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

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2002

OR

¨ **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 ¨

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 October 18, 2002**
Common Stock, $.01 par value	7,388,141 shares

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 29, 2002 (unaudited)	December 30, 2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 40,545	$ 16,342
Accounts receivable	10,091	9,969
Inventories	15,246	12,987
Deferred income taxes	7,659	7,659
Prepaid expenses and other current assets	4,225	3,736
TOTAL CURRENT ASSETS	77,766	50,693
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization	156,567	169,489
INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization	19,999	21,208
OTHER ASSETS	13,970	11,172
TOTAL ASSETS	$ 268,302	$ 252,562
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 987	$ 1,068
Current maturities of capital lease and finance obligations	1,603	1,851
Accounts payable	25,437	20,505
Accrued salaries and benefits	10,167	9,436
Accrued interest payable	6,656	1,543
Insurance reserves	13,386	13,333
Restructuring reserves	1,445	3,056
Other accrued expenses	17,089	19,260
TOTAL CURRENT LIABILITIES	76,770	70,052
DEFERRED INCOME TAXES	14,465	10,584

CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities		5,119		6,267
LONG-TERM DEBT, less current maturities		232,125		232,797
OTHER LONG-TERM LIABILITIES		28,507		28,876
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS DEFICIT:				
Common stock		74		74
Additional paid-in capital		139,725		139,290
Accumulated deficit		(228,483)		(235,378)
TOTAL STOCKHOLDERS DEFICIT		(88,684)		(96,014)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	$	268,302	$	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		For the Nine Months Ended	
	September 29, 2002	**September 30, 2001**	**September 29, 2002**	**September 30, 2001**
REVENUES	$ 161,129	$ 151,373	$ 448,609	$ 428,915
COSTS AND EXPENSES:				
Cost of sales	57,023	54,840	155,907	149,757
Labor and benefits	43,457	39,674	123,618	120,684
Operating expenses	33,817	32,479	93,512	89,031
General and administrative expenses	9,369	8,393	26,649	27,070
Reduction of restructuring reserve			(400)	
Write-downs of property and equipment		35	431	103
Depreciation and amortization	6,097	7,037	19,170	21,686
Loss (gain) on franchise sales of restaurant operations and properties	21	(219)	21	(4,042)
(Gain) loss on sales of other property and equipment, net	(150)	(317)	491	(2,559)
OPERATING INCOME	11,495	9,451	29,210	27,185
Interest expense, net	6,212	6,464	18,764	20,967
INCOME BEFORE PROVISION FOR INCOME TAXES AND EXTRAORDINARY ITEM	5,283	2,987	10,446	6,218
Provision for income taxes	(1,795)	(1,125)	(3,551)	(2,250)
INCOME BEFORE EXTRAORDINARY ITEM	3,488	1,862	6,895	3,968
Extraordinary item, net of income tax benefit of $153		(221)		(221)
NET INCOME	$ 3,488	$ 1,641	$ 6,895	$ 3,747
BASIC NET INCOME PER SHARE				
Income before extraordinary item	$ 0.47	$ 0.25	$ 0.94	$ 0.54
Extraordinary item, net of income tax benefit		(0.03)		(0.03)
Net income	$ 0.47	$ 0.22	$ 0.94	$ 0.51

DILUTED NET INCOME PER SHARE								
Income before extraordinary item	$	0.46	$	0.25	$	0.91	$	0.54
Extraordinary item, net of income tax benefit				(0.03)				(0.03)
Net income	$	0.46	$	0.22	$	0.91	$	0.51
WEIGHTED AVERAGE SHARES:								
Basic		7,379		7,359		7,366		7,366
Diluted		7,607		7,416		7,574		7,382

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 Nine months Ended	
	September 29, 2002	**September 30, 2001**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 6,895	$ 3,747
Adjustments to reconcile net income to net cash provided by operating activities:		
Extraordinary item, net of income tax benefit		221
Stock compensation expense	302	235
Depreciation and amortization	19,170	21,686
Write-downs of property and equipment	431	103
Deferred income tax expense	3,881	2,250
Loss (gain) on sales of other property and equipment, net	491	(6,710)
Changes in operating assets and liabilities:		
Accounts receivable	(122)	(2,337)
Inventories	(2,259)	(3,824)
Other assets	(3,533)	(3,204)
Accounts payable	4,932	1,522
Accrued expenses and other long-term liabilities	1,609	(1,119)
NET CASH PROVIDED BY OPERATING ACTIVITIES	31,797	12,570
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(9,004)	(8,440)
Proceeds from sales of property and equipment	3,426	23,556
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(5,578)	15,116
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings		51,405
Repayments of debt	(753)	(84,529)
Repayments of capital lease and finance obligations	(1,396)	(1,589)
Stock options exercised	133	
NET CASH USED IN FINANCING ACTIVITIES	(2,016)	(34,713)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	24,203	(7,027)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	16,342	14,584
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 40,545	$ 7,557

