FRIENDLY ICE CREAM CORP
Form 10-Q
July 26, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JULY 1, 2001
OR

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES 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 /X/ 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 JULY 20, 2001
Common Stock, $.01 par value	7,361,865 shares

PART I--FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS)

	JULY 1, 2001 (UNAUDITED)	DECEMBER 31, 2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 10,346	$ 14,584
Restricted cash	445	1,737
Accounts receivable, net	11,813	6,157
Inventories	15,445	11,570
Deferred income taxes	10,395	10,395
Prepaid expenses and other current assets	2,054	2,799
TOTAL CURRENT ASSETS	50,498	47,242
PROPERTY AND EQUIPMENT, net	201,010	226,865
INTANGIBLES AND DEFERRED COSTS, net	20,569	21,529
OTHER ASSETS	8,608	2,050
TOTAL ASSETS	$ 280,685	$ 297,686
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 3,816	$ 13,029
Current maturities of capital lease and finance obligations	1,927	2,143
Accounts payable	24,723	20,100
Accrued salaries and benefits	11,321	10,956
Accrued interest payable	1,942	3,515
Insurance reserves	13,873	13,095

Restructuring reserve	3,952	5,571
Other accrued expenses	15,309	14,262
TOTAL CURRENT LIABILITIES	76,863	82,671
DEFERRED INCOME TAXES	14,208	13,276
CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities	7,190	8,223
LONG-TERM DEBT, less current maturities	264,243	275,435
OTHER LONG-TERM LIABILITIES	16,167	18,064
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT:		
Common stock	74	74
Additional paid-in capital	139,156	138,988
Accumulated deficit	(237,216)	(239,045)
TOTAL STOCKHOLDERS' DEFICIT	(97,986)	(99,983)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 280,685	$ 297,686

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

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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 SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JULY 2, 2000
REVENUES	$152,202	$159,240	$278,280	$303,420
COSTS AND EXPENSES:				
Cost of sales	52,857	50,243	94,917	95,065
Labor and benefits	41,334	49,399	81,010	97,575
Operating expenses	30,307	30,968	57,760	61,919
General and administrative expenses	9,345	10,191	18,677	21,567
Restructuring costs	--	(1)	--	12,056
Write-downs of property and equipment	68	688	68	18,360
Depreciation and amortization	7,097	7,319	14,649	15,740
(Gain) loss on franchise sales of restaurant operations and properties	(3,823)	89	(3,823)	(1,998
Gain on disposition of other property and equipment	(261)	(509)	(2,242)	(45

OPERATING INCOME (LOSS)	15,278	10,853	17,264	(16,819
Interest expense, net	6,918	7,963	14,503	15,901
INCOME (LOSS) BEFORE (PROVISION FOR) BENEFIT FROM INCOME TAXES	8,360	2,890	2,761	(32,720
(Provision for) benefit from income taxes	(3,328)	115	(932)	17,215
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	$ 5,032	$ 3,005	$ 1,829	$(15,505
BASIC NET INCOME (LOSS) PER SHARE	$ 0.68	$ 0.40	$ 0.25	$ (2.08
DILUTED NET INCOME (LOSS) PER SHARE	$ 0.68	$ 0.40	$ 0.25	$ (2.08
WEIGHTED AVERAGE SHARES:				
Basic	7,364	7,438	7,370	7,454
Diluted	7,370	7,498	7,377	7,454

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

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)
(IN THOUSANDS)

	FOR THE SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 1,829	$(15,505)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Stock compensation expense	168	286
Depreciation and amortization	14,649	15,740
Write-downs of property and equipment	68	18,360
Deferred income tax benefit	932	(17,215)
Gain on asset retirements and sales	(6,023)	(2,677)
Changes in operating assets and liabilities:		
Accounts receivable	(5,656)	(1,886)
Inventories	(3,875)	(4,833)
Other assets	(542)	4,186
Accounts payable	4,623	348
Accrued expenses and other long-term liabilities	(3,050)	(4,440)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	3,123	(7,636)

CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(5,726)	(8,261)
Proceeds from sales of property and equipment	19,868	25,919
NET CASH PROVIDED BY INVESTING ACTIVITIES	14,142	17,658
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	34,000	56,000
Repayments of debt	(54,404)	(65,536)
Repayments of capital lease and finance obligations	(1,099)	(876)
NET CASH USED IN FINANCING ACTIVITIES	(21,503)	(10,412)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(4,238)	(390)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	14,584	12,062
CASH AND CASH EQUIVALENTS, END OF PERIOD	$10,346	$ 11,672
SUPPLEMENTAL DISCLOSURES:		
Cash paid during the period for:		
Interest	$15,498	$ 15,540
Income taxes	3	9
Capital lease obligations incurred	--	909
Capital lease obligations terminated	151	711
Note received from sale of property and equipment	4,250	577

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

INTERIM FINANCIAL INFORMATION--

The accompanying condensed consolidated financial statements as of July 1, 2001 and for the second quarter and six months ended July 1, 2001 and July 2, 2000 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 (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 and six month periods ended July 1, 2001 and July 2, 2000 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 2000 Annual Report on Form 10-K should be read in conjunction with these Condensed Consolidated Financial Statements.

INVENTORIES--

Inventories are stated at the lower of first-in, first-out cost or market. Inventories as of July 1, 2001 and December 31, 2000 were as follows (in thousands):

	JULY 1, 2001	DECEMBER 31, 2000
Raw materials	$ 3,398	$ 1,307
Goods in process	204	66
Finished goods	11,843	10,197
Total	$15,445	$11,570

DEBT--

Since 1997, the Company has entered into several amendments related to covenant violations on its credit facility, which expires in November 2002. In March 2001, under the terms of the seventh amendment, covenant requirements, interest rates and principal payments were revised. The Company is in the process of exploring various refinancing alternatives and has engaged Banc of America Securities LLC for assistance in this process. The Company believes that based on the terms of the seventh amendment, the Company has adequate cash and availability on its revolving credit facility to meet its obligations through September 30, 2002. Additionally, the Company believes that it can comply with the revised covenant requirements under the amendment through December 30, 2001. There is no assurance that the Company will be able to comply with or renegotiate such covenants for periods after December 30, 2001 or that the Company will be able to refinance its existing debt facilities.

