

EXHIBIT E

FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Rocky Mountain Chocolate Factory, Inc.
Durango, Colorado

We have audited the accompanying balance sheets of Rocky Mountain Chocolate Factory, Inc. (the "Company") as of February 28, 2006 and 2005, and the related statements of income, changes in stockholders' equity and cash flows for the years ended February 28 (29), 2006, 2005 and 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rocky Mountain Chocolate Factory, Inc. as of February 28, 2006 and 2005, and the results of their operations and their cash flows for each of the years ended February 28 (29), 2006, 2005 and 2004, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of February 28, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 28, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

Ehrhardt Keefe Steiner & Hottman PC

April 28, 2006
Denver, Colorado

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
STATEMENTS OF INCOME

	FOR THE YEARS ENDED FEBRUARY 28 or 29,		
	2006	2005	2004
Revenues			
Sales	\$22,343,209	\$19,380,861	\$16,668,210
Franchise and royalty fees	5,730,403	5,142,758	4,464,618
Total revenues	28,073,612	24,523,619	21,132,828
Costs and Expenses			
Cost of sales	13,956,550	11,741,205	10,535,352
Franchise costs	1,466,322	1,411,901	1,135,686
Sales & marketing	1,320,979	1,294,702	1,220,585
General and administrative	2,239,109	2,497,718	2,235,499
Retail operating	1,755,738	1,453,740	1,430,124
Depreciation and amortization	875,940	785,083	796,271
Total costs and expenses	21,614,638	19,184,349	17,353,517
Operating Income	6,458,974	5,339,270	3,779,311
Other Income (Expense)			
Interest expense	(19,652)	(99,988)	(144,787)
Interest income	95,360	92,938	93,847
Other, net	75,708	(7,050)	(50,940)
Income Before Income Taxes	6,534,682	5,332,220	3,728,371
Income Tax Expense	2,470,110	2,015,580	1,409,325
Net Income	\$ 4,064,572	\$ 3,316,640	\$ 2,319,046
Basic Earnings per Common Share	\$.65	\$.55	\$.40
Diluted Earnings per Common Share	\$.61	\$.51	\$.37
Weighted Average Common Shares Outstanding	6,268,202	6,006,883	5,854,060
Dilutive Effect of Employee Stock Options	407,411	474,499	449,720
Weighted Average Common Shares Outstanding, Assuming Dilution	6,675,613	6,481,382	6,303,780

The accompanying notes are an integral part of these statements.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
BALANCE SHEETS

AS OF FEBRUARY 28,
2006 2005

Assets

Current Assets

Cash and cash equivalents	\$ 3,489,750	\$ 4,438,876
Accounts receivable, less allowance for doubtful accounts of \$46,920 and \$80,641	3,296,690	2,943,835
Notes receivable	116,997	451,845
Refundable income taxes	-	364,630
Inventories, less reserve for slow moving inventory of \$61,032 and \$127,345	2,938,234	2,518,212
Deferred income taxes	117,715	156,623
Other	481,091	250,886
Total current assets	10,440,477	11,124,907

Property and Equipment, Net

6,698,604 6,125,981

Other Assets

Notes receivable, less valuation allowance of \$52,005	278,741	400,084
Goodwill, net	1,133,751	1,133,751
Intangible assets, net	402,469	426,827
Other	103,438	36,424
Total other assets	1,918,399	1,997,086

Total assets \$19,057,480 \$19,247,974

Liabilities and Stockholders' Equity

Current Liabilities

Current maturities of long-term debt	\$ -	\$ 126,000
Accounts payable	1,145,410	1,088,476
Accrued salaries and wages	507,480	1,160,937
Other accrued expenses	750,733	324,215
Dividend payable	504,150	417,090
Total current liabilities	2,907,773	3,116,718

Long-Term Debt, Less Current Maturities

- 1,539,084

Deferred Income Taxes

663,889 698,602

Commitments and Contingencies

Stockholders' Equity

Common stock, \$.03 par value; 100,000,000 shares authorized; 6,281,920 and 6,136,528 shares issued and outstanding	188,458	184,096
Additional paid-in capital	10,372,530	11,051,176
Retained earnings	4,924,830	2,658,298
Total stockholders' equity	15,485,818	13,893,570

