FRIENDLY ICE CREAM CORP
Form 10-Q
April 28, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 30, 2003

or

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

For the transition period from to
Commission file number 0-3930

FRIENDLY ICE CREAM CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Massachusetts	**04-2053130**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
1855 Boston Road, Wilbraham, Massachusetts	**01095**
(Address of Principal Executive Offices)	(Zip Code)

(413) 543-2400
(Registrant's Telephone Number, Including Area Code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes o No ý

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 21, 2003
Common Stock, $.01 par value	7,434,346 shares

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	March 30, 2003	December 29, 2002
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 30,128	$ 34,341
Accounts receivable	9,653	10,853
Inventories	17,352	17,278
Deferred income taxes	7,771	7,771
Prepaid expenses and other current assets	3,340	3,062
TOTAL CURRENT ASSETS	68,244	73,305
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization	157,758	158,373
INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization	19,194	19,642
OTHER ASSETS	5,849	5,878
TOTAL ASSETS	$ 251,045	$ 257,198
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 1,041	$ 1,031
Current maturities of capital lease and finance obligations	1,033	1,362
Accounts payable	22,698	23,902
Accrued salaries and benefits	10,201	9,329
Accrued interest payable	6,637	1,961
Insurance reserves	12,761	11,330
Restructuring reserves	818	937
Other accrued expenses	15,017	22,885
TOTAL CURRENT LIABILITIES	70,206	72,737

	March 30, 2003	December 29, 2002
DEFERRED INCOME TAXES	954	1,533
CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities	4,890	5,044
LONG-TERM DEBT, less current maturities	231,554	231,830
ACCRUED PENSION COST	15,995	16,281
OTHER LONG-TERM LIABILITIES	32,445	33,475
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT:		
Common stock	74	74
Additional paid-in capital	140,166	139,974
Accumulated other comprehensive loss	(14,559)	(14,559)
Accumulated deficit	(230,680)	(229,191)
TOTAL STOCKHOLDERS' DEFICIT	(104,999)	(103,702)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 251,045	$ 257,198

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 30, 2003	March 31, 2002
REVENUES	$ 128,690	$ 129,174
COSTS AND EXPENSES:		
Cost of sales	45,977	46,040
Labor and benefits	38,128	37,918
Operating expenses	25,063	24,040
General and administrative expenses	9,288	8,599
Write-downs of property and equipment		120
Depreciation and amortization	5,627	6,686
Loss on disposal of other property and equipment, net	573	512
OPERATING INCOME	4,034	5,259
Interest expense, net	6,102	6,337
LOSS BEFORE BENEFIT FROM INCOME TAXES	(2,068)	(1,078)
Benefit from income taxes	579	670
NET LOSS AND COMPREHENSIVE LOSS	$ (1,489)	$ (408)

	For the Three Months Ended	
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.20)	$ (0.06)
WEIGHTED AVERAGE BASIC AND DILUTED SHARES	7,415	7,353

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 30, 2003	**March 31, 2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,489)	$ (408)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock compensation expense	65	70
Depreciation and amortization	5,627	6,686
Write-downs of property and equipment		120
Deferred income tax benefit	(579)	(340)
Loss on disposal of other property and equipment, net	573	512
Changes in operating assets and liabilities:		
Accounts receivable	1,200	(776)
Inventories	(74)	(3,916)
Other assets	(229)	318
Accounts payable	(1,204)	727
Accrued expenses and other long-term liabilities	(2,324)	(3,386)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	1,566	(393)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(5,157)	(1,563)
Proceeds from sales of property and equipment		964
NET CASH USED IN INVESTING ACTIVITIES	(5,157)	(599)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of debt	(267)	(380)
Repayments of capital lease and finance obligations	(482)	(464)
Stock options exercised	127	13

	For the Three Months Ended	
NET CASH USED IN FINANCING ACTIVITIES	(622)	(831)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(4,213)	(1,823)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	34,341	16,342
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 30,128	$ 14,519
SUPPLEMENTAL DISCLOSURES:		
Cash paid (refunded) during the period for:		
Interest	$ 1,325	$ 1,343
Income taxes	686	(3)

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

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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 30, 2003 and for the three months ended March 30, 2003 and March 31, 2002 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 months ended March 30, 2003 and 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 2002 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 2002 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, net of allowances, upon delivery 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.