RECLASSIFICATIONS--

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

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

2. EARNINGS PER SHARE

Basic net income (loss) per share is calculated by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing earnings available to common stockholders 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 equivalents which could dilute basic earnings per share in the future, that were not included in the computation of diluted earnings per share because to do so would have been antidilutive, was 17,406 for the six months ended July 2, 2000.

Presented below is the reconciliation between basic and diluted weighted average shares for the three and six months ended July 1, 2001 and July 2, 2000 (in thousands):

	FOR THE THREE MONTHS ENDED			
	BASIC		DILUTED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JU
Weighted average number of common shares outstanding during the period...	7,364	7,438	7,364	7
Adjustments:				
Assumed exercise of stock options.........................	--	--	6	
Weighted average number of shares outstanding..............	7,364	7,438	7,370	7

	FOR THE SIX MONTHS ENDED			
	BASIC		DILUTED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JU
Weighted average number of common shares outstanding during the period...	7,370	7,454	7,370	7
Adjustments:				
Assumed exercise of stock options.........................	--	--	7	
Weighted average number of shares outstanding..............	7,370	7,454	7,377	7

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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

3. SEGMENT REPORTING (CONTINUED)

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.

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 loss before (i) (provision for) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization and (iv) write-downs and all other non-cash items plus cash distributions from unconsolidated subsidiaries. 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 SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JULY 2, 2000
	(IN THOUSANDS)			
Revenues:				
Restaurant	$118,953	$136,800	$226,098	$262,223
Foodservice	64,627	62,947	112,807	117,940
Franchise	3,101	1,765	4,662	4,042
Total	$186,681	$201,512	$343,567	$384,205

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

3. SEGMENT REPORTING (CONTINUED)

	FOR THE THREE MONTHS ENDED		FOR THE SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JULY 2, 2000
	(IN THOUSANDS)			
Intersegment revenues:				
Restaurant	$ --	$ --	$ --	$ --
Foodservice	(34,479)	(42,272)	(65,287)	(80,785
Franchise	--	--	--	--
Total	$(34,479)	$(42,272)	$(65,287)	$(80,785
External revenues:				
Restaurant	$118,953	$136,800	$226,098	$262,223
Foodservice	30,148	20,675	47,520	37,155
Franchise	3,101	1,765	4,662	4,042
Total	$152,202	$159,240	$278,280	$303,420
EBITDA:				
Restaurant	$ 16,024	$ 16,090	$ 24,792	$ 23,558
Foodservice	4,809	7,065	7,888	12,584
Franchise	1,927	580	2,421	1,518
Corporate	(4,422)	(5,240)	(9,016)	(10,169
Gains on property and equipment, net	4,180	509	6,064	2,132
Restructuring costs	--	1	--	(12,056
Total	$ 22,518	$ 19,005	$ 32,149	$ 17,567
Interest expense, net	$ 6,918	$ 7,963	$ 14,503	$ 15,901
Depreciation and amortization:				
Restaurant	$ 4,613	$ 4,895	$ 9,659	$ 10,930
Foodservice	841	856	1,695	1,715
Franchise	61	100	121	183
Corporate	1,582	1,468	3,174	2,912
Total	$ 7,097	$ 7,319	$ 14,649	$ 15,740
Other non-cash expenses:				
Corporate	$ 75	$ 145	$ 168	$ 286

Write-downs of property and equipment	68	688	68	18,360
Total	$ 143	$ 833	$ 236	$ 18,646

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

3. SEGMENT REPORTING (CONTINUED)

	FOR THE THREE MONTHS ENDED		FOR THE SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JULY 2, 2000
	(IN THOUSANDS)			
Income (loss) before (provision for) benefit from income taxes:				
Restaurant	$ 11,411	$ 11,195	$ 15,133	$ 12,628
Foodservice	3,968	6,209	6,193	10,869
Franchise	1,866	480	2,300	1,335
Corporate	(12,997)	(14,816)	(26,861)	(29,268
Gains (loss) on property and equipment, net	4,112	(179)	5,996	(16,228
Restructuring Costs	--	1	--	(12,056
Total	$ 8,360	$ 2,890	$ 2,761	$(32,720
Capital expenditures, including capitalized leases:				
Restaurant	$ 2,716	$ 5,830	$ 4,017	$ 6,837
Foodservice	725	908	1,215	1,797
Corporate	259	205	494	536
Total	$ 3,700	$ 6,943	$ 5,726	$ 9,170

	JULY 1, 2001	DECEMBER 31, 2000
Total assets:		
Restaurant	$176,939	$199,223
Foodservice	42,867	33,880
Franchise	6,574	3,745
Corporate	54,305	60,838
Total	$280,685	$297,686

4. NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangibles." SFAS No. 142 modifies the rules for accounting for goodwill and other intangible assets. The new rules become effective on January 1, 2002. The Company does not believe the impact of adopting SFAS No. 142 will have a material effect on the Company's consolidated financial statements. The Company will continue to amortize its license agreement related to certain trademarked products under the new rules.

In April 2001, the Financial Accounting Standards Board reached consensus on Emerging Issues Task Force ("EITF") Issue No. 00-25, "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products," which is effective for quarters beginning after December 15, 2001, with prior financial statements restated if practicable. This Issue 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 is required to adopt EITF No. 00-25 for periods beginning after December 15, 2001. Management has not yet quantified the impact of implementing Issue No. 00-25 on the Company's financial statements.

In May 2000, the Emerging Issues Task Force issued EITF No. 00-14, "Accounting for Certain Sales Incentives," which provides guidance on the recognition, measurement and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. The Company adopted EITF No. 00-14 on July 3, 2000. As a result, the Company has reclassified certain retail selling expenses against retail revenue for the three and six months ended July 2, 2000 to conform with the current period presentation.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that each derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the statement of operations, and requires that a Company formally document, designate and assess the effectiveness of transactions that receive hedge accounting. Since the Company's commodity option contracts do not meet the criteria for hedge accounting, changes in the value of the commodity option contracts are recognized monthly in earnings. The cumulative effect upon adoption of approximately $77,000 has been recorded as income in the accompanying Condensed Consolidated Statement of Operations. It is not separately reported as a cumulative effect since the amount is not significant. Additionally, losses totaling $147,000 were recorded during the six months ended July 1, 2001. The fair market value of derivatives at July 1, 2001 was approximately $89,000.

