FRIENDLY ICE CREAM CORP
Form 10-Q/A
October 30, 2002

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q/A

**(Amendment No. 1)**

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

**For the quarterly period ended March 31, 2002**

**OR**

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

**For the transition period from to**

**Commission File No. 0-3930**

# FRIENDLY ICE CREAM CORPORATION

(Exact name of registrant as specified in its charter)

| | | |
|---|---|---|
| **Massachusetts** | **5812** | **04-2053130** |
| (State of Incorporation) | (Primary Standard Industrial Classification Code Number) | (I.R.S. Employer Identification No.) |

**1855 Boston Road**
**Wilbraham, Massachusetts 01095**
**(413) 543-2400**
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

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 and 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 ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

| Class | Outstanding at April 8, 2002 |
|---|---|
| Common Stock, $.01 par value | 7,353,828 shares |

**Introductory Note - Restatements**

Friendly Ice Cream Corporation (the Company ) as a result of an extensive review of its accounting policies determined that its policy for recording restaurant advertising expense, included in operating expenses, although proper for annual reporting, needed to be revised for the Company s quarterly reporting. Accordingly, the accompanying financial statements and related disclosures have been restated to reflect this accounting change. This Form 10-Q/A does not modify or update any disclosures except as required to reflect the results of the restatement discussed above on current period and prior period financial information.

**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

| | March 31, 2002 (unaudited) | December 30, 2001 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 14,519 | $ 16,342 |
| Accounts receivable | 10,745 | 9,969 |
| Inventories | 16,903 | 12,987 |
| Deferred income taxes | 7,659 | 7,659 |
| Prepaid expenses and other current assets | 2,327 | 3,736 |
| TOTAL CURRENT ASSETS | 52,153 | 50,693 |
| PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization | 163,352 | 169,489 |
| INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization | 20,763 | 21,208 |
| OTHER ASSETS | 12,263 | 11,172 |
| TOTAL ASSETS | $ 248,531 | $ 252,562 |
| | | |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | $ 951 | $ 1,068 |
| Current maturities of capital lease and finance obligations | 1,858 | 1,851 |
| Accounts payable | 21,232 | 20,505 |
| Accrued salaries and benefits | 9,137 | 9,436 |
| Accrued interest payable | 6,238 | 1,543 |
| Insurance reserves | 12,950 | 13,333 |
| Restructuring reserves | 2,397 | 3,056 |
| Other accrued expenses | 12,636 | 19,260 |
| TOTAL CURRENT LIABILITIES | 67,399 | 70,052 |
| DEFERRED INCOME TAXES | 10,244 | 10,584 |
| CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities | 5,796 | 6,267 |

| | | | | |
|---|---|---|---|---|
| LONG-TERM DEBT, less current maturities | | 232,534 | | 232,797 |
| OTHER LONG-TERM LIABILITIES | | 28,897 | | 28,876 |
| COMMITMENTS AND CONTINGENCIES | | | | |
| STOCKHOLDERS DEFICIT: | | | | |
| Common stock | | 74 | | 74 |
| Additional paid-in capital | | 139,373 | | 139,290 |
| Accumulated deficit | | (235,786) | | (235,378) |
| TOTAL STOCKHOLDERS DEFICIT | | (96,339) | | (96,014) |
| TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT | $ | 248,531 | $ | 252,562 |

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

**FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(In thousands, except per share data)

| | For the Three Months Ended March 31, 2002 | | For the Three Months Ended April 1, 2001 | |
|---|---|---|---|---|
| REVENUES | $ | 131,486 | $ | 125,719 |
| COSTS AND EXPENSES: | | | | |
| Cost of sales | | 45,994 | | 42,060 |
| Labor and benefits | | 37,918 | | 39,676 |
| Operating expenses | | 26,398 | | 24,944 |
| General and administrative expenses | | 8,599 | | 9,332 |
| Write-downs of property and equipment | | 120 | | |
| Depreciation and amortization | | 6,686 | | 7,552 |
| Loss (gain) on sales of other property and equipment, net | | 512 | | (1,981) |
| OPERATING INCOME | | 5,259 | | 4,136 |
| Interest expense, net | | 6,337 | | 7,585 |
| LOSS BEFORE BENEFIT FROM INCOME TAXES | | (1,078) | | (3,449) |
| Benefit from income taxes | | 670 | | 1,514 |
| NET LOSS AND COMPREHENSIVE LOSS | $ | (408) | $ | (1,935) |
| BASIC AND DILUTED NET LOSS PER SHARE | $ | (0.06) | $ | (0.26) |
| WEIGHTED AVERAGE BASIC AND DILUTED SHARES | | 7,353 | | 7,376 |

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

**FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(In thousands)

| | For the Three Months Ended March 31, 2002 | April 1, 2001 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | $ (408) | $ (1,935) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Stock compensation expense | 70 | 93 |
| Depreciation and amortization | 6,686 | 7,552 |
| Write-downs of property and equipment | 120 | |
| Deferred income tax benefit | (340) | (1,514) |
| Loss (gain) on sales of other property and equipment, net | 512 | (1,981) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (776) | 598 |
| Inventories | (3,916) | (2,510) |
| Other assets | 318 | 37 |
| Accounts payable | 727 | (467) |
| Accrued expenses and other long-term liabilities | (3,386) | 2,291 |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (393) | 2,164 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (1,563) | (2,026) |
| Proceeds from sales of property and equipment | 964 | 5,246 |
| NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES | (599) | 3,220 |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from borrowings | | 8,000 |
| Repayments of debt | (380) | (18,627) |
| Repayments of capital lease and finance obligations | (464) | (572) |
| Stock options exercised | 13 | |
| NET CASH USED IN FINANCING ACTIVITIES | (831) | (11,199) |
| | | |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,823) | (5,815) |
| | | |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 16,342 | 14,584 |
| | | |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 14,519 | $ 8,769 |

| | | | | |
|---|---|---|---|---|
| SUPPLEMENTAL DISCLOSURES: | | | | |
| Cash paid (refunded) during the period for: | | | | |
| Interest | $ | 1,343 | $ | 2,136 |
| Income taxes | | (3) | | 2 |

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

**FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

*Interim Financial Information -*

The accompanying condensed consolidated financial statements as of March 31, 2002 and for the first quarters ended March 31, 2002 and April 1, 2001 are unaudited, but, in the opinion of management, include all adjustments which are necessary for a fair presentation of the consolidated financial position, results of operations, cash flows and comprehensive loss of Friendly Ice Cream Corporation ( FICC ) and subsidiaries (unless the context indicates otherwise, collectively, the Company ). Such adjustments consist solely of normal recurring accruals. Operating results for the three month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the entire year due, in part, to the seasonality of the Company s business. Historically, higher revenues and operating income have been experienced during the second and third fiscal quarters. The Company s consolidated financial statements, including the notes thereto, which are contained in the 2001 Annual Report on Form 10-K should be read in conjunction with these condensed consolidated financial statements. Capitalized terms not otherwise defined herein should be referenced to the 2001 Annual Report on Form 10-K.

*Use of Estimates in the Preparation of Financial Statements -*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The critical accounting policies and most significant estimates and assumptions relate to revenue recognition, insurance reserves, restructuring reserves, valuation allowances on net operating losses, pension and other post-retirement benefits expense and the volatility of cream prices. Actual amounts could differ significantly from the estimates.