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 among 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 years ended December 29, 2002 and December 30, 2001, respectively, since the reserve exceeded estimated remaining payments.

As of March 30, 2003, the remaining restructuring reserve was $818,000. The restructuring reserve 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.

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.

Inventories

Inventories were stated at the lower of first-in, first-out cost or market. Inventories at March 30, 2003 and December 29, 2002 were (in thousands):

	March 30, 2003	December 29, 2002
Raw materials	$ 1,832	$ 801
Goods in process	96	203
Finished goods	15,424	16,274
Total	$ 17,352	$ 17,278

Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company reviews its 1988 Non-Friendly Marks, which were assigned to the Company by Hershey in September 2002, for impairment on a quarterly basis. The Company recognizes impairment has occurred when the carrying value of the 1988 Non-Friendly Marks exceeds the estimated future undiscounted cash flows of the trademarked products.

The Company reviews each restaurant property quarterly to determine which properties will be disposed of, if any. This determination is made based on poor operating results, deteriorating property values and other factors. In addition, the Company reviews all restaurants with negative cash flow for impairment on a quarterly basis. The Company recognizes an impairment has occurred when the carrying value of property reviewed exceeds its estimated fair value, which is estimated based on the Company's experience selling similar properties and local market conditions, less costs to sell for properties to be disposed of.

Concentration of Credit Risk

Financial instruments, which potentially expose the Company to concentrations of credit risk, consist principally of accounts receivable. The Company performs ongoing credit evaluations of its customers and generally requires no collateral to secure accounts receivable. The credit review is based on both financial and non-financial factors. The Company maintains a reserve for potentially uncollectible accounts receivable based on its assessment of the collectibility of accounts receivable.

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 Restaurant Insurance Corporation ("RIC"), the Company's wholly-owned subsidiary, 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 FICC'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. FICC's and RIC's liabilities 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.

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.

Derivative Instruments and Hedging Agreements

The Company enters into commodity option contracts from time to time to manage dairy cost pressures. The Company's commodity option contracts do not meet hedge accounting criteria as

defined by SFAS No. 133 and, accordingly, are marked to market each period, with the resulting gains or losses recognized in cost of sales.

Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net 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 332,000 and 288,000 for the three months ended March 30, 2003 and March 31, 2002, respectively.

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." No stock-based compensation cost is included in net loss, as all options granted during periods presented had an exercise price equal to the market value of the stock on the date of grant. In accordance with SFAS No. 148, "Accounting for Stock Based Compensation-Transition and Disclosure," the following table presents the effect on net loss and net loss per share had compensation cost for the Company's stock plans been determined consistent with SFAS No. 123:

	March 30, 2003	March 31, 2002
Net loss, as reported	$ (1,489,000)	$ (408,000)
Less stock based compensation expense determined under fair value method for all stock options, net of related income tax benefit	(31,000)	(21,000)
Pro forma net loss	$ (1,520,000)	$ (429,000)
Basic and diluted loss per share:		
Basic and diluted loss per share, as reported	$ (0.20)	$ (0.06)
Basic and diluted loss per share, pro forma	$ (0.20)	$ (0.06)

Fair value was estimated on the grant date using the Black-Scholes option pricing model with the following assumptions for options issued in July 2002. There have been no options issued during the quarter ended March 30, 2003.

	2002
Risk free interest rate	3.60%
Expected life	5 years
Expected volatility	79.97%
Dividend yield	0.00%
Fair value	$4.99

Reclassifications

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

2. 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 Chief Executive Officer and President 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 expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarters activities.

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.

During the three months ended March 30, 2003, the foodservice segment no longer charged additional zone pricing to the restaurant and franchise segments. As a result, intercompany zone pricing of approximately $109,000 was reclassified for the quarter ended March 31, 2002 to conform with current year presentation. Additionally, certain second and third quarter ice cream promotion marketing costs that were funded by the foodservice segment in 2002 will be reclassified to the restaurant segment.

