Income Taxes." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. The interpretation applies to all tax positions accounted for in accordance with Statement 109 and requires a more-likely-than-not recognition threshold. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Subsequent recognition, derecognition, and measurement is based on management's best judgment given the facts, circumstances and information available at the reporting date. FIN 48 is effective for fiscal years beginning after December 15, 2006. Early adoption is permitted as of the beginning of an enterprise's fiscal year, provided the enterprise has not yet issued financial statements, including financial statements for any interim period, for that fiscal year. Based upon the Company's preliminary evaluation of the effects of this guidance, we do not believe that it will have a significant impact on the Company's financial statements.

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

### **A Note About Forward-Looking Statements**

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. The nature of the Company's operations and the environment in which it operates subject it to changing economic, competitive, regulatory and technological conditions, risks and uncertainties. The statements, other than statements of historical fact, included in this report are forward-looking statements. Many of the forward-looking statements contained in this document may be identified by the use of forward-looking words such as "will," "intend," "believe," "expect," "anticipate," "should," "plan," "estimate" and "potential," or similar expressions. Factors which could cause results to differ include, but are not limited to: changes in the confectionery business environment, seasonality, consumer interest in the Company's products, general economic conditions, consumer trends, costs and availability of raw materials, competition and the effect of government regulation. Government regulation which the Company and its franchisees either are or may be subject to and which could cause results to differ from forward-looking statements include, but are not limited to: local, state and federal laws regarding health, sanitation, safety, building and fire codes, franchising, employment, manufacturing, packaging and distribution of food products and motor carriers. For a detailed discussion of the risks and uncertainties that may cause the Company's actual results to differ from the forward-looking statements contained herein, please see the "Risk Factors" contained in the Company's 10-K for the fiscal year ended February 28, 2006 which can be viewed at the SEC's website at [www.sec.gov](http://www.sec.gov) or through our website at [www.rmcf.com](http://www.rmcf.com). These forward-looking statements apply only as of the date of this report. As such they should not be unduly relied upon for more current circumstances. Except as required by law, the Company is not obligated to release publicly any revisions to these forward-looking statements that might reflect events or circumstances occurring after the date of this report or those that might reflect the occurrence of unanticipated events.

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 seven 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 are located in street fronts, tourist locations, factory outlets and regional malls. 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.

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. Same store pounds purchased from the factory by franchised stores were approximately the same as the prior year period in the first quarter but declined 7.3% in the second quarter and 3.6% in the first six months of Fiscal 2007.

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 Quarterly Report on Form 10-Q.

## Results of Operations

### Three Months Ended August 31, 2006 Compared to the Three Months Ended August 31, 2005

Basic earnings per share decreased 5.6% from \$.18 for the three months ended August 31, 2005 to \$.17 for the three months ended August 31, 2006. Revenues increased 3.0% from fiscal 2006 to fiscal 2007. Operating income decreased 7.2% from \$1.8 million in fiscal 2006 to \$1.7 million in fiscal 2007. Net income decreased 7.5% from \$1.1 million in fiscal 2006 to \$1.0 million in fiscal 2007. The decrease in earnings per share, operating income, and net income for the second quarter of fiscal 2007 versus the same period in fiscal 2006 was due primarily to the shifting of a large specialty market shipment from the second quarter last year into the third quarter in Fiscal 2007 and increased stock option compensation expense offset by growth in the average number of franchise stores in operation and corresponding increases in revenues.

(\$'s in thousands)	Three Months Ended		Change	%
	August 31,			
	2006	2005		
Factory sales	\$4,507.2	\$4,294.2	\$213.0	5.0%
Retail sales	730.9	815.6	(84.7)	(10.4%)
Franchise fees	179.7	199.8	(20.1)	(10.1%)
Royalty and Marketing fees	1,361.8	1,273.6	88.2	6.9%
Total	\$6,779.6	\$6,583.2	\$196.4	3.0%

## Factory Sales

Factory sales increased for the three months ended August 31, 2006 due to an increase in the number of franchise stores in operation. The average number of franchised stores in operation increased to 295 in the second quarter of fiscal 2007 from 279 in the same period in fiscal 2006. Offsetting this increase was a 41.8% decrease in product shipments to customers outside the system of franchised retail stores. The decrease in product shipments was caused by a year-over-year timing difference in shipment dates. Also offsetting this increase was a 7.3% decrease in same store pounds purchased from the factory by franchised stores. The Company believes that this decrease in same store pounds reflects an unseasonably hot summer in many regions of the country, along with a modest softening in the retail sector of the economy. Historically, retail sales of chocolate products suffer when weather conditions are unusually hot in particular markets.

## Retail Sales

Retail sales decreased 10.4% in the second quarter of fiscal 2007 due to a decrease in the average number of stores in operation from 10 in fiscal 2006 to 8 in fiscal 2007. Same store retail sales increased 9.1% in the second quarter of fiscal 2007 compared to the same period in the prior year.

## Royalties, Marketing Fees and Franchise Fees

The increase in royalties and marketing fees resulted from growth in the average number of domestic units in operation. The average number of domestic units in operation grew 6.1% from 246 in the second quarter of fiscal 2006 to 261 in the second quarter of 2007. Partially offsetting this increase was a decline in same store sales of 1.1% in the second quarter of fiscal 2007 compared to the same period last year. Franchise fee revenues in the second quarter of fiscal 2007 decreased 10.1% due to a decrease in the number of franchises sold versus the second quarter of fiscal 2006.

## Costs and Expenses

(\$'s in thousands)	Three months ended		Change	%
	2006	2005		
Cost of sales - factory	\$2,877.4	\$2,700.0	\$177.4	6.6%
Cost of sales - retail	289.3	317.9	(28.6)	(9.0%)
Franchise costs	384.1	306.7	77.4	25.2%
Sales and marketing	353.5	284.9	68.6	24.1%
General and administrative	586.4	507.0	79.4	15.7%
Retail operating	403.4	473.6	(70.2)	(14.8%)
Total	\$4,894.1	\$4,590.1	304.0	6.6%

## Gross margin

(\$'s in thousands)	Three months ended		Change	%
	2006	2005		
Factory	\$1,629.8	\$1,594.2	\$35.6	2.2%
Retail	441.6	497.7	(56.1)	(11.3%)
Total	\$2,071.4	\$2,091.9	(20.5)	(1.0%)
(Percent)				
Factory	36.2%	37.1%	(0.9%)	(2.4%)
Retail	60.4%	61.0%	(0.6%)	(1.0%)
Total	39.5%	40.9%	(1.4%)	(3.4%)

## Costs and Expenses

### Cost of Sales

Factory margins declined 90 basis points from fiscal 2006 to fiscal 2007 due primarily to mix of product sold during the second quarter of fiscal 2007 versus the same period in the prior year. Reduction in Company-owned store margin is due to changes in mix of product sold.

## Franchise Costs

The increase in franchise costs is primarily due to increased professional fees related to franchise operations and an increase in stock option compensation expense. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 24.9% in the second quarter of fiscal 2007 from 20.8% in the second quarter of fiscal 2006. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of higher franchise costs relative to revenues.

## Sales and Marketing

The increase in sales and marketing is due primarily to stock option compensation expense as well as increased costs for marketing support of the franchisees and promotional costs related to specialty market sales.

## General and Administrative

The increase in general and administrative costs is due primarily to stock option compensation expense as well as costs incurred upon closure in the second quarter of fiscal 2007 of two of the Company-owned stores. As a percentage of total revenues, general and administrative expenses increased to 8.6% in fiscal 2007 compared to 7.7% in fiscal 2006.

## Retail Operating Expenses

The decrease in retail operating expenses was due primarily to a decrease in the average number of stores during the second quarter of fiscal 2007 versus the second quarter fiscal 2006 due to the closing of two stores. Retail operating expenses, as a percentage of retail sales, decreased from 58.1% in the second quarter of fiscal 2006 to 55.2% in the second quarter of fiscal 2007 due to a smaller decrease in revenues relative to the decrease in costs.

## Depreciation and Amortization

Depreciation and amortization of \$226,000 in the second quarter of fiscal 2007 increased 10.5% from \$204,000 incurred in the second quarter of fiscal 2006 due to increased fixed assets in service and related depreciation expense.

## Other, Net

Other, net of \$12,000 realized in the second quarter of fiscal 2007 represents a decrease of \$5,500 from the \$17,500 realized in the second quarter of fiscal 2006, due primarily to lower interest income from notes receivable and invested cash. Notes receivable balances are declining due to payments and the Company has been using its excess cash to repurchase stock.

## Income Tax Expense

The Company's effective income tax rate in the second quarter of fiscal 2007 was 37.8%, which is the same rate as the second quarter of fiscal 2006.

## **Six Months Ended August 31, 2006 Compared to the Six Months Ended August 31, 2005**

Basic earnings per share increased 6.7% from \$.30 for the six months ended August 31, 2005 to \$.32 for the six months ended August 31, 2006. Revenues increased 15.8% from fiscal 2005 to fiscal 2006. Operating income increased 4.8% from \$3.0 million in fiscal 2006 to \$3.1 million in fiscal 2007. Net income increased 5.0% from \$1.9 million in fiscal 2006 to \$2.0 million in fiscal 2007. The increase in earnings per share, operating income, and net income for the first six months of fiscal 2007 versus the same period in fiscal 2006 was due primarily to growth in the average number of franchise stores in operation and the corresponding increases in revenues offset by the shifting of a large specialty market shipment from the second quarter last year into the third quarter of fiscal 2007, increased stock option compensation expense and increased professional fees.