5. RESTRUCTURING PLAN

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. The 70 locations will remain in operation until they are sold,

5. RESTRUCTURING PLAN (CONTINUED)

subleased or closed. In connection with the restructuring plan, the Company eliminated approximately 150 management and administrative positions in the field organization and at corporate headquarters. As a result of this plan, the Company reported a pre-tax restructuring charge of approximately $12,056,000 for severance pay, 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 $17,008,000 in the first quarter ended April 2, 2000.

The following represents the restructuring reserve activity (in thousands):

	BALANCE AS OF DECEMBER 31, 2000	COSTS PAID DURING THE SIX MONTHS ENDED JULY 1, 2001	BALANCE AS OF JULY 1, 2001
Severance pay..........................	$ 74	$ (74)	$ --
Rent...................................	3,585	(643)	2,942
Utilities and real estate taxes..........	1,105	(403)	702
Demarking..............................	138	(30)	108
Lease termination costs.................	120	(120)	--
Inventory..............................	5	(5)	--
Other..................................	544	(344)	200
Total..................................	$5,571	$(1,619)	$3,952

The write-down of property and equipment consisted of $7.8 million for the 81 locations closed at the end of March 2000 and $9.2 million for the 70 locations to be disposed of over the following 24 months. At July 1, 2001, the aggregate carrying amount of the remaining 29 operating restaurants and 19 closed properties to be disposed of was $4.6 million. At December 31, 2000, the aggregate carrying value of the 73 properties to be disposed of was $7.0 million. These amounts are reflected in the condensed consolidated balance sheets as property and equipment, net.

6. SALES OF RESTAURANT OPERATIONS AND PROPERTIES TO FRANCHISEES

On April 13, 2001, the Company entered into an agreement granting J&B Restaurants Partners of Long Island Holding Co., LLC ("J&B") certain limited exclusive rights to operate and develop Friendly's full-service restaurants in the franchising regions of Nassau and Suffolk Counties in Long Island, New York (the "J&B Agreement"). Pursuant to the J&B Agreement, J&B purchased certain assets and rights in 31 existing Friendly's restaurants and committed to open an additional 29 restaurants over the next 12 years. Gross proceeds from the sale were approximately $19,950,000, of which approximately $4,250,000 was received in a note and $940,000 was for franchise fees for the initial 31 restaurants. The $940,000 was recorded as revenue in the second quarter ending July 1, 2001. The Company recognized a gain of approximately $3,935,000 related to the sale of the assets for the 31 locations in the second quarter ending July 1, 2001. The cash proceeds were used to prepay approximately $4,711,000 on the term loans with the remaining balance being applied to the revolving credit facility. The 5-year note bears interest at an annual rate of 11% using a 20-year amortization schedule. Payments are due monthly through the five years with a balloon payment due at the end of

6. SALES OF RESTAURANT OPERATIONS AND PROPERTIES TO FRANCHISEES (CONTINUED)

five years. The Company also sold certain assets and rights in two other restaurants to an additional franchisee resulting in a loss of $16,000.

On January 19, 2000, the Company entered into an agreement granting Kessler Family LLC ("Kessler") non-exclusive rights to operate and develop Friendly's full-service restaurants in the franchising region of Rochester, Buffalo and Syracuse, New York (the "Kessler Agreement"). Pursuant to the Kessler Agreement, Kessler purchased certain assets and rights in 29 existing Friendly's restaurants and committed to open an additional 15 restaurants over the next seven years. Gross proceeds from the sale were approximately $13,300,000 of which $735,000 was for franchise fees for the initial 29 restaurants. The $735,000 was recorded as revenue in the first quarter ending April 2, 2000. The Company recognized a gain of approximately $1,400,000 related to the sale of the assets for the 29 locations in the first quarter ending April 2, 2000. The Company also sold certain assets and rights in six other restaurants to two additional franchisees resulting in a gain of $687,000.

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

FICC's obligation related to the $200 million Senior Notes is 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 Friendly Ice Cream Corporation (the "Parent Company"), Friendly's Restaurants Franchise, Inc. (the "Guarantor Subsidiary") and Friendly's International, Inc., Friendly Holding (UK) Limited, Friendly Ice Cream (UK) Limited and Restaurant Insurance Corporation (collectively, the "Non-guarantor Subsidiaries"). Separate complete financial statements and other disclosures of the Guarantor Subsidiary as of July 1, 2001 and July 2, 2000, and for the periods ended July 1, 2001 and July 2, 2000, 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.

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
AS OF JULY 1, 2001
(Unaudited)
(In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Assets					
Current assets:					
Cash and cash equivalents	$ 9,008	$ 9	$ 1,329	$ --	$
Restricted cash	--	--	445	--	
Accounts receivable, net	10,896	917	--	--	
Inventories	15,445	--	--	--	
Deferred income taxes	10,258	43	--	94	
Prepaid expenses and other current assets	6,871	610	3,505	(8,932)	
Total current assets	52,478	1,579	5,279	(8,838)	
Deferred income taxes	--	506	1,327	(1,833)	
Property and equipment, net	201,010	--	--	--	2
Intangibles and deferred costs, net	20,569	--	--	--	
Investments in subsidiaries	4,680	--	--	(4,680)	
Other assets	7,692	3,689	6,229	(9,002)	
Total assets	$286,429	$5,774	$12,835	$(24,353)	$2
Liabilities and Stockholders' Equity (Deficit)					
Current liabilities:					
Current maturities of long-term obligations	$ 9,243	$ --	$ --	$ (3,500)	$
Accounts payable	24,723	--	--	--	
Accrued expenses	43,317	637	7,690	(5,247)	
Total current liabilities	77,283	637	7,690	(8,747)	
Deferred income taxes	15,947	--	--	(1,739)	
Long-term obligations, less current maturities	276,747	--	--	(5,314)	2
Other long-term liabilities	14,438	1,061	4,541	(3,873)	
Stockholders' (deficit) equity	(97,986)	4,076	604	(4,680)	(
Total liabilities and stockholders' equity (deficit)	$286,429	$5,774	$12,835	$(24,353)	$2

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE THREE MONTHS ENDED JULY 1, 2001
(Unaudited)
(In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Revenues	$149,478	$2,724	$ --	$ --	$1
Costs and expenses:					
Cost of sales	52,857	--	--	--	
Labor and benefits	41,334	--	--	--	
Operating expenses and write-downs of property and equipment	30,377	--	(2)	--	
General and administrative expenses	8,188	1,157	--	--	
Depreciation and amortization	7,097	--	--	--	
Gain on franchise sales of restaurant operations and properties	(3,823)	--	--	--	
Gain on dispositions of other property and equipment	(261)	--	--	--	
Interest expense (income)	7,094	--	(176)	--	
Income before provision for income taxes and equity in net income of consolidated subsidiaries	6,615	1,567	178	--	
Provision for income taxes	(2,623)	(642)	(63)	--	
Income before equity in net income of consolidated subsidiaries	3,992	925	115	--	
Equity in net income of consolidated subsidiaries	1,040	--	--	(1,040)	
Net income (loss)	$ 5,032	$ 925	$115	$(1,040)	$