SUPPLEMENTAL DISCLOSURES:				
Cash paid (refunded) during the period for:				
Interest	$	13,030	$	16,699
Income taxes		(9)		3
Capital lease obligations terminated				170
Note received from sale of property and equipment				4,250

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATMENTS

(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Interim Financial Information -

The accompanying condensed consolidated financial statements as of September 29, 2002 and for the third quarters and nine months ended September 29, 2002 and September 30, 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 income 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 and nine month periods ended September 29, 2002 and September 30, 2001 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, recoverability of accounts receivable, restructuring reserves, valuation allowances and pension and other post-retirement benefits expense. 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 $400,000 and $1,900,000 during the nine months ended September 29, 2002 and the year ended December 30, 2001, respectively, since the reserve exceeded estimated remaining payments.

As of September 29, 2002, the remaining restructuring reserve was $1,445,000. The restructuring reserves may be increased or decreased based upon remaining payments, which could vary materially from the estimates depending upon the timing of restaurant closings and other factors.

Income Taxes -

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards (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 September 29, 2002 and December 30, 2001, 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. Significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other post-retirement obligations and expense.

Stock-Based Compensation

The Company accounts for stock based compensation for employees under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and elected the disclosure only alternative under SFAS No. 123, Accounting for Stock Based Compensation.

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 (the New 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.

Inventories -

Inventories are stated at the lower of first-in, first-out cost or market. Inventories as of September 29, 2002 and December 30, 2001 were as follows (in thousands):

	September 29, 2002	December 30, 2001
Raw materials	$ 607	$ 1,269
Goods in process	147	73
Finished goods	14,492	11,645
Total	$ 15,246	$ 12,987

Reclassifications -

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

2. EARNINGS PER SHARE

Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income 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 income per share because to do so would have been antidilutive, was 50,960 and 472,610 for the three months ended September 29, 2002 and September 30, 2001, respectively. 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 income per share because to do so would have been antidilutive, was 84,514 and 569,350 for the nine months ended September 29, 2002 and September 30, 2001, respectively.

Presented below is the reconciliation between basic and diluted weighted average shares for the three and nine months ended September 29, 2002 and September 30, 2001 (in thousands):

	For the Three Months Ended			
	Basic		Diluted	
	September 29, 2002	September 30, 2001	September 29, 2002	September 30, 2001
Weighted average number of common shares outstanding during the period	7,379	7,359	7,379	7,359
Adjustments:				
Assumed exercise of stock options			228	57
Weighted average number of shares outstanding	7,379	7,359	7,607	7,416

	For the Nine months Ended			
	Basic		Diluted	
	September 29, 2002	September 30, 2001	September 29, 2002	September 30, 2001
Weighted average number of common shares outstanding during the period	7,366	7,366	7,366	7,366
Adjustments:				
Assumed exercise of stock options			208	16
Weighted average number of shares outstanding	7,366	7,366	7,574	7,382

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, the Company s foodservice division decreased its ice cream pricing to all restaurants. This resulted in decreased total foodservice revenues and decreased external foodservice revenues of 1.2% and 0.6%, respectively, for the nine months ended September 29, 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) (provision for) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) extraordinary item, (v) write downs of property and equipment and (vi) 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		**For the Nine months Ended**	
	September 29, 2002	**September 30, 2001**	**September 29, 2002**	**September 30, 2001**
		(in thousands)		
Revenues:				
Restaurant	$ 124,885	$ 118,931	$ 351,034	$ 345,029
Foodservice	69,276	64,263	189,309	176,332
Franchise	2,663	2,535	7,342	7,197
Total	$ 196,824	$ 185,729	$ 547,685	$ 528,558
Intersegment revenues:				
Restaurant	$	$	$	$
Foodservice	(35,695)	(34,356)	(99,076)	(99,643)
Franchise				
Total	$ (35,695)	$ (34,356)	$ (99,076)	$ (99,643)
External revenues:				
Restaurant	$ 124,885	$ 118,931	$ 351,034	$ 345,029
Foodservice	33,581	29,907	90,233	76,689
Franchise	2,663	2,535	7,342	7,197
Total	$ 161,129	$ 151,373	$ 448,609	$ 428,915