## Revenues

(\$'s in thousands)	Six Months Ended August 31,		Change	%
	2006	2005		
Factory sales	\$9,212.7	\$ 7,683.9	\$1,528.8	19.9%
Retail sales	1,374.5	1,457.4	(82.9)	(5.7%)
Franchise fees	306.8	361.8	(55.0)	(15.2%)
Royalty and marketing fees	2,654.0	2,446.9	207.1	8.5%
Total	\$13,548.0	\$11,950.0	\$1,598.0	13.4%

## Factory Sales

Factory sales increased for the six months ended August 31, 2006 due to an increase of 56.2% in product shipments to specialty markets and growth in the average number of stores in operation to 296 in the first six months of fiscal 2007 from 278 in the same period in fiscal 2006. Partially offsetting this increase was a 3.6% decrease in same store pounds purchased from the factory by franchised stores when compared to the six months ended August 31, 2005. The Company believes that this same store pounds decrease reflects an unseasonably hot summer in many regions of the country, along with a modest softening in the retail sector of the economy. Historically, retail sales of chocolate products suffer when weather conditions are unusually hot in particular markets.

## Retail Sales

Retail sales decreased 5.7% in the first six months of fiscal 2007 due to a decrease in the average number of stores in operation from 9 in fiscal 2006 to 8 in fiscal 2007. Same store retail sales increased 7.0% in the first six months of fiscal 2007 compared to the same period in the prior year.

## Royalties, Marketing Fees and Franchise Fees

The increase in royalties and marketing fees resulted from growth in the average number of domestic units in operation. The average number of domestic units in operation grew 6.5% from 246 in the first six months of fiscal 2006 to 262 in 2007. Same store sales decreased 0.1% in the first six months of fiscal 2007 compared to the same period last year. Franchise fee revenues in the first six months of fiscal 2007 decreased 15.2% due to a decrease in the number of franchises sold versus the same period last year.

## Costs and Expenses

(\$'s in thousands)	Six months ended		Change	%
	2005	2005		
Cost of sales - factory	\$5,960.0	\$4,847.4	\$1,112.6	23.0%
Cost of sales - retail	543.1	568.1	(25.0)	(4.4%)
Franchise costs	716.6	645.0	71.6	11.1%
Sales and marketing	704.8	590.7	114.1	19.3%
General and administrative	1,219.3	1,036.0	183.3	17.7%
Retail operating	812.2	862.5	(50.3)	(5.8%)
Total	\$9,956.0	\$8,549.7	\$1,406.3	16.4%

## Gross margin

(\$'s in thousands)	Six months ended		Change	%
	2006	2005		
Factory	\$3,252.7	\$2,836.5	\$416.2	14.7%
Retail	831.4	889.3	(57.9)	(6.5%)
Total	\$4,084.1	\$3,725.8	\$358.3	9.6%

  

(Percent)	Six months ended		Change	%
	2006	2005		
Factory	35.3%	36.9%	(1.6%)	(4.3%)
Retail	60.5%	61.0%	(0.5%)	(0.8%)
Total	38.6%	40.8%	(2.2%)	(5.4%)

Costs and Expenses  
Cost of Sales

Factory margins declined 160 basis points from fiscal 2006 to fiscal 2007 due primarily to mix of product sold during the first six months of fiscal 2006 versus the same period in the prior year. Reduction in Company-owned store margin is due to changes in mix of product sold.

Franchise Costs

The increase in franchise costs is due primarily to increased professional fees related to franchise operations as well as increased stock option compensation expense. As a percentage of total royalty and marketing fees and franchise fee revenue, franchise costs increased to 24.2% in the first six months of fiscal 2007 from 23.0% in the first six months of fiscal 2006. This increase as a percentage of royalty, marketing and franchise fees is primarily a result of higher franchise costs relative to revenues.

Sales and Marketing

The increase in sales and marketing is due primarily to increased costs for marketing support of the franchisees, promotional costs related to sales to specialty markets and increased stock option compensation expense.

General and Administrative

The increase in general and administrative costs is due primarily to public company costs, costs incurred upon closure in the second quarter of fiscal 2007 of two Company-owned stores and increased stock option compensation expense. The public company costs are primarily professional fees as they relate to compliance with the Sarbanes-Oxley Act of 2002. As a percentage of total revenues, general and administrative expenses increased to 9.0% in fiscal 2007 compared to 8.7% in fiscal 2006.

Retail Operating Expenses

This decrease was due primarily to a decrease in the average number of stores during the first six months of fiscal 2007 versus the first six months of fiscal 2006. Retail operating expenses, as a percentage of retail sales, remained relatively consistent from 59.2% in the first six months of fiscal 2006 to 59.1% in the first six months of fiscal 2007.

Depreciation and Amortization

Depreciation and amortization of \$461,000 in the first six months of fiscal 2007 increased 11.5% from \$414,000 incurred in the first six months of fiscal 2006 due primarily to increased fixed assets in service and related depreciation expenses.

Other, Net

Other, net of \$37,200 realized in the first six months of fiscal 2007 represents an increase of \$7,400 from the \$29,800 in the first six months of fiscal 2006, due primarily to lower interest expense on lower average outstanding balances of long-term debt. The Company also realized decreased interest income on notes receivable and invested cash due to the use of excess cash to repurchase Company stock. The Company paid its long-term debt in full during the first quarter of fiscal 2006.

Income Tax Expense

The Company's effective income tax rate in the first six months of fiscal 2007 was 37.8% which is the same rate as the first six months of fiscal 2006.

## **Liquidity and Capital Resources**

As of August 31, 2006, working capital was \$5.7 million, compared with \$7.5 million as of February 28, 2006, a decrease of \$1.8 million. The decrease in working capital was primarily due to repurchase and retirement of \$3.8 million of the Company's common stock in the first six months of fiscal 2007.

Cash and cash equivalent balances decreased from \$3.5 million as of February 28, 2006 to \$743,000 as of August 31, 2006 as a result of cash flows provided by operating activities less than cash flows used by financing and investing activities. The Company's current ratio was 2.88 to 1 at August 31, 2006 in comparison with 3.59 to 1 at February 28, 2006. The Company monitors current and anticipated future levels of cash and cash equivalents in relation to anticipated operating, financing and investing requirements.

The Company has a \$5.0 million (\$5.0 million available as of August 31, 2006) 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, 2007.

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 2007.

## **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.

## **New Accounting Pronouncements**

In March 2006, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross versus Net Presentation). Taxes within the scope of EITF Issue No. 06-3 include any taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer and may include, but are not limited to, sales taxes, use taxes, value-added taxes, and some excise taxes. The EITF concluded that the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements. The Company's policy is to exclude all such taxes from revenue. EITF 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. The adoption of EITF 06-3 will not have any effect on the Company's financial statements.

In July 2006, the FASB issued Interpretation 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes," an interpretation of SFAS No. 109, "Accounting for Income Taxes." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. The interpretation applies to all tax positions accounted for in accordance with Statement 109 and requires a more-likely-than-not recognition threshold. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Subsequent recognition, derecognition, and measurement is based on management's best judgment given the facts, circumstances and information available at the reporting date. FIN 48 is effective for fiscal years beginning after December 15, 2006. Early adoption is permitted as of the beginning of an enterprise's fiscal year, provided the enterprise has not yet issued financial statements, including financial statements for any interim period, for that fiscal year. Based upon the Company's preliminary evaluation of the effects of this guidance, we do not believe that it will have a significant impact on the Company's financial statements.

### 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, 2006, all of the Company's long-term debt was paid in full. The Company also has a \$5.0 million bank line of credit that bears interest at a variable rate. As of August 31, 2006, no amount was outstanding under the line of credit. The Company does not believe that it is exposed to any material interest rate risk related to 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 management, including the principal executive officer and principal financial officer, the Company has evaluated the effectiveness of the design and operation of the disclosure controls and procedures within 90 days of the filing date of this quarterly report, and, based on their evaluation, the Company's principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in the Company's internal controls, financial or otherwise, or in other factors that could significantly affect these controls subsequent to the date of their evaluation. Disclosure controls and procedures are the Company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits 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 in the reports that the Company files under the Exchange Act is accumulated and communicated to management, including the principal executive officer and the 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 1A. Risk Factors

No material change. See "A Note About Forward-Looking Statements" above.

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

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
June 2006	1,700	\$ 12.80	1,700	\$ 2,082,863
July 2006	20,583	13.34	20,583	1,808,317
August 2006	20,416	13.99	20,416	1,522,640
Total	42,699	\$ 13.63	42,699	\$ 1,522,640

(1) During the second quarter of Fiscal 2007 ending August 31, 2006, the Company purchased 42,699 shares in the open market.

(2) On May 4, 2006 and May 25, 2006 the Company announced plans to repurchase up to \$2,000,000 of the Company's common stock in the open market or in private transactions, whenever deemed appropriate by management. The plans were only to expire once the designated amounts were reached. The May 4, 2006 plan was completed in July 2006.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

The 2006 Annual Meeting of the Shareholders of the Company was held in Durango, Colorado on July 21, 2006.