*Revenue Recognition -*

The Company s revenues are derived primarily from the operation of full-service restaurants, the distribution and sale of frozen desserts through retail and institutional locations and franchising. The Company recognizes restaurant revenue upon receipt of payment from the customer and retail revenue upon shipment of product. Reserves for discounts and allowances from retail sales are estimated and accrued when revenue is recorded. Actual amounts could differ materially from the estimates. Franchise royalty income, based on net sales of franchisees, is payable monthly and is recorded on the accrual method. Initial franchise fees are recorded as revenue upon completion of all significant services, generally upon opening of the restaurant.

*Insurance Reserves -*

The Company is self - insured through retentions or deductibles for the majority of its workers compensation, automobile, general liability, employer s liability, product liability and group health insurance programs. Self-insurance amounts vary up to $500,000 per occurrence. Insurance with third parties, some of which is then reinsured through RIC, is in place for claims in excess of these self insured amounts. RIC reinsured 100% of the risk from $500,000 to $1,000,000 per occurrence through September 2, 2000 for the Company s workers compensation, general liability, employer s liability and product liability insurance. Subsequent to September 2, 2000, the Company discontinued its use of RIC as a captive insurer for new claims. The Company s and RIC s liability for estimated incurred losses are actuarially determined and recorded in the accompanying condensed consolidated financial statements on an undiscounted basis. Actual incurred losses may vary from the estimated incurred losses and could have a material affect on the Company s insurance expense.

*Restructuring Reserves -*

On October 10, 2001, the Company eliminated approximately 70 positions at corporate headquarters. In addition, approximately 30 positions in the restaurant construction and fabrication areas were eliminated by December 30, 2001. The purpose of the reduction was to streamline functions and reduce redundancy amongst its business segments. As a result of the elimination of the positions and the outsourcing of certain functions, the Company reported a pre-tax restructuring charge of approximately $2,536,000 for severance, rent and unusable construction supplies in the year ended December 30, 2001.

In March 2000, the Company s Board of Directors approved a restructuring plan that provided for the immediate closing of 81 restaurants at the end of March 2000 and the disposition of an additional 70 restaurants over the next 24 months. As a result of this plan, the Company reported a pre-tax restructuring charge of approximately $12,100,000 for severance, rent, utilities and real estate taxes, demarking, lease termination costs and certain other costs associated with the closing of the locations, along with a pre-tax write-down of property and equipment for these locations of approximately $17,000,000 in the year ended December 31, 2000. The Company reduced the restructuring reserve by $1,900,000 during the year ended December 30, 2001 since the reserve exceeded estimated remaining payments.

As of March 31, 2002, the remaining restructuring reserve was $2,397,000. The restructuring reserves may be increased or decreased based upon remaining payments, which could vary materially from the estimates depending upon the timing of store closings and other factors.

*Income Taxes -*

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. A valuation allowance is recorded for deferred tax assets whose realization is not likely. As of December 30, 2001 and March 31, 2002, a valuation allowance of $11,295,000 existed related to state NOL carryforwards due to restrictions on the usage of state NOL carryforwards and short carryforward periods for certain states. Taxable income by state for future periods is difficult to estimate. The amount and timing of any future taxable income may affect the usage of such carryforwards, which could result in a material change in the valuation allowance.

*Pension and Other Post-Retirement Benefits -*

The determination of the Company s obligation and expense for pension and other post-retirement benefits is dependent upon the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among other things, the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs. In accordance with accounting principles generally accepted in the United States, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in such future periods. While FICC believes that the assumptions used are appropriate, significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other post-retirement obligations and expense.

*Volatility of Cream Prices -*

The cost of cream, the principal ingredient used in making ice cream, affects cost of sales as a percentage of total revenues, especially in foodservice s retail business. The Company believes that cream prices will be slightly higher in 2002 than in 2001. A $0.10 increase in the cost of a pound of AA butter adversely affects the Company s annual cost of sales by approximately $1,100,000. To minimize risk, alternative supply sources continue to be pursued. However, no assurance can be given that the Company will be able to offset any cost increases in the future and future increases in cream could have a material adverse effect on the Company s results of operations.

*Debt -*

In December 2001, the Company completed a financial restructuring plan (the Refinancing Plan ) which included the repayment of $64,545,000 outstanding under the Old Credit Facility and the repurchase of approximately $21,300,000 in Senior Notes for $17,000,000 with the proceeds from $55,000,000 in long-term mortgage financing (the Mortgage Financing ) and a $33,700,000 sale and leaseback transaction (the Sale/Leaseback Financing ). In addition, FICC secured a new $30,000,000 revolving credit facility of which up to $20,000,000 is available to support letters of credit. The $30,000,000 commitment less outstanding letters of credit is available for borrowing to provide working capital and for other corporate needs (the New Credit Facility ).

Inventories -

Inventories are stated at the lower of first-in, first-out cost or market. Inventories as of March 31, 2002 and December 30, 2001 were as follows (in thousands):

| | March 31, 2002 | December 30, 2001 |
|---|---|---|
| Raw materials | $ 828 | $ 1,269 |
| Goods in process | 142 | 73 |
| Finished goods | 15,933 | 11,645 |
| Total | $ 16,903 | $ 12,987 |

*Reclassifications -*

Certain prior year amounts have been reclassified to conform with current year presentation.

**2. NET LOSS PER SHARE**

Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated by dividing net loss by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. Common stock equivalents are dilutive stock options and warrants that are assumed exercised for calculation purposes. The number of common stock options which could dilute basic earnings per share in the future, that were not included in the computation of diluted loss per share because to do so would have been antidilutive, was 389,000 and 650,000 for the three months ended March 31, 2002 and April 1, 2001, respectively.

**3. SEGMENT REPORTING**

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company s chief operating decision-maker is the Chairman of the Board and Chief Executive Officer of the Company. The Company s operating segments include restaurant, foodservice and franchise. The revenues from these segments include both sales to unaffiliated customers and intersegment sales, which generally are accounted for on a basis consistent with sales to unaffiliated customers. Intersegment sales and other intersegment transactions have been eliminated in the accompanying condensed consolidated financial statements.

The Company s restaurants target families with children and adults who desire a reasonably-priced meal in a full-service setting. The Company s menu offers a broad selection of freshly-prepared foods which appeal to customers throughout all dayparts. The menu currently features over 100 items comprised of a broad selection of breakfast, lunch, dinner and afternoon and evening snack items. Foodservice operations manufactures frozen dessert products and distributes such manufactured products and purchased finished goods to the Company s restaurants and franchised operations. Additionally, it sells frozen dessert products to distributors and retail and institutional locations. The Company s franchise segment includes a royalty based on franchise restaurant revenue. In addition, the Company receives rental income from various franchised restaurants. The Company does not allocate general and administrative expenses associated with its headquarters operations to any business segment. These costs include general and administrative expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarters activities.

