

SPICY PICKLE FRANCHISING INC

Form 10-Q

August 12, 2010

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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 June 30, 2010

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

000-53000

(Commission file number)

SPICY PICKLE FRANCHISING, INC.  
(Exact name of registrant as specified in its charter)

Colorado  
(State or other jurisdiction  
of incorporation or organization)

38-3750924  
(IRS Employer Identification No.)

90 Madison Street, Suite 700, Denver,  
Colorado  
(Address of principal executive offices)

80206  
(Zip Code)

(303) 297-1902

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No  (Not required)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of July 31, 2010 there were 82,494,274 shares of common stock outstanding.

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Spicy Pickle Franchising, Inc.  
Condensed Consolidated Balance Sheets

|   | June 30,<br>2010<br>(Unaudited) | December 31,<br>2009 |
|---|---------------------------------|----------------------|
| Assets  |                                 |                      |
| Current assets:   |                                 |                      |
| Cash and cash equivalents   | \$ 461,113                      | \$ 809,790           |
| Accounts receivable, trade  | 266,705                         | 193,138              |
| Inventory   | 31,101                          | 30,828               |
| Prepaid expenses and other current assets   | 324,907                         | 254,667              |
|   | 1,083,826                       | 1,288,423            |
| Property and equipment, net of accumulated depreciation   | 1,430,007                       | 1,583,729            |
| Other assets:   |                                 |                      |
| Deposits and other assets   | 112,152                         | 140,853              |
| Goodwill  | 1,597,461                       | 1,597,461            |
| Other intangible assets   | 1,184,592                       | 1,228,728            |
| Total other assets  | 2,894,205                       | 2,967,042            |
| Total assets  | \$ 5,408,038                    | \$ 5,839,194         |
| Liabilities and equity  |                                 |                      |
| Current liabilities:  |                                 |                      |
| Current portion of long term debt   | \$ 451,307                      | \$ 30,000            |
| Accounts payable  | 325,814                         | 329,871              |
| Accrued expenses and compensation   | 169,988                         | 118,467              |
| Deferred franchise revenue  | 440,500                         | 661,500              |
| Dividends accrued   | 68,521                          | 68,521               |
| Total current liabilities   | 1,456,130                       | 1,208,359            |
| Long-term debt  | -                               | 467,000              |
| Notes payable related parties   | 1,210,605                       | 676,927              |
| Deferred rent expense   | 140,079                         | 143,401              |
| Commitments and contingencies   | -                               | -                    |
| Equity  |                                 |                      |
| Spicy Pickle Franchising Inc. stockholders' equity  |                                 |                      |
| Preferred stock, \$.001 par value, 20,000,000 shares authorized, none issued or outstanding   | -                               | -                    |
| Common stock, \$.001 par value, 200,000,000 shares authorized, 82,494,274 and 80,994,274 shares issued and outstanding in 2010 and 2009, respectively | 82,494                          | 80,994               |
| Additional paid in capital  | 17,079,523                      | 16,782,258           |
| Fair value of common stock warrants   | 628,010                         | 628,010              |
| Accumulated (deficit)   | (15,224,432 )                   | (14,194,039 )        |
| Accumulated comprehensive (loss)  | (16,326 )                       | (5,671 )             |

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|   |              |              |
|---|--------------|--------------|
| Total Spicy Pickle Franchising, Inc. stockholders' equity | 2,549,269    | 3,291,552    |
| Non controlling interest                                  | 51,955       | 51,955       |
| Total equity  | 2,601,224    | 3,343,507    |
| Total liabilities and equity                              | \$ 5,408,038 | \$ 5,839,194 |

See the accompanying notes to the consolidated financial statements

Spicy Pickle Franchising, Inc.  
Condensed Consolidated Statements of Operations and Comprehensive Loss  
For The Three Months and Six Months Ended June 30, 2010 and 2009  
(Unaudited)

|   | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                   |
|---|--------------------------------|-------------------|------------------------------|-------------------|
|   | 2010                           | 2009              | 2010                         | 2009              |
| <b>Revenue:</b>                                       |                                |                   |                              |                   |
| Restaurant and bakery sales                           | \$ 674,063                     | \$ 730,445        | \$ 1,292,760                 | \$ 1,429,065      |
| Franchise fees and royalties                          | 541,378                        | 493,413           | 895,832                      | 798,388           |
| <b>Total revenues</b>                                 | <b>1,215,441</b>               | <b>1,223,858</b>  | <b>2,188,592</b>             | <b>2,227,453</b>  |
| <b>Operating costs and expenses:</b>                  |                                |                   |                              |                   |
| <b>Restaurant and bakery:</b>                         |                                |                   |                              |                   |
| Cost of sales   | 239,179                        | 240,440           | 452,851                      | 470,641           |
| Labor   | 229,480                        | 296,895           | 489,868                      | 596,856           |
| Occupancy   | 114,548                        | 102,758           | 227,624                      | 206,770           |
| Depreciation  | 85,471                         | 69,731            | 154,572                      | 141,789           |
| Other operating costs                                 | 114,044                        | 83,945            | 206,583                      | 161,925           |
| <b>Total restaurant and bakery operating costs</b>    | <b>782,722</b>                 | <b>793,769</b>    | <b>1,531,498</b>             | <b>1,577,981</b>  |
| <b>Franchise and general:</b>                         |                                |                   |                              |                   |
| General and administrative                            | 581,047                        | 652,503           | 1,542,363                    | 1,347,989         |
| Depreciation  | 27,596                         | 8,623             | 55,363                       | 17,311            |
| <b>Total franchise and general</b>                    | <b>608,643</b>                 | <b>661,126</b>    | <b>1,597,726</b>             | <b>1,365,300</b>  |
| <b>Total operating costs and expenses</b>             | <b>1,391,365</b>               | <b>1,454,895</b>  | <b>3,129,224</b>             | <b>2,943,281</b>  |
| <b>(Loss) from operations</b>                         | <b>(175,924 )</b>              | <b>(231,037 )</b> | <b>(940,632 )</b>            | <b>(715,828 )</b> |
| <b>Other income (expense):</b>                        |                                |                   |                              |                   |
| Interest income (expense)                             | (54,296 )                      | (16,820 )         | (89,760 )                    | (31,369 )         |
| Other income (expense)                                | -                              | (894 )            | -                            | (894 )            |
| <b>Total other income (expense):</b>                  | <b>(54,296 )</b>               | <b>(17,714 )</b>  | <b>(89,760 )</b>             | <b>(32,263 )</b>  |
| <b>Net (loss)</b>                                     | <b>(230,220 )</b>              | <b>(248,751 )</b> | <b>(1,030,392 )</b>          | <b>(748,091 )</b> |
| <b>Dividends on preferred stock</b>                   | <b>-</b>                       | <b>(68,943 )</b>  | <b>-</b>                     | <b>(137,887 )</b> |
| <b>Net (loss) attributable to common shareholders</b> | <b>(230,220 )</b>              | <b>(317,694 )</b> | <b>(1,030,392 )</b>          | <b>(885,978 )</b> |

Other comprehensive  
income (loss):

|                                     |           |           |           |           |
|-------------------------------------|-----------|-----------|-----------|-----------|
| Foreign currency translation (loss) | (10,688 ) | (12,205 ) | (10,655 ) | (32,571 ) |
|-------------------------------------|-----------|-----------|-----------|-----------|

|                      |               |               |                 |               |
|----------------------|---------------|---------------|-----------------|---------------|
| Comprehensive (loss) | \$ (240,908 ) | \$ (329,899 ) | \$ (1,041,047 ) | \$ (918,549 ) |
|----------------------|---------------|---------------|-----------------|---------------|

Per share information -  
basic and fully diluted:

|                                     |            |            |            |            |
|-------------------------------------|------------|------------|------------|------------|
| Weighted average shares outstanding | 82,494,274 | 54,387,357 | 82,494,274 | 54,378,422 |
|-------------------------------------|------------|------------|------------|------------|

|                      |            |            |            |            |
|----------------------|------------|------------|------------|------------|
| Net (loss) per share | \$ (0.00 ) | \$ (0.01 ) | \$ (0.01 ) | \$ (0.02 ) |
|----------------------|------------|------------|------------|------------|

See accompanying notes to condensed consolidated financial statements

Spicy Pickle Franchising, Inc.  
Condensed Consolidated Statements of Cash Flows  
Six Months Ended June 30, 2010 and 2009  
(Unaudited)

|  | 2010          | 2009          |
|--|---------------|---------------|
| Net cash (used in) operating activities        | \$ (771,252 ) | \$ (568,413 ) |
| Cash flows from investing activities:          |               |               |
| Purchase of property and equipment             | (11,980 )     | -             |
| Net cash (used in) investing activities        | (11,980 )     | -             |
| Cash flows from financing activities:          |               |               |
| Proceeds from note payable to related parties  | 500,000       | 500,000       |
| Proceeds from notes payable                    | 9,000         | -             |
| Repayment of notes payable                     | (63,692 )     | (21,000 )     |
| Net cash provided by financing activities      | 445,308       | 479,000       |
| Effect of foreign exchange rate changes        | (10,753 )     | (34,916 )     |
| Net (decrease) in cash and cash equivalents    | (348,677 )    | (124,329 )    |
| Cash and cash equivalents, beginning of period | 809,790       | 287,482       |
| Cash and cash equivalents, end of period       | \$ 461,113    | \$ 163,513    |
| Supplemental cash flow information:            |               |               |
| Cash paid for income taxes                     | \$ -          | \$ -          |
| Cash paid for interest                         | \$ 17,130     | \$ 33,280     |

See the accompanying notes to the consolidated financial statements



Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## 1. Basis of Presentation of Interim Period

Throughout this report, the terms “our,” “we,” “us,” and “Company” refer to Spicy Pickle Franchising, Inc. including its subsidiaries. The accompanying unaudited financial statements of Spicy Pickle Franchising, Inc. at June 30, 2010 and 2009 have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial statements, instructions to Form 10-Q, and Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. These condensed financial statements should be read in conjunction with the financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2009. In management's opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation to make our financial statements not misleading have been included. The results of operations for the periods ended June 30, 2010 and 2009 presented are not necessarily indicative of the results to be expected for the full year. The December 31, 2009 balance sheet has been derived from our audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2009.