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE SIX MONTHS ENDED JULY 1, 2001
(Unaudited)
(In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Revenues	$274,363	$3,917	$ --	$ --	$2
Costs and expenses:					
Cost of sales	94,917	--	--	--	
Labor and benefits	81,010	--	--	--	
Operating expenses and write-downs of property and equipment	57,839	--	(11)	--	
General and administrative expenses	16,361	2,316	--	--	
Depreciation and amortization	14,649	--	--	--	
Gain on franchise sales of restaurant operations and properties	(3,823)	--	--	--	
Gain on dispositions of other property and equipment	(2,242)	--	--	--	
Interest expense (income)	14,900	--	(397)	--	
Income before provision for income taxes and equity in net income of consolidated subsidiaries	752	1,601	408	--	
Provision for income taxes	(132)	(656)	(144)	--	
Income before equity in net income of consolidated subsidiaries	620	945	264	--	
Equity in net income of consolidated subsidiaries	1,209	--	--	(1,209)	
Net income (loss)	$ 1,829	$ 945	$ 264	$(1,209)	$

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED JULY 1, 2001
(Unaudited)
(In thousands

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CON
Net cash provided by (used in) operating activities	$ 2,750	$(24)	$1,688	$(1,291)	$
Cash flows from investing activities:					
Purchases of property and equipment	(5,726)	--	--	--	
Proceeds from sales of property and equipment	19,868	--	--	--	
Net cash provided by investing activities	14,142	--	--	--	
Cash flows from financing activities:					
Proceeds from borrowings	34,000	--	--	--	
Repayments of obligations	(55,503)	--	--	--	
Reinsurance deposits received	--	--	505	(505)	
Reinsurance payments made from deposits	--	--	(1,796)	1,796	
Net cash used in financing activities	(21,503)	--	(1,291)	1,291	
Net (decrease) increase in cash and cash equivalents	(4,611)	(24)	397	--	
Cash and cash equivalents, beginning of period	13,619	33	932	--	
Cash and cash equivalents, end of period	$ 9,008	$ 9	$1,329	$ --	$
Supplemental disclosures:					
Interest paid (received)	$ 15,895	$ --	$ (397)	$ --	$
Income taxes refunded	1	2	--	--	
Capital lease obligations terminated	151	--	--	--	
Note received from the sale of property and equipment	4,250	--	--	--	

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 31, 2000

(In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Assets					
Current assets:					
Cash and cash equivalents.........	$ 13,619	$ 33	$ 932	$ --	$
Restricted cash..................	--	--	1,737	--	
Accounts receivable, net..........	5,649	508	--	--	
Inventories......................	11,570	--	--	--	
Deferred income taxes............	10,258	43	--	94	
Prepaid expenses and other current assets.........................	7,435	551	4,057	(9,244)	
Total current assets...............	48,531	1,135	6,726	(9,150)	
Deferred income taxes..............	--	506	1,327	(1,833)	
Property and equipment, net.........	226,865	--	--	--	2
Intangible assets and deferred costs, net.......................	21,529	--	--	--	
Investments in subsidiaries.........	3,500	--	--	(3,500)	
Other assets.......................	1,135	3,614	5,729	(8,428)	
Total assets.......................	$301,560	$5,255	$13,782	$(22,911)	$2
Liabilities and Stockholders' (Deficit) Equity					
Current liabilities:					
Current maturities of long-term obligations....................	$ 19,172	$ --	$ --	$ (4,000)	$
Accounts payable.................	20,100	--	--	--	
Accrued expenses.................	43,683	648	8,082	(5,014)	
Total current liabilities..........	82,955	648	8,082	(9,014)	
Deferred income taxes..............	15,015	--	--	(1,739)	
Long-term obligations, less current maturities.......................	288,472	--	--	(4,814)	2
Other liabilities..................	15,101	1,475	5,332	(3,844)	
Stockholders' (deficit) equity......	(99,983)	3,132	368	(3,500)	(
Total liabilities and stockholders' equity (deficit).................	$301,560	$5,255	$13,782	$(22,911)	$2

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE THREE MONTHS ENDED JULY 2, 2000
(Unaudited)
(In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Revenues	$157,934	$1,306	$ --	$ --	$1
Costs and expenses:					
Cost of sales	50,243	--	--	--	
Labor and benefits	49,399	--	--	--	
Operating expenses and write-downs of property and equipment	31,711	--	(55)	--	
General and administrative expenses	9,345	845	--	--	
Depreciation and amortization	7,319	--	--	--	
Loss on franchise sales of restaurant operations and properties	89	--	--	--	
Gain on dispositions of other property and equipment	(509)	--	--	--	
Interest expense (income)	8,136	--	(173)	--	
Income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	2,201	461	228	--	
Benefit from (provision for) income taxes	385	(190)	(80)	--	
Income before equity in net income of consolidated subsidiaries	2,586	271	148	--	
Equity in net income of consolidated subsidiaries	419	--	--	(419)	
Net income (loss)	$ 3,005	$ 271	$ 148	$(419)	$

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE SIX MONTHS ENDED JULY 2, 2000
(Unaudited)
(In thousands)

PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS

Revenues	$300,240	$3,180	$ --	$ --	$3
Costs and expenses:					
Cost of sales	95,065	--	--	--	
Labor and benefits	97,575	--	--	--	
Operating expenses and write-downs of property and equipment	80,394	--	(115)	--	
General and administrative expenses	20,296	1,271	--	--	
Restructuring costs	12,056	--	--	--	
Depreciation and amortization	15,740	--	--	--	
Gain on franchise sales of restaurant operations and properties	(1,998)	--	--	--	
Gain on dispositions of other property and equipment	(45)	--	--	--	
Interest expense (income)	16,246	--	(345)	--	
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(35,089)	1,909	460	--	(
Benefit from (provision for) income taxes	18,159	(783)	(161)	--	
(Loss) income before equity in net income of consolidated subsidiaries	(16,930)	1,126	299	--	(
Equity in net income of consolidated subsidiaries	1,425	--	--	(1,425)	
Net (loss) income	$(15,505)	$1,126	$ 299	$(1,425)	$(