On May 1, 2001, foodservice decreased its ice cream pricing to all restaurants. This resulted in decreased foodservice revenues of 3.9% for the three months ended March 31, 2002.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that the financial results for the foodservice operating segment, prior to intersegment eliminations, have been prepared using a management approach, which is consistent with the basis and manner in which the Company s management internally reviews financial information for the purpose of assisting in making internal operating decisions. The Company evaluates performance based on stand-alone operating segment income (loss) before income taxes and generally accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

EBITDA represents net income (loss) before (i) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) write-downs of property and equipment and (v) other non-cash items. The Company has included information concerning EBITDA in this Form 10-Q because it believes that such information is used by certain investors as one measure of a company s historical ability to service debt. EBITDA should not be considered as an alternative to, or more meaningful than, earnings (loss) from operations or other traditional indications of a company s operating performance.

| | For the Three Months Ended | | | |
|---|---|---|---|---|
| | March 31, 2002 | | April 1, 2001 | |
| | (in thousands) | | | |
| Revenues: | | | | |
| Restaurant | $ | 104,256 | $ | 107,145 |
| Foodservice | | 54,133 | | 47,822 |
| Franchise | | 2,129 | | 1,561 |
| Total | $ | 160,518 | $ | 156,528 |
| | | | | |
| Intersegment revenues: | | | | |
| Restaurant | $ | | $ | |
| Foodservice | | (29,032) | | (30,809) |
| Franchise | | | | |
| Total | $ | (29,032) | $ | (30,809) |
| | | | | |
| External revenues: | | | | |
| Restaurant | $ | 104,256 | $ | 107,145 |
| Foodservice | | 25,101 | | 17,013 |
| Franchise | | 2,129 | | 1,561 |
| Total | $ | 131,486 | $ | 125,719 |
| | | | | |
| EBITDA: | | | | |
| Restaurant | $ | 12,051 | $ | 10,845 |
| Foodservice | | 3,674 | | 3,078 |
| Franchise | | 1,327 | | 494 |
| Corporate | | (4,402) | | (4,520) |
| (Loss) gain on property and equipment, net | | (515) | | 1,884 |
| Total | $ | 12,135 | $ | 11,781 |
| | | | | |
| Interest expense, net-Corporate | $ | 6,337 | $ | 7,585 |
| | | | | |
| Depreciation and amortization: | | | | |
| Restaurant | $ | 4,626 | $ | 5,046 |
| Foodservice | | 671 | | 854 |
| Franchise | | 74 | | 60 |
| Corporate | | 1,315 | | 1,592 |
| Total | $ | 6,686 | $ | 7,552 |
| | | | | |
| Other non-cash expenses: | | | | |
| Corporate | $ | 70 | $ | 93 |
| Write-downs of property and equipment | | 120 | | |
| Total | $ | 190 | $ | 93 |
| | | | | |
| Income (loss) before income taxes: | | | | |
| Restaurant | $ | 7,425 | $ | 5,799 |
| Foodservice | | 3,003 | | 2,224 |

| | | | | |
|---|---|---|---|---|
| Franchise | | 1,253 | | 434 |
| Corporate | | (12,124) | | (13,790) |
| (Loss) gain on property and equipment, net | | (635) | | 1,884 |
| Total | $ | (1,078) | $ | (3,449) |

| | | March 31, 2002 | | December 30, 2001 |
|---|---|---|---|---|
| Capital expenditures, including assets acquired under capital leases: | | | | |
| Restaurant | $ | 1,200 | $ | 10,821 |
| Foodservice | | 368 | | 2,090 |
| Corporate | | (5) | | 1,011 |
| Total | $ | 1,563 | $ | 13,922 |
| | | | | |
| Total assets: | | | | |
| Restaurant | $ | 144,443 | $ | 148,475 |
| Foodservice | | 41,636 | | 38,474 |
| Franchise | | 6,384 | | 7,076 |
| Corporate | | 56,068 | | 58,537 |
| Total | $ | 248,531 | $ | 252,562 |

**4. NEW ACCOUNTING PRONOUNCEMENTS**

In August 2001, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 modifies the rules for accounting for the impairment or disposal of long-lived assets. The impact of adopting SFAS No. 144 on December 31, 2001 had no material effect on the Company s financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangibles. SFAS No. 142 modifies the rules for accounting for goodwill and other intangible assets. The new rules became effective for the Company on December 31, 2001. The impact of adopting SFAS No. 142 on December 31, 2001 had no effect on the Company s financial condition or results of operations and the Company is continuing to amortize its license agreement related to certain trademarked products over the term of the license agreement.

In April 2001, the FASB reached consensus on Emerging Issues Task Force ( EITF ) Issue No. 00-25, Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor s Products. EITF Issue No. 00-25 was effective for quarters beginning after December 15, 2001, with prior financial statements restated if practicable. EITF Issue No. 00-25 requires that consideration from a vendor to a retailer be recorded as a reduction in revenue unless certain criteria are met. Arrangements within the scope of this Issue include slotting fees, cooperative advertising arrangements and buy-downs. As a result of EITF Issue No. 00-25, certain costs previously recorded as expense have been reclassified and offset against revenue for the quarter ended April 1, 2001.

**5. RESTRUCTURING RESERVES**

The following represents the reserve and activity associated with the March 2000 and October 2001 restructurings (in thousands):

| | For the Three Months Ended April 1, 2001 | | |
|---|---|---|---|
| | Restructuring Reserves as of December 31, 2000 | Costs Paid | Restructuring Reserves as of April 1, 2001 |
| Severance pay | $ 74 | $ (74) | $ |
| Rent | 3,585 | (278) | 3,307 |
| Utilities and real estate taxes | 1,105 | (210) | 895 |
| Demarking | 138 | (12) | 126 |
| Lease termination costs | 120 | | 120 |
| Inventory | 5 | (5) | |
| Other | 544 | (148) | 396 |
| Total | $ 5,571 | $ (727) | $ 4,844 |

| | For the Three Months Ended March 31, 2002 | | | |
|---|---|---|---|---|
| | Restructuring Reserves as of December 30, 2001 | Expense | Costs Paid | Restructuring Reserves as of March 31, 2002 |
| Severance pay | $ 516 | $ | $ (408) | $ 108 |
| Rent | 1,318 | | (136) | 1,182 |
| Utilities and real estate taxes | 185 | 91 | (78) | 198 |
| Equipment | 480 | | | 480 |
| Outplacement services | 6 | | (1) | 5 |
| Other | 551 | (91) | (36) | 424 |
| Total | $ 3,056 | $ | $ (659) | $ 2,397 |

Based on information currently available, management believes that the restructuring reserve as of March 31, 2002 is adequate and not excessive.

**6. FRANCHISE TRANSACTIONS**

In 2000, the Company and its first franchisee, Davco, agreed to terminate Davco s rights as the exclusive developer of new Friendly s restaurants in Maryland, Delaware, the District of Columbia and northern Virginia, effective December 28, 2000. Davco has the right to close up to 16 existing franchised locations and will operate the remaining 32 locations under their respective existing franchise agreements until such time as a new franchisee is found for those locations. The existing franchise agreements for the 32 locations were modified as of December 29, 2001 to allow early termination subject to liquidated damages on 22 of the 32 franchise agreements. Effective August 6, 2001, Davco transferred its rights to three franchised locations to a third party. Davco closed two units during the year ended December 30, 2001. During the quarter ended March 31, 2002, Davco transferred its rights to eight additional franchised locations to three separate third parties.