EBITDA:								
Restaurant	$	15,494	$	15,425	$	43,376	$	40,626
Foodservice		5,099		2,616		13,565		10,505
Franchise		1,796		1,482		4,816		3,903
Corporate		(4,771)		(2,878)		(13,154)		(11,834)
Gain (loss) on property and equipment, net		143		(55)		110		6,009
Reduction of restructure reserve						400		
Total	$	17,761	$	16,590	$	49,113	$	49,209
Interest expense, net-Corporate	$	6,212	$	6,464	$	18,764	$	20,967
Depreciation and amortization:								
Restaurant	$	4,545	$	4,618	$	13,589	$	14,277
Foodservice		1,142		834		2,469		2,529
Franchise		63		62		202		183
Corporate		347		1,523		2,910		4,697
Total	$	6,097	$	7,037	$	19,170	$	21,686
Other non-cash expenses:								
Corporate	$	169	$	67	$	302	$	235
Write-downs of property and equipment				35		431		103
Total	$	169	$	102	$	733	$	338
Income (loss) before income taxes:								
Restaurant	$	10,949	$	10,807	$	29,787	$	26,349
Foodservice		3,957		1,782		11,096		7,976
Franchise		1,733		1,420		4,614		3,720
Corporate		(11,499)		(10,932)		(35,130)		(37,733)
Gain (loss) on property and equipment, net		143		(90)		(321)		5,906
Reduction of restructure reserve						400		
Total	$	5,283	$	2,987	$	10,446	$	6,218

	September 29, 2002		December 30, 2001	
	(in thousands)			
Capital expenditures, including assets acquired under capital leases:				
Restaurant	$	7,475	$	10,821
Foodservice		948		2,090
Corporate		581		1,011
Total	$	9,004	$	13,922
Total assets:				
Restaurant	$	141,192	$	148,475
Foodservice		39,517		38,474
Franchise		8,504		7,076
Corporate		79,089		58,537
Total	$	268,302	$	252,562

4. NEW ACCOUNTING PRONOUNCEMENTS

In July 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The principal difference between SFAS No. 146 and EITF 94-3 relates to the timing of liability recognition. Under SFAS No. 146, a liability for a cost associated with an exit or disposal activity is recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of an entity s commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS No. 146 is not expected to have a material impact on the Company s financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, Rescission of SFAS Nos. 4, 44, and 64, Amendment of SFAS No. 13, and Technical Corrections. SFAS No. 4 required all gains and losses from the extinguishment of debt to be reported as extraordinary items and SFAS No. 64 related to the same matter. SFAS No. 145 requires gains and losses from certain debt extinguishment not to be reported as extraordinary items when the use of debt extinguishment is part of a risk management strategy. SFAS No. 44 was issued to establish transitional requirements for motor carriers. Those transitions are completed, therefore SFAS No. 145 rescinds SFAS No. 44. SFAS No. 145 also amends SFAS No. 13 requiring sale-leaseback accounting for certain lease modifications. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002. The provisions relating to sale-leaseback accounting are effective for transactions after May 15, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the Company s financial position or results of operations.

In August 2001, the FASB issued 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 in 2002 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 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. The Company adopted EITF Issue No. 00-25 during 2001 and, as a result, certain costs previously recorded as expense were reclassified and offset against revenue for the quarter and nine months ended September 30, 2001.

5. RESTRUCTURING RESERVES

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

	For the Nine months Ended September 29, 2002			
	Restructuring Reserves as of December 30, 2001	Costs Paid	Reserve Reduction	Restructuring Reserves as of September 29, 2002
Severance pay	$ 516	$ (473)	$ (43)	$
Rent	1,318	(320)	(298)	700
Utilities and real estate taxes	185	(89)	(3)	93
Equipment	480	(197)	219	502
Outplacement services	6	(6)		
Other	551	(126)	(275)	150
Total	$ 3,056	$ (1,211)	$ (400)	$ 1,445

	For the Nine months Ended September 30, 2001		
	Restructuring Reserves as of December 31, 2000	Costs Paid	Restructuring Reserves as of September 30, 2001
Severance pay	$ 74	$ (74)	$
Rent	3,585	(900)	2,685
Utilities and real estate taxes	1,105	(519)	586
Demarking	138	(126)	12
Lease termination costs	120	(120)	
Inventory	5	(5)	
Other	544	(169)	375
Total	$ 5,571	$ (1,913)	$ 3,658

Based on information currently available, management believes that the restructuring reserve as of September 29, 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 restaurants during the year ended December 30, 2001. During the nine months ended September 29, 2002, Davco transferred its rights to 24 additional franchised locations to six separate third parties and closed six restaurants.