EBITDA represents net income 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 the Company's management incentive plan pays bonuses based on achieving EBITDA targets and the Company 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 30, 2003	March 31, 2002
	(in thousands)	
Revenues before elimination of inter-segment revenues:		
Restaurant	$ 103,168	$ 104,256
Foodservice	52,326	51,712
Franchise	2,255	2,129
Total	$ 157,749	$ 158,097
Intersegment revenues:		
Restaurant	$	$
Foodservice	(29,059)	(28,923)
Franchise		
Total	$ (29,059)	$ (28,923)
Revenues:		
Restaurant	$ 103,168	$ 104,256
Foodservice	23,267	22,789
Franchise	2,255	2,129
Total	$ 128,690	$ 129,174

	For the Three Months Ended	
	March 30, 2003	March 31, 2002

	For the Three Months Ended	
	(in thousands)	
EBITDA:		
Restaurant	$ 10,081	$ 12,105
Foodservice	3,189	3,566
Franchise	1,561	1,381
Corporate	(4,764)	(4,402)
Loss on property and equipment, net, excluding write-downs of property and equipment	(341)	(515)
Total	$ 9,726	$ 12,135
Interest expense, net-Corporate	$ 6,102	$ 6,337
Depreciation and amortization:		
Restaurant	$ 3,799	$ 4,097
Foodservice	736	843
Franchise	39	74
Corporate	1,053	1,672
Total	$ 5,627	$ 6,686
Other non-cash expenses:		
Corporate	$ 65	$ 70
Write-downs of property and equipment		120
Total	$ 65	$ 190
Income (loss) before income taxes:		
Restaurant	$ 6,282	$ 8,008
Foodservice	2,453	2,723
Franchise	1,522	1,307
Corporate	(11,984)	(12,481)
Loss on property and equipment, net, including write-downs of property and equipment	(341)	(635)
Total	$ (2,068)	$ (1,078)

	March 30, 2003	December 29, 2002
	(in thousands)	
Capital expenditures, including assets acquired under capital leases:		
Restaurant	$ 4,286	$ 15,386
Foodservice	832	1,667
Corporate	39	1,039

	March 30, 2003	December 29, 2002
Total	$ 5,157	$ 18,092
Total assets:		
Restaurant	$ 146,134	$ 144,927
Foodservice	38,277	39,631
Franchise	8,129	9,062
Corporate	58,505	63,578
Total	$ 251,045	$ 257,198

3. NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," which states that cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the statement of operations. That presumption is overcome when the consideration is either a reimbursement of specific, incremental, identifiable costs incurred to sell the vendor's products, or a payment for assets or services delivered to the vendor. EITF Issue No. 02-16 is effective for arrangements entered into after November 21, 2002. The adoption of EITF Issue No. 02-16 had no material impact on net earnings in 2003.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure," which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 allows for three methods of transition for those companies that adopt SFAS No. 123's provisions for fair value recognition. SFAS No. 148's transition guidance and provisions for annual disclosures are effective for fiscal years ending after December 15, 2002. The Company did not adopt fair value accounting for employee stock options under SFAS No. 123 and SFAS No. 148, but will continue to disclose the required pro-forma information in the notes to the consolidated financial statements.

In July 2002, the FASB issued 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 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 Issue No. 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 Issue No. 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 had no material effect 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 occurring after May 15, 2002. The adoption of SFAS No. 145 had no material effect on the Company's financial position or results of operations.

4. 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 March 30, 2003

	Restructuring Reserves as of December 29, 2002	Costs Paid	Restructuring Reserves as of March 30, 2003
Rent	$ 679	$ (64)	$ 615
Utilities and real estate taxes	121	(23)	98
Equipment	77	(31)	46
Other	60	(1)	59
Total	$ 937	$ (119)	$ 818

	For the Three Months Ended March 31, 2002		
	Restructuring Reserves as of December 30, 2001	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	13	198
Equipment	480		480
Outplacement services	6	(1)	5
Other	551	(127)	424
Total	$ 3,056	$ (659)	$ 2,397

Based on information currently available, management believes that the restructuring reserve as of March 30, 2003 was adequate and not excessive.