**7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

FICC s obligation related to the Senior Notes are guaranteed fully and unconditionally by one of FICC s wholly owned subsidiaries. There are no restrictions on FICC s ability to obtain dividends or other distributions of funds from this subsidiary, except those imposed by applicable law. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for FICC (the Parent Company ), Friendly s Restaurants Franchise, Inc. (the Guarantor Subsidiary ) and Friendly s International, Inc., Restaurant Insurance Corporation, and the three LLC subsidiaries created in 2001, Friendly s Realty I, LLC, Friendly s Realty II, LLC and Friendly s Realty III, LLC (collectively, the Non-guarantor Subsidiaries ). All of the LLCs assets are owned by the LLCs, which are separate entities with separate creditors which will be entitled to be satisfied out of the LLCs assets. Separate complete financial statements and other disclosures of the Guarantor Subsidiary as of March 31, 2002 and April 1, 2001 and for the three months ended March 31, 2002 and April 1, 2001 are not presented because management has determined that such information is not material to investors.

Investments in subsidiaries are accounted for by the Parent Company on the equity method for purposes of the supplemental consolidating presentation. Earnings of the subsidiaries are, therefore, reflected in the Parent Company s investment accounts and earnings. The principal elimination entries eliminate the Parent Company s investments in subsidiaries and intercompany balances and transactions.

**Supplemental Condensed Consolidating Balance Sheet**

**As of March 31, 2002**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $ 12,449 | $ 16 | $ 2,054 | $ | $ 14,519 |
| Accounts receivable, net | 10,087 | 658 | | | 10,745 |
| Inventories | 16,903 | | | | 16,903 |
| Deferred income taxes | 7,448 | 99 | | 112 | 7,659 |
| Prepaid expenses and other current assets | 6,606 | 255 | 3,503 | (8,037) | 2,327 |
| Total current assets | 53,493 | 1,028 | 5,557 | (7,925) | 52,153 |
| Deferred income taxes | | 350 | 1,327 | (1,677) | |
| Property and equipment, net | 111,956 | | 51,396 | | 163,352 |
| Intangibles and deferred costs, net | 17,884 | | 2,879 | | 20,763 |
| Investments in subsidiaries | 5,254 | | | (5,254) | |
| Other assets | 11,348 | 5,100 | 6,229 | (10,414) | 12,263 |
| Total assets | $ 199,935 | $ 6,478 | $ 67,388 | $ (25,270) | $ 248,531 |
| Liabilities and Stockholders (Deficit) Equity | | | | | |
| Current liabilities: | | | | | |
| Current maturities of long-term obligations | $ 5,358 | $ | $ 951 | $ (3,500) | $ 2,809 |
| Accounts payable | 21,232 | | | | 21,232 |
| Accrued expenses | 39,313 | 271 | 8,076 | (4,302) | 43,358 |
| Total current liabilities | 65,903 | 271 | 9,027 | (7,802) | 67,399 |
| Deferred income taxes | 11,809 | | | (1,565) | 10,244 |
| Long-term obligations, less current maturities | 189,837 | | 53,807 | (5,314) | 238,330 |
| Other long-term liabilities | 28,725 | 1,057 | 4,450 | (5,335) | 28,897 |
| Stockholders (deficit) equity | (96,339) | 5,150 | 104 | (5,254) | (96,339) |
| Total liabilities and stockholders (deficit) equity | $ 199,935 | $ 6,478 | $ 67,388 | $ (25,270) | $ 248,531 |

**Supplemental Condensed Consolidating Statement of Operations**

**For the Three Months Ended March 31, 2002**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ 129,699 | $ 1,787 | $ | $ | $ 131,486 |
| Costs and expenses: | | | | | |
| Cost of sales | 45,994 | | | | 45,994 |
| Labor and benefits | 37,918 | | | | 37,918 |
| Operating expenses and write-downs of property and equipment | 28,267 | | (1,749) | | 26,518 |
| General and administrative expenses | 7,435 | 1,164 | | | 8,599 |
| Depreciation and amortization | 6,099 | | 587 | | 6,686 |
| Loss on sales of other property and equipment, net | 512 | | | | 512 |
| Interest expense | 5,174 | | 1,163 | | 6,337 |
| (Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries | (1,700) | 623 | (1) | | (1,078) |
| Benefit from (provision for) income taxes | 1,044 | (255) | (119) | | 670 |
| (Loss) income before equity in net income of consolidated subsidiaries | (656) | 368 | (120) | | (408) |
| Equity in net income of consolidated subsidiaries | 248 | | | (248) | |
| Net (loss) income | $ (408) | $ 368 | $ (120) | $ (248) | $ (408) |

**Supplemental Condensed Consolidating Statement of Cash Flows**

**For the Three Months Ended March 31, 2002**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net cash (used in) provided by operating activities | $ (1,479) | $ (88) | $ 1,054 | $ 120 | $ (393) |
| Cash flows from investing activities: | | | | | |
| Purchases of property and equipment | (1,563) | | | | (1,563) |
| Proceeds from sales of property and equipment | 964 | | | | 964 |
| Net cash used in investing activities | (599) | | | | (599) |
| Cash flows from financing activities: | | | | | |
| Repayments of obligations | (602) | | (242) | | (844) |
| Stock options exercised | 13 | | | | 13 |
| Reinsurance deposits received | | | 1,000 | (1,000) | |
| Reinsurance payments made from deposits | | | (880) | 880 | |
| Net cash used in financing activities | (589) | | (122) | (120) | (831) |
| Net (decrease) increase in cash and cash equivalents | (2,667) | (88) | 932 | | (1,823) |
| Cash and cash equivalents, beginning of period | 15,116 | 104 | 1,122 | | 16,342 |
| Cash and cash equivalents, end of period | $ 12,449 | $ 16 | $ 2,054 | $ | $ 14,519 |
| Supplemental disclosures: | | | | | |
| Interest paid | $ 180 | $ | $ 1,163 | $ | $ 1,343 |
| Income taxes (refunded) paid | (5) | 2 | | | (3) |

**Supplemental Condensed Consolidating Balance Sheet**

**As of December 30, 2001**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | $ 15,116 | $ 104 | $ 1,122 | $ | $ 16,342 |
| Accounts receivable, net | 9,468 | 501 | | | 9,969 |
| Inventories | 12,987 | | | | 12,987 |
| Deferred income taxes | 7,448 | 99 | | 112 | 7,659 |
| Prepaid expenses and other current assets | 8,704 | 1,002 | 3,560 | (9,530) | 3,736 |
| Total current assets | 53,723 | 1,706 | 4,682 | (9,418) | 50,693 |
| Deferred income taxes | | 350 | 1,327 | (1,677) | |
| Property and equipment, net | 117,564 | | 51,925 | | 169,489 |
| Intangibles and deferred costs, net | 18,271 | | 2,937 | | 21,208 |
| Investments in subsidiaries | 5,061 | | | (5,061) | |
| Other assets | 10,258 | 4,863 | 6,229 | (10,178) | 11,172 |
| Total assets | $ 204,877 | $ 6,919 | $ 67,100 | $ (26,334) | $ 252,562 |
| Liabilities and Stockholders (Deficit) Equity | | | | | |
| Current liabilities: | | | | | |
| Current maturities of long-term obligations | $ 5,489 | $ | $ 930 | $ (3,500) | $ 2,919 |
| Accounts payable | 20,505 | | | | 20,505 |
| Accrued expenses | 43,853 | 1,042 | 7,491 | (5,758) | 46,628 |
| Total current liabilities | 69,847 | 1,042 | 8,421 | (9,258) | 70,052 |
| Deferred income taxes | 12,149 | | | (1,565) | 10,584 |
| Long-term obligations, less current maturities | 190,308 | | 54,070 | (5,314) | 239,064 |
| Other long-term liabilities | 28,587 | 1,095 | 4,330 | (5,136) | 28,876 |
| Stockholders (deficit) equity | (96,014) | 4,782 | 279 | (5,061) | (96,014) |
| Total liabilities and stockholders (deficit) equity | $ 204,877 | $ 6,919 | $ 67,100 | $ (26,334) | $ 252,562 |