Total liabilities and stockholders' equity \$19,057,480 \$19,247,974

The accompanying notes are an integral part of these statements.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	FOR THE YEARS ENDED FEBRUARY 28 or 29,		
	2006	2005	2004
Common Stock			
Balance at beginning of year	\$ 184,096	\$ 179,458	\$ 173,259
Repurchase and retirement of common stock	(5,827)	(3,756)	(5,052)
Issuance of common stock	53	18	-
Exercise of stock options and other	10,136	8,376	11,251
Balance at end of year	188,458	184,096	179,458
Additional Paid-In Capital			
Balance at beginning of year	11,051,176	2,631,358	2,623,178
Repurchase and retirement of common stock	(2,952,614)	(840,450)	(904,543)
Stock dividends declared	-	8,156,857	-
Costs related to stock splits and dividends	(8,902)	(15,638)	(10,002)
Issuance of common stock	37,447	4,939	-
Exercise of stock options and other	1,062,593	582,750	744,350
Tax benefit from employee stock transactions	1,182,830	531,360	178,375
Balance at end of year	10,372,530	11,051,176	2,631,358
Retained Earnings			
Balance at beginning of year	2,658,298	8,779,136	7,094,554
Net income	4,064,572	3,316,640	2,319,046
Stock dividends declared	-	(8,156,857)	-
Cash dividends declared	(1,798,040)	(1,280,621)	(634,464)
Balance at end of year	4,924,830	2,658,298	8,779,136
Total Stockholders' Equity	\$15,485,818	\$13,893,570	\$11,589,952
Common Shares			
Balance at beginning of year	6,136,528	5,981,948	5,775,285
Repurchase and retirement of common stock	(194,246)	(125,216)	(168,399)
Issuance of common stock	1,752	616	-
Exercise of stock options and other	337,886	279,180	375,062
Balance at end of year	6,281,920	6,136,528	5,981,948

The accompanying notes are an integral part of these statements.

ROCKY MOUNTAIN CHOCOLATE FACTORY, INC.
STATEMENTS OF CASH FLOWS

	FOR THE YEARS ENDED FEBRUARY 28 or 29,		
	2006	2005	2004
Cash Flows From Operating Activities:			
Net income	\$ 4,064,572	\$ 3,316,640	\$ 2,319,046
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	875,940	785,083	796,271
Provision for loss on accounts and notes receivable and related foreclosure costs	-	25,000	50,000
Provision for inventory loss	45,000	90,000	55,000
Loss on sale of assets	37,411	44,789	87,136
Deferred income taxes	4,195	135,716	348,664
Changes in operating assets and liabilities:			
Accounts receivable	(445,921)	(453,255)	(417,457)
Refundable income taxes	364,630	(364,630)	548,490
Inventories	(461,207)	(136,402)	535,325
Other assets	(236,640)	89,661	(92,541)
Accounts payable	56,934	135,934	339,772
Income taxes payable	357,970	409,957	299,778
Accrued liabilities	602,187	23,726	391,072
Net cash provided by operating activities	5,265,071	4,102,219	5,260,556
Cash Flows From Investing Activities:			
Additions to notes receivable	-	(236,142)	(53,676)
Proceeds received on notes receivable	345,442	172,776	227,790
Proceeds from sale of assets	(4,395)	23,834	84,572
Decrease in other assets	15,748	451	6,938
Purchase of property and equipment	(1,300,314)	(1,406,698)	(469,893)
Net cash used in investing activities	(943,519)	(1,445,779)	(204,269)
Cash Flows From Financing Activities:			
Payments on long-term debt	(1,665,084)	(1,401,490)	(1,224,624)
Costs of stock split or dividend	(8,902)	(15,638)	(10,002)
Issuance of common stock	1,072,729	591,126	755,601
Repurchase and redemption of common stock	(2,958,441)	(844,206)	(909,595)
Dividends paid	(1,710,980)	(1,099,639)	(398,356)
Net cash used in financing activities	(5,270,678)	(2,769,847)	(1,786,976)
Net (Decrease) Increase In Cash And Cash Equivalents	(949,126)	(113,407)	3,269,311
Cash And Cash Equivalents At Beginning Of Year	4,438,876	4,552,283	1,282,972
Cash And Cash Equivalents At End Of Year	\$ 3,489,750	\$ 4,438,876	\$ 4,552,283

The accompanying notes are an integral part of these statements.

