FRIENDLY ICE CREAM CORP
Form 10-K
February 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

FOR THE FISCAL YEAR ENDED DECEMBER 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM ______________ TO ______________

COMMISSION FILE NO. 0-3930

FRIENDLY ICE CREAM CORPORATION
(Exact name of registrant as specified in its charter)

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

1855 BOSTON ROAD
WILBRAHAM, MASSACHUSETTS 01095
(413) 543-2400
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

TITLE OF CLASS
Common Stock, $.01 par value

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 by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K / /.

The aggregate market value of voting stock held by nonaffiliates of the registrant, based upon the closing sales price of the registrant's common stock on February 1, 2002 on the American Stock Exchange was $25,078,384. For purpose of the foregoing calculation only, all members of the Board of Directors and executive officers of the registrant have been deemed affiliates. The number of shares of common stock outstanding was 7,352,262 as of February 1, 2002.

DOCUMENTS INCORPORATED BY REFERENCE:

Part III of this 10-K incorporates information by reference from the registrant's definitive proxy statement which will be filed no later than 120 days after December 30, 2001.

PART I

ITEM 1. BUSINESS

ORGANIZATION

Friendly's, founded in 1935, was publicly held from 1968 until January 1979, at which time it was acquired by Hershey Foods Corporation ("Hershey"). In 1988, The Restaurant Company ("TRC"), an investor group led by Donald N. Smith, the Company's current Chairman and Chief Executive Officer, acquired Friendly's from Hershey (the "TRC Acquisition"). In November 1997, the Company completed a public offering of 5,000,000 shares of its common stock (the "Common Stock Offering") for gross proceeds of $90 million and a public offering of $200 million of Senior Notes (the "Senior Notes") (collectively, the "Offerings"). In December 2001, the Company successfully completed a financial restructuring plan (the "Refinancing Plan") which included the repayment of the $64.5 million outstanding on its term loans and revolving credit facility (the "Old Credit Facility") and the repurchase of approximately $21.3 million in Senior Notes with the proceeds from $55 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 million revolving credit facility of which up to $20 million is available to support letters of credit. The $30 million commitment less issued letters of credit is available for borrowing to provide working capital and for other corporate needs (the "New Credit Facility"). In connection with the Mortgage Financing, three new limited liability corporations ("LLCs") were organized. Friendly Ice Cream Corporation is the sole member of each LLC.

Unless the context indicates otherwise: (i) references herein to "Friendly's" or the "Company" refer to Friendly Ice Cream Corporation, its predecessors and its consolidated subsidiaries; (ii) references herein to "FICC" refer to Friendly Ice Cream Corporation and not its subsidiaries; and (iii) as used herein, "Northeast" refers to the Company's core markets, which include Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont. The Company's fiscal years ended December 30, 2001, December 31, 2000, January 2, 2000, December 27, 1998 and December 28, 1997 are referred to herein as 2001, 2000, 1999, 1998 and 1997, respectively. Each year included 52 weeks except 1999, which included 53 weeks.

GENERAL

As of December 30, 2001, the Company owned and operated 393 restaurants and franchised 161 full-service restaurants and six non-traditional units. The Company manufactures a complete line of packaged frozen desserts distributed through more than 3,500 supermarkets and other retail locations in 17 states. Friendly's offers its customers a unique dining experience by serving a variety of high-quality, reasonably-priced breakfast, lunch and dinner items, as well as its signature frozen desserts, in a fun and casual neighborhood setting. For the year ended December 30, 2001, Friendly's generated $561.9 million in total revenues, $3.1 million of income before extraordinary items and $60.9 million in EBITDA (as defined herein) and incurred $27.3 million of interest expense.