1. Election of six Directors. Messrs. Franklin E. Crail, Bryan J. Merryman, Gerald A. Kien, Lee N. Mortenson, Fred M. Trainor and Clyde Wm. Engle were elected to the Company's Board of Directors. The results of the voting were as follows: 5,667,049 votes in favor of Franklin E. Crail, with 24,901 votes withheld; 5,606,746 votes in favor of Bryan J. Merryman, with 85,204 votes withheld; 5,595,309 votes in favor of Gerald A. Kien, with 27,341 votes withheld; 5,266,227 votes in favor of Lee N. Mortenson, with 356,423 votes withheld; 5,322,226 votes in favor of Fred M. Trainor, with 300,424 votes withheld; and 5,218,564 votes in favor of Clyde Wm. Engle, with 404,386 votes withheld.

Item 5. Other Information

None

Item 6. Exhibits

- 3.1 Articles of Incorporation of the Registrant, as amended, incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K of the Registrant filed on August 1, 1988
- 3.2 By-laws of the Registrant, as amended on November 25, 1997, incorporated by reference to Exhibit 3.2 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1998
- 4.1 Specimen Common Stock Certificate, incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K of the Registrant filed on August 1, 1988
- 4.2 \* Business Loan Agreement dated July 31, 2006 between Wells Fargo Bank and the Registrant.
- 4.3 \* Promissory Note dated July 31, 2006 in the amount of \$5,000,000 between Wells Fargo Bank and the Registrant
- 10.1 Form of Stock Option Agreement for the Registrant, incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1986
- 10.2 Incentive Stock Option Plan of the Registrant as amended July 27, 1990, incorporated by reference to Exhibit 10.2 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1991
- 10.3 Form of Employment Agreement between the Registrant and its officers, incorporated by reference to Exhibit 99.2 to Schedule on Form 14D9 of the Registrant filed on May 21, 1999
- 10.4 Current form of franchise agreement used by the Registrant incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q of the Registrant for the quarter ended May 31, 2005.
- 10.5 Form of Real Estate Lease between the Registrant as Lessee and franchisee as Sublessee, incorporated by reference to Exhibit 10.7 to Registration Statement on Form S-18 (Registration No. 33-2016-D)
- 10.6 Form of Nonqualified Stock Option Agreement for Nonemployee Directors for the Registrant, incorporated by reference to Exhibit 10.8 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1991
- 10.7 Nonqualified Stock Option Plan for Nonemployee Directors dated March 20, 1990, incorporated by reference to Exhibit 10.9 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1991
- 10.8 1995 Stock Option Plan of the Registrant, incorporated by reference to Exhibit 10.9 to Registration Statement on Form S-1 (Registration No. 33-62149) filed August 25, 1995
- 10.9 Forms of Incentive Stock Option Agreement for 1995 Stock Option Plan, incorporated by reference to Exhibit 10.10 to Registration Statement on Form S-1 (Registration No. 33-62149) filed on August 25, 1995
- 10.10 Forms of Nonqualified Stock Option Agreement for 1995 Stock Option Plan, incorporated by reference to Exhibit 10.11 to Registration Statement on Form S-1 (Registration No. 33-62149) filed on August 25, 1995

- 10.11 Form of Indemnification Agreement between the Registrant and its directors, incorporated by reference to Exhibit 10.12 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1998
  - 10.12 Form of Indemnification Agreement between the Registrant and its officers, incorporated by reference to Exhibit 10.13 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 1998
  - 10.13 2000 Nonqualified Stock Option Plan for Nonemployee Directors of the Registrant, incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8 (Registration No. 333-109936 filed on October 23, 2003.
  - 10.14 Commodity Contract with Guittard Chocolate Company, incorporated by reference to Exhibit 10.15 to the Annual Report on Form 10-K of the Registrant for the fiscal year ended February 28, 2006
  - 10.15 Rocky Mountain Chocolate Factory, Inc. 2004 Stock Option Plan, incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8 (Registration No. 333-119107) filed September 17, 2004
  - 31.1 \*Certification Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002, Chief Executive Officer
  - 31.2 \*Certification Filed Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002, Chief Financial Officer
  - 32.1 \*Certification Furnished Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002, Chief Executive Officer
  - 32.2 \*Certification Furnished Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002, Chief Financial Officer
- \* Filed herewith.

Signatures

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

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.  
(Registrant)

Date: October 5, 2006

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

**BUSINESS LOAN AGREEMENT**

Principal	Loan Date	Maturity	Loan No	Call / Coll	Account	Officer	Initials
\$5,000,000.00	07-31-2006	07-31-2007	7657418442-34		482375	K5997	
References in the shaded area are for Lender's use only and do not limit the applicability of this document to any particular loan or item. Any item above containing **** has been omitted due to text length limitations.							

**Borrower:** Rocky Mountain Chocolate Factory, Inc.  
265 Turner Drive  
Durango.CO 81303-7941

**Lender:** Wells Fargo Bank, National Association  
Durango Main  
200 West College Drive  
Durango, CO 81301

**THIS BUSINESS LOAN AGREEMENT** dated July 31, 2006, is made and executed between Rocky Mountain Chocolate Factory, Inc. ("Borrower") and Wells Fargo Bank, National Association ("Lender") on the following terms and conditions. Borrower has received prior commercial loans from Lender or has applied to Lender for a commercial loan or loans or other financial accommodations, including those which may be described on any exhibit or schedule attached to this Agreement ("Loan"). Borrower understands and agrees that: (A) in granting, renewing, or extending any Loan, Lender is relying upon Borrower's representations, warranties, and agreements as set forth in this Agreement; (B) the granting, renewing, or extending of any Loan by Lender at all times shall be subject to Lender's sole judgment and discretion; and (C) all such Loans shall be and remain subject to the terms and conditions of this Agreement.

**TERM.** This Agreement shall be effective as of July 31, 2006, and shall continue in full force and effect until such time as all of Borrower's Loans in favor of Lender have been paid in full, including principal, interest, costs, expenses, attorneys' fees, and other fees and charges, or until such time as the parties may agree in writing to terminate this Agreement.

**CONDITIONS PRECEDENT TO EACH ADVANCE.** Lender's obligation to make the initial Advance and each subsequent Advance under this Agreement shall be subject to the fulfillment to Lender's satisfaction of all of the conditions set forth in this Agreement and in the Related Documents.

**Loan Documents.** Borrower shall provide to Lender the following documents for the Loan: (1) the Note; (2) Security Agreements granting to Lender security interests in the Collateral; (3) financing statements and all other documents perfecting Lender's Security Interests; (4) evidence of insurance as required below; (5) together with all such Related Documents as Lender may require for the Loan; all in form and substance satisfactory to Lender and Lender's counsel.

**Borrower's Authorization.** Borrower shall have provided in form and substance satisfactory to Lender properly certified resolutions, duly authorizing the execution and delivery of this Agreement, the Note and the Related Documents. In addition, Borrower shall have provided such other resolutions, authorizations, documents and instruments as Lender or its counsel, may require.

**Payment of Fees and Expenses.** Borrower shall have paid to Lender all fees, charges, and other expenses which are then due and payable as specified in this Agreement or any Related Document.

**Representations and Warranties.** The representations and warranties set forth in this Agreement, in the Related Documents, and in any document or certificate delivered to Lender under this Agreement are true and correct.

**No Event of Default.** There shall not exist at the time of any Advance a condition which would constitute an Event of Default under this Agreement or under any Related Document.

**REPRESENTATIONS AND WARRANTIES.** Borrower represents and warrants to Lender, as of the date of this Agreement, as of the date of each disbursement of loan proceeds, as of the date of any renewal, extension or modification of any Loan, and at all times any Indebtedness exists:

**Organization.** Borrower is a corporation for profit which is, and at all times shall be, duly organized, validly existing, and in good standing under and by virtue of the laws of the State of Colorado. Borrower is duly authorized to transact business in all other states in which Borrower is doing business, having obtained all necessary filings, governmental licenses and approvals for each state in which Borrower is doing business. Borrower maintains an office at 265 Turner Drive, Durango, CO 81303-7941. Unless Borrower has designated otherwise in writing, the principal office is the office at which Borrower keeps its books and records including its records concerning the Collateral. Borrower will notify Lender prior to any change in the location of Borrower's state of organization or any change in Borrower's name.

**Assumed Business Names.** Borrower has filed or recorded all documents or filings required by law relating to all assumed business names used by Borrower. Excluding the name of Borrower, the following is a complete list of all assumed business names under which Borrower does business: **None.**

**Authorization.** Borrower's execution, delivery, and performance of this Agreement and all the Related Documents have been duly authorized by all necessary action by Borrower and do not conflict with, result in a violation of, or constitute a default under (1) any provision of (a) Borrower's articles of incorporation or organization, or bylaws, or (b) any agreement or other instrument binding upon Borrower or (2) any law, governmental regulation, court decree, or order applicable to Borrower or to Borrower's properties.

**Properties.** Except as contemplated by this Agreement or as previously disclosed in Borrower's financial statements or in writing to Lender and as accepted by Lender, and except for property tax liens for taxes not presently due and payable, Borrower owns and has good title to all of Borrower's properties free and clear of all liens and security interests, and has not executed any security documents or financing statements relating to such properties. All of Borrower's properties are titled in Borrower's legal name, and Borrower has not used or filed a financing statement under any other name for at least the last five (5) years.

**AFFIRMATIVE COVENANTS.** Borrower covenants and agrees with Lender that, so long as this Agreement remains in effect. Borrower will:

**Notices of Claims and Litigation.** Promptly inform Lender in writing of (1) all material adverse changes in Borrower's financial condition, and (2) all existing and all threatened litigation, claims, investigations, administrative proceedings or similar actions affecting Borrower or any Guarantor which could materially affect the financial condition of Borrower or the financial condition of any Guarantor.