NOTE 1 - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 Rocky Mountain Chocolate Factory stores at February 28, 2006:

	Sold, Not Yet Open	Open	Total
Company owned stores	-	9	9
Franchise stores - Domestic stores	18	243	261
Franchise stores - Domestic kiosks	2	21	23
Franchise stores - International	1	35	36
	21	308	329

Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of six months or less to be cash equivalents. The Company continually monitors its positions with, and the credit quality of, the financial institutions it invests with. As of the balance sheet date, and periodically throughout the year, the Company has maintained balances in various operating accounts in excess of federally insured limits, approximately \$3.1 million at February 28, 2006.

Insurance and Self-Insurance Reserves

The Company uses a combination of insurance and self-insurance plans to provide for the potential liabilities for workers' compensation, general liability, property insurance, director and officers' liability insurance, vehicle liability and employee health care benefits. Liabilities associated with the risks that are retained by the Company are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other assumptions. While the Company believes that its assumptions are appropriate, the estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Accounts and Notes Receivable

At the time that accounts, notes and royalties receivable are originated, the Company considers a reserve for doubtful accounts. The provision for uncollectible amounts is continually reviewed and adjusted to maintain the allowance at a level considered adequate to cover future losses. The allowance is management's best estimate of uncollectible amounts and is determined based on historical performance that is tracked by the Company on an ongoing basis. The losses ultimately incurred could differ materially in the near term from the amounts estimated in determining the allowance. At February 28, 2006, the Company has \$448,000 of notes receivable outstanding. The notes require monthly payments and bear interest at rates ranging from 7.25% to 12.5%. The notes mature through November 2009 and are secured by the assets financed.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property and Equipment and Other Assets

Property and equipment are recorded at cost. Depreciation and amortization are computed using the straight-line method based upon the estimated useful life of the asset, which range from five to thirty-nine years. Leasehold improvements are amortized on the straight-line method over the lives of the respective leases or the service lives of the improvements, whichever is shorter.

The Company reviews its long-lived assets through analysis of estimated fair value, including identifiable intangible assets, whenever events or changes indicate the carrying amount of such assets may not be recoverable. The Company's policy is to review the recoverability of all assets, at a minimum, on an annual basis.

Income Taxes

The Company recognizes deferred tax liabilities and assets based on the differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. The Company's temporary differences are listed in Note 6.

Goodwill

Goodwill arose from two transaction types. The first type was the result of the incorporation of the Company after its inception as a partnership. The goodwill recorded was the excess of the purchase price of the Company over the fair value of its assets. The Company has allocated this goodwill equally between its Franchising and Manufacturing operations. The second type was the purchase of various retail stores, either individually or as a group, for which the purchase price was in excess of the fair value of the assets acquired.

Sales

Sales of products to franchisees and other customers are recognized at the time of shipment. Sales of products at retail stores are recognized at the time of sale.

Shipping Fees

Shipping fees charged to customers by the Company's trucking department are reported as sales. Shipping costs incurred by the Company's trucking department are reported as cost of sales.

Franchise and Royalty Fees

Franchise fee revenue is recognized upon completion of all significant initial services provided to the franchisee and upon satisfaction of all material conditions of the franchise agreement. In addition to the initial franchise fee, the Company receives a royalty fee of approximately five percent (5%) and a marketing and promotion fee of one percent (1%) of the Rocky Mountain Chocolate Factory franchised stores' gross sales.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, the disclosure of contingent assets and liabilities, at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimates.

Vulnerability Due to Certain Concentrations

As of February 28, 2006, the Company had notes receivable of approximately \$400,000 due from three franchisees. The notes are collateralized by the underlying store assets. The Company is, therefore, vulnerable to changes in the cash flow from these locations.

Stock-Based Compensation

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," the Company continues to apply Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees" and related interpretations in accounting for our stock option grants. APB No. 25 provides that the compensation expense relative to stock options is measured based on the intrinsic value of the stock option at date of grant.

Stock-Based Compensation - CONTINUED

On February 21, 2006, the Company accelerated the vesting of all outstanding stock options in order to prevent past option grants from having an impact on future results. The Company recognized a share-based compensation charge totaling approximately \$71,000 related to this acceleration, which was determined by measuring the intrinsic value on the date of the acceleration for all options that would have expired in the future unexercisable had the acceleration not occurred. The calculation of this charge required that management make estimates and assumptions concerning future employee turnover. Adjustments in future periods may be necessary as actual results could differ from these estimates and assumptions.