**Supplemental Condensed Consolidating Statement of Operations**

**For the Three Months Ended April 1, 2001**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Revenues | $ 124,526 | $ 1,193 | $ | $ | $ 125,719 |
| Costs and expenses: | | | | | |
| Cost of sales | 42,060 | | | | 42,060 |
| Labor and benefits | 39,676 | | | | 39,676 |
| Operating expenses and write-downs of property and equipment | 24,953 | | (9) | | 24,944 |
| General and administrative expenses | 8,173 | 1,159 | | | 9,332 |
| Depreciation and amortization | 7,552 | | | | 7,552 |
| Gain on sales of other property and equipment, net | (1,981) | | | | (1,981) |
| Interest expense (income) | 7,806 | | (221) | | 7,585 |
| (Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries | (3,713) | 34 | 230 | | (3,449) |
| Benefit from (provision for) income taxes | 1,609 | (14) | (81) | | 1,514 |
| (Loss) income before equity in net income of consolidated subsidiaries | (2,104) | 20 | 149 | | (1,935) |
| Equity in net income of consolidated subsidiaries | 169 | | | (169) | |
| Net (loss) income | $ (1,935) | $ 20 | $ 149 | $ (169) | $ (1,935) |

**Supplemental Condensed Consolidating Statement of Cash Flows**

**For the Three Months Ended April 1, 2001**

(In thousands)

| | Parent Company | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net cash provided by (used in) operating activities | $ 1,986 | $ (21) | $ 1,184 | $ (985) | $ 2,164 |
| | | | | | |
| Cash flows from investing activities: | | | | | |
| Purchases of property and equipment | (2,026) | | | | (2,026) |
| Proceeds from sales of property and equipment | 5,246 | | | | 5,246 |
| Net cash provided by investing activities | 3,220 | | | | 3,220 |
| | | | | | |
| Cash flows from financing activities: | | | | | |
| Proceeds from borrowings | 8,000 | | | | 8,000 |
| Repayments of obligations | (19,199) | | | | (19,199) |
| Reinsurance payments made from deposits | | | (962) | 962 | |
| Net cash used in financing activities | (11,199) | | (962) | 962 | (11,199) |
| | | | | | |
| Net (decrease) increase in cash and cash equivalents | (5,993) | (21) | 222 | (23) | (5,815) |
| | | | | | |
| Cash and cash equivalents, beginning of period | 13,619 | 33 | 932 | | 14,584 |
| | | | | | |
| Cash and cash equivalents, end of period | $ 7,626 | $ 12 | $ 1,154 | $ (23) | $ 8,769 |
| | | | | | |
| Supplemental disclosures: | | | | | |
| Interest paid (received) | $ 2,357 | $ | $ (221) | $ | $ 2,136 |
| Income taxes paid | | 2 | | | 2 |

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

*The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements of the Company and the notes thereto included elsewhere herein.*

**Forward Looking Statements**

Statements contained herein that are not historical facts constitute forward looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. All forward looking statements are subject to risks and uncertainties which could cause results to differ materially from those anticipated. These factors include the Company s highly competitive business environment, exposure to commodity prices, risks associated with the foodservice industry, the ability to retain and attract new employees, government regulations, the Company s high geographic concentration in the Northeast and its attendant weather patterns, conditions needed to meet restaurant re-imaging and new opening targets and risks associated with improved service and other initiatives. Other factors that may cause actual results to differ from the forward looking statements contained herein and that may affect the Company s prospects in general are included in the Company s other filings with the Securities and Exchange Commission.

**Overview**

Friendly s owns and operates 390 restaurants, franchises 160 full-service restaurants and six non-traditional units and manufactures a full line of frozen desserts distributed through more than 3,500 supermarkets and other retail locations in 17 states. The restaurants offer a wide variety of reasonably priced breakfast, lunch and dinner menu items as well as the frozen dessert products.

Following is a summary of the Company-owned and franchised units:

| | **For the Three Months Ended** | |
|---|---|---|
| | **March 31, 2002** | **April 1, 2001** |
| Company Units: | | |
| Beginning of period | 393 | 449 |
| Closings | (3) | (11) |
| End of Period | 390 | 438 |
| | | |
| Franchised Units: | | |
| Beginning of period | 167 | 127 |
| Openings | 2 | 1 |
| Closings | (3) | |
| End of Period | 166 | 128 |

20

*Revenues:*

Total revenues increased $5.8 million, or 4.6%, to $131.5 million for the first quarter ended March 31, 2002 from $125.7 million for the same quarter in 2001. Restaurant revenues decreased $2.8 million, or 2.7%, to $104.3 million for the first quarter of 2002 from $107.1 million for the same quarter in 2001. Restaurant revenues decreased by $11.9 million in the 2002 period as compared to the 2001 period due to the closing of 19 under-performing restaurants and the re-franchising of 57 additional locations over the past 15 months. Closing of restaurants accounted for $1.5 million of the restaurant revenue decline in the 2002 period as compared to the 2001 period and re-franchising reduced restaurant revenues by an additional $10.4 million in the 2002 period as compared to the 2001 period. Partially offsetting these decreases was an 8.8% increase in comparable restaurant revenues from the 2001 quarter to the 2002 quarter. Revenues from the one location open less than one year were $0.3 million. Foodservice (product sales to franchisees, retail and institutional) revenues increased by $8.1 million, or 47.5%, to $25.1 million for the first quarter ended March 31, 2002 from $17.0 million for the same quarter in 2001. The increase in the number of franchised units and increases in comparable franchised restaurant revenues accounted for $4.7 million of the increase, sales to foodservice retail supermarket customers increased by $3.6 million and sales to outside distributors decreased by $0.2 million. On May 1, 2001, foodservice decreased its ice cream pricing to all restaurants. This resulted in decreased foodservice revenues of 3.9% for the three months ended March 31, 2002. Franchise revenue increased $0.5 million, or 36.4%, to $2.1 million for the first quarter ended March 31, 2002 compared to $1.6 million for the same quarter in 2001. The increase is largely the result of the difference in the number of franchised locations operating during each period. Comparable franchised restaurant revenues also rose in the 2002 period when compared to the same period in 2001. There were 166 franchise units open at March 31, 2002 compared to 128 franchise units open at April 1, 2001.

*Cost of sales:*

Cost of sales increased $3.9 million, or 9.3%, to $46.0 million for the three months ended March 31, 2002 from $42.1 million for the same period in 2001. Cost of sales as a percentage of total revenues increased to 35.0% for the quarter ended March 31, 2002 from 33.5% for the same period in 2001. The higher food cost as a percentage of total revenue was partially due to a shift in sales mix from Company-owned restaurant sales to foodservice sales and a shift in restaurant sales to entrees with a higher food cost as a percentage of revenues. Foodservice sales to franchisees and retail customers have a higher food cost as a percentage of revenue than sales in Company-owned restaurants to restaurant patrons. The cost of cream, the principal ingredient used in making ice cream, was lower in 2002 when compared to 2001; however, the Company expects that cream prices will increase during the remainder of 2002. In May 2001, the Company raised prices to its retail customers, which decreased cost of sales as a percentage of revenues. To minimize risk, alternative supply sources continue to be pursued.