### Use of Estimates

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

### Recent Pronouncements

In June 2009, the Financial Accounting Standards Board (“FASB”) approved the FASB Accounting Standards Codification (“the “Codification”, “ASC”) as the single source of authoritative nongovernmental GAAP. All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission (“SEC”), have been superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification has become non-authoritative. The Codification did not change GAAP, but instead introduced a new structure that combines all authoritative standards into a comprehensive, topically organized online database. The Codification is effective for interim or annual periods ending after September 15, 2009, and impacts our financial statements as all future references to authoritative accounting literature will be referenced in accordance with the Codification. There have been no changes to the content of our financial statements or disclosures as a result of implementing the Codification.

As a result of our implementation of the Codification during fiscal 2009, previous references to new accounting standards and literature are no longer applicable.

We have reviewed all recently issued, but not yet effective, accounting pronouncements and do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of our operations.

## 2. Per Share Information

Earnings per share are based on the weighted average number of shares outstanding during the period after consideration of the dilutive effect, if any, for common stock equivalents, including stock options, restricted stock, and other stock-based compensation. Earnings per common share are computed in accordance with ASC Topic 260, Earnings Per Share which requires companies to present basic earnings per share and diluted earnings per share. Basic earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per common share are computed by dividing net income by the weighted average number of shares of common stock outstanding and dilutive securities outstanding during the year. We had a net loss for the three-month and six month periods ended June 30, 2010 and 2009, and accordingly, any outstanding equivalents would be anti-dilutive.

Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

### 3. Goodwill and Other Intangible Assets

Goodwill and other intangible assets include the following at June 30, 2010 and December 31, 2009:

|  | 2010         | 2009         |
|--|--------------|--------------|
| Goodwill:  |              |              |
| Related to franchise operation (Bread Garden)      | \$ 1,276,882 | \$ 1,276,882 |
| Related to restaurant operations                   | 320,579      | 320,579      |
| Total goodwill                                     | \$ 1,597,461 | \$ 1,597,461 |
| Other intangibles                                  |              |              |
| Acquired trademarks                                | \$ 291,000   | \$ 291,000   |
| Acquired franchise agreements, net of amortization | 838,592      | 882,728      |
| Reacquired franchise agreements                    | 55,000       | 55,000       |
| Total other intangibles                            | \$ 1,184,592 | \$ 1,228,728 |

We recognize goodwill and identifiable intangibles arising from the allocation of the purchase prices of assets acquired in accordance with ASC Topic 805, Business Combinations (“ASC 805”). Goodwill represents the excess of cost over fair value of all identifiable assets less any liabilities assumed. ASC 805 gives guidance on five types of assets: marketing-related, customer-related, artistic-related, contract-related, and technology based intangible assets. We identified identifiable intangibles that are market-related and contract-related. Acquired trademarks represent the trademarks associated with the Bread Garden Urban Café franchise business acquired in 2008. These trademarks were determined to have an indefinite life. Acquired franchise agreements represent franchise agreements between Bread Garden, the company that we purchased the assets from, and the then existing franchisees. Reacquired franchise agreements represent franchise agreements that were in place between us and the franchisees that we purchased assets from in the acquisition of four restaurants and have an indefinite life. Acquired franchise agreements have determinable lives between 5.5 years and 11 years.

Amortization expenses related to acquired franchise agreements was \$22,068 and \$22,068 for the three months ended June 30, 2010 and 2009, respectively, and \$44,136 and \$44,136 for the six months ended June 30, 2010 and 2009, respectively.

Goodwill and other intangible assets with indefinite lives are not subject to amortization, but are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. ASC 350 requires a two-step approach for testing impairment. For goodwill, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, the fair value of the reporting unit’s goodwill is determined by allocating the unit’s fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. For intangibles with indefinite lives, the fair value is compared to the carrying value. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying amount over its fair value.

In accordance with ASC 350 we perform an impairment analysis of the goodwill and indefinite lived intangibles assets on an annual basis. We have two reporting units for which goodwill has been recognized, franchise operations and restaurant operations. We performed the analysis at December 31, 2009 on each of these reporting units separately and there was no indication of impairment in goodwill and indefinite lived intangible assets.

In making an estimate of future cash flow as they relate to our franchise operations of the Bread Garden Cafes, we considered the following items:

- Growth of the number of opened Bread Garden Urban Cafe franchised restaurants at the date of the acquisition to date.
  - The economic forecast in Canada with particular emphasis on British Columbia and western Canada.
- Industry forecast for the restaurant industry in Canada with particular emphasis on British Columbia and western Canada.
  - Historical operating history of acquired assets as adjusted for forecast.

Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

- Management's estimates of new franchisees.
- Trends in the real estate markets.

At the time of our last analysis the fair value of goodwill and other indefinite lived intangibles as related to the Bread Garden franchise operations was in excess of 150% of the carrying value.

In making an estimate of future cash flow as they relate to our restaurant operations, we considered the following items:

- The economic forecast in United States.
- Industry forecast for the restaurant industry in United States with emphasis on the quick serve segment.
  - Historical operating history of acquired assets as adjusted for forecast.
  - Changes to our menu and introduction of a new day part in our restaurants.

At the time of our last analysis the fair value of goodwill and other indefinite lived intangibles as related to the restaurant operations was in excess of 150% of the carrying value.

We will test for impairment between our annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the asset.

#### 4. Fair Value

Effective January 1, 2008, we adopted ASC Topic 825, Financial Instruments ("ASC 825"). ASC 825 permits entities to choose to measure many financial instruments and certain other items at fair value. We did not elect the fair value reporting option for any assets and liabilities not previously recorded at fair value.

Effective January 1, 2008, we adopted the provisions of ASC Topic 820, Fair Value Measurement and Disclosures ("ASC 820") applicable to all financial assets and liabilities and for nonfinancial assets and liabilities recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The standard also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. ASC 820 describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted market prices in active markets for identical assets or liabilities.
- Level 2 Observable market-based inputs or unobservable inputs that are corroborated by market data.
- Level 3 Unobservable inputs that are not corroborated by market data.

We have identified the following as financial assets and liabilities:

Cash and cash equivalents

Accounts receivable, trade  
Accounts payable, accrued expenses and accrued dividends  
Notes payable to related parties  
Long-term debt

At June 30, 2010 and December 31, 2009 the carrying amount of financial instruments approximated the fair value of those instruments.

Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

## 5. Related Party Transactions

In December 2008, two members of our Board of Directors granted us a line of credit which was to expire January 31, 2010. The line of credit was for an aggregate of \$550,000 and bears interest at a rate of one percent above the prime rate and is secured by certain of our assets. During 2009 the amount of the line was increased to \$800,000. Interest expense for the three months ended June 30, 2010 and 2009 was \$25,420 and \$3,070, respectively, and for the six months ended June 30, 2010 and 2009 was \$50,840 and \$5,955, respectively. At June 30, 2010, the interest rate on the borrowings was 4.25%.

During 2009, the line of credit was renegotiated and the outstanding principal and accrued interest totaling, \$817,252, was converted to a convertible promissory note (“Convertible Note”). The Convertible Note is due January 31, 2012, bears interest at the same rate that the line of credit did, one percent above the prime rate. The due date was subsequently changed to May 1, 2013 (see below). Interest is payable semi-annually. The holders of the Convertible Note may convert any amount of the principal and accrued interest due into our par value \$.001 common stock (“Common Stock”) at the rate of \$0.13 per share. In addition, for every two dollars converted into Common Stock, we will issue to the holder of the Convertible Note a warrant to purchase one share of Common Stock. The exercise price of the warrant will be equal to 120% of the price per share of the Common Stock calculated using the average of the volume weighted average prices per share for the 10 trading days prior to the election to convert.

The conversion feature in the Convertible Note is considered to be a beneficial conversion feature. We have accounted for the beneficial conversion feature in accordance with ASC Topic 470, Liabilities. We accounted for a portion of the proceeds, \$157,164, from the Convertible Note which related to the intrinsic value of the beneficial conversion feature by allocating that amount to additional paid in capital. The following summarizes the carrying amount of the Convertible Note at June 30, 2010:

|  |             |
|--|-------------|
| Face value of the note to be repaid if not converted | \$817,252   |
| Amount allocated to additional paid in capital       | ( 106,647 ) |
| Note payable to related parties                      | \$710,605   |

In accordance with ASC Topic 835, Interest, the amount allocated to the beneficial conversion will be amortized as interest expense over the life of the Convertible Note in such a way as to result in a constant rate of interest.

The annual interest rate giving effect to the amortization of the beneficial conversion is 9.188% per annum. When combined with the stated interest rate of one percent above the prime rate at June 30, 2010, the effective interest rate on the borrowings was 12.438%.

During the three months ended June 30, 2010, we entered into an agreement with two members of our Board of Directors whereby they will loan the Company up to \$2,000,000 as a revolving line of credit. The line of credit is evidenced by a Convertible Promissory Note and Secured Loan Agreement (the “Note”). The Note bears interest at the rate of 10% per annum and matures on May 1, 2013. At the lenders option the Note is convertible into our common stock at \$0.105 per share, the value of the common stock on the date the Note was executed. In addition for every two shares of common stock issued on conversion we will issue to the lenders a warrant to purchase one share of common stock at a price equal to 120% of the average volume weighted average price per share for the 10 days prior to the conversion. The Note is also secured by the assets of the Company. We believe that the terms of the note are arms length. Interest expense recognized on the note was \$6,250 for the three and six month periods ended June 30, 2010. As of June 30, 2010 we have drawn down \$500,000 of the loan and have \$1,500,000 available.