**Financial Records.** Maintain its books and records in accordance with accounting principles acceptable to Lender, applied on a consistent basis, and permit Lender to examine and audit Borrower's books and records at all reasonable times.

**Financial Statements.** Furnish Lender with such financial statements and other related information at such frequencies and in such detail as Lender may reasonably request.

**BUSINESS LOAN AGREEMENT  
(Continued)**

Loan No: 7657418442-34

Page 2

**Loan Proceeds.** Use all Loan proceeds solely for Borrower's business operations, including stock repurchases, unless specifically consented to the contrary by Lender in writing.

**Taxes, Charges and Liens.** Pay and discharge when due all of its indebtedness and obligations, including without limitation all assessments, taxes, governmental charges, levies and liens, of every kind and nature, imposed upon Borrower or its properties, income, or profits, prior to the date on which penalties would attach, and all lawful claims that, if unpaid, might become a lien or charge upon any of Borrower's properties, income, or profits.

**Performance.** Perform and comply, in a timely manner, with all terms, conditions, and provisions set forth in this Agreement, in the Related Documents, and in all other instruments and agreements between Borrower and Lender. Borrower shall notify Lender immediately in writing of any default in connection with any agreement.

**Operations.** Maintain executive and management personnel with substantially the same qualifications and experience as the present executive and management personnel; provide written notice to Lender of any change in executive and management personnel; conduct its business affairs in a reasonable and prudent manner.

**Compliance with Governmental Requirements.** Comply with all laws, ordinances, and regulations, now or hereafter in effect, of all governmental authorities applicable to the conduct of Borrower's properties, businesses and operations, and to the use or occupancy of the Collateral, including without limitation, the Americans With Disabilities Act. Borrower may contest in good faith any such law, ordinance, or regulation and withhold compliance during any proceeding, including appropriate appeals, so long as Borrower has notified Lender in writing prior to doing so and so long as, in Lender's sole opinion, Lender's interests in the Collateral are not jeopardized. Lender may require Borrower to post adequate security or a surety bond, reasonably satisfactory to Lender, to protect Lender's interest.

**Inspection.** Permit employees or agents of Lender at any reasonable time to inspect any and all Collateral for the Loan or Loans and Borrower's other properties and to examine or audit Borrower's books, accounts, and records and to make copies and memoranda of Borrower's books, accounts, and records. If Borrower now or at any time hereafter maintains any records (including without limitation computer generated records and computer software programs for the generation of such records) in the possession of a third party, Borrower, upon request of Lender, shall notify such party to permit Lender free access to such records at all reasonable times and to provide Lender with copies of any records it may request, all at Borrower's expense.

**LENDER'S EXPENDITURES.** If any action or proceeding is commenced that would materially affect Lender's interest in the Collateral or if Borrower fails to comply with any provision of this Agreement or any Related Documents, including but not limited to Borrower's failure to discharge or pay when due any amounts Borrower is required to discharge or pay under this Agreement or any Related Documents, Lender on Borrower's behalf may (but shall not be obligated to) take any action that Lender deems appropriate on any Collateral and paying all costs for insuring, maintaining and preserving any Collateral. All such expenditures incurred or paid by Lender for such purposes will then bear interest at the rate charged under the Note from the date incurred or paid by Lender to the date of repayment by Borrower. All such expenses will become a part of the Indebtedness and, at Lender's option, will (A) be payable on demand; (B) be added to the balance of the Note and be apportioned among and be payable with any installment payments to become due during either (1) the term of any applicable insurance policy; or (2) the remaining term of the Note; or (C) be treated as a balloon payment which will be due and payable at the Note's maturity.

**CESSATION OF ADVANCES.** If Lender has made any commitment to make any Loan to Borrower, whether under this Agreement or under any other agreement, Lender shall have no obligation to make Loan advances or to disburse Loan proceeds if: (A) Borrower or any guarantor is in default under the terms of this Agreement or any other agreement that Borrower or any guarantor has with Lender; (B) Borrower or any guarantor dies, becomes incompetent or becomes insolvent, files a petition in bankruptcy or similar proceedings, or is adjudged a bankrupt; (C) there occurs a material adverse change in Borrower's financial condition, in the financial condition of any guarantor, or in the value of any collateral securing any Loan; or (D) any guarantor seeks, claims or otherwise attempts to limit, modify or revoke such guarantor's guaranty of the Loan or any other loan with Lender; or (E) Lender in good faith deems itself insecure, even though no Event of Default shall have occurred.

**RIGHT OF SETOFF.** To the extent permitted by applicable law, Lender reserves a right of setoff in all Borrower's accounts with Lender (whether checking, savings, or some other account). This includes all accounts Borrower holds jointly with someone else and all accounts Borrower may open in the future. However, this does not include any IRA or Keogh accounts, or any trust accounts for which setoff would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the Indebtedness against any and all such accounts, and, at Lender's option, to administratively freeze all such accounts to allow Lender to protect Lender's charge and setoff rights provided in this paragraph.

**DEFAULT.** Each of the following shall constitute an Event of Default under this Agreement:

**Payment Default.** Borrower fails to make any payment when due under the Loan.

**Other Default.** Borrower fails to comply with any other term, obligation, covenant or condition contained in this Agreement or in any of the Related Documents.

**Default in Favor of Third Parties.** Borrower defaults under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's property or Borrower's ability to repay the Loans or perform Borrower's obligations under this Agreement or any related document.

**False Statements.** Any representation or statement made by Borrower to Lender is false in any material respect.

**Insolvency.** The dissolution or termination of Borrower's existence as a going business, the insolvency of Borrower, the appointment of a receiver for any part of Borrower's property, any assignment for the benefit of creditors, any type of creditor workout, or the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower.

**Creditor or Forfeiture Proceedings.** Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Borrower or by any governmental agency against any collateral securing the Loan.

**Events Affecting Guarantor.** Any of the preceding events occurs with respect to any Guarantor of any of the Indebtedness or any Guarantor dies or becomes incompetent, or revokes or disputes the validity of, or liability under, any Guaranty of the Indebtedness.

**Change in Ownership.** Any change in ownership of twenty-five percent (25) or more of the common stock of Borrower.

**Insecurity.** Lender in good faith believes itself insecure.

**EFFECT OF AN EVENT OF DEFAULT.** If any Event of Default shall occur, except where otherwise provided in this Agreement or the Related Documents, all commitments and obligations of Lender under this Agreement immediately will terminate (including any obligation to make further Loan Advances or disbursements), and, at Lender's option, all Indebtedness immediately will become due and payable, all without notice of any kind to Borrower, except that in the case of an Event of Default of the type described in the "Insolvency" subsection above, such acceleration shall be

**BUSINESS LOAN AGREEMENT  
(Continued)**

Loan No: 7657418442-34

Page 3

automatic and not optional. In addition, Lender shall have all the rights and remedies provided in the Related Documents or available at law, in equity, or otherwise. Except as may be prohibited by applicable law, all of Lender's rights and remedies shall be cumulative and may be exercised singularly or concurrently. Election by Lender to pursue any remedy shall not exclude pursuit of any other remedy, and an election to make expenditures or to take action to perform an obligation of Borrower or of any Grantor shall not affect Lender's right to declare a default and to exercise its rights and remedies.

**FACSIMILE AND COUNTERPART.** This document may be signed in any number of separate copies, each of which shall be effective as an original, but all of which taken together shall constitute a single document. An electronic transmission or other facsimile of this document or any related document shall be deemed an original and shall be admissible as evidence of the document and the signer's execution.

**INSURANCE.** Borrower shall assure that insurance is maintained pursuant to any insurance requirements set forth in the Agreement To Provide Insurance and /or other Related Documents, if applicable.

**LOAN AGREEMENT PROVISION.** The following covenants apply to the loan evidenced by the Note and to all other loans or other credit accommodations from Lender to Borrower now existing or subsequently arising under any future confirmation letter, agreement or promissory note, excluding any loans or financial accommodations which are not serviced by the Wells Fargo Business Banking Group, or its successors ("Excluded Loans"). These covenants supersede and replace any prior financial reporting and condition covenants and shall survive the payoff of the Loan, but shall not affect any Excluded Loans or covenants which by their nature relate only to a specific credit transaction.

**COVENANTS FOR. Rocky Mountain Chocolate Factory, Inc..**

**FINANCIAL CONDITION.** Borrower shall maintain its financial condition as follows using generally accepted accounting principles consistently applied and used consistently with prior practices (except to the extent modified by the definitions herein):

Definitions:

"Cash Flow" means the sum of net income after taxes plus depreciation expense, amortization expense, and interest expense less the sum of dividends and distributions.

"Current Maturities of Long Term Debt" means that portion of the Borrower's long term debt and capital leases maturing or scheduled to be paid in the prior period.

"Current Liabilities" means the aggregate amount of Borrower's items properly shown as current liabilities on its balance sheet less any portion of such current liabilities that constitute Subordinated Debt.

"EBITDA" means net income before tax plus interest expense (net of capitalized interest expense), depreciation expense and amortization expense.

"Net Worth" means total owner's equity.

"Subordinated Debt" means debt that is expressly subordinated to Lender in a writing acceptable to Lender.

"Tangible Net Worth" means Net Worth less any intangible assets.

"Total Liabilities" means the aggregate amount of Borrower's items properly shown as liabilities on its balance sheet.