*Labor and benefits:*

Labor and benefits decreased $1.8 million, or 4.5%, to $37.9 million for the first quarter ended March 31, 2002 from $39.7 million for the same quarter in 2001. Labor and benefits as a percentage of total revenues decreased to 28.8% for the first quarter ended March 31, 2002 from 31.6% for the same quarter in 2001. The lower labor cost as a percentage of total revenue is partially the result of revenue increases derived from additional franchised locations and higher sales to foodservice retail supermarket customers, which do not have any associated restaurant labor and benefits. In addition, the closing of 19 under-performing Company-owned units over the past 15 months improved the relationship of restaurant labor and benefits to restaurant sales as well as to total revenues.

*Operating expenses:*

Operating expenses increased $1.5 million, or 6.0%, to $26.4 million for the first quarter ended March 31, 2002 from $24.9 million for the same quarter in 2001. Operating expenses as a percentage of total revenues were 20.1% and 19.8% for the first quarters ended March 31, 2002 and April 1, 2001, respectively. The increase as a percentage of total revenues resulted from higher costs for restaurant rent associated with the December 2001 sale/leaseback transaction and higher costs for foodservice retail selling expense in the 2002 period when compared to the 2001 period.

*General and administrative expenses:*

General and administrative expenses were $8.6 million and $9.3 million for the first quarters ended March 31, 2002 and April 1, 2001, respectively. General and administrative expenses as a percentage of total revenues decreased to 6.5% for the first quarter ended March 31, 2002 from 7.4% for the same period in 2001. The decrease is primarily the result of the elimination of certain management and administrative positions associated with the Company s closing of 19 locations and the re-franchising of 57 locations over the past 15 months. In October 2001, the Company eliminated approximately 70 positions at corporate headquarters. The Company has a hiring freeze at its corporate headquarters.

*EBITDA:*

As a result of the above, EBITDA (EBITDA represents net income (loss) before (i) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) write-downs of property and equipment and (v) other non-cash items) increased $0.4 million, or 3.0%, to $12.1 million for the quarter ended March 31, 2002 from $11.8 million for the same quarter in 2001. EBITDA as a percentage of total revenues was 9.3% and 9.4% for the 2002 and 2001 periods, respectively.

*Depreciation and amortization:*

Depreciation and amortization decreased $0.9 million, or 11.5%, to $6.7 million for the first quarter ended March 31, 2002 from $7.6 million for the same quarter in 2001. Depreciation and amortization as a percentage of total revenues was 5.1% and 6.0% in the 2002 and 2001 quarters, respectively. The reduction reflects the impact on depreciation associated with the Company s closing of 19 locations and the re-franchising of 57 locations over the past 15 months.

*(Loss) gain on sales of other property and equipment, net:*

The loss on sales of other property and equipment, net was $0.5 million for the quarter ended March 31, 2002 as compared to a gain of $2.0 million for the quarter ended April 1, 2001. The loss in the 2002 quarter primarily resulted from the sale of idle land and two closed locations. The gain in the 2001 quarter primarily resulted from the sale of 11 closed locations.

W*rite-downs of property and equipment:*

Write-downs of property and equipment were $0.1 million for the three months ended March 31, 2002 as a result of a write down of a vacant land parcel.

*Interest expense, net:*

Interest expense, net of capitalized interest and interest income, decreased by $1.3 million, or 16.5%, to $6.3 million for the first quarter ended March 31, 2002 from $7.6 million for the same period in 2001. The decrease is primarily impacted by the decrease in the average outstanding debt in the 2002 quarter compared to the 2001 quarter as a result of the Refinancing Plan. Total outstanding debt, including capital lease obligations, was reduced from $287.6 million at April 1, 2001 to $241.1 million at March 31, 2002.

*Benefit from income taxes:*

The benefit from income taxes was $0.7 million, an effective tax rate of 62.2%, for the first quarter ended March 31, 2002 compared to a benefit from taxes of $1.5 million, or 43.9%, for the 2001 quarter. The Company records income taxes based on the effective rate expected for the year with any changes in the valuation allowance reflected in the period of change.

*Net loss:*

Net loss was $0.4 million and $1.9 million for the first quarters ended March 31, 2002 and April 1, 2001, respectively, for the reasons discussed above.

**Liquidity and Capital Resources**

The Company s primary sources of liquidity and capital resources are cash generated from operations and borrowings under its revolving credit facility. Net cash used in operating activities was $0.4 million for the first quarter ended March 31, 2002 compared to net cash provided by operations of $2.2 million for the same quarter of 2001. During the three months ended March 31, 2002, inventories increased $3.9 million in an effort to build manufactured inventory to take advantage of lower cream prices. Accrued expenses and other long-term liabilities decreased $3.4 million as a result of $3.9 million of payments made for corporate and restaurant bonuses, $0.7 million of payments made against the restructuring reserve and $1.2 million of payments made for accrued construction costs. These decreases were offset by an increase in accrued interest of $4.7 million related to the timing of interest payment dates and decreased accrued payroll costs. During the 2001 quarter, inventory increased $2.5 million as a result of anticipated increases in retail sales. Accrued expenses and other long-term liabilities increased $2.3 million from December 31, 2000 to April 1, 2001 primarily due to a $5.2 million increase in accrued interest on the Senior Notes due to four months accrued at April 1, 2001 compared to one month accrued at December 31, 2000. This increase was offset by $1.0 million of payments made against the captive insurance company s reserves for workers compensation claims. Available borrowings under the revolving credit facility were $17.1 million as of March 31, 2002. Total letters of credit issued and outstanding were approximately $12.9 million and there were no revolving credit loans outstanding.

Additional sources of liquidity consist of capital and operating leases for financing leased restaurant locations (in malls and shopping centers and land or building leases), restaurant equipment, manufacturing equipment, distribution vehicles and computer equipment. Additionally, sales of under-performing existing restaurant properties and other assets (to the extent FICC s and its subsidiaries debt instruments, if any, permit) are sources of cash. The amount of debt financing that FICC will be able to incur is limited by the terms of its New Credit Facility and Senior Notes.

Net cash (used in) provided by investing activities was ($0.6 million) and $3.2 million for the three months ended March 31, 2002 and April 1, 2001, respectively. Capital expenditures for restaurant operations were approximately $1.2 million and $1.3 million for the quarters ended March 31, 2002 and April 1, 2001, respectively. Capital expenditures were offset by proceeds from the sales of property and equipment of $1.0 million and $5.2 million in the 2002 quarter and the 2001 quarter, respectively.

The Company had a working capital deficit of $15.2 million as of March 31, 2002. The Company is able to operate with a substantial working capital deficit because: (i) restaurant operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable; (ii) rapid turnover allows a limited investment in inventories and (iii) cash from sales is usually received before related expenses for food, supplies and payroll are paid.