At the same time as the above, the holders of the Convertible Note described above have agreed to extend the due date of their Convertible Note to coincide with the Note. As consideration for the extension of the due date, the holders will receive a security interest in the assets of the Company on a pro rata basis with the lenders above. One of the holders of the Convertible Note is also a lender of the Note.



Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

#### 6. Long-term Debt

Long-term debt represents notes issued in connection with the acquisition of certain assets during the year ended December 31, 2008. The notes bear interest at the rate of 10% per annum payable monthly. The balance of the notes is due and payable in March 2011.

#### 7. Stockholders' Equity

During the six months ended June 30, 2010 we issued 1,500,000 shares of our common stock to two officers (related parties). The stock was issued as consideration for the reduction of salaries. The stock was valued at the trading price, \$0.11 per share, at the date of grant, January 26, 2010. We recognized \$165,000 as compensation expense for the six months ended June 30, 2010 and no compensation expense was recognized for the three months ended June 30, 2010.

#### 8. Income Taxes

We account for income taxes in interim periods in accordance with ASC Topic 740, Income Taxes ("ASC 740"). We have determined an estimated annual effective tax rate. The rate will be revised, if necessary, as of the end of each successive interim period during our fiscal year to our best current estimate. As of June 30, 2010, the estimated effective tax rate for the year will be zero.

ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This pronouncement also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

#### 9. Stock-Based Compensation

In October 2006, our Board of Directors adopted the 2006 Stock Option Plan ("2006 Plan"), which was approved by our shareholders the same month. The 2006 Plan provides for the granting of up to 7,500,000 shares of our common stock (subject to certain adjustments in the event of stock splits or other similar events) as incentive stock options. Our Board of Directors has delegated authority to grant awards under the 2006 Plan to our Compensation Committee.

There were no options granted under the 2006 Plan during the three-month and six month periods ended June 30, 2010 and 2009.

A summary of stock option activity under the 2006 Plan is set forth below:

|                                | Options   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|-----------|--|--|---------------------------------|
| Outstanding January 1,<br>2010 | 6,790,000 | \$0.20                                   | 3.38   | \$ 98,317                       |

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|                           |           |        |      |           |
|---------------------------|-----------|--------|------|-----------|
| Granted                   | -         | -      |      |           |
| Exercised                 | -         | -      |      |           |
| Cancelled                 | -         | -      |      |           |
| Outstanding June 30, 2010 | 6,790,000 | \$0.20 | 2.89 | \$ 98,317 |
| Exercisable June 30, 2010 | 6,790,000 | \$0.20 | 2.89 | \$ 98,317 |

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Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

In December 2009, our Board of Directors adopted the 2009 Stock Option Plan (“2009 Plan”). The 2009 Plan, as amended by the Board of Directors, provides for the grant of up to 13,000,000 shares of our common stock (subject to certain adjustments in the event of stock splits or other similar events) as incentive stock options. Our Board of Directors has delegated authority to grant awards under the 2009 Plan to a Compensation Committee. There were grants for 2,000,000 shares made during the six months ended June 30, 2010 and no grants during the three month period ended June 30, 2010.

A summary of stock option activity under the 2009 Plan is set forth below:

|                                | Options   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|-----------|--|--|---------------------------------|
| Outstanding January 1,<br>2010 | -         | -  |  | \$ -                            |
| Granted                        | 2,000,000 | \$0.16                                   | 5  |                                 |
| Exercised                      | -         | -  |  |                                 |
| Cancelled                      | -         | -  |  |                                 |
| Outstanding June 30, 2010      | 2,000,000 | \$0.16                                   | 4.8  | \$ 129,879                      |
| Exercisable June 30, 2010      | 2,000,000 | \$0.16                                   | 4.8  | \$ 129,879                      |

We also issued stock options to certain employees of our Canadian subsidiary. These options were not included in either the 2006 Plan or the 2009 Plan. A summary of stock option activity to those employees is set forth below:

|                                | Options   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|-----------|--|--|---------------------------------|
| Outstanding January 1,<br>2010 | 1,200,000 | \$0.20                                   | 4.16   | \$ 19,561                       |
| Granted                        |           |  |  |                                 |
| Exercised                      | -         | -  |  |                                 |
| Cancelled                      | -         | -  |  |                                 |
| Outstanding June 30, 2010      | 1,200,000 | \$0.20                                   | 3.66   | \$ 19,561                       |
| Exercisable June 30, 2010      | 1,125,000 | \$0.20                                   | 3.66   | \$ 18,338                       |

Stock-based compensation expense accounted for in accordance with ASC Topic 718, Compensation – Stock Compensation (“ASC 718”) related to employee stock options for the three-month periods ended June 30, 2010 and 2009 was \$3,886 and (\$7,823) respectively, and for the six months ended June 30, 2010 and 2009 was \$133,765 and \$4,437, respectively, and as discussed in Note 7, \$165,000 for shares issued to employees in consideration of salary reductions in 2010.

#### 10. Business Segment information

We operate in three business segments. Our Restaurant Operations segment is comprised of restaurants owned by the Company. The company-owned restaurants conduct business under the Spicy Pickle name. These restaurants specialize in fast casual dining featuring fresh, made-to-order, premium submarine, deli and panini sandwiches, salads, soups and soft drinks. Information for this segment for the periods ended June 30, 2010, and 2009 include the operating activities of seven company-owned restaurants through April 2010 and six company-own restaurants in May and June 2010.

Our Bakery Operations segment is comprised of the operating activities of a bakery co-located at one our Denver restaurants, which supplies breads and other bakery products for Company and franchisee-owned locations in Colorado.

Spicy Pickle Franchising, Inc.  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Our Franchise Operations segment is comprised of the operating activities of the franchise business unit, which licenses qualified operators to conduct business under the Spicy Pickle name or the Bread Garden Urban Café name, and also of the costs to monitor the operations of these restaurants. Under the terms of the agreements, the licensed operators pay royalties and fees to the Company in return for the use of the Spicy Pickle or the Bread Garden Urban Café name, as the case may be.

We are operating in two geographic segments, United States and Canada.

There were no differences in the basis of measurement of segment profit or loss between these financial statements and the financial statements for the year ended December 31, 2009. There have been no material changes in segment assets since December 31, 2009. Segment information related to the Company's three business segments follows:

|                                | Three Months Ended<br>June 30, |                      | Six Months Ended<br>June 30, |                      |
|--------------------------------|--------------------------------|----------------------|------------------------------|----------------------|
|                                | 2010                           | 2009                 | 2010                         | 2009                 |
| <b>Revenues:</b>               |                                |                      |                              |                      |
| Company restaurants operations | \$ 617,440                     | \$ 649,335           | \$ 1,180,530                 | \$ 1,266,473         |
| Company bakery operations      | 56,623                         | 81,110               | 112,230                      | 162,592              |
| Franchise operations           | 541,378                        | 493,413              | 895,832                      | 798,388              |
| <b>Total Revenues</b>          | <b>\$ 1,215,441</b>            | <b>\$ 1,223,858</b>  | <b>\$ 2,188,592</b>          | <b>\$ 2,227,453</b>  |
| <b>Segment profit (loss):</b>  |                                |                      |                              |                      |
| Company restaurants operations | \$ (103,321 )                  | \$ (76,507 )         | \$ (228,972 )                | \$ (147,296 )        |
| Company bakery operations      | (5,338 )                       | 13,183               | (9,766 )                     | (1,620 )             |
| Franchise operations           | (67,265 )                      | (167,713 )           | (701,894 )                   | (566,912 )           |
| <b>Total segment (loss)</b>    | <b>(175,924 )</b>              | <b>(231,037 )</b>    | <b>(940,632 )</b>            | <b>(715,828 )</b>    |
| Interest income (expense)      | (54,296 )                      | (16,820 )            | (89,760 )                    | (31,369 )            |
| Other expense                  | -                              | (894 )               | -                            | (894 )               |
| <b>Net loss</b>                | <b>\$ (230,220 )</b>           | <b>\$ (248,751 )</b> | <b>\$ (1,030,392 )</b>       | <b>\$ (748,091 )</b> |

## 11. Subsequent Events

We evaluated all activity of the Company and concluded that no subsequent events have occurred that would require recognition in our financial statements or disclosed in the notes to our financial statements except as follows.

On August 3, 2010 we entered into an Executive Employment Agreement with our Chief Executive Officer (“Agreement”). Pursuant to the Agreement the Chief Executive Officer will receive a base salary of \$225,000 per annum, will be issued 3,000,000 restricted common shares of the registrant, with the shares to vest immediately, and option to purchase 3,000,000 shares of the registrants common stock. The option will be exercisable at a price of \$0.06 per share, the closing price of the stock on the date of grant. The options will vest (i) 1,000,000 options on April 12, 2011 and (ii) 2,000,000 options on April 12, 2012. The options have a term of 5 years and will expire on August 3, 2015.

In accordance with the provisions of ASC 718, in future periods we will expense \$180,000, the value of the shares issued based on the trading value at the date of the contract. In addition, approximately \$55,000 will be expenses over the vesting period for the value of the options calculated using the Black-Sholes option-pricing model.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results could differ materially from those anticipated in the forward-looking statements.

Overview

Our business is the franchise and operation of Spicy Pickle and Bread Garden Urban Café restaurants. Spicy Pickle is a fast casual restaurant where made-to-order panini, sandwiches, pizzetti (Neapolitan thin crust pizza), and salads created by our staff are served using fresh-baked breads and high-quality ingredients. Spicy Pickle restaurants are located in 10 states in the United States. Bread Garden Urban Café restaurants also specialize in fast casual dining. Unlike our Spicy Pickle restaurants, our Bread Garden Urban Café restaurants offer a full line of specialty coffees, pastries, and desserts along with hot entrees, salads, soups, and sandwiches. Bread Garden Urban Cafés are located primarily in metropolitan Vancouver, British Columbia, Canada.

We market our menu primarily through targeted local store marketing efforts, mail drops, media advertising, and print campaigns, as well as through other grass roots efforts. The "Spicy Pickle" brand name has existed for ten years. The "Bread Garden Urban Café" brand name has existed since 1979. We are headquartered in Denver, Colorado.