- a. Current Ratio as of the end of each month not less than 1.5000 to 1.0, with "Current Ratio" defined as current assets divided by Current Liabilities.
- b. Working Capital as of the end of each month not less than \$3,750,000.00, with "Working Capital" defined as current assets minus Current Liabilities.
- c. Tangible Net Worth as of the end of each month not less than \$9,000,000.00.
- d. Total Liabilities divided by Tangible Net Worth as of the end of each quarter not greater than 1.6000 to 1.0.
- e. Debt Coverage Ratio as of the end of each quarter on a rolling four-quarter basis not less than 1.2500 to 1.0, with "Debt Coverage Ratio" defined as the ratio of Cash Flow to the sum of Current Maturities of Long Term Debt plus interest expense.

**INTERIM FINANCIAL STATEMENTS.** Borrower shall provide to Lender interim financial statements not later than 45 days after and as of the end of each month, prepared by Borrower to include a balance sheet as of the end of each such period, and an income statement and a statement of changes to owner's equity, from the beginning of the then fiscal year to the end of such period. If Borrower has subsidiaries, interim financial statements shall be provided on a consolidated and consolidating basis.

**LINE REST REQUIREMENT.** Borrower shall maintain a zero balance on the line of credit governed by this Agreement for a minimum of 30 consecutive days during the first twelve months of the line of credit, and during each successive twelve-month period.

**ACCOUNTS RECEIVABLES ADVANCE RATES.** Limitation on Advances. Amounts outstanding under any line of credit governed by this Agreement, to a maximum of the principal remaining available, shall not exceed 75% of Borrowers Eligible Accounts Receivable and 50% of Eligible Inventory as determined by Lender ("Borrowing Base"). All of the foregoing shall be determined by Lender upon receipt and review of all collateral reports and borrowing base certificates required hereunder and such other documents and collateral information as Lender may from time to time require.

As used herein, "eligible accounts receivable" shall consist solely of trade accounts created in the ordinary course of Borrower's business, upon which Borrower's right to receive payment is absolute and not contingent upon the fulfillment of any condition whatsoever, and in which Lender has a perfected security interest of first priority, and shall not include

any account which represents an obligation of an account debtor located in a foreign country, except to the extent any such account, in Lender's determination, is supported by a letter of credit or insured under a policy of foreign credit insurance, in each case in form, substance and issued by a party acceptable to Lender;

any account which represents an obligation of any account debtor when ten percent (10) or more of Borrower's accounts from such account debtor are greater than 90 days past due, unless Borrower has provided extended payment terms acceptable to Lender and such extended payment accounts are not more than 30 days past due;

any account deemed ineligible by Lender when Lender, in its sole discretion, deems the creditworthiness or financial condition of the account debtor, or the industry in which the account debtor is engaged, to be unsatisfactory.

**ACCOUNTS RECEIVABLE AND OTHER REPORTS.** Borrower shall provide the following reports to Lender, all in a form satisfactory to Lender:

not later than 45 days following, and as of the end of each month, a Borrowing Base certificate.

**BUSINESS LOAN AGREEMENT  
(Continued)**

Loan No: 7657418442-34

Page 4

**NEGATIVE COVENANTS.** Borrower further covenants that so long as Lender remains committed to extend credit to Borrower pursuant hereto, or any liabilities (whether direct or contingent, liquidated or un-liquidated) of Borrower to Lender under any of the Loan Documents remain outstanding, and until payment in full of all obligations of Borrower subject hereto, Borrower will not without Lender's prior written consent:

**CAPITAL EXPENDITURES.** Make any additional investment in fixed assets in an fiscal year in excess of an aggregate of \$1,750,000.00

**DIVIDENDS, DISTRIBUTIONS (CORPORATION)** Declare or pay any dividend distribution in excess \$8,000,000.00 annually, either in cash, stock or any other property on Borrower's stock now or hereafter outstanding. If Borrower is a Subchapter S corporation, so long as Borrower maintains its valid election as an S corporation, Borrower may pay cash dividends or distributions to its shareholders in any fiscal year to cover its shareholders' federal and state income tax liability for the immediately preceding fiscal year arising as a direct result of Borrower's reported income for said fiscal year, but not to exceed the minimum amount so required, and Borrower shall provide to Lender, upon request, any documentation required by Lender to substantiate the appropriateness of amounts paid or to be paid.

**OTHER.** Fiscal Business Plan.

Quarterly 10Q Report.

Annual 10 K Report.

**EFFECTIVE DATE.** The undersigned intends and agrees that the date of this agreement shall be its effective date, though it is being signed on a later date.

**DEFINITIONS.** The following capitalized words and terms shall have the following meanings when used in this Agreement. Unless specifically stated to the contrary, all references to dollar amounts shall mean amounts in lawful money of the United States of America. Words and terms used in the singular shall include the plural, and the plural shall include the singular, as the context may require. Words and terms not otherwise defined in this Agreement shall have the meanings attributed to such terms in the Uniform Commercial Code. Accounting words and terms not otherwise defined in this Agreement shall have the meanings assigned to them in accordance with generally accepted accounting principles as in effect on the date of this Agreement:

**Advance.** The word "Advance" means a disbursement of Loan funds made, or to be made, to Borrower or on Borrower's behalf on a line of credit or multiple advance basis under the terms and conditions of this Agreement.

**Agreement.** The word "Agreement" means this Business Loan Agreement, as this Business Loan Agreement may be amended or modified from time to time, together with all exhibits and schedules attached to this Business Loan Agreement from time to time.

**Borrower.** The word "Borrower" means Rocky Mountain Chocolate Factory, Inc.

**Collateral.** The word "Collateral" means all property and assets granted as collateral security for a Loan, whether real or personal property, whether granted directly or indirectly, whether granted now or in the future, and whether granted in the form of a security interest, mortgage, collateral mortgage, deed of trust, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor's lien, equipment trust, conditional sale, trust receipt, lien, charge, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever, whether created by law, contract, or otherwise.

**Event of Default.** The words "Event of Default" mean any of the events of default set forth in this Agreement in the default section of this Agreement.

**Grantor.** The word "Grantor" means each and all of the persons or entities granting a Security Interest in any Collateral for the Loan, including without limitation all Borrowers granting such a Security Interest.

**Guarantor.** The word "Guarantor" means any guarantor, surety, or accommodation party of any or all of the Loan.

**Guaranty.** The word "Guaranty" means the guaranty from Guarantor to Lender, including without limitation a guaranty of all or part of the Note.

**Indebtedness.** The word "Indebtedness" means the indebtedness evidenced by the Note or Related Documents, including all principal and interest together with all other indebtedness and costs and expenses for which Borrower is responsible under this Agreement or under any of the Related Documents.

**Lender.** The word "Lender" means Wells Fargo Bank, National Association, its successors and assigns.

**Loan.** The word "Loan" means any and all loans and financial accommodations from Lender to Borrower whether now or hereafter existing, and however evidenced, including without limitation those loans and financial accommodations described herein or described on any exhibit or schedule attached to this Agreement from time to time.

**Note.** The word "Note" means the Note executed by Rocky Mountain Chocolate Factory, Inc. in the principal amount of \$5,000,000.00 dated July 31, 2006, together with all renewals of, extensions of, modifications of, refinancings of, consolidations of, and substitutions for the note or credit agreement.

**Related Documents.** The words "Related Documents" mean all promissory notes, credit agreements, loan agreements, environmental agreements, guaranties, security agreements, mortgages, deeds of trust, security deeds, collateral mortgages, and all other instruments, agreements and documents, whether now or hereafter existing, executed in connection with the Loan.

**Security Agreement.** The words "Security Agreement" mean and include without limitation any agreements, promises, covenants, arrangements, understandings or other agreements, whether created by law, contract, or otherwise, evidencing, governing, representing, or creating a Security Interest.

**Security Interest.** The words "Security Interest" mean, without limitation, any and all types of collateral security, present and future, whether in the form of a lien, charge, encumbrance, mortgage, deed of trust, security deed, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor's lien, equipment trust, conditional sale, trust receipt, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever whether created by law, contract, or otherwise.

**BUSINESS LOAN AGREEMENT  
(Continued)**

**Loan No: 7657418442-34**

**Page 5**

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**BORROWER ACKNOWLEDGES HAVING READ ALL THE PROVISIONS OF THIS BUSINESS LOAN AGREEMENT AND BORROWER AGREES TO ITS TERMS. THIS BUSINESS LOAN AGREEMENT IS DATED JULY 31, 2006.**

**BORROWER:**

**ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.**

**By: /s/ Bryan Merryman  
Bryan Merryman, CFO/COO of Rocky Mountain  
Chocolate Factory, Inc.**

**LENDER:**

**WELLS FARGO BANK, NATIONAL ASSOCIATION**

**By: /s/ Mary Nordquist-Green  
Authorized Signer**

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## PROMISSORY NOTE

Principal	Loan Date	Maturity	Loan No	Call / Coll	Account	Officer	Initials
\$5,000,000.00	07-31-2006	07-31-2007	7657418442-34		482375	K5997	
References in the shaded area are for Lender's use only and do not limit the applicability of this document to any particular loan or item. Any item above containing **** has been omitted due to text length limitations.							

**Borrower:** Rocky Mountain Chocolate Factory, Inc.  
265 Turner Drive  
Durango, CO 81303-7941

**Lender:** Wells Fargo Bank, National Association  
Durango Main  
200 West College Drive  
Durango, CO 81301

**Principal Amount:** \$5,000,000.00

**Initial Rate:** 7.750

**Date of Note:** July 31, 2006

**PROMISE TO PAY.** Rocky Mountain Chocolate Factory, Inc. ("Borrower") promises to pay to Wells Fargo Bank, National Association ("Lender"), or order, in lawful money of the United States of America, the principal amount of Five Million & 00/100 Dollars (\$5,000,000.00) or so much as may be outstanding, together with interest on the unpaid outstanding principal balance of each advance. Interest shall be calculated from the date of each advance until repayment of each advance.