The Company has adopted the disclosure-only provisions of SFAS 123. In accordance with those provisions, the Company applies APB 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation cost if the exercise price is not less than market at date of grant. The fiscal year 2006 pro forma fair value expense includes the impact of the February 21, 2006 accelerated vesting of stock options. No compensation expense was recognized during the fiscal years ended February 28, 2005 or February 29, 2004. If the Company had elected to recognize compensation cost based on the fair value of the options granted at grant dates as prescribed by SFAS 123, net income and earnings per share would have been reduced to the pro-forma amounts indicated in the table below for the years ending February 28 (29) (in 000's except per share amounts):

	2006	2005	2004
Net Income - as reported	\$ 4,065	\$ 3,317	\$ 2,319
Stock-based compensation expense included in reported net income, net of tax	43	-	-
Deduct stock-based compensation expense determined under fair value based method, net of tax	(676)	(120)	(73)
Net Income - pro forma	3,432	3,197	2,246
Basic Earnings per Share-as reported	.65	.55	.40
Diluted Earnings per Share-as reported	.61	.51	.37
Basic Earnings per Share-pro forma	.55	.53	.38
Diluted Earnings per Share-pro forma	.51	.50	.36

The above pro forma results are not indicative of future results under the requirements of SFAS No. 123R, "Share-based Payments."

Earnings Per Share

Basic earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding during each year. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options. During 2006, 2005 and 2004, 137,320, 0 and 148,286 stock options were excluded from diluted shares as their affect was anti-dilutive.

Advertising and Promotional Expenses

The Company expenses advertising costs as incurred. Total advertising expense amounted to approximately \$354,367, \$296,985 and \$334,885 for the fiscal years ended February 28 (29), 2006, 2005 and 2004, respectively.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, trade receivables, payables, notes receivable, and debt. The fair value of all instruments approximates the carrying value.

NOTE 2 - INVENTORIES

Inventories consist of the following at February 28:

	2006	2005
Ingredients and supplies	\$ 1,507,193	\$ 1,365,421
Finished candy	1,431,041	1,152,791
	\$ 2,938,234	\$ 2,518,212

NOTE 3 - PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following at February 28:

	2006	2005
Land	\$ 513,618	\$ 513,618
Building	4,705,242	3,962,051
Machinery and equipment	6,252,011	7,553,261
Furniture and fixtures	817,137	611,930
Leasehold improvements	641,637	484,385
Transportation equipment	331,640	180,723
Construction in progress	-	527,658
	13,261,285	13,833,626
Less accumulated depreciation	6,562,681	7,707,645
Property and equipment, net	\$ 6,698,604	\$ 6,125,981

NOTE 4 - LINE OF CREDIT AND LONG-TERM DEBT

Line of Credit

At February 28, 2006 the Company had a \$5.0 million line of credit from a bank, collateralized by substantially all of the Company's assets with the exception of the Company's retail store assets. Draws may be made under the line at 75% of eligible accounts receivable plus 50% of eligible inventories. Interest on borrowings is at prime less 50 basis points (7.0% at February 28, 2006). At February 28, 2006, \$5.0 million was available for borrowings under the line of credit, subject to borrowing base limitations. Terms of the line require that the line be rested (that is, that there be no outstanding balance) for a period of 30 consecutive days during the term of the loan. Additionally, the line of credit is subject to various financial ratio and leverage covenants. At February 28, 2006 the Company was in compliance with all such covenants. The credit line is subject to renewal in July, 2006.

Long-term debt

Long-term debt consists of the following at February 28:

	2006	2005
Mortgage note payable, paid in full during fiscal 2006.	\$ -	\$ 1,665,084
Less current maturities	-	126,000
	\$ -	\$ 1,539,084

NOTE 5 - COMMITMENTS AND CONTINGENCIES

Operating leases

The Company conducts its retail operations in facilities leased under five to ten-year noncancelable operating leases. Certain leases contain renewal options for between two and ten additional years at increased monthly rentals. The majority of the leases provide for contingent rentals based on sales in excess of predetermined base levels.