The first Spicy Pickle restaurant was launched in 1999 by two Denver based chefs under the name Spicy Pickle. In late 2001, there were three restaurants, two in Denver and one in Lakewood, a Denver suburb. By January 2003, we organized Spicy Pickle Franchising, LLC and launched the Spicy Pickle brand as a national franchise.

As of June 30, 2010, we had 27 franchised Spicy Pickle restaurants and six company-owned Spicy Pickle restaurants opened. One of our company owned restaurants was closed in May 2010 and we are looking for the appropriate real estate to relocate it. Co-located with one of the restaurants is a bakery which provides fresh baked breads to the local area Denver restaurants. Spicy Pickle restaurants outside this market are equipped for bread baking at the store location.

Our franchise agreements include build-out schedules for franchisee restaurants. As a result of the recent economic slowdown a number of our franchisees that had agreements for multiple restaurants failed to meet their commitments. We are evaluating all of our agreements and where the franchisee cannot meet the obligation of their build out schedule we are terminating their agreements for future restaurants. In the three months ended June 30, 2010, we recorded revenue of \$175,000 which represented 15 future units. As of June 30, 2010, we still had agreements with franchisees to open 42 additional restaurants under the Spicy Pickle Brand. We will continue to monitor the franchisee's ability to meet their build out schedule and terminate those agreements that are in violation of their terms and will not meet their commitment. Based on current franchise agreements and construction schedules, we believe there will be approximately 32 Spicy Pickle, franchisee-owned and operated restaurants and at least six company-operated restaurants open by the end of 2010. The Company continues to interview prospective franchisees and relies on the cash deposits from the franchise sales as well as royalty fees from the existing stores to support the expenses of the business.

Our locations and marketing efforts are directed principally to white collar administrative, managerial, professional, and sales personnel, who are generally found in and near downtown districts, technological centers, universities, hospitals and government complexes.

We currently derive our revenue from the sale of franchises, from royalties paid by franchisees and from the sale of food and beverages at the company owned restaurants. Our business is headquartered in Colorado, and we have a high concentration of restaurants in the Rocky Mountain region. Additionally, we have franchises opened and planned in a number of other regions in the United States. Our Spicy Pickle restaurant locations, by state, (including both company-owned and franchisee-owned), including those under construction and lease negotiation as of June 30, 2010, are:



| Location    | Restaurants<br>Operating | Under<br>Construction | In Lease<br>Negotiation |
|-------------|--------------------------|-----------------------|-------------------------|
| Colorado    | 16                       |                       |                         |
| Texas       | 4                        | 1                     | 1                       |
| California  | 3                        |                       |                         |
| Nevada      | 3                        | 1                     |                         |
| Illinois    | 2                        |                       |                         |
| Arizona     | 1                        |                       |                         |
| Mississippi | 1                        |                       |                         |
| Ohio        | 1                        |                       |                         |
| Oklahoma    | 1                        |                       |                         |
| Oregon      | 1                        |                       |                         |
|             | 33                       | 2                     | 1                       |

In October 2008 we acquired the franchise rights to the Bread Garden Urban Café restaurant chain. We believe that our core competence is the building and operation of franchised restaurant chains. Our purpose in acquiring the Bread Garden Urban Café restaurant chain was to allow us to better utilize our existing infrastructure by expanding our operating base. In addition we made the acquisition to increase our revenues. We are currently working towards increasing the number of franchised restaurants in the Bread Garden Urban Café chain. We are also working to improve the menu offerings, develop new operating procedures and manuals, and to develop a more comprehensive marketing strategy.

All of our Bread Garden Urban Cafés are located in British Columbia, Canada. There are 18 units operating and four under construction as of June 30, 2010. A test unit is operating in Brisbane, Australia.

We intend to increase our revenues by adding new company-owned stores, selling new franchises and expanding consumption of our food products at all restaurants. General economic and industry conditions may affect our ability to do so and our revenue performance.

We have been developing our franchise network through the sale of franchises and through acquisition. We have relied on fund raising and the sales of new franchises to augment the cash we receive from continuing royalty payments for our cash flow. The unanticipated economic conditions that surfaced in 2008 and continued into 2009 resulted in a significant reduction in the sales of new franchises which in turn resulted in a significant decrease in our cash position. As soon as it became apparent that the economic downturn would not correct itself in the short term, we significantly reduced our corporate overhead, mostly in the area of personnel cost.

Our ability to fund our operations will depend on the length of time for the economy to improve, our future performance and our ability to successfully implement our business and growth strategies. In the event that we need additional capital and are unable to obtain it, we could be left without sufficient liquidity. The nature of our business is that a portion of our revenue is a continuing stream from franchisees. We will continually monitor our expenses and reduce those expenses as best we can to match the revenue flow. However, realization of a significant portion of the assets on the balance sheet is dependent on our continued operations, which in turn is dependent on the increase in sales of new franchises, the number of operating franchise restaurants, the additional capital raised through a placement of our securities or our ability to borrow sufficient funds for working capital purposes.

During the three months ended June 30, 2010, we entered into an agreement with two members of our Board of Directors whereby they will loan the Company up to \$2,000,000 as a revolving line of credit. The line of credit is evidenced by a Convertible Promissory Note and Secured Loan Agreement (the "Note"). The Note bears interest at the rate of 10% per annum and matures on May 1, 2013. At the lenders option the Note is convertible into our common

stock at \$0.105 per share, the value of the common stock on the date the Note was executed. In addition for every two shares of common stock issued on conversion we will issue to the lenders a warrant to purchase one share of common stock at a price equal to 120% of the average volume weighted average price per share for the 10 days prior to the conversion. The Note is also secured by the assets of the Company. We believe that the terms of the note are arm's length. As of June 30, 2010 we have drawn down \$500,000 of the loan and have \$1,500,000 available.

## Critical Accounting Policies and Estimates

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”).

The preparation of our financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting periods. Actual results could differ from those estimates. A summary of accounting policies that have been applied to the historical financial statements presented in this report can be found in the footnotes thereto. We consider certain of these accounting policies to be critical as they are important to the portrayal of our financial condition and results of operations and may require judgments on the part of management about matters that are uncertain. We have identified the following accounting policies that are important to the presentation of financial information in this report.

### Goodwill and Other Intangible Assets

We recognize goodwill and identifiable intangibles arising from the allocation of the purchase prices of assets acquired in accordance with ASC Topic 805, Business Combinations (“ASC 805”). Goodwill represents the excess of cost over fair value of all identifiable assets less any liabilities assumed. ASC 805 gives guidance on five types of assets: marketing-related, customer-related, artistic-related, contract-related and technology based intangible assets. We identified identifiable intangibles that are market-related and contract-related. Acquired trademarks represent the trademarks associated with the Bread Garden Urban Café franchise business acquired in 2008. These trademarks were determined to have an indefinite life. Acquired franchise agreements represent franchise agreements between Bread Garden, the company that we purchased the assets from, and the then existing franchisees. Reacquired franchise agreements represent franchise agreements that were in place between us and the franchisees that we purchased assets from in the acquisition of four restaurants and have an indefinite life. Acquired franchise agreements have determinable lives between 5.5 years and 11 years.

Goodwill and other intangible assets with indefinite lives are not subject to amortization, but are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. ASC Topic 350, Intangibles – Goodwill and Other (“ASC 350”) requires a two-step approach for testing impairment. For goodwill, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, the fair value of the reporting unit’s goodwill is determined by allocating the unit’s fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. For intangibles with indefinite lives, the fair value is compared to the carrying value. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying amount over its fair value.

In accordance with ASC 350 we perform an impairment analysis of the goodwill and indefinite lived intangibles assets on an annual basis. We have two reporting units for which goodwill has been recognized, franchise operations and restaurant operations. We determine our reporting units in accordance with the guidance in ASC Topic 280 Segment Reporting (“ASC 280”). We look at the following specific items:

- a) The nature of the products and services
- b) The nature of the production processes
- c) The type or class of customer for their products and services
- d) The methods used to distribute their products or provide their services

We performed the analysis at December 31, 2009 on each of these reporting units separately and there was no indication of impairment in goodwill and indefinite lived intangible assets.

In making an estimate of future cash flow as they relate to our franchise operations of the Bread Garden Cafes, we considered the following items:

- Growth of the number of opened Bread Garden Urban Cafe franchised restaurants at the date of the acquisition to date.
  - The economic forecast in Canada with particular emphasis on British Columbia and western Canada.

- Industry forecast for the restaurant industry in Canada with particular emphasis on British Columbia and western Canada.
  - Historical operating history of acquired assets as adjusted for forecast.
    - Management's estimates of new franchisees.
    - Trends in the real estate markets.

At the time of our last analysis the fair value of goodwill and other indefinite lived intangibles as related to the Bread Garden franchise operations was in excess of 150% of the carrying value.

In making an estimate of future cash flow as they relate to our restaurant operations, we considered the following items:

- The economic forecast in United States.
  - Industry forecast for the restaurant industry in United States with emphasis on the quick serve segment.
    - Historical operating history of acquired assets as adjusted for forecast.
  - Changes to the our menu and introduction of a new day part in our restaurants.

At the time of our last analysis the fair value of goodwill and other indefinite lived intangibles as related to the restaurant operations was in excess of 150% of the carrying value.

We will test for impairment between our annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the asset.

#### Long-Lived Assets

In accordance with ASC Topic 360, Property, Plant and Equipment ("ASC 360"), long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset.

We performed an analysis on a unit by unit basis for both our restaurants and bakery at December 31, 2009. Assumptions used in preparing the expected cash flows were as follows:

- Sales projections for 2010 were based on 2009 sales with increases in the later part of the year for the introduction of another day part on our menu. For the years 2011 through 2019 we used annual increases of 3%. We believe the 3% increases beyond 2010 is a reasonable growth.
  - Our food costs are projected based on 2009 operating cost as adjusted for new menu items.
- Our variable and semi-variable operating costs are projected to increase and include an additional 1.5% per year as inflation.
  - Our fixed operating costs are projected to increase 1.5% per year.
  - Salvage value has been estimated on a restaurant by restaurant basis.