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

FICC s obligations 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 September 29, 2002 and September 30, 2001 and for the nine months ended September 29, 2002 and September 30, 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 September 29, 2002

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 36,581	$ 1,069	$ 2,895	$	$ 40,545
Accounts receivable, net	8,802	1,289			10,091
Inventories	15,246				15,246
Deferred income taxes	7,448	99		112	7,659
Prepaid expenses and other current assets	9,469	1,110	7,953	(14,307)	4,225
Total current assets	77,546	3,567	10,848	(14,195)	77,766
Deferred income taxes		350	1,327	(1,677)	
Property and equipment, net	106,295		50,272		156,567
Intangible assets and deferred costs, net	17,231		2,768		19,999
Investments in subsidiaries	5,859			(5,859)	
Other assets	13,055	6,125	915	(6,125)	13,970
Total assets	$ 219,986	$ 10,042	$ 66,130	$ (27,856)	$ 268,302
Liabilities and Stockholders (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations	$ 9,380	$	$ 986	$ (7,776)	$ 2,590
Accounts payable	25,437				25,437
Accrued expenses	44,323		8,106	(6,446)	48,743
Total current liabilities	79,140	2,760	9,092	(14,222)	76,770
Deferred income taxes	16,030			(1,565)	14,465
Long-term obligations, less current maturities	183,845		53,399		237,244
Other long-term liabilities	29,655	903	4,159	(6,210)	28,507
Stockholders (deficit) equity	(88,684)	6,379	(520)	(5,859)	(88,684)
Total liabilities and stockholders (deficit) equity	$ 219,986	$ 10,042	$ 66,130	$ (27,856)	$ 268,302

Supplemental Condensed Consolidating Statement of Operations

For the Three Months Ended September 29, 2002

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 158,918	$ 2,211	$	$	$ 161,129
Costs and expenses:					
Cost of sales	57,023				57,023
Labor and benefits	43,457				43,457
Operating expenses and write-downs of property and equipment	35,551		(1,734)		33,817
General and administrative expenses	8,204	1,165			9,369
Depreciation and amortization	5,515		582		6,097
Loss on franchise sales of restaurant operations and properties	21				21
(Gain) loss on sales of other property and equipment, net	(219)		69		(150)
Interest expense, net	5,027		1,185		6,212
Income (loss) before provision for income taxes and equity in net income of consolidated subsidiaries	4,339	1,046	(102)		5,283
Provision for income taxes	(1,312)	(429)	(54)		(1,795)
Income (loss) before equity in net income of consolidated subsidiaries	3,027	617	(156)		3,488
Equity in net income of consolidated subsidiaries	461			(461)	
Net income (loss)	$ 3,488	$ 617	$ (156)	$ (461)	$ 3,488

Supplemental Condensed Consolidating Statement of Operations

For the Nine Months Ended September 29, 2002

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 442,409	$ 6,200	$	$	$ 448,609
Costs and expenses:					
Cost of sales	155,907				155,907
Labor and benefits	123,618				123,618
Operating expenses and write-downs of property and equipment	99,167		(5,224)		93,943
General and administrative expenses	23,156	3,493			26,649
Reduction of restructure reserve	(400)				(400)
Depreciation and amortization	17,417		1,753		19,170
Loss on franchise sales of restaurant operations and properties	21				21
Loss on sales of other property and equipment, net	422		69		491
Interest expense, net	15,244		3,520		18,764
Income (loss) before provision for income taxes and equity in net income of consolidated subsidiaries	7,857	2,707	(118)		10,446
Provision for income taxes	(2,210)	(1,110)	(231)		(3,551)
Income (loss) before equity in net income of consolidated subsidiaries	5,647	1,597	(349)		6,895
Equity in net income of consolidated subsidiaries	1,248			(1,248)	
Net income (loss)	$ 6,895	$ 1,597	$ (349)	$ (1,248)	$ 6,895

Supplemental Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 29, 2002

(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	$ 29,482	$ 965	$ 2,559	$ (1,209)	$ 31,797
Cash flows from investing activities:					
Purchases of property and equipment	(9,004)				(9,004)
Proceeds from sales of property and equipment	3,426				3,426
Net cash used in investing activities	(5,578)				(5,578)
Cash flows from financing activities:					
Repayments of obligations	(2,572)		(615)	1,038	(2,149)
Stock options exercised	133				133
Reinsurance deposits received			2,024	(2,024)	
Reinsurance payments made from deposits			(2,195)	2,195	
Net cash used in financing activities	(2,439)		(786)	1,209	(2,016)
Net increase in cash and cash equivalents	21,465	965	1,773		24,203