5. 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, 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 were 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 30, 2003 and December 29, 2002 and for the three months ended March 30, 2003 and March 31, 2002 were 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 30, 2003
(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 26,413	$ 1,411	$ 2,304	$	$ 30,128
Accounts receivable, net	8,298	1,355			9,653
Inventories	17,352				17,352
Deferred income taxes	7,718	18		35	7,771
Prepaid expenses and other current assets	9,293	1,516	7,777	(15,246)	3,340
Total current assets	69,074	4,300	10,081	(15,211)	68,244
Deferred income taxes		264		(264)	
Property and equipment, net	108,772		48,986		157,758
Intangibles and deferred costs, net	16,536		2,658		19,194
Investments in subsidiaries	4,448			(4,448)	
Other assets	4,934	6,940	915	(6,940)	5,849
Total assets	$ 203,764	$ 11,504	$ 62,640	$ (26,863)	$ 251,045
Liabilities and Stockholders' (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations	$ 8,809	$	$ 1,041	$ (7,776)	$ 2,074
Accounts payable	22,698				22,698
Accrued expenses	42,312	3,532	6,912	(7,322)	45,434
Total current liabilities	73,819	3,532	7,953	(15,098)	70,206
Deferred income taxes	1,183			(229)	954
Long-term obligations, less current maturities	183,617		52,827		236,444
Other long-term liabilities	50,144	720	4,664	(7,088)	48,440
Stockholders' (deficit) equity	(104,999)	7,252	(2,804)	(4,448)	(104,999)
Total liabilities and stockholders' (deficit) equity	$ 203,764	$ 11,504	$ 62,640	$ (26,863)	$ 251,045

Supplemental Condensed Consolidating Statement of Operations
For the Three Months Ended March 30, 2003
(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Revenues	$ 126,700	$ 1,990	$	$	$ 128,690
Costs and expenses:					
Cost of sales	45,977				45,977
Labor and benefits	38,128				38,128
Operating expenses and write-downs of property and equipment	26,812		(1,749)		25,063

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
General and administrative expenses	8,129	1,159			9,288
Depreciation and amortization	5,052		575		5,627
Loss on sales of other property and equipment, net	511		62		573
Interest expense, net	4,954		1,148		6,102
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(2,863)	831	(36)		(2,068)
Benefit from (provision for) income taxes	969	(341)	(49)		579
(Loss) income before equity in net income of consolidated subsidiaries	(1,894)	490	(85)		(1,489)
Equity in net income of consolidated subsidiaries	405			(405)	
Net (loss) income	$ (1,489)	$ 490	$ (85)	$ (405)	$ (1,489)

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Supplemental Condensed Consolidating Statement of Cash Flows
For the Three Months Ended March 30, 2003
(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	$ 2,029	$ (533)	$ 605	$ (535)	$ 1,566
Cash flows from investing activities:					
Purchases of property and equipment	(5,157)				(5,157)
Return of investment in subsidiary	179			(179)	
Net cash used in investing activities	(4,978)			(179)	(5,157)
Cash flows from financing activities:					
Repayments of obligations	(482)		(267)		(749)
Stock options exercised	127				127
Reinsurance payments made from deposits			(535)	535	
Dividends paid			(179)	179	
Net cash used in financing activities	(355)		(981)	714	(622)
Net decrease in cash and cash equivalents	(3,304)	(533)	(376)		(4,213)
Cash and cash equivalents, beginning of period	29,717	1,944	2,680		34,341
Cash and cash equivalents, end of period	$ 26,413	$ 1,411	$ 2,304	$	$ 30,128

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Supplemental disclosures:					
Interest paid	$ 175	$	$ 1,150	$	$ 1,325
Income taxes paid	675	11			686

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Supplemental Condensed Consolidating Balance Sheet
As of December 29, 2002
(In thousands)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current assets:					
Cash and cash equivalents	$ 29,717	$ 1,944	$ 2,680	$	$ 34,341
Accounts receivable, net	9,695	1,158			10,853
Inventories	17,278				17,278
Deferred income taxes	7,718	18		35	7,771
Prepaid expenses and other current assets	8,624	1,175	7,778	(14,515)	3,062
Total current assets	73,032	4,295	10,458	(14,480)	73,305
Deferred income taxes		264		(264)	
Property and equipment, net	108,805		49,568		158,373
Intangibles and deferred costs, net	16,930		2,712		19,642
Investments in subsidiaries	4,222			(4,222)	
Other assets	4,963	6,742	915	(6,742)	5,878
Total assets	$ 207,952	$ 11,301	$ 63,653	$ (25,708)	$ 257,198
Liabilities and Stockholders' (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations	$ 9,138	$	$ 1,031	$ (7,776)	$ 2,393
Accounts payable	23,902				23,902
Accrued expenses	42,581	3,654	6,861	(6,654)	46,442
Total current liabilities	75,621	3,654	7,892	(14,430)	72,737
Deferred income taxes	1,762			(229)	1,533
Long-term obligations, less current maturities	183,771		53,103		236,874
Other long-term liabilities	50,500	885	5,198	(6,827)	49,756
Stockholders' (deficit) equity	(103,702)	6,762	(2,540)	(4,222)	(103,702)
Total liabilities and stockholders' (deficit) equity	$ 207,952	$ 11,301	$ 63,653	$ (25,708)	$ 257,198