Based on our analysis, no impairment charges were recognized for the six months ended June 30, 2010.

Our impairment analysis included a sensitivity analysis with regard to the cash flow projections that determine the recoverability of each restaurant's assets. The results indicate that even with a 20% decline in our projected cash flows we would still not have any potential impairment issues. However if we elect to sublease, close or otherwise exit a restaurant location, impairment could be required.

Each time we conduct an impairment analysis in the future we will compare actual results to our projections and assumptions, and to the extent our actual results do not meet expectations, we will revise our assumptions and this could result in impairment charges being recognized.

All of the judgments and assumptions made in preparing the cash flow projections are consistent with our other financial statement calculations and disclosures. The assumptions used in the cash flow projections are consistent with other forward-looking information prepared by the company, such as those used for internal budgets, discussions with third parties, and/or reporting to management or the board of directors.

To date we have not written down any assets due to impairment; however projecting the cash flows for the impairment analysis involves significant estimates with regard to the performance of each restaurant, and it is reasonably possible that the estimates of cash flows may change in the near term resulting in the need to write down operating assets to fair value. If the assets are determined to be impaired, the amount of impairment recognized is the amount by which the carrying amount of the assets exceeds their fair value. Fair value would be determined using forecasted cash flows discounted using an estimated average cost of capital and the impairment charge would be recognized in income from operations.

#### Revenue Recognition

**Initial Franchise Fees** - We enter into franchise agreements, which grant franchisees the exclusive right to develop and operate businesses at certain locations. Initial franchise fees are recognized as revenue when all material services and conditions required to be performed by us have been substantially completed, which is generally when the restaurant opens. Initial franchise fees for Spicy Pickle restaurants is \$45,000 and the fee for Bread Garden Urban Café restaurants is Canadian dollars (“CNS\$”) 50,000. In certain instances we charge a transfer fee when an existing restaurant is transferred to a new franchisee. These fees are less than the full fee charged. Franchise fees recognized were \$175,000 and \$186,017 for the three months ended June 30, 2010 and 2009, respectively, and \$235,000 and \$212,050 for the six months ended June 30, 2010 and 2009, respectively.

**Royalty Fees** - Pursuant to the franchise agreements of both our Spicy Pickle and Bread Garden Urban Café brands, franchisees are required to pay royalties to us based on 5% of weekly gross sales as reported to us through the franchisees’ point of sales systems. The royalties are recognized as revenue in the period corresponding to the sales reporting period. Royalty fees were \$253,970 and \$231,380 for the three months ended June 30, 2010 and 2009, respectively and \$487,760 and \$443,626 for the six months ended June 30, 2010 and 2009, respectively.

With regard to royalty fees, our franchisees grant us the right to extract data from their point of sale systems in each restaurant they operate. We receive weekly reports on sales at each franchise location and calculate our revenue directly from those reports. This allows for extremely accurate accounting of our revenue stream from royalty fees. We do not anticipate any future change in the method of reporting.

**Rebates** - We receive rebates from certain purveyors that supply products to our franchisees, these rebates are included in Franchise Fees and Royalties on the statement of operations. The rebates are recorded when earned. Rebates that relate to company-owned restaurants are offset against restaurant cost of sales. Rebates related to franchisees were \$112,408 and \$76,016, for the three months ended June 30, 2010 and 2009, respectively, and \$173,072 and \$142,712 for the six months ended June 30, 2010 and 2009, respectively.

**Restaurant and Bakery Sales** - We record revenue from company-owned restaurant sales upon delivery of the related food and other products to customers. Our restaurant sales are either cash or credit card (which are pre-approved) sales and, therefore, no estimate for allowance for doubtful accounts is necessary. We record revenue from bakery sales when sold to the bakery customers, which are our franchisees.

#### Advertising Costs

Franchisees must contribute to an advertising fund established by us at a rate of up to 2% for our Spicy Pickle brand and 1.5% for our Bread Garden Urban Café brand of total franchisee gross sales. At our discretion, we may spend more or less than our actual advertising receipts from the franchisees. Advertising fees collected were \$97,178 and \$93,772 for the three months ended June 30, 2010 and 2009, and \$183,652 and \$186,320 for the six months ended June 30, 2010 and 2009, respectively. These fees are offset against actual advertising expenses, which are recognized when incurred. We incurred advertising expenses of \$95,762 and \$75,260 for the three months ended June 30, 2010 and 2009, respectively, and \$185,860 and \$130,596 for the six months ended June 30, 2010 and 2009, respectively. We anticipate that for the year ending December 31, 2010 we will spend at least as much as we collect. To the extent we do not spend all that we have collected we are allowed to utilize the funds to offset amounts

spent in previous periods and other indirect costs associated with marketing and promotion. The net amounts reflected as advertising costs in the financial statements was \$2,208 for the six months ended June 30, 2010. There were no amounts reflected as advertising costs for the three months ended June 30, 2010 and the three and six months ended June 30, 2009.



#### Rent Expense

We recognize rent expense on a straight-line basis over the reasonably assured lease term as defined in ASC Topic 840, Leases. In addition, certain of our lease agreements provide for scheduled rent increases during the lease term or for rental payments commencing on a date other than the date of initial occupancy. We include any rent escalations and construction period and other rent holidays in our determination of straight-line rent expense. Therefore, rent expense for new locations is charged to expense beginning with the start of the construction period.

#### Equity-Based Compensation

Stock-based compensation is presented in accordance with the guidance of ASC Topic 718, Compensation – Stock Compensation (“ASC 718”). Under the provisions of ASC 718, companies are required to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our statement of operations.

We issued share-based payments under our 2006 Stock Option Plan and our 2009 Stock Option Plan, both of which are qualified stock option plans and to employees of our Canadian subsidiary on an individual by individual basis.

In both instances we used the Black-Scholes option-pricing model (“Black-Scholes model”) to determine fair value. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Although the fair value of employee stock options is determined in accordance with ASC 718 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

The weighted average fair value of options granted during the six months ended June 30, 2010 of \$0.06 was estimated on the grant date using the Black-Scholes model with the following weighted average assumptions: expected volatility of 41.22%, expected term of 5 years, risk-free interest rate of 2.37% and no expected dividend yield. There were no options granted during the three months ended June 30, 2010 nor were there any options granted during the six months ended June 30, 2009.

Stock-based compensation expense accounted for in accordance with ASC 718 related to employee stock options for the three-month periods ended June 30, 2010 and 2009 was \$3,886 and \$(7,822), respectively and \$133,765 and \$4,437 for the six months ended June 30, 2010 and 2009, respectively, and \$165,000 for shares issued to employees in consideration of salary reductions in 2010 for the six months ended June 30, 2010.

#### Recent Pronouncements

In June 2009, The Financial Accounting Standards Board (“FASB”) approved the FASB Accounting Standards Codification (“the Codification”) as the single source of authoritative nongovernmental GAAP. All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission (“SEC”), have been superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification has become non-authoritative. The Codification did not change GAAP, but instead introduced a new structure that combines all authoritative standards into a comprehensive, topically organized online database. The Codification is effective for interim or annual periods ending after September 15, 2009, and impacts our financial statements as all future references to authoritative accounting literature will be referenced in accordance with the Codification. There have been no changes to the content of the Company’s financial statements or disclosures as a result of implementing the Codification.

As a result of our implementation of the Codification during fiscal 2009, previous references to new accounting standards and literature are no longer applicable.

We have reviewed all recently issued, but not yet effective, accounting pronouncements and do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of our operations.

## Results of Operations

## Operating Statistics

The following analysis shows operating statistics for the three months ended June 30, 2010 and 2009:

|                              | 2010         |                                  | 2009         |                                  |
|------------------------------|--------------|----------------------------------|--------------|----------------------------------|
| Revenues:                    | Amount       | As a Percentage of Total Revenue | Amount       | As a Percentage of Total Revenue |
| Restaurant sales             | \$ 617,440   | 50.80 %                          | \$ 649,335   | 53.05 %                          |
| Bakery sales                 | 56,623       | 4.66 %                           | 81,110       | 6.63 %                           |
| Franchise fees and royalties | 541,378      | 44.54 %                          | 493,413      | 40.32 %                          |
| Total revenue                | \$ 1,215,441 | 100.00 %                         | \$ 1,223,858 | 100.00 %                         |

## Operating costs and expenses:

| Restaurant:                         |            | As a Percentage of Restaurant Sales |            | As a Percentage of Restaurant Sales |
|-------------------------------------|------------|-------------------------------------|------------|-------------------------------------|
| Cost of sales                       | \$ 222,862 | 36.09 %                             | \$ 219,839 | 33.86 %                             |
| Labor                               | 205,838    | 33.34 %                             | 273,330    | 42.09 %                             |
| Occupancy                           | 109,314    | 17.70 %                             | 99,313     | 15.29 %                             |
| Depreciation                        | 76,132     | 12.33 %                             | 59,530     | 9.17 %                              |
| Other operating cost                | 106,615    | 17.27 %                             | 73,830     | 11.37 %                             |
| Total restaurant operating expenses | \$ 720,761 | 116.73 %                            | \$ 725,842 | 111.78 %                            |

| Bakery:                         |           | As a Percentage of Bakery Sales |           | As a Percentage of Bakery Sales |
|---------------------------------|-----------|---------------------------------|-----------|---------------------------------|
| Cost of sales                   | \$ 16,317 | 28.82 %                         | \$ 20,061 | 25.40 %                         |
| Labor                           | 23,642    | 41.75 %                         | 23,565    | 29.05 %                         |
| Occupancy                       | 5,234     | 9.24 %                          | 3,445     | 4.25 %                          |
| Depreciation                    | 9,339     | 16.49 %                         | 10,201    | 12.58 %                         |
| Other operating cost            | 7,429     | 13.12 %                         | 10,115    | 12.47 %                         |
| Total bakery operating expenses | \$ 61,961 | 109.42 %                        | \$ 67,927 | 83.75 %                         |

| Franchise and general:               |            | As a Percentage of Franchise Fees and Royalties |            | As a Percentage of Franchise Fees and Royalties |
|--------------------------------------|------------|---|------------|---|
| General and administrative           | \$ 581,047 | 107.33 %  | \$ 652,503 | 132.24 %  |
| Depreciation                         | 27,596     | 5.10 %  | 8,623      | 1.75 %  |
| Total franchise and general expenses | \$ 608,643 | 112.43 %  | \$ 661,126 | 133.99 %  |