The following is a schedule by year of future minimum rental payments required under such leases for the years ending February 28 or 29:

2007	\$ 277,400
2008	259,700
2009	202,500
2010	151,200
2011	74,100
	\$ 964,900

In some instances, in order to retain the right to site selection or because of requirements imposed by the lessor, the Company has leased space for its proposed franchise outlets. When a franchise was sold, the store was subleased to the franchisee who is responsible for the monthly rent and other obligations under the lease. The Company's liability as primary lessee on sublet franchise outlets, all of which is offset by sublease rentals, is as follows for the years ending February 28 or 29:

NOTE 5 - COMMITMENTS AND CONTINGENCIES - CONTINUED

2007	\$ 108,200
2008	52,400
2009	19,700
	\$ 180,300

The following is a schedule of lease expense for all retail operating leases for the three years ended February 28 or 29:

	2006	2005	2004
Minimum rentals	\$ 611,535	\$ 616,669	\$ 753,314
Less sublease rentals	(239,300)	(313,800)	(427,600)
Contingent rentals	23,921	28,949	11,187
	\$ 396,156	\$ 331,818	\$ 336,901

The Company also leases trucking equipment under operating leases. The following is a schedule by year of future minimum rental payments required under such leases for the years ending February 28 or 29:

2007	\$ 189,600
2008	148,200
2009	98,800
	\$ 436,600

The following is a schedule of lease expense for trucking equipment operating leases for the three years ended February 28 or 29:

	2006	2005	2004
	308,719	304,515	\$ 301,600

Purchase contracts

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. Currently the Company has contracted for approximately \$3,167,000 of raw materials under such agreements.

Contingencies

The Company is party to various legal proceedings arising in the ordinary course of business. Management believes that the resolution of these matters will not have a significant adverse effect on the Company's financial position, results of operations or cash flows.

NOTE 6 - INCOME TAXES

Income tax expense is comprised of the following for the years ending February 28 or 29:

	2006	2005	2004
Current			
Federal	\$ 2,147,826	\$ 1,586,493	\$ 878,546
State	318,089	293,371	182,115
Total Current	2,465,915	1,879,864	1,060,661
Deferred			
Federal	3,774	122,072	313,613
State	421	13,644	35,051
Total Deferred	4,195	135,716	348,664
Total	\$ 2,470,110	\$ 2,015,580	\$ 1,409,325

A reconciliation of the statutory federal income tax rate and the effective rate as a percentage of pretax income is as follows for the years ending February 28 or 29:

	2006	2005	2004
Statutory rate	34.0%	34.0%	34.0%
State income taxes, net of federal benefit	3.2%	3.8%	3.7%
Other	.6%	-	.1%
Effective Rate	37.8%	37.8%	37.8%

NOTE 6 - INCOME TAXES - CONTINUED

The components of deferred income taxes at February 28 are as follows:

	2006	2005
Deferred Tax Assets		
Allowance for doubtful accounts and notes	37,394	50,140
Inventories	23,070	48,136
Accrued compensation	49,632	44,066
Loss provisions and deferred income	49,173	49,472
Self insurance accrual	15,370	24,488
Amortization, design costs	60,355	49,980
	234,994	266,282
Deferred Tax Liabilities		
Depreciation and amortization	(781,168)	(808,261)
Net deferred tax liability	(546,174)	(541,979)
Current deferred tax assets	\$ 117,715	\$ 156,623
Non-current deferred tax liabilities	(663,889)	(698,602)
Net deferred tax liability	\$ (546,174)	\$ (541,979)

NOTE 7 - STOCKHOLDERS' EQUITY

Stock Issuance

In September 2005, the Company issued 1,752 shares of stock, valued at \$37,500, for certain licensing rights for five years and partial payment of certain sales services for one year.

Stock Dividends

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.

On May 4, 2004 the Board of Directors declared a 10 percent stock dividend payable on May 27, 2004 to shareholders of record as of May 13, 2004. Shareholders received one additional share of Common Stock for every ten shares owned prior to the record date. Subsequent to the dividend there were 4,286,722 shares outstanding.

Stock Splits

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.