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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	$ 127,387	$ 1,787	$	$	$ 129,174
Costs and expenses:					
Cost of sales	46,040				46,040
Labor and benefits	37,918				37,918
Operating expenses and write-downs of property and equipment	25,909		(1,749)		24,160
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, net	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)

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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)

	Parent Company	Guarantor Subsidiary	Non-guarantor Subsidiaries	Eliminations	Consolidated
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)

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

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. Friendly's owns and operates 385 full-service restaurants, franchises 158 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 14 states.

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

	For the Three Months Ended	
	March 30, 2003	March 31, 2002
Company Units:		

	For the Three Months Ended	
Beginning of period	387	393
Closings	(2)	(3)
End of period	385	390
Franchised Units:		
Beginning of period	162	167
Openings	2	2
Closings		(3)
End of period	164	166

Revenues:

Total revenues decreased $0.5 million, or 0.4%, to $128.7 million for the first quarter ended March 30, 2003 from $129.2 million for the same quarter in 2002. Restaurant revenues decreased $1.1 million, or 1.0%, to $103.2 million for the first quarter of 2003 from $104.3 million for the same quarter in 2002. The closing of eight locations over the past 15 months and a fire at an existing location resulted in a $0.9 million decline in restaurant revenues in the 2003 period as compared to the 2002 period. Operating days in comparable operating units were further reduced by 0.5% due to winter storm closings and the construction period closings associated with the Company's re-image program. Eleven locations were re-imaged during the first quarter ended March 30, 2003. Partially offsetting these decreases was a 0.3% increase in comparable restaurant revenues from the 2002 quarter to the

2003 quarter. Foodservice (product sales to franchisees and retail customers) revenues increased by $0.5 million, or 2.1%, to $23.3 million for the first quarter ended March 30, 2003 from $22.8 million for the same quarter in 2002. Franchised restaurant product revenues were unchanged while sales to foodservice retail supermarket customers increased by $0.5 million. Franchise royalty and fee revenues increased $0.1 million, or 5.9%, to $2.2 million for the first quarter ended March 30, 2003 compared to $2.1 million for the same quarter in 2002. The increase is largely the result of increased comparable franchised restaurant revenues in the 2003 period when compared to the same period in 2002. There were 164 franchise units open at March 30, 2003 compared to 166 franchise units open at March 31, 2002.

Cost of sales:

Cost of sales was $46.0 million for the three months ended March 30, 2003 and for the same period in 2002. Cost of sales as a percentage of total revenues increased to 35.7% for the quarter ended March 30, 2003 from 35.6% for the same period in 2002. The higher food cost as a percentage of total revenue was due to a shift in sales mix from Company-owned restaurant sales to foodservice sales and a decline in restaurant ice cream sales, which had an unfavorable impact on the restaurant snack daypart, as mild weather in the 2002 period did not repeat in the 2003 period. An increase in foodservice retail sales promotional allowances, recorded as offsets to revenues, also had an unfavorable impact. Foodservice sales to franchisees and retail supermarket customers have a higher food cost as a percentage of revenue than sales in Company-owned restaurants to restaurant patrons. Restaurant cost of sales as a percentage of restaurant revenues improved in the 2003 period when compared to the 2002 period in part due to an improvement in food cost controls in the current period. The cost of cream, the principal ingredient used in making ice cream, was lower in 2003 when compared to 2002. The Company expects that cream prices will increase during the remainder of 2003.

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. 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, which may be offset by a price increase or other factors. 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 prices could have a material adverse effect on the Company's results of operations.