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|                                    |               | As a Percentage<br>of Total<br>Revenue |    | As a Percentage<br>of Total<br>Revenue |           |
|------------------------------------|---------------|--|----|--|-----------|
| Total operating costs and expenses | \$ 1,391,365  | 114.47                                 | %  | \$ 1,454,895                           | 118.88 %  |
| (Loss) from operations             | (175,924 )    | (14.47                                 | )% | (231,037 )                             | (18.88 )% |
| Other income and (expense):        |               |  |    |  |           |
| Net interest (expense)             | (54,296 )     | (4.47                                  | )% | (16,820 )                              | (1.37 )%  |
| Other (expense)                    | -             | -                                      |    | (894 )                                 | (0.07 )%  |
| Total other income and (expense)   | (54,296 )     | (4.47                                  | )% | (17,714 )                              | (1.44 )%  |
| Net (loss)                         | \$ (230,220 ) | (18.94                                 | )% | \$ (248,751 )                          | (20.33 )% |

The components of revenue are restaurant sales for company-owned restaurants, bakery sales for the company-owned bakery and royalties and franchise fees for our franchise operations.

For the three months ended June 30, 2010, total revenue decreased \$8,417 (0.69%) from \$1,223,858 for the three months ended June 30, 2009 to \$1,215,441 for the same period in 2010. For the three months ended June 30, 2010, restaurant sales decreased by \$31,895 (4.91%) from \$649,335 in 2009 to \$617,440 in 2010. The decrease in restaurant revenue was principally due to changes in economic conditions and the closure of one restaurant in May 2010.

For the three months ended June 30, 2010, bakery sales decreased by \$24,487 (30.19%) from \$81,110 in 2009 to \$56,623 in 2010. We had fewer customers, both franchise and our restaurants, in 2010 than we did in 2009. In addition our customers' revenues were down in 2010 resulting in lower bread sales.

The loss from restaurant operations increased \$26,814 (35.05%) from \$76,507 for the three months ended June 30, 2009 to \$103,321 for the three months ended June 30, 2010. The increased loss resulted from a decrease in revenue and the effect of closing one restaurant.

The loss from bakery operations increased \$18,521 (140.49%) from income of \$13,183 for the three months ended June 30, 2009 to a loss of \$5,338 for the three months ended June 30, 2010. The increased loss resulted from a decrease in revenue selling to fewer customers.

Franchise fees and royalty revenue increased \$47,965 (9.72%) from \$493,413 for the three months ended June 30, 2009 to \$541,378 in 2010. Initial franchise fee are collected when a franchisee enters into a franchise agreement. At that point in time these fees are recorded as deferred revenue and are recognized as revenue on the statement of operations when the franchised restaurant is opened. In certain cases if a franchisee fails to meet its obligation under its franchise/development agreement we can terminate that agreement and we recognize revenue at that time. No Spicy Pickle restaurants for which we collected fees were opened and 15 agreements were terminated during the three-month period ended June 30, 2010 and we recognized fees of \$175,000. Two new Spicy Pickle restaurants were opened and one agreement was terminated during the three months ended June 30, 2009. We recognized fees of \$186,017 for the three months ended June 30, 2009. We recognized no fees for the Bread Garden Urban Café restaurants for the three months ended June 30, 2010. Deferred franchise fees collected but not recognized as revenue during the three months ended June 30, 2010 was \$5,000 as compared to \$55,000 in the three months ended June 30, 2009. Royalty fees increased \$22,590 (9.76%) from \$231,380 for the three months ended June 30, 2009 to \$253,970

for the three months ended June 30, 2010. The increase is due primarily to an increase in the number of franchised restaurants, primarily Bread Garden, offset by an overall decline in system wide revenues. Rebates related to franchisees increased \$36,392 (47.87%) from \$76,016 for the three months ended June 30, 2009 to \$112,408 for the three months ended June 30, 2010. The increase is due primarily to an increase in the number of franchised restaurants, primarily Bread Garden, offset by an overall decline in system wide revenues.

The economic downturn which began in 2008 and continued through the first half of 2010 had a negative effect on our business. In response to the economy in late 2008 we began to scale back in the infrastructure we had in place. Our most significant expense is personnel and related costs. We reduced the number of full time employees from a high of 28 in 2008 to 14 at June 30, 2009 with a further reduction to 12 at June 30, 2010. We also reduced overhead expenses that have a direct bearing on the number of personnel employed as well as other areas such as travel and entertainment and communication. We will continue to review our general and administrative costs and respond to the effects of the general economy as timely as possible.

The following sets forth details of the costs that make up general and administrative expenses and the difference for the three months ended June 30, 2010 and compared to the three months ended June 30, 2009.

|   | 2010       | 2009       | Difference   |
|---|------------|------------|--------------|
| Personnel cost                            | \$ 374,245 | \$ 400,285 | \$ (26,040 ) |
| Rent                                      | 44,048     | 49,551     | (5,503 )     |
| Travel and entertainment                  | 42,347     | 46,308     | (3,961 )     |
| Professional fees                         | 39,901     | 68,238     | (28,337 )    |
| Investor relations                        | 13,386     | 4,412      | 8,974        |
| Stock options                             | 3,886      | (7,822 )   | 11,708       |
| Other general and administrative expenses | 63,234     | 91,531     | (28,297 )    |
| Total general and administrative expenses | \$ 581,047 | \$ 652,503 | \$ (71,456 ) |

General and administrative expenses decreased \$71,456 (10.95%) from \$652,503 for the three-month period ended June 30, 2009 to \$581,047 for the three-month period ended June 30, 2010.

Our most significant expense continues to be personnel costs. The number of full time employees was reduced from 14 at June 30, 2009 to 12 at June 30, 2010. Personnel cost decreased \$26,040 (6.51%) from \$400,285 for the three months ended June 30, 2009 to \$374,245 for the three months ended June 30, 2010. The decrease results from fewer employees offset by severance payments to employees. We intend to closely monitor our personnel cost and we will attempt to outsource personnel as need rather than employ full time personnel.

Franchisees must contribute to an advertising fund established by us at a rate of up to 2% for our Spicy Pickle brand and 1.5% for our Bread Garden Urban Café brand of total franchisee gross sales. At our discretion, we may spend more or less than our actual advertising receipts from the franchisees. Advertising fees collected were \$97,178 and \$93,772 for the three months ended June 30, 2010 and 2009, respectively. These fees are offset against actual advertising expenses, which are recognized when incurred. We incurred advertising expenses of \$95,762 and \$75,260 for the three months ended June 30, 2010 and 2009, respectively. We anticipate that for the year ending December 31, 2010 we will spend at least as much as we collect. To the extent we do not spend all that we have collected we are allowed to utilize the funds to offset amounts spent in previous periods and other indirect costs associated with marketing and promotion. There were no amounts reflected as advertising costs for the three months ended June 30, 2010 and 2009.

Rent expense decreased \$5,503 (11.11%) from \$49,551 for the three months ended June 30, 2009 to \$44,048 for the three months ended June 30, 2010. The decrease resulted from subletting a portion of our office space offset by expected rent rate increases.

Travel and entertainment decreased \$3,961 (8.55%) from \$46,308 for the three months ended June 30, 2009 to \$42,347 for the three months ended June 30, 2010. The decrease was due to less travel related to our operations department in visiting franchised location to perform onsite evaluations. We anticipate that travel expenses will go up in future periods as we make more visits to our franchised locations.

Professional fees decreased \$28,337 (41.53%) from \$68,238 for the three-month period ended June 30, 2009 to \$39,901 for the three-month period ended June 30, 2010. The decrease is primarily due to timing of expenses. The decrease for the six months ended June 30, 2010 was less significant.



Investor relations increased \$8,974 (203.4%) from \$4,412 for the three months ended June 30, 2009 to \$13,386 for the three months ended June 30, 2010. In 2009 we reduced the amount of time spent on investor relations. In 2010 we intentionally increased our attention to investor relations in order for the public to become more aware of what was happening in our company.

Stock option expense is a non-cash expense. We estimate the fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model. Stock option expense increased \$11,708 (149.7%) from \$(7,822) for the three months ended June 30, 2009 to \$3,886 for the three months ended June 30, 2010. There were no options granted during the three month periods ended June 30, 2010 and 2009. All of the employee options are fully vested at March 31, 2010.

Other general and administrative expenses decreased \$28,297 (30.92%) from \$91,531 for the three months ended June 30, 2009 to \$63,234 for the three months ended June 30, 2010. The decrease resulted from a variety of different items none of which is significant.

The loss from operations was \$175,924 for the three months ended June 30, 2010 as compared to \$231,037 for the three months ended June 30, 2009. The decrease in the loss from operations of \$55,113 (23.85%) was primarily due over all cost cutting measures. Other expense which represents interest cost was \$54,296 for the three months ended June 30, 2010 as compared to an expense of \$16,820 for the three months ended June 30, 2009. The increase in interest costs is primarily due to borrowing of \$500,000 against our line of credit in the three months ended June 30, 2010. The net loss for the three months ended June 30, 2010 was \$230,220 compared to a net loss of \$248,751 for the three months ended June 30, 2009, a decreased loss of \$18,531 (7.45%).