**PAYMENT.** Borrower will pay this loan in one payment of all outstanding principal plus all accrued unpaid interest on July 31, 2007. In addition, Borrower will pay regular monthly payments of all accrued unpaid interest due as of each payment date, beginning August 31, 2006, with all subsequent interest payments to be due on the last day of each month after that. Unless otherwise agreed or required by applicable law, payments will be applied first to any accrued unpaid interest; then to principal; and then to any late charges. The annual interest rate for this Note is computed on a 365/360 basis; that is, by applying the ratio of the annual interest rate over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal balance is outstanding. Borrower will pay Lender at Lender's address shown above or at such other place as Lender may designate in writing.

**VARIABLE INTEREST RATE.** The interest rate on this Note is subject to change from time to time based on changes in an index which is the floating rate equal to the Prime Rate set from time to time by Lender that serves as the basis upon which effective rates of interest are calculated for those loans making reference thereto (the "Index"). The Index is not necessarily the lowest rate charged by Lender on its loans and is set by Lender in its sole discretion. If the Index becomes unavailable during the term of this loan, Lender may designate a substitute index after notifying Borrower. Lender will tell Borrower the current Index rate upon Borrower's request. The interest rate change will not occur more often than each time the Index changes. Each change in the Prime Rate of interest hereunder shall become effective on the date each Prime Rate change is announced within Lender. The "initial rate" is the rate per annum which Borrower and Lender agree shall be the initial rate of this Note, and the "index currently" is the Index amount upon which said initial rate is based; they do not necessarily reflect the Index in effect on the date of this Note. Borrower understands that Lender may make loans based on other rates as well. **The Index currently is 8.250% per annum. The interest rate to be applied to the unpaid principal balance of this Note will be at a rate of 0.500 percentage points under the Index, resulting in an initial rate of 7.750% per annum.** NOTICE: Under no circumstances will the interest rate on this Note be more than the maximum rate allowed by applicable law.

**PREPAYMENT.** Borrower may pay without penalty all or a portion of the amount owed earlier than it is due. Early payments will not, unless agreed to by Lender in writing, relieve Borrower of Borrower's obligation to continue to make payments of accrued unpaid interest. Rather, early payments will reduce the principal balance due. Borrower agrees not to send Lender payments marked "paid in full", "without recourse", or similar language. If Borrower sends such a payment, Lender may accept it without losing any of Lender's rights under this Note, and Borrower will remain obligated to pay any further amount owed to Lender. All written communications concerning disputed amounts, including any check or other payment instrument that indicates that the payment constitutes "payment in full" of the amount owed or that is tendered with other conditions or limitations or as full satisfaction of a disputed amount must be mailed or delivered to: Wells Fargo Bank, National Association Ann: Commercial Loan Research Department, PO Box 659713 San Antonio, TX 78265.

**LATE CHARGE.** If a payment is 15 days or more late, Borrower will be charged \$50.00.

**INTEREST AFTER DEFAULT.** Upon default, including failure to pay upon final maturity, at Lender's option, and if permitted by applicable law, Lender may add any unpaid accrued interest to principal and such sum will bear interest therefrom until paid at the rate provided in this Note (including any increased rate). Upon default, Lender, at its option, may, if permitted under applicable law, increase the variable interest rate on this Note 4.000 percentage points. The interest rate will not exceed the maximum rate permitted by applicable law.

**DEFAULT.** Each of the following shall constitute an event of default ("Event of Default") under this Note:

**Payment Default.** Borrower fails to make any payment when due under this Note.

**Other Defaults.** Borrower fails to comply with or to perform any other term, obligation, covenant or condition contained in this Note or in any of the related documents or to comply with or to perform any term, obligation, covenant or condition contained in any other agreement between Lender and Borrower.

**Default in Favor of Third Parties.** Borrower or any Grantor defaults under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's property or Borrower's ability to repay this Note or perform Borrower's obligations under this Note or any of the related documents.

**False Statements.** Any warranty, representation or statement made or furnished to Lender by Borrower or on Borrower's behalf under this Note or the related documents is false or misleading in any material respect, either now or at the time made or furnished or becomes false or misleading at any time thereafter.

**Insolvency.** The dissolution or termination of Borrower's existence as a going business, the insolvency of Borrower, the appointment of a receiver for any part of Borrower's property, any assignment for the benefit of creditors, any type of creditor workout, or the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower.

**Creditor or Forfeiture Proceedings.** Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Borrower or by any governmental agency against any collateral securing the loan. This includes a garnishment of any of Borrower's accounts, including deposit accounts, with Lender. However, this Event of Default shall not apply if there is a good faith dispute by Borrower as to the validity or reasonableness of the claim which is the basis of the creditor or forfeiture proceeding and if Borrower gives Lender written notice of the creditor or forfeiture proceeding and deposits with Lender monies or a surety bond for the creditor or forfeiture proceeding, in an amount determined by Lender, in its sole discretion, as being an adequate reserve or bond for the dispute.

**Events Affecting Guarantor.** Any of the preceding events occurs with respect to any guarantor, endorser, surety, or accommodation party of any of the indebtedness or any guarantor, endorser, surety, or accommodation party dies or becomes incompetent, or revokes or disputes the validity of, or liability under, any guaranty of the indebtedness evidenced by this Note.

**Change In Ownership.** Any change in ownership of twenty-five percent (25) or more of the common stock of Borrower.

**Adverse Change.** A material adverse change occurs in Borrower's financial condition, or Lender believes the prospect of payment or performance of this Note is impaired.

**Insecurity.** Lender in good faith believes itself insecure.

**LENDER'S RIGHTS.** Upon default, Lender may declare the entire unpaid principal balance on this Note and all accrued unpaid interest immediately due, and then Borrower will pay that amount.

**ATTORNEYS' FEES; EXPENSES.** Lender may hire or pay someone else to help collect this Note if Borrower does not pay. Borrower will pay Lender the reasonable costs of such collection. This includes, subject to any limits under applicable law, Lender's attorneys' fees and Lender's legal expenses, whether or not there is a lawsuit, including without limitation attorneys' fees and legal expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction), and appeals. If not prohibited by applicable law, Borrower also will pay any court costs, in addition to all other sums provided by law.

**GOVERNING LAW.** This Note will be governed by federal law applicable to Lender and, to the extent not preempted by federal law, the laws of the State of Colorado without regard to its conflicts of law provisions. This Note has been accepted by Lender in the State of Colorado.

**RIGHT OF SETOFF.** To the extent permitted by applicable law, Lender reserves a right of setoff in all Borrower's accounts with Lender (whether checking, savings, or some other account). This includes all accounts Borrower holds jointly with someone else and all accounts Borrower may open in the future. However, this does not include any IRA or Keogh accounts, or any trust accounts for which setoff would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the indebtedness against any and all such accounts, and, at Lender's option, to administratively freeze all such accounts to allow Lender to protect Lender's charge and setoff rights provided in this paragraph.

**LINE OF CREDIT.** This Note evidences a revolving line of credit. Advances under this Note may be requested either orally or in writing by Borrower or by an authorized person. Lender may, but need not, require that all oral requests be confirmed in writing. All communications, instructions, or directions by telephone or otherwise to Lender are to be directed to Lender's office shown above. Borrower agrees to be liable for all sums either: (A) advanced in accordance with the instructions of an authorized person or (B) credited to any of Borrower's accounts with Lender. The unpaid principal balance owing on this Note at any time may be evidenced by endorsements on this Note or by Lender's internal records, including daily computer print-outs.

**FINANCIAL STATEMENTS.** Borrower agrees to provide to Lender, upon request, financial statements prepared in a manner and form acceptable to Lender, and copies of such tax returns and other financial information and statements as may be requested by Lender. Borrower shall also furnish such information regarding Borrower or the Collateral as may be requested by Lender. Borrower warrants that all financial statements and information provided to Lender are and will be accurate, correct and complete.

**EXTENSION AND RENEWAL.** Lender may, at Lender's discretion, renew or extend this Note by written notice ("Renewal Notice") to Borrower. Such renewal or extension shall be effective as of the maturity date of this Note, and may be conditioned among other things on modification of Borrower's obligations hereunder, including but not limited to a decrease in the amount available under this Note, an increase in the interest rate applicable to this Note and/or payment of a fee for such renewal or extension. In addition, Lender may increase the principal amount available under the Note at any time. Borrower shall be deemed to have accepted the terms of each Renewal Notice, including any notice of an increase in availability, if Borrower does not deliver to Lender written rejection of such renewal or extension within 10 days following receipt of such Renewal Notice, or if Borrower draws additional funds following the date of notification. After any renewal or extension of Borrower's obligations under this Note, the term "maturity date" as used in this Note shall mean the new maturity date set forth in the Renewal Notice. This Note may be renewed and extended repeatedly in this manner.

**LINE ADVANCES.** Notwithstanding anything to the contrary, requests for advances communicated to any office of Lender by any person believed by Lender in good faith to be authorized to make the request, whether written, verbal, telephonic or electronic, may be acted upon by Lender, and Borrower will be liable for sums advanced by Lender pursuant to such request. Such requests for advances shall be deemed authorized by Borrower, and Lender shall not be liable for such advances made in good faith, and with respect to advances deposited to the credit of any deposit account of Borrower, such advances, when so deposited, shall be conclusively presumed to have been made to or for the benefit of Borrower regardless of the fact that persons other than those authorized to request advances may have authority to draw against such account. Borrower agrees to indemnify and hold Lender harmless from and against all damages, liabilities, costs and expenses (including attorney's fees) arising out of any claim by Borrower or any third party against Lender in connection with Lender's performance of transfers as described above.