Labor and benefits:

Labor and benefits increased $0.2 million, or 0.6%, to $38.1 million for the first quarter ended March 30, 2003 from $37.9 million for the same quarter in 2002. Labor and benefits as a percentage of total revenues increased to 29.6% for the first quarter ended March 30, 2003 from 29.3% for the same quarter in 2002. As a percentage of restaurant revenues, labor and benefits increased to 37.0% for the 2003 period from 36.4% in the 2002 period. The increase in labor and benefits as a percentage of restaurant revenue related to restaurant benefits, as the restaurant pension benefit was reduced in the 2003 period when compared to the 2002 period. Additionally, restaurant group insurance costs rose in the current period when compared to the 2002 period. Revenue increases derived from franchised locations and retail supermarket customers, which do not have any associated restaurant labor and benefits, reduced the impact of the higher restaurant benefits as a percentage of total revenues.

Operating expenses:

Operating expenses increased $1.1 million, or 4.3%, to $25.1 million for the first quarter ended March 30, 2003 from $24.0 million for the same quarter in 2002. Operating expenses as a percentage of total revenues were 19.5% and 18.6% for the first quarters ended March 30, 2003 and March 31, 2002, respectively. The increase as a percentage of total revenues resulted from restaurant increases for snow removal, natural gas and advertising costs in the 2003 period when compared to the 2002 period.

General and administrative expenses:

General and administrative expenses were $9.3 million and $8.6 million for the first quarters ended March 30, 2003 and March 31, 2002, respectively. General and administrative expenses as a percentage of total revenues increased to 7.2% for the first quarter ended March 30, 2003 from 6.7% for the same period in 2002. The increase is primarily the result of increases in employment recruitment and bonus expenses and a reduction in the period on period pension benefit.

Depreciation and amortization:

Depreciation and amortization decreased $1.1 million, or 15.8%, to $5.6 million for the first quarter ended March 30, 2003 from $6.7 million for the same quarter in 2002. Depreciation and amortization as a percentage of total revenues was 4.4% and 5.2% in the 2003 and 2002 quarters, respectively. The reduction reflects the impact on depreciation associated with the Company's closing of eight locations over the past 15 months and the decline in depreciation expense associated with certain purchased software at the Company's headquarters.

Loss on disposal of other property and equipment, net:

The loss on disposal of other property and equipment, net was $0.6 million and $0.5 million for the quarters ended March 30, 2003 and March 31, 2002, respectively. The loss in the 2003 quarter primarily resulted from disposals related to the remodeling of restaurants and the replacement of inoperative equipment. The loss in the 2002 quarter primarily resulted from the sale of idle land and two closed locations.

Write-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 $0.2 million, or 3.7%, to $6.1 million for the first quarter ended March 30, 2003 from $6.3 million for the same period in 2002. The decrease is primarily impacted by the decrease in the average outstanding debt in the 2003 quarter compared to the 2002 quarter as a result of the Refinancing Plan as described in Liquidity and Capital Resources. Total outstanding debt, including capital lease and finance obligations, was reduced from $241.1 million at March 31, 2002 to $238.5 million at March 30, 2003.

Benefit from income taxes:

The benefit from income taxes was $0.6 million, an effective tax rate of 28%, for the first quarter ended March 30, 2003 compared to a benefit from taxes of $0.7 million, or 62.2%, for the 2002 quarter. The rate in 2002 was reduced in subsequent quarters as tax credits and changes to state valuation allowances reduced the rate. The tax rate at the end of the 2002 fiscal year was 24.0%. At this time, the Company estimates that the effective tax rate for 2003 will be 28%. 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 $1.5 million and $0.4 million for the first quarters ended March 30, 2003 and March 31, 2002, 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 provided by operating activities was $1.6 million for the first quarter ended March 30, 2003. During the three months ended March 30, 2003, accounts receivable decreased $1.2 million due to the receipt of monies related to franchisee gift cards sold of $0.4 million, fire proceeds collected of $0.3 million and collections related to strong fourth quarter 2002 retail activity. Accrued expenses and other long-term liabilities decreased $2.3 million as a result of $4.3 million of payments made for corporate and restaurant bonuses and $3.3 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 increased accrued payroll taxes as wage limits are not yet reached in the early part of the year.

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 investing activities was $5.2 million for the three months ended March 30, 2003. Capital expenditures for restaurant operations were approximately $4.3 million for the quarter ended March 30, 2003.