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(UNAUDITED)

7. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED JULY 2, 2000

(Unaudited) (In thousands)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CON
Net cash (used in) provided by operating activities	$ (8,133)	$ 37	$ 1,420	$ (960)	$

Cash flows from investing activities:					
Purchases of property and equipment........................	(8,261)	--	--	--	
Proceeds from sales of property and equipment........................	25,919	--	--	--	
Net cash provided by investing activities......................	17,658	--	--	--	
Cash flows from financing activities:					
Proceeds from borrowings...........	56,000	--	--	--	
Repayments of obligations..........	(66,412)	--	--	--	
Reinsurance deposits received......	--	--	1,600	(1,600)	
Reinsurance payments made from deposits.........................	--	--	(2,560)	2,560	
Net cash (used in) provided by financing activities..............	(10,412)	--	(960)	960	
Net (decrease) increase in cash and cash equivalents..................	(887)	37	460	--	
Cash and cash equivalents, beginning of period.........................	9,674	14	2,374	--	
Cash and cash equivalents, end of period............................	$ 8,787	$ 51	$ 2,834	$ --	$
Supplemental disclosures:					
Interest paid (received)...........	$ 16,069	$ --	$ (529)	$ --	$
Income taxes (refunded) paid.......	(1,022)	866	165	--	
Capital lease obligations incurred...	909	--	--	--	
Capital lease obligations terminated........................	711	--	--	--	
Note received from the sale of property and equipment............	577	--	--	--	

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, uncertainty with respect to the Company's ongoing compliance with covenants and its existing debt facilities and its ability to refinance its existing debt facilities, 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 re-imaging and new opening and franchising 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

As of July 1, 2001, the Company owns and operates 403 restaurants, franchises 158 restaurants and 5 cafes and manufactures and distributes a full line of frozen dessert products. These products are distributed to Friendly's restaurants and through more than 3,500 supermarkets and other retail locations in 15 states. The restaurants offer a wide variety of reasonably priced breakfast, lunch and dinner menu items as well as the frozen dessert products.

	FOR THE THREE MONTHS ENDED		FOR THE SIX MONTHS ENDED	
	JULY 1, 2001	JULY 2, 2000	JULY 1, 2001	JULY 2, 2000
COMPANY UNITS:				
Beginning of period	438	502	449	618
Openings	--	1	--	2
Re-franchised	(33)	(2)	(33)	(37)
Closings	(2)	(15)	(13)	(97)
End of period	403	486	403	486
FRANCHISED UNITS:				
Beginning of period	128	109	127	69
Re-franchised openings	33	2	33	37
Openings	2	4	3	10
Closings	--	(1)	--	(2)
End of period	163	114	163	114

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REVENUES:

Total revenues decreased $7.0 million, or 4.4%, to $152.2 million for the second quarter ended July 1, 2001 from $159.2 million for the same quarter in 2000. Restaurant revenues decreased $17.8 million, or 13.0%, to $119.0 million for the second quarter of 2001 from $136.8 million for the same quarter in 2000. Restaurant revenues decreased by $19.7 million due to the closing of 53 under-performing restaurants and the re-franchising of 47 additional locations over the past 15 months. Closing of restaurants accounted for $7.3 million of the restaurant revenue decline and re-franchising reduced restaurant revenues by an additional $12.4 million. Partially offsetting this decrease was a 1.4% increase in comparable restaurant revenues. Revenues from the one location open less than one year were $0.2 million. Foodservice (product sales to franchisees, retail and institutional) revenues increased by $9.4 million, or 45.4%, to

$30.1 million for the second quarter of 2001 from $20.7 million for the same quarter in 2000. The increase was due to the increase in the number of franchised units and higher sales to foodservice retail supermarket customers. The Company's foodservice division sells a variety of products to the Company's franchisees and ice cream products to supermarkets and other retail locations. Franchise revenues increased $1.3 million, or 72.2%, to $3.1 million for the three months ended July 1, 2001 compared to $1.8 million for the three months ended July 2, 2000. The increase is primarily due to an increase of $0.9 million in initial fees as 35 new locations were added in the second quarter of 2001 and only six locations were added in the same period in 2000.

Total revenues decreased $25.1million, or 8.3%, to $278.3 million for the six months ended July 1, 2001 from $303.4 million for the same period in 2000. Restaurant revenues decreased $36.1 million, or 13.8%, to $226.1 million for the six months of 2001 from $262.2 million for the same period in 2000. Restaurant revenues decreased by $39.3 million due to the closing of 135 under-performing restaurants and the re-franchising of 82 additional locations over the past 18 months. Closing of restaurants accounted for $21.4 million of the restaurant revenue decline and re-franchising reduced restaurant revenues by an additional $17.9 million. Partially offsetting this decrease was a 1.2% increase in comparable restaurant revenues. Revenues from the one location open less than one year were $0.5 million. Foodservice (product sales to franchisees, retail and institutional) and other revenues increased by $10.3 million, or 27.7%, to $47.5 million for the six months ended July 2, 2001 from $37.2 million for the same period in 2000. The increase was due to the increase in the number of franchised units and higher sales to foodservice retail supermarket customers. Franchise revenue increased $0.6 million, or 14.6%, to $4.7 million for the six months ended July 1, 2001 compared to $4.1 million for the six months ended July 2, 2000. The increase is primarily the result of the fact that there are 163 franchise units open at the end of the second quarter ended July 1, 2001 compared to 114 franchise units open at the end of the second quarter ended July 2, 2000.

COST OF SALES:

Cost of sales increased $2.7 million, or 5.4%, to $52.9 million for the second quarter ended July 1, 2001 from $50.2 million for the same quarter in 2000. Cost of sales as a percentage of total revenues increased to 34.8% for the second quarter of 2001 from 31.6% for the second quarter of 2000. The higher food cost as a percentage of total revenue was partially due to a shift in sales mix from Company-owned restaurant sales to foodservice sales. Foodservice sales to franchisees and retail customers have a higher food cost as a percentage of revenue than sales in Company-owned restaurants to restaurant patrons. The cost of cream, the principal ingredient used in making ice cream, was higher in the second quarter of 2001 when compared to the second quarter of 2000 and contributed to the rise in cost of sales as a percentage of total revenues, especially in foodservice's retail supermarket business. The Company believes that cream prices will continue to rise and will peak during the summer months. To minimize risk, alternative supply sources continue to be pursued. Additionally in May 2001, the Company raised prices to its retail customers.