On December 17, 2003 the Board of Directors approved a three-for-two stock split payable February 2, 2004 to shareholders of record at the close of business on January 20, 2004. Shareholders received one additional share of Common Stock for every two shares owned prior to the record date. Immediately prior to the split there were 2,618,954 shares outstanding. Subsequent to the split there were 3,928,782 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 March 24, 2006 and April 28, 2006 the Company repurchased 70,713 shares at an average price of \$15.65 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. Between October 3, 2003 and February 19, 2004 the Company repurchased 168,399 Company shares at an average price of \$5.40 per share.

NOTE 7 - STOCKHOLDERS' EQUITY - CONTINUED

Cash Dividend

The Company paid an initial quarterly cash dividend of \$0.0325 per common share on September 16, 2003 to shareholders of record on September 2, 2003. The Company paid a quarterly cash dividend of \$0.0352 per common share on December 16, 2003 to shareholders of record on December 2, 2003. The Company paid a quarterly cash dividend of \$0.0390 per common share on March 16, 2004 to shareholders of record on March 3, 2004. The Company paid a quarterly cash dividend of \$0.0429 per common share on June 16, 2004 and September 16, 2004 to shareholders of record on June 3, 2004 and September 2, 2004, respectively. The Company paid a quarterly cash dividend of \$0.0571 per common share on December 16, 2004 to shareholders of record on December 2, 2004. 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. The Company paid a quarterly cash dividend of \$0.08 per common share on March 16, 2006 to shareholders of record on March 8, 2006.

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 8 - STOCK OPTION PLANS

Under the 1995 Stock Option Plan (the "1995 Plan"), the 2004 Stock Option Plan (the "2004 Plan") the Nonqualified Stock Option Plan for Nonemployee Directors (the "Director's Plan") and the 2000 Nonqualified Stock Option Plan for Nonemployee Directors (the "2000 Director's Plan"), options to purchase up to 924,000, 420,000, 277,200 and 266,400 shares, respectively, of the Company's common stock may be granted at prices not less than market value at the date of grant. Options granted may not have a term exceeding ten years under the 1995 plan, the 2004 plan and the Director's Plan. Options granted may not have a term exceeding five years under the 2000 Director's Plan. Options representing the right to purchase 171,066, 374,010, 0 and 30,800 shares of the Company's common stock were outstanding under the 1995 Plan, the 2004 Plan, the Director's Plan, and the 2000 Director's Plan, respectively, at February 28, 2006. On February 21, 2006, the Company accelerated the vesting of all outstanding stock options in order to prevent past option grants from having an impact on future results. The options outstanding under these plans will expire, if not exercised through February 2016.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model utilizing the following weighted average assumptions:

	2006	2005	2004
Expected dividend yield	2.18%	2.16%	3.09%
Expected stock price volatility	30%	30%	30%
Risk-free interest rate	4.5%	3.8%	2.4%
Expected life of options	5 years	5 years	5 years

Information with respect to options outstanding under the Plans at February 28, 2006, and changes for the three years then ended was as follows:

	2006	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	770,000	\$ 4.69
Granted	149,640	18.14
Exercised	(337,884)	3.17
Forfeited	(5,880)	7.78
Outstanding at end of year	575,876	\$ 9.04
Options exercisable at February 28, 2006	575,876	\$ 9.04
	2005	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	758,142	\$ 2.52
Granted	300,720	7.71
Exercised	(278,542)	2.12
Forfeited	(10,320)	2.54
Outstanding at end of year	770,000	\$ 4.69
Options exercisable at February 28, 2005	284,020	\$ 2.76

NOTE 8 - STOCK OPTION PLANS - CONTINUED

		2004
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,062,600	\$ 2.29
Granted	70,070	3.37
Exercised	(374,528)	2.03
Outstanding at end of year	758,142	\$ 2.52
Options exercisable at February 29, 2004	474,474	\$ 2.28

Weighted average fair value per share of options granted during 2006, 2005 and 2004 were \$3.03, \$2.05 and \$0.77, respectively.