In December 2001, the Company completed a financial restructuring plan (the Refinancing Plan ) which included the repayment of the $64.5 million outstanding under the Old Credit Facility and the repurchase of approximately $21.3 million in Senior Notes with the proceeds from $55.0 million in long-term mortgage financing (the Mortgage Financing ) and a $33.7 million sale and leaseback transaction (the Sale/Leaseback Financing ). In addition, FICC secured a new $30.0 million revolving credit facility of which up to $20.0 million is available to support letters of credit. The $30.0 million commitment less outstanding letters of credit is available for borrowing to provide working capital and for other corporate needs (the New Credit Facility ). As of March 31, 2002, $17.1 million was available for additional borrowings under the New Credit Facility. The refinancing improved the Company s financial condition by reducing total debt by approximately $30.8 million and by extending the average life of the Company s debt.

Three new limited liability corporations ( LLCs ) were organized in connection with the Mortgage Financing. Friendly Ice Cream Corporation is the sole member of each LLC. FICC sold 75 of its operating Friendly s restaurants to the LLCs in exchange for the proceeds from the Mortgage Financing. Promissory notes were issued for each of the 75 properties. Each LLC is a separate entity with separate creditors which will be entitled to be satisfied out of such LLC s assets. Each LLC is a borrower under the Mortgage Financing.

The Mortgage Financing has a maturity date of January 1, 2022 and is amortized over 20 years. Interest on $10.0 million of the Mortgage Financing is variable and is the sum of the 30-day LIBOR rate in effect (1.87875% at March 31, 2002) plus 6% on an annual basis. Changes in the interest rate are calculated monthly and recognized annually when the monthly payment amount is adjusted. Changes in the monthly payment amounts owed due to interest rate changes are reflected in the principal balances which are reamortized over the remaining life of the mortgages. The remaining $45.0 million of the Mortgage Financing bears interest at a fixed annual rate of 10.16%. Each promissory note may be prepaid in full. The variable rate notes are subject to prepayment penalties during the first five years. The fixed rate notes may not be prepaid without the Company providing the note holders with a yield maintenance premium.

The Mortgage Financing requires the Company to maintain an annual fixed charge coverage ratio, as defined, of at least 1.10 to 1 and each LLC to maintain a fixed charge coverage ratio, as defined, on an aggregate restaurant basis of at least 1.25 to 1.

The New Credit Facility is secured by substantially all of the assets of FICC and two of its six subsidiaries, Friendly s Restaurants Franchise Inc. and Friendly s International Inc. These two subsidiaries also guaranty FICC s obligations under the New Credit Facility. The New Credit Facility expires on December 17, 2004. As of March 31, 2002, there were no revolving credit loans outstanding.

The revolving credit loans bear interest at the Company s option at either (a) the Base Rate plus the applicable margin as in effect from time to time (the Base Rate ) (7.25% at March 31, 2002) or (b) the Eurodollar rate plus the applicable margin as in effect from time to time (the Eurodollar Rate ) (6.33% at March 31, 2002).

As of March 31, 2002 and December 30, 2001, total letters of credit issued and outstanding were approximately $12.9 million and $14.6 million, respectively.

The New Credit Facility has an annual clean-up provision which obligates the Company to repay in full all revolving credit loans on or before September 30 (or, if September 30 is not a business day, as defined, then the next business day) of each year and maintain a zero balance on such revolving credit for at least 30 consecutive days, to include September 30, immediately following the date of such repayment.

The New Credit Facility includes certain restrictive covenants including limitations on indebtedness, limitations on restricted payments such as dividends and stock repurchases and limitations on sales of assets and of subsidiary stock. Additionally, the New Credit Facility limits the amount which the Company may spend on capital expenditures, restricts the use of proceeds, as defined, from asset sales and requires the Company to comply with certain financial covenants.

In connection with the Refinancing Plan, in December 2001, the Company entered into and accounted for the Sale/Leaseback Financing, which provided approximately $33.7 million of proceeds to the Company. The Company sold 44 properties operating as Friendly s Restaurants and entered into a master lease with the buyer to lease the 44 properties for an initial term of 20 years under a triple net lease. There are four five-year renewal options and lease payments are subject to escalator provisions every five years based upon increases in the Consumer Price Index. A gain of $11.3 million was deferred and was included in other accrued expenses and other long-term liabilities in the accompanying condensed consolidated balance sheets. The deferred gain is being amortized in proportion to the rent charged to expense over the initial lease term.

The $200 million Senior Notes issued in connection with the November 1997 Recapitalization (the Senior Notes ) are unsecured senior obligations of FICC, guaranteed on an unsecured senior basis by FICC s Friendly s Restaurants Franchise, Inc. subsidiary, but are effectively subordinated to all secured indebtedness of FICC, including the indebtedness incurred under the New Credit Facility. The Senior Notes mature on December 1, 2007. Interest on the Senior Notes is payable at 10.50% per annum semi-annually on June 1 and December 1 of each year. In connection with the Refinancing Plan, FICC repurchased approximately $21.3 million in aggregate principal amount of the Senior Notes for $17.0 million. The gain of $4.3 million ($2.5 million net of tax) was recorded as an extraordinary item in the consolidated statement of operations for the year ended December 30, 2001. The remaining Senior Notes are redeemable, in whole or in part, at FICC s option any time on or after December 1, 2002 at redemption prices from 105.25% to 100.00%, based on the redemption date.

The Company anticipates requiring capital in the future principally to maintain existing restaurant and plant facilities and to continue to renovate and re-image existing restaurants. Capital expenditures for 2002 are anticipated to be $16.0 million in the aggregate, of which $13.0 million is expected to be spent on restaurant operations. The Company s actual 2002 capital expenditures may vary from these estimated amounts. The Company believes that the combination of the funds anticipated to be generated from operating activities and borrowing availability under the New Credit Facility will be sufficient to meet the Company s anticipated operating requirements, capital requirements and obligations associated with the restructuring.

The following represents the contractual obligations and commercial commitments of the Company as of March 31, 2002 (in thousands):

| | Payments due by Period | | | | |
|---|---|---|---|---|---|
| | Total | 2002 | 2003-2004 | 2005-2006 | Thereafter |
| Contractual Obligations: | | | | | |
| Long-term debt | $ 233,485 | $ 688 | $ 2,124 | $ 2,605 | $ 228,068 |
| Capital lease obligations | 11,564 | 1,941 | 2,940 | 1,817 | 4,866 |
| Operating leases | 158,333 | 16,869 | 30,175 | 24,503 | 86,786 |
| Purchase commitments | 86,218 | 78,200 | 7,945 | 65 | 8 |

| | Amount of Commitment Expiration by Period | | | | |
|---|---|---|---|---|---|
| | Total | 2002 | 2003-2004 | 2005-2006 | Thereafter |
| Other Commercial Commitments: | | | | | |
| Revolving credit facility | $ 17,089 | $ | $ 17,089 | $ | $ |
| Letters of credit | 12,911 | | 12,911 | | |

**Seasonality**

Due to the seasonality of frozen dessert consumption, and the effect from time to time of weather on patronage of the restaurants, the Company s revenues and EBITDA are typically higher in its second and third fiscal quarters.

**Geographic Concentration**

Approximately 89% of the Company-owned restaurants are located, and substantially all of its retail sales are generated, in the Northeast. As a result, a severe or prolonged economic recession or changes in demographic mix, employment levels, population density, weather, real estate market conditions or other factors specific to this geographic region may adversely affect the Company more than certain of its competitors which are more geographically diverse.