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Cost of sales decreased $0.2 million, or 0.2%, to $94.9 million for the six months ended July 1, 2001 from $95.1 million for the same period in 2000. Cost of sales as a percentage of total revenues increased to 34.1% for the six months in 2001 from 31.3% for the same period in 2000. The higher food cost as a percentage of total revenue was partially due to a shift in sales mix from Company-owned restaurant sales to foodservice sales. Foodservice sales to franchisees and retail customers have a higher food cost as a percentage of revenue than sales in Company-owned restaurants to restaurant patrons. The cost of cream, the principal ingredient used in making ice cream, was higher in the first six months of 2001 when compared to the first six months of 2000 and contributed to the rise in cost of sales as a percentage of total revenues, especially in foodservice's retail supermarket business. The Company believes that cream prices will continue to rise and will peak during the summer months. To minimize risk, alternative supply sources will continue to be pursued. Additionally in May 2001, the Company raised prices to its retail customers.

LABOR AND BENEFITS:

Labor and benefits decreased $8.1 million, or 16.4%, to $41.3 million for the second quarter ended July 1, 2001 from $49.4 million for the same quarter in 2000. Labor and benefits as a percentage of total revenues decreased to 27.2% for the second quarter of 2001 from 31.0% for the same quarter in 2000. The lower labor cost as a percentage of total revenue is partially the result of revenue increases derived from additional franchised locations and higher sales to foodservice retail supermarket customers, which do not have any associated restaurant labor and benefits. In addition, the closing of 38 under-performing Company-owned units over the past 15 months improved the relationship of restaurant labor and benefits to restaurant sales as well as to total revenues.

Labor and benefits decreased $16.6 million, or 17.0%, to $81.0 million for the six months ended July 1, 2001 from $97.6 million for the same period in 2000. Labor and benefits as a percentage of total revenues decreased to 29.1% for the six months of 2001 from 32.2% for the same period in 2000. The lower labor cost as a percentage of total revenue is partially the result of revenue increases derived from additional franchised locations and higher sales to foodservice retail supermarket customers, which do not have any associated restaurant labor and benefits. In addition, the closing of 135 under-performing Company-owned units over the past 18 months improved the relationship of restaurant labor and benefits to restaurant sales as well as to total revenues. Partially offsetting the decreases were higher group insurance costs in 2001 when compared to the same period in 2000.

OPERATING EXPENSES:

Operating expenses decreased $0.7 million, or 2.3%, to $30.3 million for the second quarter ended July 1, 2001 from $31.0 million for the same quarter in 2000. Operating expenses as a percentage of total revenues were 19.9% and 19.4% for the second quarters ended July 1, 2001 and July 2, 2000, respectively. The increase as a percentage of total revenues resulted from higher costs for foodservice retail promotions, restaurant maintenance and utilities in the 2001 quarter when compared to the 2000 quarter.

Operating expenses decreased $4.1 million, or 6.6%, to $57.8 million for the six months ended July 1, 2001 from $61.9 million for the same period in 2000. Operating expenses as a percentage of total revenues were 20.8% and 20.4% for the six months ended July 1, 2001 and July 2, 2000, respectively. The increase as a percentage of total revenues resulted from higher costs for restaurant advertising, foodservice retail promotions, utilities and restaurant maintenance including snowplowing in the 2001 period when compared to the 2000 period.

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GENERAL AND ADMINISTRATIVE EXPENSES:

General and administrative expenses were $9.3 million for the second quarter ended July 1, 2001 and $10.2 million for the same period in 2000. General and administrative expenses as a percentage of total revenues decreased to 6.1% in the second quarter of 2001 from 6.4% for the same period in 2000. The decrease is primarily the result of a hiring freeze that was implemented after the Company's announcement of the immediate closing of 81 restaurants and the planned closing of 70 additional restaurants in March 2000.

General and administrative expenses were $18.7 million and $21.6 million for the six months ended July 1, 2001 and July 2, 2000, respectively. General and administrative expenses as a percentage of total revenues decreased to 6.7% in the six months ended July 1, 2001 from 7.1% for the same period in 2000. The decrease is primarily the result of the elimination of certain management and administrative positions associated with the Company's announcement of the immediate closing of 81 restaurants and the planned closing of 70 additional restaurants in March 2000 and an on-going hiring freeze.

EBITDA:

As a result of the above, EBITDA (EBITDA represents net income (loss) before (i) benefit from (provision for) income taxes, (ii) interest expense, net, (iii) depreciation and amortization and (iv) write-downs and all other non-cash items plus cash distributions from unconsolidated subsidiaries) increased $3.5 million, or 18.4%, to $22.5 million for the second quarter ended July 1, 2001 from $19.0 million for the same quarter in 2000. EBITDA as a percentage of total revenues was 14.8% and 11.9% for the second quarters of 2001 and 2000, respectively.

EBITDA increased $14.5 million, or 82.4%, to $32.1 million for the six months ended July 1, 2001 from $17.6 million for the same period in 2000. EBITDA as a percentage of total revenues was 11.6% and 5.8% for the six months ended July 1, 2001 and July 2, 2000, respectively.

RESTRUCTURING COSTS:

Restructuring costs were $12.1 million for the six months ended July 2, 2000 as a result of the costs associated with the Company's decision to reorganize its restaurant field and headquarters organizations in conjunction with the closing of 81 under-performing restaurants and the planned closing of an additional 70 restaurants over the next 24 months. Included in these costs are severance, rent on closed units until lease termination, utilities and real estate taxes, demarking, lease termination, environmental and other miscellaneous costs.

WRITE-DOWNS OF PROPERTY AND EQUIPMENT:

Write-downs of property and equipment were $0.1 million and $0.7 million for the three months ended July 1, 2001 and July 2, 2000, respectively. Write-downs of property and equipment were $0.1 million and $18.4 million for the six months ended July 1, 2001 and July 2, 2000, respectively. The decrease in write-downs is primarily the result of the non-cash write-down of the 81 under-performing restaurants which were closed at the end of March 2000 and the non-cash write-down of the additional 70 restaurants which will be closed over the next 24 months to their estimated net realizable value. As of July 1, 2001, 29 of these 70 restaurants are still operating.