The following analysis shows operating statistics for the six months ended June 30, 2010 and 2009:

|  | 2010                |                                     | 2009                |                                     |
|--|---------------------|-------------------------------------|---------------------|-------------------------------------|
|  | Amount              | As a Percentage of Total Revenue    | Amount              | As a Percentage of Total Revenue    |
| <b>Revenues:</b>                           |                     |                                     |                     |                                     |
| Restaurant sales                           | \$ 1,180,530        | 53.94 %                             | \$ 1,266,473        | 56.87 %                             |
| Bakery sales                               | 112,230             | 5.13 %                              | 162,592             | 7.30 %                              |
| Franchise fees and royalties               | 895,832             | 40.93 %                             | 798,388             | 35.84 %                             |
| <b>Total revenue</b>                       | <b>\$ 2,188,592</b> | <b>100.00 %</b>                     | <b>\$ 2,227,453</b> | <b>100.00 %</b>                     |
| <b>Operating costs and expenses:</b>       |                     |                                     |                     |                                     |
|  |                     | As a Percentage of Restaurant Sales |                     | As a Percentage of Restaurant Sales |
| <b>Restaurant:</b>                         |                     |                                     |                     |                                     |
| Cost of sales                              | \$ 422,705          | 35.81 %                             | \$ 428,967          | 33.87 %                             |
| Labor                                      | 443,342             | 37.55 %                             | 526,171             | 41.55 %                             |
| Occupancy                                  | 216,741             | 18.36 %                             | 196,909             | 15.55 %                             |
| Depreciation                               | 135,894             | 11.51 %                             | 121,387             | 9.58 %                              |
| Other operating cost                       | 190,502             | 16.16 %                             | 140,335             | 11.08 %                             |
| <b>Total restaurant operating expenses</b> | <b>\$ 1,409,502</b> | <b>119.39 %</b>                     | <b>\$ 1,413,769</b> | <b>111.63 %</b>                     |

| Bakery:                              |                 | As a Percentage<br>of Bakery Sales                       |   |               | As a Percentage<br>of Bakery Sales                       |   |  |
|--------------------------------------|-----------------|--|---|---------------|--|---|--|
| Cost of sales                        | \$ 30,145       | 26.86  | % | \$ 41,674     | 25.63  | % |  |
| Labor                                | 46,526          | 41.46  | % | 70,685        | 43.47  | % |  |
| Occupancy                            | 10,884          | 9.70   | % | 9,861         | 6.06   | % |  |
| Depreciation                         | 18,678          | 16.64  | % | 20,402        | 12.55  | % |  |
| Other operating cost                 | 15,763          | 14.05  | % | 21,590        | 13.28  | % |  |
| Total bakery operating expenses      | \$ 121,996      | 109.42   | % | \$ 164,212    | 100.99   | % |  |
|                                      |                 |  |   |               |  |   |  |
| Franchise and general:               |                 | As a Percentage<br>of Franchise<br>Fees and<br>Royalties |   |               | As a Percentage<br>of Franchise<br>Fees and<br>Royalties |   |  |
| General and administrative           | \$ 1,542,363    | 172.17   | % | \$ 1,347,989  | 168.84   | % |  |
| Depreciation                         | 55,363          | 6.18   | % | 17,311        | 2.17   | % |  |
| Total franchise and general expenses | \$ 1,597,726    | 178.35   | % | \$ 1,365,300  | 171.01   | % |  |
|                                      |                 |  |   |               |  |   |  |
|                                      |                 | As a Percentage<br>of Total<br>Revenue                   |   |               | As a Percentage<br>of Total<br>Revenue                   |   |  |
| Total operating costs and expenses   | \$ 3,129,224    | 142.98   | % | \$ 2,943,281  | 132.14   | % |  |
| (Loss) from operations               | (940,632 )      | (42.98 )%  |   | (715,828 )    | (32.14 )%  |   |  |
| Other income and (expense):          |                 |  |   |               |  |   |  |
| Net interest (expense)               | (89,760 )       | (4.10 )%   |   | (31,369 )     | (1.41 )%   |   |  |
| Other (expense)                      | -               | -  |   | (894 )        | (0.04 )%   |   |  |
| Total other income and (expense)     | (89,760 )       | (4.10 )%   |   | (32,263 )     | (1.45 )%   |   |  |
| Net (loss)                           | \$ (1,030,392 ) | (47.08 )%  |   | \$ (748,091 ) | (35.59 )%  |   |  |

The components of revenue are restaurant sales for company-owned restaurants, bakery sales for the company-owned bakery and royalties and franchise fees for our franchise operations.

For the six months ended June 30, 2010, total revenue decreased \$38,861 (1.74%) from \$2,227,453 for the six months ended June 30, 2009 to \$2,188,592 for the same period in 2010. For the six months ended June 30, 2010, restaurant sales decreased by \$85,943 (6.79%) from \$1,266,473 in 2009 to \$1,180,530 in 2010. The decrease in restaurant revenue was principally due to changes in economic conditions and the closure of one company owned restaurant in May 2010.

For the six months ended June 30, 2010, bakery sales decreased by \$50,362 (30.97%) from \$162,592 in 2009 to \$112,230 in 2010. We had fewer customers, both franchise and our restaurants, in 2010 than we did in 2009. In addition our customers' revenues were down in 2010 resulting in lower bread sales.

The loss from restaurant operations increased \$81,676 (55.45%) from \$147,296 for the six months ended June 30, 2009 to \$228,972 for the six months ended June 30, 2010. The increased loss resulted from a decrease in revenue and the effect of closing one restaurant in 2010.

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The loss from bakery operations increased \$8,146 (502.8%) from \$1,620 for the six months ended June 30, 2009 to \$9,766 for the six months ended June 30, 2010. The increased loss resulted from a decrease in revenue.

Franchise fees and royalty revenue increased \$97,444 (12.21%) from \$798,388 for the six months ended June 30, 2009 to \$895,832 in 2010. Initial franchise fee are collected when a franchisee enters into a franchise agreement. At that point in time these fees are recorded as deferred revenue and are recognized as revenue on the statement of operations when the franchised restaurant is opened. In certain cases if a franchisee fails to meet its obligation under its franchise/development agreement we can terminate that agreement and we recognize revenue at that time. Two Spicy Pickle restaurants for which we collected fees were opened and 15 agreements were terminated or transferred during the six months ending June 30, 2010 and we recognized fees of \$235,000. Three new Spicy Pickle restaurants were opened and three agreements were terminated during the six months ended June 30, 2009. We recognized fees of \$205,000 for the six months ended June 30, 2009. We recognized no fees for the Bread Garden Urban Café restaurants for the six months ended June 30, 2010 and we recognized a transfer fee of \$7,050 for the six months ended June 30, 2009. Deferred franchise fees collected but not recognized as revenue during the six months ended June 30, 2010 was \$5,000 as compared to \$55,000 in the six months ended June 30, 2009. Royalty fees increased \$44,134 (9.95%) from \$443,626 for the six months ended June 30, 2009 to \$487,760 for the six months ended June 30, 2010. The increase is due primarily to an increase in the number of franchised Bread Garden Urban Café restaurants. Rebates related to franchisees increased \$30,360 (21.27%) from \$142,712 for the six months ended June 30, 2009 to \$173,072 for the six months ended June 30, 2010. The increase is due primarily to an increase in the number of franchised restaurants, primarily Bread Garden, offset by an overall decline in system wide revenues.

The economic downturn which began in 2008 and continued through the first half of 2010 had a negative effect on our business. In response to the economy in late 2008 we began to scale back in the infrastructure we had in place. Our most significant expense is personnel and related costs. We reduced the number of full time employees from a high of 28 in 2008 to 14 at June 30, 2009 with a further to 12 at June 30, 2010. We also reduced overhead expenses that have a direct bearing on the number of personnel employed as well as other areas such as travel and entertainment and communication. We will continue to review our general and administrative costs and respond to the effects of the general economy as timely as possible.

The following sets forth details of the costs that make up general and administrative expenses and the difference for the six months ended June 30, 2010 and compared to the six months ended June 30, 2009.

|   | 2010         | 2009         | Difference |
|---|--------------|--------------|------------|
| Personnel cost                            | \$ 887,557   | \$ 807,348   | \$ 80,209  |
| Professional fees                         | 136,171      | 146,770      | (10,599 )  |
| Stock options                             | 133,765      | 4,437        | 129,328    |
| Rent                                      | 91,658       | 99,448       | (7,790 )   |
| Travel and entertainment                  | 79,057       | 88,802       | (9,745 )   |
| Investor relations                        | 29,116       | 9,699        | 19,417     |
| Marketing, advertising, promotion         | 2,088        | -            | 2,088      |
| Other general and administrative expenses | 182,951      | 191,485      | (8,534 )   |
| Total general and administrative expenses | \$ 1,542,363 | \$ 1,347,989 | \$ 194,374 |

General and administrative expenses increased \$194,374 (14.42%) from \$1,347,989 for the six months ended June 30, 2009 to \$1,542,363 for the six months ended June 30, 2010.

Our most significant expense continues to be personnel costs. The number of full time employees was reduced from 14 at June 30, 2009 to 12 at June 30, 2010. However, personnel cost increased \$80,209 (9.93%) from \$807,348 for the six months ended June 30, 2009 to \$887,557 for the six months ended June 30, 2010, primarily as a result of issuing 1,500,000 shares of our common stock to two officers of the company. The shares were accounted for at the

trading price, \$0.11, at the date of issuance. We recorded an expense of \$165,000. Severance payments to former employees accounted for an increase of approximately \$73,000. The reduction in the number of employees and salary adjustments resulted in a decrease in personnel cost of approximately \$158,000 which offset the increases.

We intend to closely monitor our personnel cost and we will attempt to outsource personnel as need rather than employ full time personnel.

Professional fees decreased \$10,599 (7.22%) from \$146,770 for the six months ended June 30, 2009 to \$136,171 for the six months ended June 30, 2010. The decrease is not significant.