Friendly'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. Breakfast items include specialty omelettes and breakfast combinations featuring eggs, pancakes and bacon or sausage. Breakfasts generally range from $3.49 to $5.79. Lunch and dinner items include a line of wrap sandwiches, entree salads, soups, super-melts, specialty burgers, appetizers including quesadillas, mozzarella cheese sticks and "Fronions," and stir-fry, chicken, pot pie, tenderloin steak and seafood entrees. These lunch and dinner items generally range from $3.49 to $9.79. Entree selections are complemented by Friendly's premium frozen desserts, including soft serve, which was introduced in

1999, the Fribble-Registered Trademark-, the Company's signature thick shake, Happy Ending-Registered Trademark- Sundaes, Candy Shoppe-Registered Trademark- Sundaes, the Wattamelon Roll-Registered Trademark- and Towering Mug beverages. The Company's frozen desserts are an important component of the Company's snack daypart.

Despite the Company's capital constraints, management has implemented a number of initiatives to restore and improve operational and financial efficiencies. From the date of the TRC Acquisition through 2001, the Company (i) implemented a major revitalization of its restaurants, (ii) repositioned the Friendly's concept from a sandwich and ice cream shoppe to a full-service, family-oriented restaurant with broader menu and daypart appeal, (iii) elevated customer service levels by recruiting more qualified managers and expanding the Company's training program, (iv) disposed of 371 under-performing restaurants, (v) capitalized upon the Company's strong brand name recognition by initiating the sale of Friendly's unique line of packaged frozen desserts through retail locations and (vi) implemented a franchising strategy to extend profitably the Friendly's brand without the substantial capital required to build new restaurants. The Company has expanded its franchise operations through sales of existing restaurants, which included development agreements, in under-penetrated markets.

CAPITAL INVESTMENT PROGRAM

A significant component of the Company's capital investment program is the FOCUS 2000 initiative, which is designed to establish a consistent, enhanced Friendly's brand image across the Company's entire restaurant operations. The Company's capital spending strategy seeks to increase comparable restaurant revenues and restaurant cash flow through the on-going revitalization and re-imaging of existing restaurants and to increase total restaurant revenues through the addition of new restaurants. The following illustrates the key components of the Company's capital spending program.

RESTAURANT RE-IMAGING. The Company substantially completed the re-imaging of nine restaurants in 2001 at a cost of approximately $156,000 per restaurant (not including costs related to development of the prototype). In addition, one new exterior project with an interior redecoration at a cost of approximately $91,000 was completed in 2001. The Company expects to complete the re-imaging of 50 restaurants at an estimated cost of $112,000 per project during 2002.

NEW RESTAURANT CONVERSION AND CONSTRUCTION. The Company constructed one new restaurant in 2001 at a cost of approximately $854,000, excluding land and pre-opening expenses. The Company does not expect to convert or construct any new buildings in 2002.

SEATING CAPACITY EXPANSION PROGRAM. Beginning with the TRC Acquisition through December 30, 2001, the Company has expanded seating capacity at 34 restaurants by approximately 50 seats on average per unit at an average cost of $294,000 per restaurant. The cost of a building expansion typically includes adding 50 seats per restaurant, relocating certain equipment, redecorating the interior, changing the exterior package and increasing parking capacity where necessary and available. There were no Company expansion projects completed during 2001. The Company plans to complete one expansion in 2002.

INSTALLATION OF RESTAURANT AUTOMATION SYSTEMS. Beginning with the TRC Acquisition through December 30, 2001, the Company has installed touch-screen point of sale ("POS") register systems in all Company-owned restaurants and franchised locations. The majority of these systems were installed at an average cost of $30,000 per restaurant, although complete systems have recently averaged $28,000. In addition, a limited system is now being deployed in the older, smaller buildings at an average cost of $17,000. These POS register systems are designed to improve revenue realization; food cost management and labor scheduling while increasing the speed and accuracy of processing customer orders. There were no significant system upgrades or deployments in 2001.