DEPRECIATION AND AMORTIZATION:

Depreciation and amortization decreased $0.2 million, or 2.7%, to $7.1 million for the second quarter ended July 1, 2001 from $7.3 million for the same quarter in 2000. Depreciation and amortization as a percentage of total revenues was 4.7% and 4.6% for the second quarters of 2001 and 2000, respectively.

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Depreciation and amortization decreased $1.1 million, or 7.0%, to $14.6 million for the six months ended July 1, 2001 from $15.7 million for the same period in 2000. Depreciation and amortization as a percentage of total revenues was 5.3% and 5.2% for the six months ended July 1, 2001 and July 2, 2000, respectively.

(GAIN) LOSS ON FRANCHISE SALES OF RESTAURANT OPERATIONS AND PROPERTIES:

Gain on franchise sales of restaurant operations and properties for the second quarter ended July 1, 2001 was $3.8 million compared to a loss on sales of restaurant operations and properties of $0.1 million for the second quarter ended July 2, 2000. The increase was the result of the gain of $3.9 million associated with the sale of 31 restaurants to a franchisee during the second quarter ended July 1, 2001. The gain on sales of restaurant operations and properties was $3.8 million and $2.0 million for the six months ended July 1, 2001 and July 2, 2000, respectively. The increase was primarily the result of the gain of $3.9 million associated with the sale of 31 restaurants to a franchisee during the second quarter ended July 1, 2001 as compared to the gain of $1.4 million associated with the sale of 29 restaurants to a franchisee on January 19, 2000. The Company also sold certain assets and rights in eight other restaurants to three additional franchisees resulting in a gain of $0.7 million during the six months ended July 2, 2000.

GAIN ON DISPOSITION OF OTHER PROPERTY AND EQUIPMENT:

The gain on disposition of other property and equipment was $0.3 million and $0.5 million for the quarters ended July 1, 2001 and July 2, 2000, respectively. The gain on disposition of other property and equipment was $2.2 million for the six months ended July 1, 2001. The gain in 2001 resulted from the sale of 17 closed locations during the six month period ended July 1, 2001 compared to the sale of 10 closed locations during the six month period ended July 2, 2000.

INTEREST EXPENSE, NET:

Interest expense, net of capitalized interest and interest income, decreased by $1.1 million, or 13.1%, to $6.9 million for the second quarter ended July 1, 2001 from $8.0 million for the same quarter in 2000. The decrease is primarily due to a reduction in the average outstanding debt.

Interest expense, net of capitalized interest and interest income, decreased by $1.4 million, or 8.8%, to $14.5 million for the six months ended July 1, 2001 from $15.9 million for the same period in 2000. The decrease is primarily impacted by the decrease in the average outstanding balance on the term loans for the six months ended July 1, 2001 compared to the six months ended July 2, 2000. Total outstanding debt, including capital leases, was reduced from $305.5 million at July 2, 2000 to $277.2 million at July 1, 2001.

(PROVISION FOR) BENEFIT FROM INCOME TAXES:

The provision for income taxes was $3.3 million, or 39.8%, for the second quarter ended July 1, 2001 compared to a benefit from income taxes of $0.1 million, or 4.0%, for the second quarter ended July 2, 2000. The provision for income taxes was $0.9 million, or 33.8%, for the six months ended July 1, 2001 compared to a benefit from taxes of $17.2 million, or 52.6%, for the six months ended July 2, 2000. 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. The sales of the land and buildings to franchisees during the six months ended July 2, 2000 favorably impacted the provision for income taxes as it triggered built-in gains, which allowed for a reduction in the valuation allowance on certain net operating loss carryforwards.

NET INCOME (LOSS):

Net income was $5.0 million and $3.0 million for the second quarters ended July 1, 2001 and July 2, 2000, respectively. Net income was $1.8 million for the six months ended July 1, 2001 compared to a net loss of $15.5 million for the six months ended July 2, 2000.

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 $3.1 million for the six months ended July 1, 2001 compared to net cash used in operating activities of $7.6 million in the six months ended July 2, 2000. During the six months ended July 1, 2001, inventories increased $3.9 million as a result of increased retail and restaurant promotional activity during the summer months. Accounts Payable increased $4.6 million primarily as a result of increased inventory purchases. Accounts Receivable increased $5.7 million primarily due to increased retail supermarket sales along with the increase in volume of Foodservice product sales to franchisees. Accrued expenses and other long term-liabilities decreased $3.1 million as a result of a $1.5 million reduction in accrued interest on the revolver and term loans due to the timing of interest payments and $1 million of payments made against the captive insurance company's reserves for workers compensation claims. Available borrowings under the revolving credit facility were $11.7 million as of July 1, 2001.

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 the Company's and its subsidiaries' debt instruments, if any, permit) are sources of cash. The amounts of debt financing that the Company will be able to incur under capital leases and for property and casualty insurance financing and the amount of asset sales by the Company are limited by the terms of its credit facility and Senior Notes.

Net cash provided by investing activities was $14.1 million and $17.7 million in the six months ended July 1, 2001 and July 2, 2000, respectively. Capital expenditures for restaurant operations were approximately $4.0 million and $5.9 million for the six months ended July 1, 2001 and July 2, 2000, respectively. Other capital expenditures were $1.7 million and $2.3 million for the six months ended July 1, 2001 and July 2, 2000, respectively. The decrease in capital expenditures was primarily due to the reduction in new units, replacements and re-imaging projects. Proceeds from the sale of property and equipment were $19.9 million and $25.9 million in the six months ended July 1, 2001 and July 2, 2000, respectively. The decrease in proceeds was primarily due to the receipt of $12.9 million in 2001 compared to $17.1 million in 2000 related to sales of restaurants to franchisees.

Net cash used in financing activities was $21.5 million and $10.4 million in the six months ended July 1, 2001 and July 2, 2000, respectively.

The Company had a working capital deficit of $26.4 million as of July 1, 2001. 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.

The Company's credit facility imposes significant operating and financial restrictions on the Company's ability to, among other things, incur indebtedness, create liens, sell assets, engage in mergers or consolidations, pay dividends and engage in certain transactions with affiliates. The credit facility limits the amount which the Company may spend on capital expenditures and requires the

Company to comply with certain financial covenants. The Company's credit facility also restricts the use of proceeds from asset sales. Proceeds, as defined in the credit agreement and subject to certain exceptions, in excess of stated maximum allowable amounts must be used to permanently reduce outstanding obligations under the credit facility. During the six months ended July 1, 2001, the Company received $10.6 million of asset sale proceeds which were used to reduce the amount outstanding on the term loans.