Stock option expense is a non-cash expense. We estimate the fair value of share-based payment awards on the date of grant using the Black-Scholes option-pricing model. Stock option expense increased \$129,328 (2915%) from \$4,437 for the six months ended June 30, 2009 to \$133,765 for the six months ended June 30, 2010. We granted 1,000,000 options to each of two new members of our Board of Directors. All of the employee options were fully vested at June 30, 2010.

Rent expense decreased \$7,790 (7.83%) from \$99,448 for the six months ended June 30, 2009 to \$91,658 for the six months ended June 30, 2010. The decrease resulted from subletting a portion of our office space offset by expected rent rate increases.

Travel and entertainment decreased \$9,745 (10.97%) from \$88,802 for the six months ended June 30, 2009 to \$79,057 for the six months ended June 30, 2010. The decrease was due to less travel related to our operations department in visiting franchised location to perform onsite evaluations. We anticipate that travel expenses will go up in future periods as we make more visits to our franchised locations.

Investor relations increased \$19,417 (200.2%) from \$9,699 for the six months ended June 30, 2009 to \$29,116 for the six months ended June 30, 2010. In 2009 we reduced the amount of time spent on investor relations. In 2010 we intentionally increased our attention to investor relations in order for the public to become more aware of what was happening in our company.

Franchisees must contribute to an advertising fund established by us at a rate of up to 2% for our Spicy Pickle brand and 1.5% for our Bread Garden Urban Café brand of total franchisee gross sales. At our discretion, we may spend more or less than our actual advertising receipts from the franchisees. Advertising fees collected were \$183,652 and \$186,320 for the six months ended June 30, 2010 and 2009. These fees are offset against actual advertising expenses, which are recognized when incurred. We incurred advertising expenses of \$185,860 and \$130,596 for the six months ended June 30, 2010 and 2009, respectively. We anticipate that for the year ending December 31, 2010 we will spend at least as much as we collect. To the extent we do not spend all that we have collected we are allowed to utilize the funds to offset amounts spent in previous periods and other indirect costs associated with marketing and promotion. The net amount reflected as advertising cost for the six months ended June 30, 2010 was \$2,088. There were no amounts reflected as advertising cost for the six months ended 2009.

Other general and administrative expenses decreased \$8,534 (4.46%) from \$191,485 for the six months ended June 30, 2009 to \$182,951 for the six months ended June 30, 2010.

The loss from operations was \$940,632 for the six months ended June 30, 2010 as compared to \$715,828 for the six months ended June 30, 2009. The increase in the loss from operations of \$224,804 (31.4%) was primarily due to non-cash equity based compensation charged to personnel costs and stock option expense. Other expense which represents interest cost was \$89,760 for the six months ended June 30, 2010 as compared to an expense of \$31,369 for the six months ended June 30, 2009. The increase in interest expense is a result of increased borrowings. The net loss for the six months ended June 30, 2010 was \$1,030,392 compared to a net loss of \$748,091 for the six months ended June 30, 2009, an increased loss of \$282,301 (37.74%).

#### Liquidity and Capital Resources

At June 30, 2010, we had a working capital deficit of \$372,304, as compared to working capital of \$80,064 at December 31, 2009. Of the working capital deficit at June 30, 2010, \$440,500 was deferred franchise fee revenue and does not represent a cash liability. The decrease in working capital is primarily due to certain debt maturing in 2011.

We receive payments from franchisees when they sign a franchise agreement. We do not include those payments in revenue until such time as the franchisee opens the restaurant. The amount recorded as deferred revenue at June 30, 2010 was \$440,500, a decrease of \$221,000 compared to December 31, 2009. Although not recorded as revenue, any payments received will provide working capital.

At June 30, 2010 we had contractual obligations for operating leases of \$2,138,344, of which \$226,425 is due by December 31, 2010.

As of June 30, 2010, our aggregate minimum requirements under non-cancelable leases are as follows:

|             |             |
|-------------|-------------|
| 2010        | \$226,425   |
| 2011        | 391,701     |
| 2012        | 348,294     |
| 2013        | 274,826     |
| 2014        | 263,783     |
| Later years | 633,315     |
|             | \$2,138,444 |

The current portion of our long term debt is \$451,307 which is due and payable in 2011 and we have long-term debt in the amount of \$1,210,605 which is due and payable in 2013.

#### Summary – June 30, 2010

The difficult economic conditions of 2008 and 2009 resulted in us not selling as many new franchises as we initially projected and reduced system wide revenue which results in lower revenue to us. The extent of the recession was not clear until the third or fourth quarter of 2008. We reacted to the downturn as soon as it became apparent that it would not correct itself in the short term. Our need to raise additional equity or debt financing and our ability to generate cash flow from operations will depend on the speed with which the U.S. economy recovers from the recession, the availability of financing for existing and potential franchisees to open new restaurants, our future performance and our ability to successfully implement our stated business and growth strategies. Many of these factors are beyond our control. If our working capital is insufficient to fund the implementation of our business plan we will be required to seek additional financing sooner than currently anticipated in order to proceed with our business goals. In the event that we need additional capital and are unable to obtain it, we could be left without sufficient liquidity. The nature of our business is that a portion of our revenue is a continuing stream from franchisees. We will continually monitor our expenses and reduce those expenses as best we can to match the revenue flow. In the past we have issued common stock to our consultants and professional services providers in lieu of cash payments for these services. We may continue this practice to conserve our cash to pay for operations, product development and inventory.

During the six months ended June 30, 2010 we entered into an agreement with two members of our Board of Directors whereby they will loan the Company up to \$2,000,000 as a revolving line of credit. The line of credit is evidenced by a Convertible Promissory Note and Secured Loan Agreement (the “Note”). The Note bears interest at the rate of 10% per annum and matures on May 1, 2013. At the lenders option the Note is convertible into our common stock at \$0.105 per share. In addition for every two shares of common stock issued on conversion we will issue to the lenders a warrant to purchase one share of common stock at a price equal to 120% of the average volume weighted average price per share for the 10 days prior to the conversion. The Note is also secured by the assets of the Company. We believe that the terms of the note are arms length. As of June 30, 2010 we have drawn down \$500,000 of the loan and have \$1,500,000 available.

At the same time as the above, the holders of the Convertible Note described in Note 5 to the June30, 2010 financial statements have agreed to extend the due date of their Convertible Note to coincide with the Note. As consideration for the extension of the due date, the holders will receive a security interest in the assets of the Company on a pro rata



basis with the lenders above. One of the holders of the Convertible Note is also a lender of the Note.

Off-Balance Sheet Arrangements

At June 30, 2010 we had no obligations that would qualify to be disclosed as off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), has evaluated the effectiveness of the Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based on such evaluation, our CEO and CFO have concluded that, as of the end of such period, the Company’s disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act and are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including the Company’s CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company’s internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not required.

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

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

None.

Item 5. Other Information

None

Item 6. Exhibits

Regulation

S-K Number Exhibit

|      |  |
|------|--|
| 3.1  | Amended and Restated Articles of Incorporation (1)                                   |
| 3.2  | Bylaws (2)   |
| 4.1  | Certificate of Designation of Series A Variable Rate Convertible Preferred Stock (3) |
| 4.2  | Form of warrant to be issued to Midtown Partners & Co, LLC and assigns (4)           |
| 4.3  | Form of warrant to be issued to private placement investors (5)                      |
| 10.1 | 2006 Stock Option Plan (2)   |
| 10.2 | Promissory Note to Spicy Pickle, LLC (2)   |
| 10.3 | Amendment, Redemption and Conversion Agreement (6)                                   |
| 10.4 | Agreement with Midtown Partners & Co, LLC and assigns (7)                            |
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Regulation

S-K Number Exhibit

|       |   |
|-------|---|
| 10.7  | Convertible Promissory Note and Secured Loan Agreement dated May 10, 2010 – Presley Reed and Patricia Stacey Reed (9) |
| 10.8  | First Amendment to Convertible Promissory Note Dated May 10, 2010 - Presley Reed and Patricia Stacey Reed (9)         |
| 10.9  | First Amendment to Convertible Promissory Note Dated May 10, 2010 - Raymond BonAnno and Joan BonAnno (9)              |
| 10.10 | Executive Employment Agreement with Mark Laramie dated August 3, 2010(10)   |
| 31.1  | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (11)  |
| 31.2  | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (11)  |
| 32.1  | Section 1350 Certification of Chief Executive Officer (11)  |
| 32.2  | Section 1350 Certification of Chief Financial Officer (11)  |

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- (1) Incorporated by reference to the exhibit of the same number to Amendment No. 1 to the registrant’s registration statement on Form SB-2 filed on December 12, 2006.
- (2) Incorporated by reference to the exhibit of the same number to the registrant’s registration statement on Form SB-2 filed on October 26, 2006.
- (3) Incorporated by reference to the exhibit of the same number to the registrant’s Current Report on Form 8-K filed on December 19, 2007
- (4) Incorporated by reference to exhibit 4.1 in the registrant’s Current Report on Form 8-K filed on September 23, 2009.
- (5) Incorporated by reference to exhibit 4.2 in the registrant’s Current Report on Form 8-K filed on September 23, 2009.
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- (7) Incorporated by reference to exhibit 10.2 in the registrant’s Current Report on Form 8-K filed on September 23, 2009.
- (8) Incorporated by reference to the exhibits of the same number to the registrant’s Current Report on Form 8-K filed on January 6, 2010.
- (9) Incorporated by reference to the exhibits of the same number to the registrant’s Quarterly Report on Form 10-Q filed on May 13, 2010.
- (10) Incorporated by reference to the exhibits of the same number to the registrant’s Current Report on Form 8-K filed on August 5, 2010.
- (11) 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.

SPICY PICKLE FRANCHISING, INC.

August 12, 2010 By: /s/ Mark Laramie  
Mark Laramie  
Chief Executive Officer

August 12, 2010 By: /s/ Arnold Tinter  
Arnold Tinter  
Chief Financial Officer

## EXHIBIT INDEX

## Regulation

| S-K Number | Exhibit   |
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