Additional information about stock options outstanding at February 28, 2006 is summarized as follows:

Range of exercise prices	Number exercisable	Options Outstanding	
		Weighted average remaining contractual life	Weighted average exercise price
\$1.603 to 3.935	175,826	5.75	3.25
\$6.149 to 7.807	253,490	8.25	7.76
\$14.955 to 21.600	146,560	9.19	18.21

NOTE 9 - OPERATING SEGMENTS

The Company classifies its business interests into two reportable segments: Franchising and Manufacturing. Previously the Company segregated Retail as a third reportable segment. The Company has phased out its Company-owned store program to nine remaining stores. The remaining stores provide an environment for testing new products and promotions, operating and training methods and merchandising techniques. Company management evaluates these stores in relation to their contribution to franchising efforts. The previously reported Retail segment is now included in the Franchising segment and all previously reported periods have been restated. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1. The Company evaluates performance and allocates resources based on operating contribution, which excludes unallocated corporate general and administrative costs, provision for loss on accounts and notes receivable and related foreclosure 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:

	Franchising	Manufacturing	Other	Total
FY 2006				
Total revenues	\$ 8,776,429	\$ 21,035,748	\$ -	\$ 29,812,177
Intersegment revenues	-	(1,738,565)	-	(1,738,565)
Revenue from external customers	8,776,429	19,297,183	-	28,073,612
Segment profit (loss)	2,986,944	5,884,990	(2,337,252)	6,534,682
Total assets	2,964,486	10,209,790	5,883,204	19,057,480
Capital expenditures	90,757	878,871	330,686	1,300,314
Total depreciation & amortization	264,658	406,494	204,788	875,940
FY 2005				
Total revenues	\$ 7,869,207	\$ 18,058,455	\$ -	\$ 25,927,662
Intersegment revenues	-	(1,404,043)	-	(1,404,043)
Revenue from external customers	7,869,207	16,654,412	-	24,523,619
Segment profit (loss)	2,714,261	5,256,713	(2,638,754)	5,332,220
Total assets	2,809,651	9,043,385	7,394,938	19,247,974
Capital expenditures	462,088	687,632	256,978	1,406,698
Total depreciation & amortization	223,561	384,291	177,231	785,083
FY 2004				
Total revenues	\$ 7,029,453	\$ 15,196,410	\$ -	\$ 22,225,863
Intersegment revenues	-	(1,093,035)	-	(1,093,035)
Revenue from external customers	7,029,453	14,103,375	-	21,132,828
Segment profit (loss)	2,270,890	3,846,198	(2,388,717)	3,728,371
Total assets	2,636,145	8,061,324	7,269,776	17,967,245
Capital expenditures	213,072	170,192	86,629	469,893
Total depreciation & amortization	219,742	390,714	185,815	796,271

NOTE 10 - SUPPLEMENTAL CASH FLOW INFORMATION

For the three years ended February 28 or 29:

	2006	2005	2004
Interest paid	\$ 19,872	\$ 100,067	\$ 144,936
Income taxes paid	560,485	1,834,536	212,393

Non-Cash Investing Activities:

Dividend payable	\$ 87,060	\$ 180,982	236,108
Issue stock for rights and services	37,500	-	-
Fair value of assets received upon settlement of notes and accounts receivable:			
Store to be operated	200,000	-	-
Inventory	3,815	-	-
Note receivable	153,780	-	-

NOTE 11 - EMPLOYEE BENEFIT PLAN

The Company has a 401(k) plan called the Rocky Mountain Chocolate Factory, Inc. 401(k) Plan. Eligible participants are permitted to make contributions up to statutory limits. The Company makes a matching contribution, which vests ratably over a 3-year period, and is 25% of the employee's contribution up to a maximum of 1.5% of the employee's compensation. For fiscal 2005 and 2004, the Company made an additional discretionary contribution by doubling the normal matching. During the years ended February 28 or 29, 2006, 2005 and 2004, the Company's contribution was approximately \$46,000, \$74,000 and \$63,000, respectively, to the plan.

NOTE 12 - SUMMARIZED QUARTERLY DATA (UNAUDITED)

Following is a summary of the quarterly results of operations for the fiscal years ended February 28, 2006 and 2005:

	Fiscal Quarter				
	First	Second	Third	Fourth	Total
2006					
Total revenue	\$ 5,366,801	\$6,583,160	\$7,997,547	\$8,126,104	\$28,073,612
Gross margin	1,633,931	2,091,825	2,444,166	2,216,737	8,386,659
Net income	752,585	1,123,538	1,115,740	1,072,709	4,064,572
Basic earnings per share	.12	.18	.18	.17	.65
Diluted earnings per share	.11	.17	.17	.16	.61