The Company had a working capital deficit of $2.0 million as of March 30, 2003. 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 (the "New 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. As of March 30, 2003, $15.4 million was available for additional borrowings under the New Credit Facility, total letters of credit outstanding were approximately $14.6 million and there were no revolving credit loans outstanding.

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 million of the original $55 million from the Mortgage Financing is variable and is the sum of the 30-day LIBOR rate in effect (1.3075% at March 30, 2003) 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 re-amortized over the remaining life of the mortgages. The remaining $45 million of the original $55 million from 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 a 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 Company is in compliance with these covenants.

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 was amended on December 27, 2002 to extend the maturity date to December 17, 2005. As of March 30, 2003, 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") (6.25% at March 30, 2003) or (b) the Eurodollar rate plus the applicable margin as in effect from time to time (the "Eurodollar Rate") (5.25% at March 30, 2003).

As of March 30, 2003 and December 29, 2002, total letters of credit outstanding were approximately $14.6 million. During the three months ended March 30, 2003 and March 31, 2002, there were no drawings against the letters of credit.

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, restricted payments such as dividends and stock repurchases and 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. 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.

The $200 million Senior Notes issued in November 1997 (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 remaining $178.7 million of the $200 million 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.

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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 2003 are anticipated to be $31.2 million in the aggregate, of which $24.9 million is expected to be spent on restaurant operations. The Company's actual 2003 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 30, 2003 (in thousands):

		Payments due by Period			
Contractual Obligations:	**Total**	**Less than 1 year**	**2-3 years**	**4-5 years**	**More than 5 years**
Long-Term Debt	$ 232,595	$ 765	$ 2,368	$ 181,616	$ 47,846
Capital Lease Obligations	9,140	1,299	2,189	1,513	4,139
Operating Leases	150,903	17,045	30,794	22,589	80,475
Purchase Commitments	90,110	86,331	3,714	65	

		Amount of Commitment Expiration by Period			
Other Commercial Commitments:	**Total**	**Less than 1 year**	**2-3 years**	**4-5 years**	**More than 5 years**
Revolving Credit Facility	$ 15,394	$	$ 15,394	$	$
Letters of Credit	14,606		14,606		

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 operating income are typically higher in its second and third 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 2002 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, 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, net of allowances, upon delivery 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 Restaurant Insurance Corporation ("RIC"), the Company's wholly-owned subsidiary, 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 FICC'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. FICC's and RIC's liabilities 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.

Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company reviews its 1988 Non-Friendly Marks, which were assigned to the Company by Hershey in September 2002, for impairment on a quarterly basis. The Company recognizes impairment has occurred when the carrying value of the 1988 Non-Friendly Marks exceeds the estimated future undiscounted cash flows of the trademarked products.

The Company reviews each restaurant property quarterly to determine which properties will be disposed of, if any. This determination is made based on poor operating results, deteriorating property values and other factors. In addition, the Company reviews all restaurants with negative cash flow for impairment on a quarterly basis. The Company recognizes impairment has occurred when the carrying value of property reviewed exceeds its estimated fair value, which is estimated based on the Company's experience selling similar properties and local market conditions, less costs to sell for properties to be disposed of.

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 March 30, 2003 and December 29, 2002, a valuation allowance of $10.2 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. 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." No stock-based compensation cost is included in net loss, as all options granted during periods presented had an exercise price equal to the market value of the stock on the date of grant. In accordance with SFAS No. 148, "Accounting for Stock Based Compensation-Transition and Disclosure," the Company will continue to disclose the required pro-forma information in the notes to the consolidated financial statements.

Recently Issued Accounting Pronouncements

In January 2003, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor," which states that cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the statement of operations. That presumption is overcome when the consideration is either a reimbursement of specific, incremental, identifiable costs incurred to sell the vendor's products, or a payment for assets or services delivered to the vendor. EITF Issue No. 02-16 is effective for arrangements entered into after November 21, 2002. The adoption of EITF Issue No. 02-16 had no material impact on net earnings in 2003.

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure," which amends SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 allows for three methods of transition for those companies that adopt SFAS No. 123's provisions for fair value recognition. SFAS No. 148's transition guidance and provisions for annual disclosures are effective for fiscal years ending after December 15, 2002. The Company did not adopt fair value accounting for employee stock options

under SFAS No. 123 and SFAS No. 148, but will continue to disclose the required pro-forma information in the notes to the consolidated financial statements.