**CREDIT BUREAU INQUIRIES.** The parties hereto, and each individual signing below in a representative capacity, agree that Lender may obtain business and/or personal credit reports and tax returns on each of them in their individual capacities.

**APPLICATION OF PAYMENTS.** Notwithstanding the application of payment provided in the Payment section of this Note, unless otherwise agreed, all sums received from Borrower may be applied to interest, fees, principal, or any other amounts due to Lender in any order at Lender's sole discretion. If a final payment amount is set out in the Payment section of this Note, Borrower understands that it is an estimate, and that the actual final payment amount will depend upon when payments are received and other factors.

**ADDITIONAL EVENTS OF DEFAULT.** If the Borrower is a partnership, in addition to the Events of Default described above, the following shall also be an Event of Default: (a) the resignation or expulsion of any general partner with an ownership interest of twenty-five percent (25%) or more in any Borrower which is a partnership or (b) if any general partner of Borrower is generally not paying its debts as they become due.

**DEFAULT RATE.** At Lender's option and without prior notice, upon default or at any time during the pendency of any event of default under this Note or any related loan documents, Lender may increase the interest rate applicable to the Note by four percent (4.0%) (the "Default Rate"), not to exceed the maximum lawful rate. (If the applicable rate is a floating or variable rate, then the Default Rate will be a varying rate equal to the sum of the normally applicable Index and spread, plus four percent.) The Default Rate shall remain in effect until the default has been cured and that fact has been communicated to and confirmed by Lender. Lender shall give written notice to Borrower of Lender's imposition of the Default Rate. If the Note is not paid at maturity, Lender may impose the Default Rate from the maturity date to the date paid in full without notice. Lender's imposition of the Default Rate shall not constitute an election of remedies or otherwise limit Lender's rights concerning other remedies available to Lender as a result of the occurrence of an event of default. In the event of a conflict between the provisions of this paragraph and any other provision of this Note or any related agreement, the provisions of this paragraph shall control. If a default rate is prohibited by applicable law, then the interest rate applicable after default or maturity shall be the prematurity rate which would be applicable in the absence of any default.

**PROMISSORY NOTE  
(Continued)**

Loan No: 7657418442-34

Page 3

**FURTHER ASSURANCES.** The parties hereto agree to do all things deemed necessary by Lender in order to fully document the loan evidenced by this Note and any related agreements, and will fully cooperate concerning the execution and delivery of security agreements, stock powers, instructions and/or other documents pertaining to any collateral intended to secure the Indebtedness. The undersigned agree to assist in the cure of any defects in the execution, delivery or substance of the Note and related agreements, and in the creation and perfection of any liens, security interests or other collateral rights securing the Note.

**CONSENT TO SELL LOAN.** The parties hereto agree: (a) Lender may sell or transfer all or part of this loan to one or more purchasers, whether related or unrelated to Lender; (b) Lender may provide to any purchaser, or potential purchaser, any information or knowledge Lender may have about the parties or about any other matter relating to this loan obligation, and the parties waive any rights to privacy it may have with respect to such matters; (c) the purchaser of a loan will be considered its absolute owner and will have all the rights granted under the loan documents or agreements governing the sale of the loan; and (d) the purchaser of a loan may enforce its interests irrespective of any claims or defenses that the parties may have against Lender.

**FACSIMILE AND COUNTERPART.** This document may be signed in any number of separate copies, each of which shall be effective as an original, but all of which taken together shall constitute a single document. An electronic transmission or other facsimile of this document or any related document shall be deemed an original and shall be admissible as evidence of the document and the signer's execution.

**ADDITIONAL SECURITY.** Notwithstanding anything to the contrary in this or any related agreement, to further secure the indebtedness and obligations of the Note and related loan documents. Borrower pledges and grants to Lender a contractual right of offset and security interest in Borrower's accounts with Lender and Borrower's accounts with any Wells Fargo Affiliate, whether checking, savings, investment, or some other account, including without limitation, accounts held jointly with others and accounts opened in the future, excluding however all IRAs, Keogh accounts, and trust accounts to the extent a security interest would be invalid or prohibited by law. As used herein, "Wells Fargo Affiliate" means any present or future subsidiary of Wells Fargo & Company, and any subsidiary thereof, and any successors of such financial service companies.

**LOAN FEE AUTHORIZATION.** Borrower shall pay to Lender any and all fees as specified in the "Disbursement Request and Authorization" executed by Borrower in connection with this Note. Such fees are non-refundable and shall be due and payable in full immediately upon Borrower's execution of this Note.

**LETTERS OF CREDIT AND FOREIGN EXCHANGE.** Borrower shall have available a Letter of Credit Subfeature and a Foreign Exchange Subfeature as described in this section, in a total amount not to exceed the available principal amount of the line of credit evidenced by this Note.

A. **Letter of Credit Subfeature.** As a Subfeature this Note, Lender may from time to time issue or cause to be issued by a Wells Fargo Affiliate (such Lender or Wells Fargo Affiliate being referred to herein as the "Issuer") for your account, commercial and/or standby letters of credit (each individually, a "Letter of Credit" and collectively "Letters of Credit"); provided however, that the form and substance of each Letter of Credit shall be the subject to approval by the Issuer in its sole discretion. Each Letter of Credit shall be issued for a term designated by Borrower; provided however, that no Letter of Credit shall have an expiration subsequent to the maturity of the Note. Each Letter of Credit shall be subject to the terms and conditions of a Letter of Credit Agreement and related documents, if any, required by Issuer in connection with the issuance of such Letter of Credit (each individually a "Letter of Credit Agreement" and collectively, the "Letter of Credit Agreements"). Each draft paid by Issuer under a Letter of Credit and reimbursed by Lender and shall be paid with an advance under the Note and shall be repaid by Borrower in accordance with the terms and conditions of the Note applicable to such advances; provided however, that if advances under the Note are not available, for any reason whatsoever, at the time any amount is paid by Lender, then the full amount of such advance shall be immediately due and payable, together with interest thereon, from the date such amount is paid by Issuer or Lender to the date such amount is fully repaid by Borrower, at the rate of interest applicable to advances under the Note. In such event, Borrower agrees that Issuer or Lender, at Issuer's or Lender's sole discretion, may debit Borrower's deposit account(s) with Lender or a Wells Fargo Affiliate for the amount of any such draft. Upon the issuance of an amendment to a Letter of Credit, upon the reimbursement by Lender of a draft under any Letter of Credit, and otherwise as agreed by Borrower and Issuer pursuant to the Letter of Credit Agreements, Borrower shall pay to Issuer or Lender fees determined in accordance with Issuer's/Lender's standard fees and charges at such time.

B. **Foreign Exchange Subfeature.** As a Subfeature of this Note, Lender or a Wells Fargo Affiliate (such Lender or Wells Fargo Affiliate being referred to herein as the "Exchanger") may make available to Borrower a foreign exchange facility under which Exchanger, from time to time up to and including the maturity date of the Note, will enter into foreign exchange contracts for the account of Borrower for the purchase and/or sale by Borrower in United States Dollars of the foreign currency or currencies specified in the foreign exchange agreement establishing the foreign exchange facility. Each foreign exchange transaction shall be subject to the terms and conditions of the foreign exchange agreement, the form and substance of which must be acceptable to the Exchanger in all respects in its sole discretion.

C. **Subfeature Limits.** The outstanding amount of all Letters of Credit and foreign exchange contracts, plus the reserve percentage applicable to foreign exchange contracts, shall be reserved under the Note and shall not be available for Note advances. If the Trade Finance Subfeature relates to a non-revolving line of credit, the amounts described in the preceding sentence shall permanently reduce the remaining amount available under the non-revolving line of credit. The amount of all outstanding foreign exchange contracts plus a reserve percentage of 20 of said amount, plus the aggregate principal amount of all outstanding Letters of Credit, plus the principal amounts of any advances outstanding under the Note, shall not at any time exceed the principal amount of the Note, unless allowed by Lender at Lender's full discretion. Any excess amount shall be fully due and payable immediately without notice. As used herein, Wells Fargo Affiliate means any present or future subsidiary of Wells Fargo & Company, any subsidiary thereof, and any successors of such financial service companies.

**ARBITRATION AGREEMENT. Arbitration - Binding Arbitration.** Lender and each party to this agreement hereby agree, upon demand by any party, to submit any Dispute to binding arbitration in accordance with the terms of this Arbitration Program. A "Dispute" shall include any dispute, claim or controversy of any kind, whether in contract or in tort. Legal or equitable, now existing or hereafter arising, relating in any way to this Agreement or any related agreement incorporating this Arbitration Program (the "Documents"), or any past, present, or future loans, transactions, contracts, agreements, relationships, incidents or injuries of any kind whatsoever relating to or involving Business Banking, Regional Banking, or any successor group or department of Lender. DISPUTES SUBMITTED TO ARBITRATION ARE NOT RESOLVED IN COURT BY A JUDGE OR JURY.