	Fiscal Quarter				
	First	Second	Third	Fourth	Total
2005					
Total revenue	\$ 4,725,284	\$5,867,937	\$7,097,878	\$6,832,520	\$24,523,619
Gross margin	1,438,450	1,980,886	2,169,222	2,051,098	7,639,656
Net income	591,912	1,003,446	871,162	850,120	3,316,640
Basic earnings per share	.10	.17	.15	.14	.55
Dilute earnings per share	.09	.16	.13	.13	.51

NOTE 13 - GOODWILL AND INTANGIBLE ASSETS

Intangible assets consist of the following at February 28:

	Amortization Period	2006		2005	
		Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Intangible assets subject to amortization					
Store design	10 Years	\$ 205,777	\$ 85,093	\$ 205,777	\$ 63,983
Packaging licenses	3-5 Years	120,830	99,164	95,831	84,848
Packaging design	10 Years	430,973	170,854	403,238	129,188
Total		757,580	355,111	704,846	278,019
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	\$ 1,087,322	\$ 2,570,808	\$ 1,010,230

NOTE 13 - GOODWILL AND INTANGIBLE ASSETS - CONTINUED

Amortization expense related to intangible assets totaled \$77,092 and \$72,058 during the fiscal year ended February 28, 2006 and 2005. The aggregate estimated amortization expense for intangible assets remaining as of February 28, 2006 is as follows:

2007	73,100
2008	73,100
2009	73,100
2010	73,100
2011	64,400
Thereafter	45,669
Total	\$402,469

NOTE 14 - RECENT ACCOUNTING PRONOUNCEMENTS

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143 ("FIN 47"), which clarifies the impact that uncertainty surrounding the timing or method of settling an obligation should have on accounting for that obligation under SFAS No. 143, Accounting for Asset Retirement Obligations ("SFAS 143"). FIN 47 is effective no later than the end of the fiscal year ending after December 15, 2005, or December 31, 2005 for calendar year companies. The Company adopted this standard as of February 28, 2006. The adoption of this statement had no impact on the Company's financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections ("SFAS 154"). SFAS 154 replaces Accounting Principles Board Opinion No. 20 ("APB 20"), Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, APB 20 required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of direct effects of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 carries forward without change the guidance for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted this standard as of March 1, 2006. The adoption of this statement had no impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" ("SFAS No. 123R") which replaces SFAS No. 123, supersedes Accounting Principles Board (APB) No. 25 and related interpretations and amends SFAS No. 95, "Statement of Cash Flows." The provisions of SFAS No. 123R are similar to those of SFAS No. 123; however, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statement as compensation cost based on their fair value on the date of the grant. The fair value of the share-based awards will be determined using an option-pricing model on the grant date. SFAS No. 123R is effective at the beginning of the first fiscal year beginning after June 15, 2005. The Company adopted SFAS No. 123R effective March 1, 2006.

Through fiscal 2006, the Company accounted for stock-based employee compensation under the recognition and measurement principles of APB Opinion No. 25. In accordance with that standard, no stock-based employee compensation cost for stock options has been reflected in the statements of income except in fiscal 2006 upon acceleration of options (Note 1). In accordance with the provisions of the original SFAS No. 123, the Company has disclosed, on a pro forma basis, the effect on net income had the Company applied the provisions of that statement to Stock-based employee compensation.

SFAS No. 123R requires the Company to recognize stock option expense in the statements of income beginning in the first quarter of fiscal 2007 and to estimate the effect of stock option forfeitures. Through fiscal 2006, as permitted by the original SFAS No. 123, the Company has accounted for forfeitures as they occur. In addition, SFAS 123(R) amends FASB Statement No. 95, "Statements of Cash Flows," to require that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid.

NOTE 14 - RECENT ACCOUNTING PRONOUNCEMENTS - CONTINUED

As of the beginning of the first quarter in fiscal 2007 (the "required effective date"), the Company will apply the provisions of SFAS 123R to new stock awards and to awards modified, repurchased or canceled after the required effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the service is rendered on or after that date. The compensation cost for that portion of awards will be based on the fair value of those awards as calculated for pro forma disclosure purposes under the original SFAS No. 123.

The Company estimates that stock option expense in fiscal 2007 will be approximately \$30,000 to \$60,000 post-tax. The actual amount of stock option expense may vary materially from this estimate, due to certain factors, including number of options that will actually be issued, the timing of option grants, and the market price of our stock on the date of grant.