The Company entered into its existing credit facility in November 1997. Since 1997, the Company has executed several amendments to the credit facility. The most recent amendment occurred on March 19, 2001. All of the existing financial covenants were amended and a new financial covenant was added requiring minimum cumulative Consolidated EBITDA, as defined, on a monthly basis. Interest rates on term loans, borrowings under the revolving credit facility and issued letters of credit increased 0.25%. In addition, automatic increases in the interest rates will occur on August 2, 2001, January 2, 2002, April 1, 2002, July 1, 2002 and October 1, 2002 of 0.25%, 0.50%, 0.25%, 0.25% and 0.25%, respectively. Interest payments on all ABR loans, Eurodollar loans and issued letters of credit are required on a monthly basis rather than quarterly.

Also due to the March 19, 2001 amendment, the maturity dates of Tranche B and Tranche C of the term loans were changed to November 15, 2002 from their original maturity dates of November 15, 2004 and November 15, 2005, respectively. Annual scheduled principal payments due through October 15, 2002 did not change. However, the amendment requires additional minimum cumulative prepayments on the term loans by the dates specified below as follows:

October 15, 2001......................................	$6,000,000
January 15, 2002......................................	7,500,000
April 15, 2002..	8,500,000
July 15, 2002...	10,000,000

Any remaining unpaid balances due on Tranches B and C of the term loans will be paid on November 15, 2002.

FICC paid a fee of approximately $256,000 to the lenders in connection with this amendment. Also, unless all obligations under the credit facility are satisfied prior to September 30, 2001, FICC will pay an additional fee of approximately $512,000 on that date. If all obligations under the credit facility are satisfied prior to September 30, 2001, the additional fee will be payable at that time and will be reduced to approximately $128,000.

The Company is in the process of exploring various refinancing alternatives and has engaged Banc of America Securities LLC for assistance in this process. The Company believes that based on the terms of the seventh amendment, the Company has adequate cash and availability on its revolving credit facility to meet its obligations through September 30, 2002. Additionally, the Company believes that it can comply with the revised covenant requirements under the amendment through December 30, 2001. There is no assurance that the Company will be able to comply with or renegotiate such covenants for periods after December 30, 2001 or that the Company will be able to refinance its existing debt facilities.

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 2001 are anticipated to be $12.0 million in the aggregate, of which $8.8 million is expected to be spent on restaurant operations. The Company's actual 2001 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 credit facility will be sufficient to meet the Company's anticipated operating requirements, capital requirements and obligations associated with the restructuring.

On April 13, 2001, the Company executed an agreement granting J&B Restaurants Partners of Long Island Holding Co., LLC ("J&B") certain limited exclusive rights to operate and develop Friendly's full-service restaurants in the franchising regions of Nassau and Suffolk Counties in Long Island, New York (the "J&B Agreement"). Pursuant to the J&B Agreement, J&B purchased certain assets and rights in 31 existing Friendly's restaurants and committed to open an additional 29 restaurants over the next 12 years. The transaction price was approximately $19,950,000, of which approximately $4,250,000 was received in a note. The cash proceeds were used to prepay approximately $4.7 million on the term loans with the remaining balance being applied to the revolving credit facility. The 5-year note bears interest at an annual rate of 11% using a 20-year amortization schedule. Payments are due monthly through the five years with a balloon payment due at the end of five years.

SEASONALITY

Due to the seasonality of frozen dessert consumption and the effect from time to time of weather on patronage in its restaurants, the Company's revenues and EBITDA 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.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangibles." SFAS No. 142 modifies the rules for accounting for goodwill and other intangible assets. The new rules become effective on January 1, 2002. The Company does not believe the impact of adopting SFAS No. 142 will have a material effect on the Company's consolidated financial statements. The Company will continue to amortize its license agreement related to certain trademarked products under the new rules.

In April 2001, the Financial Accounting Standards Board reached consensus on Emerging Issues Task Force ("EITF") Issue No. 00-25, "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products," which is effective for quarters beginning after December 15, 2001, with prior financial statements restated if practicable. This Issue 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 is required to adopt EITF No. 00-25 for periods beginning after December 15, 2001. Management has not yet quantified the impact of implementing Issue No. 00-25 on the Company's financial statements.

In May 2000, the Emerging Issues Task Force issued EITF No. 00-14, "Accounting for Certain Sales Incentives," which provides guidance on the recognition, measurement, and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. The Company adopted EITF No. 00-14 on July 3, 2000. As a result, the Company has reclassified certain retail selling expenses against retail revenue for the three months ended April 2, 2000 to conform with the current period presentation.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that each derivative

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instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the statement of operations, and requires that a Company formally document, designate and assess the effectiveness of transactions that receive hedge accounting. Since the Company's commodity option contracts do not meet the criteria for hedge accounting, changes in the value of the commodity option contracts are recognized monthly in earnings. The cumulative effect upon adoption of approximately $77,000 has been recorded as income in the accompanying Condensed Consolidated Statement of Operations. It is not separately reported as a cumulative effect since the amount is not significant. Additionally, losses totaling $147,000 were recorded during the six months ended July 1, 2001. The fair market value of derivatives at July 1, 2001 was approximately $89,000.

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 10K.

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PART II--OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) An annual meeting of Company's shareholders was held on May 16, 2001.

(b) Not applicable.

(c) The election of two nominees for directors of the Company was voted upon at the meeting. The number of affirmative votes and the number of votes withheld with respect to such approvals are as follows:

NOMINEE	AFFIRMATIVE VOTES	VOTES WITHHELD

Michael J. Daly	5,521,075	1,356,041
Burton J. Manning	5,531,600	1,345,516

The results of the voting to approve the appointment of Arthur Andersen LLP to audit the accounts of the Company and its subsidiaries for 2001 are as follows:

FOR	AGAINST	ABSTAIN
6,767,341	104,375	5,400

There were no matters voted upon at the Company's annual meeting to which broker non-votes applied.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None

(b) No report on Form 8-K was filed during the three months and six months ended July 1, 2001.

SIGNATURES

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

FRIENDLY ICE CREAM CORPORATION

By: /s/ PAUL V. HOAGLAND

Name: Paul V. Hoagland
Title: Senior Vice President, Chief Financial Officer, Treasurer and Assi
Clerk