**Governing Rules.** Any arbitration proceeding will (i) be governed by the Federal Arbitration Act (Title 9 of the United States Code), notwithstanding any conflicting choice of law provision in any of the documents between the parties; and (ii) be conducted by the AAA (American Arbitration Association), or such other administrator as the parties shall mutually agree upon, in accordance with the AAA's commercial dispute resolution procedures, unless the claim or counterclaim is at least \$1,000,000.00 exclusive of claimed interest, arbitration fees and costs in which case the arbitration shall be conducted in accordance with the AAA's optional procedures for large, complex commercial disputes (the commercial dispute resolution procedures or the optional procedures for large, complex commercial disputes to be referred to, as applicable, as the "Rules"). If there is any inconsistency between the terms hereof and the Rules, the terms and procedures set forth herein shall control. Arbitration proceedings hereunder shall be conducted at a location mutually agreeable to the parties, or if they cannot agree, then at a location selected by the AAA in the state of the applicable substantive law primarily governing the Credit. Any party who fails or refuses to submit to arbitration following a demand by any other party

shall bear all costs and expenses incurred by such other party in compelling arbitration of any Dispute. Arbitration may be demanded at any time, and may be compelled by summary proceedings in Court. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy shall not constitute a waiver of the right of any party, including the plaintiff, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief. The arbitrator shall award all costs and expenses of the arbitration proceeding. Nothing contained herein shall be deemed to be a waiver by any party that is a Bank of the protections afforded to it under 12 U.S.C. §91 or any similar applicable state law.

**No Waiver of Provisional Remedies, Self-Help and Foreclosure.** The arbitration requirement does not limit the right of any party to (i) foreclose against real or personal property collateral; (ii) exercise self-help remedies relating to collateral or proceeds of collateral such as setoff or repossession; or (iii) obtain provisional or ancillary remedies such as replevin, injunctive relief, attachment or the appointment of a receiver, before during or after the pendency of any arbitration proceeding. This exclusion does not constitute a waiver of the right or obligation of any party to submit any Dispute to arbitration or reference hereunder, including those arising from the exercise of the actions detailed in sections (i), (ii) and (iii) of this paragraph.

**Arbitrator Qualifications and Powers.** Any arbitration proceeding in which the amount in controversy is \$5,000,000.00 or less will be decided by a single arbitrator selected according to the Rules, and who shall not render an award of greater than \$5,000,000.00. Any Dispute in which the amount in controversy exceeds \$5,000,000.00 shall be decided by majority vote of a panel of three arbitrators; provided however, that all three arbitrators must actively participate in all hearings and deliberations. Every arbitrator must be a practicing attorney or a retired member of the state or federal judiciary, in either case with a minimum of ten years experience in the substantive law applicable to the subject matter of the Dispute. The arbitrator will determine whether or not an issue is arbitratable and will give effect to the statutes of limitation in determining any claim. In any arbitration proceeding the arbitrator will decide (by documents only or with a hearing at the arbitrator's discretion) any pre-hearing motions which are similar to motions to dismiss for failure to state a claim or motions for summary adjudication. The arbitrator shall resolve all Disputes in accordance with the applicable substantive law and may grant any remedy or relief that a court of such state could order or grant within the scope hereof and such ancillary relief as is necessary to make effective any award. The arbitrator shall also have the power to award recovery of all costs and fees, to impose sanctions and to take such other action as the arbitrator deems necessary to the same extent a judge could pursuant to the Federal Rules of Civil Procedure, the applicable State Rules of Civil Procedure, or other applicable law. Judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction.

**Discovery.** In any arbitration proceeding discovery will be permitted in accordance with the Rules. All discovery shall be expressly limited to matters directly relevant to the Dispute being arbitrated and must be completed no later than 20 days before the hearing date and within 180 days of the filing of the Dispute with the AAA. Any requests for an extension of the discovery periods, or any discovery disputes, will be subject to final determination by the arbitrator upon a showing that the request for discovery is essential for the party's presentation and that no alternative means for obtaining information is available.

**Miscellaneous.** To the maximum extent practicable, the AAA, the arbitrators and the parties shall take all action required to conclude any arbitration proceeding within 180 days of the filing of the Dispute with the AAA. The resolution of any Dispute shall be determined by a separate arbitration proceeding and such Dispute shall not be consolidated with other disputes or included in any class proceeding. No arbitrator or other party to an arbitration proceeding may disclose the existence, content or results thereof, except for disclosures of information by a party required in the ordinary course of its business or by applicable law or regulation. If more than one agreement for arbitration by or between the parties potentially applies to a Dispute, the arbitration provision most directly related to the documents between the parties or the subject matter of the Dispute shall control. This arbitration provision shall survive termination, amendment or expiration of any of the documents or any relationship between the parties.

#### State-Specific Provisions.

If **California** law governs the Dispute, the following provision is included:

**Real Property Collateral; Judicial Reference.** Notwithstanding anything herein to the contrary, no Dispute shall be submitted to arbitration if the Dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration. If any such Dispute is not submitted to arbitration, the Dispute shall, at the election of any party, be referred to a referee in accordance with California Code of Civil Procedure Section 638 et seq., and this general reference agreement is intended to be specifically enforceable in accordance with said Section 638. A referee with the qualifications required herein for arbitrators shall be selected pursuant to the AAA's selection procedures. Judgment upon the decision rendered by a referee shall be entered in the court in which such proceeding was commenced in accordance with California Code of Civil Procedure Sections 644 and 645.

If **Idaho** law governs the Dispute, the following provision is included:

**Real Property Collateral; Judicial Reference.** Notwithstanding anything herein to the contrary, no dispute shall be submitted to arbitration if the dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of Idaho, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable.

If **Montana** law governs the Dispute, the following provision is included;

**Real Property Collateral; Judicial Reference.** Notwithstanding anything herein to the contrary, no dispute shall be submitted to arbitration if the dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of Montana, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable.

If **Nevada** law governs the Dispute, the following provision is included:

**Real Property Collateral; Judicial Reference.** Notwithstanding anything herein to the contrary, no dispute shall be submitted to arbitration if the dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless (i) the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration, or (ii) all parties to the arbitration waive any rights or benefits that might accrue to them by virtue of the single action rule statute of Nevada, thereby agreeing that all indebtedness and obligations of the parties, and all mortgages, liens and security interests securing such indebtedness and obligations, shall remain fully valid and enforceable.

If **Utah** law governs the Dispute, the following provision is included:

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**Real Property Collateral; Judicial Reference.** Notwithstanding anything herein to the contrary, no Dispute shall be submitted to arbitration if the Dispute concerns indebtedness secured directly or indirectly, in whole or in part, by any real property unless the holder of the mortgage, lien or security interest specifically elects in writing to proceed with the arbitration. If any such Dispute is not submitted to arbitration, the Dispute shall, at the election of any party, be referred to a master in accordance with Utah Rule of Civil Procedure 53, and this general reference agreement is intended to be specifically enforceable. A master with the qualifications required herein for arbitrators shall be selected pursuant to the AAA's selection procedures. Judgment upon the decision rendered by a master shall be entered in the court in which such proceeding was commenced in accordance with Utah Rule of Civil Procedure 53(e).

**EFFECTIVE DATE.** The undersigned intends and agrees that the date of this agreement shall be its effective date, though it is being signed on a later date.

**SUCCESSOR INTERESTS.** The terms of this Note shall be binding upon Borrower, and upon Borrower's heirs, personal representatives, successors and assigns, and shall inure to the benefit of Lender and its successors and assigns.

**GENERAL PROVISIONS.** Lender may delay or forgo enforcing any of its rights or remedies under this Note without losing them. Borrower and any other person who signs, guarantees or endorses this Note, to the extent allowed by law, waive presentment, demand for payment, and notice of dishonor. Upon any change in the terms of this Note, and unless otherwise expressly stated in writing, no party who signs this Note, whether as maker, guarantor, accommodation maker or endorser, shall be released from liability. All such parties agree that Lender may renew or extend (repeatedly and for any length of time) this loan or release any party or guarantor or collateral; or impair, fail to realize upon or perfect Lender's security interest in the collateral; and take any other action deemed necessary by Lender without the consent of or notice to anyone. All such parties also agree that Lender may modify this loan without the consent of or notice to anyone other than the party with whom the modification is made. The obligations under this Note are joint and several.

**PRIOR TO SIGNING THIS NOTE, BORROWER READ AND UNDERSTOOD ALL THE PROVISIONS OF THIS NOTE, INCLUDING THE VARIABLE INTEREST RATE PROVISIONS. BORROWER AGREES TO THE TERMS OF THE NOTE.**

**BORROWER ACKNOWLEDGES RECEIPT OF A COMPLETED COPY OF THIS PROMISSORY NOTE.**

**BORROWER:**

**ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.**

By: /s/ Bryan Merryman  
Bryan Merryman, CFO/COO of Rocky Mountain  
Chocolate Factory, Inc.

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## Certifications

I, Franklin E. Crail, certify that:

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

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;

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;

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-15(e) 15d-15(e), for the registrant and we have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
- b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and have presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 5, 2006

/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:

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

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;

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;

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-15(e) and 15d-15(e), for the registrant and we have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
- b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and have presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, 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 and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 5, 2006

/s/ Bryan J. Merryman

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

Certification of Chief Executive Officer

CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)

In connection with the Quarterly Report of Rocky Mountain Chocolate Factory, Inc. (the "Company") on Form 10-Q for the quarterly period ended August 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certifies pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: October 5, 2006

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

Certification of Chief Financial Officer

CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)

In connection with the Quarterly Report of Rocky Mountain Chocolate Factory, Inc. (the "Company") on Form 10-Q for the quarterly period ended August 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certifies pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: October 5, 2006

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