In July 2002, the FASB issued 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 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 Issue No. 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 Issue No. 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 had no material effect 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 occurring after May 15, 2002. The adoption of SFAS No. 145 had no material effect on the Company's financial position or results of operations.

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 30, 2003, 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 30, 2003. 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 30, 2003.

PART II OTHER INFORMATION

Item 6. Exhibits and reports on Form 8-K

(a) Exhibits

The exhibit index is incorporated by reference herein.

(b) None

SIGNATURES

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

FRIENDLY ICE CREAM CORPORATION

By: /s/ PAUL V. HOAGLAND

Name: Paul V. Hoagland
Title: Executive Vice President of Administration and Chief Financial Officer
Date: April 28, 2003

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Certifications

I, John L. Cutter, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: April 28, 2003 /s/ JOHN L. CUTTER

Chief Executive Officer and President

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I, Paul V. Hoagland, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: April 28, 2003

/s/ PAUL V. HOAGLAND

Executive Vice President of Administration and Chief Financial Officer

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Exhibit Index

3.1	Restated Articles of Organization of Friendly Ice Cream Corporation (the "Company") (Incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
3.2	Amended and Restated By-laws of the Company (Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).
4.1	Credit Agreement among the Company, Fleet Bank, N.A and certain other banks and financial institutions ("Credit Agreement") dated as of December 17, 2001 (Incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, File No. 0-3930).
4.1(a)	Consent, Limited Waiver and Amendment No. 1 to Revolving Credit Agreement dated as of February 15, 2002. (Incorporated by reference to Exhibit 4.1(a) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).
4.1(b)	Limited Waiver and Amendment No. 2 to Revolving Credit Agreement dated as of December 27, 2002. (Incorporated by reference to Exhibit 4.1(b) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).
4.2	Loan Agreement between the Company's subsidiary, Friendly's Realty I, LLC and G.E. Franchise Finance Corporation dated as of December 17, 2001 (Incorporated by reference to Exhibit 4.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, File No. 0-3930).
4.3	Loan Agreement between the Company's subsidiary, Friendly's Realty II, LLC and G.E. Franchise Finance Corporation dated as of December 17, 2001 (Incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, File No. 0-3930).
4.4	Loan Agreement between the Company's subsidiary, Friendly's Realty III, LLC and G.E. Franchise Finance Corporation dated as of December 17, 2001 (Incorporated by reference to Exhibit 4.4 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, File No. 0-3930).
4.5	Senior Note Indenture between Friendly Ice Cream Corporation, Friendly's Restaurants Franchise, Inc. and The Bank of New York, as Trustee (Incorporated by reference to Exhibit 4.5 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).
4.6	Rights Agreement between the Company and The Bank of New York, a Rights Agent (Incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.1	

	The Company's Stock Option Plan (Incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).*
10.1(a)	The Company's 1997 Stock Option Plan (as amended effective March 27, 2000). (Incorporated by reference to Exhibit 10.1(a) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).*
10.1(b)	The Company's 1997 Stock Option Plan (as amended effective October 24, 2001). (Incorporated by reference to Exhibit 10.1(b) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).*
10.2	The Company's Restricted Stock Plan (Incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).*
10.3	Purchase Agreement between Realty Income Corporation as buyer and Company as seller dated December 13, 2001 (Incorporated by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, File No. 0-3930).

10.9	Sublease between SSP Company, Inc. and the Company, as amended, for the Chicopee, Massachusetts Distribution Center (Incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.10	TRC Management Contract between the Company and The Restaurant Company (Incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.11	Aircraft Reimbursement Agreement between the Company and TRC Realty Co (Incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).
10.12	Agreement between Company and Robert L. Hogan executed January 13, 2003.*
21.1	Subsidiaries of the Company. (Incorporated by reference to Exhibit 21.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).
23.1	Consent of Ernst & Young LLP. (Incorporated by reference to Exhibit 23.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).
23.2	Consent of Arthur Andersen LLP. (Incorporated by reference to Exhibit 23.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2002, File No. 0-3930).
99.1	Certification of Periodic Report dated April 28, 2003 signed by John L. Cutter.
99.2	Certification of Periodic Report dated April 28, 2003 signed by Paul V. Hoagland.

*Management Contract or Compensatory Plan or Arrangement

QuickLinks