**Significant Accounting Policies**

Financial Reporting Release No. 60 issued by the Securities and Exchange Commission requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. The following is a brief discussion of the more significant accounting policies and methods used by the Company. The Company s consolidated financial statements, including the notes thereto, which are contained in the 2001 Annual Report on Form 10-K should be read in conjunction with this discussion.

*Use of Estimates in the Preparation of Financial Statements -*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The critical accounting policies and most significant estimates and assumptions relate to revenue recognition, insurance reserves, restructuring reserves, valuation allowances on net operating losses, pension and other post-retirement benefits expense and the volatility of cream prices. Actual amounts could differ significantly from the estimates.

*Revenue Recognition -*

The Company s revenues are derived primarily from the operation of full-service restaurants, the distribution and sale of frozen desserts through retail and institutional locations and franchising. The Company recognizes restaurant revenue upon receipt of payment from the customer and retail revenue upon shipment of product. Reserves for discounts and allowances from retail sales are estimated and accrued when revenue is recorded. Actual amounts could differ materially from the estimates. Franchise royalty income, based on net sales of franchisees, is payable monthly and is recorded on the accrual method. Initial franchise fees are recorded as revenue upon completion of all significant services, generally upon opening of the restaurant.

*Insurance Reserves -*

The Company is self-insured through retentions or deductibles for the majority of its workers compensation, automobile, general liability, employer s liability, product liability and group health insurance programs. Self-insurance amounts vary up to $0.5 million per occurrence. Insurance with third parties, some of which is then reinsured through RIC, is in place for claims in excess of these self-insured amounts. RIC reinsured 100% of the risk from $0.5 million to $1.0 million per occurrence through September 2, 2000 for the Company s workers compensation, general liability, employer s liability and product liability insurance. Subsequent to September 2, 2000, the Company discontinued its use of RIC as a captive insurer for new claims. The Company s and RIC s liability for estimated incurred losses are actuarially determined and recorded in the accompanying condensed consolidated financial statements on an undiscounted basis. Actual incurred losses may vary from the estimated incurred losses and could have a material affect on the Company s insurance expense.

*Restructuring Reserves -*

On October 10, 2001, the Company eliminated approximately 70 positions at corporate headquarters. In addition, approximately 30 positions in the restaurant construction and fabrication areas were eliminated by December 30, 2001. The purpose of the reduction was to streamline functions and reduce redundancy amongst its business segments. As a result of the elimination of the positions and the outsourcing of certain functions, the Company reported a pre-tax restructuring charge of approximately $2.5 million for severance, rent and unusable construction supplies in the year ended December 30, 2001.

In March 2000, the Company s Board of Directors approved a restructuring plan that provided for the immediate closing of 81 restaurants at the end of March 2000 and the disposition of an additional 70 restaurants over the next 24 months. As a result of this plan, the Company reported a pre-tax restructuring charge of approximately $12.1 million for severance, rent, utilities and real estate taxes, demarking, lease termination costs and certain other costs associated with the closing of the locations, along with a pre-tax write-down of property and equipment for these locations of approximately $17.0 million in the year ended December 31, 2000. The Company reduced the restructuring reserve by $1.9 million during the year ended December 30, 2001 since the reserve exceeded estimated remaining payments.

As of March 31, 2002, the remaining restructuring reserve was $2.4 million. The restructuring reserves may be increased or decreased based upon remaining payments, which could vary materially from the estimates depending upon the timing of store closings and other factors.

*Income Taxes -*

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. A valuation allowance is recorded for deferred tax assets whose realization is not likely. As of December 30, 2001 and March 31, 2002, a valuation allowance of $11.3 million existed related to state NOL carryforwards due to restrictions on the usage of state NOL carryforwards and short carryforward periods for certain states. Taxable income by state for future periods is difficult to estimate. The amount and timing of any future taxable income may affect the usage of such carryforwards, which could result in a material change in the valuation allowance.

*Pension and Other Post-Retirement Benefits -*

The determination of the Company s obligation and expense for pension and other post-retirement benefits is dependent upon the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among other things, the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs. In accordance with accounting principles generally accepted in the United States, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in such future periods. While FICC believes that the assumptions used are appropriate, significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other post-retirement obligations and expense.

*Volatility of Cream Prices -*

The cost of cream, the principal ingredient used in making ice cream, affects cost of sales as a percentage of total revenues, especially in foodservice s retail business. The Company believes that cream prices will be slightly higher in 2002 than in 2001. A $0.10 increase in the cost of a pound of AA butter adversely affects the Company s annual cost of sales by approximately $1.1 million. To minimize risk, alternative supply sources continue to be pursued. However, no assurance can be given that the Company will be able to offset any cost increases in the future and future increases in cream could have a material adverse effect on the Company s results of operations.

**Recently Issued Accounting Pronouncements**

In August 2001, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 modifies the rules for accounting for the impairment or disposal of long-lived assets. The impact of adopting SFAS No. 144 on December 31, 2001 had no material effect on the Company s financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 142, Goodwill and Other Intangibles. SFAS No. 142 modifies the rules for accounting for goodwill and other intangible assets. The new rules became effective for the Company on December 31, 2001. The impact of adopting SFAS No. 142 on December 31, 2001 had no effect on the Company s financial condition or results of operations and the Company is continuing to amortize its license agreement related to certain trademarked products over the term of the license agreement.

In April 2001, the FASB reached consensus on Emerging Issues Task Force ( EITF ) Issue No. 00-25, Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor s Products. EITF Issue No. 00-25 was effective for quarters beginning after December 15, 2001, with prior financial statements restated if practicable. EITF Issue No. 00-25 requires that consideration from a vendor to a retailer be recorded as a reduction in revenue unless certain criteria are met. Arrangements within the scope of this Issue include slotting fees, cooperative advertising arrangements and buy-downs. As a result of EITF Issue No. 00-25, certain costs previously recorded as expense have been reclassified and offset against revenue for the quarter ended April 1, 2001.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There has been no material change in the Company s market risk exposure since the filing of the Annual Report on Form 10-K.

**Item 4. Controls and Procedures**

As of March 31, 2002, an evaluation was performed under the supervision and with the participation of the Company s management, including the CEO and CFO, of the effectiveness of the design and operation of the Company s disclosure controls and procedures. Based on that evaluation, the Company s management, including the CEO and CFO, concluded that the Company s disclosure controls and procedures were effective as of March 31, 2002. There have been no significant changes in the Company s internal controls or in other factors that could significantly affect internal controls subsequent to March 31, 2002.

## PART II - OTHER INFORMATION

**Item 6. Exhibits and reports on Form 8-K**

(a) Exhibits

None

(b) No report on Form 8-K was filed during the three months ended March 31, 2002.

## SIGNATURES

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

FRIENDLY ICE CREAM CORPORATION

By: /s/ Paul v. Hoagland
Name: Paul V. Hoagland
Title: Senior Vice President,
Chief Financial Officer, Treasurer and
Assistant Clerk

**Certifications**

I, Donald N. Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Friendly Ice Cream Corporation;

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

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

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

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

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

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 30, 2002

/s/ Donald N. Smith
*Chief Executive Officer*

I, Paul V. Hoagland, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Friendly Ice Cream Corporation;

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

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

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

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

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

6. The registrant s other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: October 30, 2002

/s/ Paul V. Hoagland
*Chief Financial Officer, Treasurer and Assistant Clerk*