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FRANCHISING PROGRAM

The Company has initiated a franchising strategy to expand its restaurant presence in under-penetrated markets, accelerate restaurant growth in new markets, increase marketing and distribution efficiencies and preempt competition by acquiring restaurant locations in the Company's targeted markets. The Company's wholly-owned subsidiary, Friendly's Restaurants Franchise, Inc. ("FRFI") commenced operations in 1996 for the purpose of franchising various restaurant concepts. Since it began operations, FRFI has developed and now offers a franchise program for Friendly's restaurants. The Company generally seeks franchisees that have related business experience, capital adequacy to build-out the Friendly's concept and no other operations which have directly competitive restaurant or food concepts. As part of the development of its franchise business, the Company also sells existing Company-owned restaurants, known as "re-franchising." In addition to certain development and other fees, Friendly's receives (i) a royalty based on franchised restaurant revenues and (ii) revenues and earnings from the sale of Friendly's frozen desserts and other products.

On September 14, 2001, the Company entered into an agreement granting Revere Restaurant Group, Inc. ("Revere") certain limited exclusive rights to operate and develop Friendly's full-service restaurants in designated areas within Lehigh and Northampton counties, Pennsylvania (the "Revere Agreement"). Pursuant to the Revere Agreement, Revere purchased certain assets and rights in six existing Friendly's restaurants and committed to open an additional four restaurants over the next seven years. The president of Revere is a former employee of the Company. Gross proceeds from the sale were approximately $3,400,000 of which approximately $200,000 was for franchise fees for the

initial six restaurants. The $200,000 was recorded as revenue in the year ended December 30, 2001. The Company also recognized a gain of approximately $300,000 related to the sale of the assets for the six locations in the year ended December 30, 2001.

On April 13, 2001, the Company entered into an agreement granting J&B Restaurants Partners of Long Island Holding Co., LLC and its subsidiaries ("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 year ended December 30, 2001. The Company recognized a gain of approximately $4,300,000 related to the sale of the assets for the 31 locations in the year ended December 30, 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, in each case under the Old Credit Facility. The 5-year note receivable bears interest at an annual rate of 11% using a 20-year amortization schedule. Payments are due monthly through the first five years with a balloon payment due at the end of 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 year ended December 31, 2000. The Company recognized a gain of approximately $1,400,000 related to the sale of the assets for the 29 locations in the year ended December 31, 2000. The Company also sold certain assets and rights in six other restaurants to two additional franchisees resulting in a gain of $687,000.

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On October 2, 2000, the Company entered into an agreement granting Kessler non-exclusive rights to operate and develop Friendly's full-service restaurants in the franchising region of Elmira, Binghamton, Utica and Watertown, New York (the "Second Kessler Agreement"). Pursuant to the Second Kessler Agreement, Kessler purchased certain assets and rights in 12 existing Friendly's restaurants and has an option to open an additional eight restaurants over the next six years. Gross proceeds from the sale were approximately $8,100,000, of which $370,000 was for franchise fees for the initial 12 restaurants. The $370,000 was recorded as revenue in the year ended December 31, 2000. The Company recognized a gain of approximately $3,600,000 related to the sale of the assets for the 12 locations in the year ended December 31, 2000. During the year ended December 30, 2001, the Company recognized an additional gain of approximately $200,000 since the estimates for remaining closing costs exceeded actual payments.

In 2000, the Company and its first franchisee, Davco Restaurants, Inc. ("Davco"), agreed to terminate Davco's rights as the exclusive developer of new Friendly's restaurants in Maryland, Delaware, the District of Columbia and northern Virginia, effective December 28, 2000. Accordingly, the deferred development fees of $1,029,000 were recorded as revenue in 2000. Additionally,

Davco has the right to close up to 16 existing franchised locations and will operate the remaining 32 locations under their respective existing franchise agreements until such time as a new franchisee is found for those locations. The existing franchise agreements for the 32 locations were modified as of December 29, 2001 to allow early termination subject to liquidated damages, as defined, on 22 of the 32 franchise agreements. Effective August 6, 2001, Davco transferred its rights to three franchised locations to a third party. Davco closed two units during the year ended December 30, 2001.

The Company has limited experience in franchising restaurants and there can be no assurance that the Company will continue to successfully locate and attract suitable franchisees or that such franchisees will have the business abilities or sufficient access to capital to open restaurants or will operate restaurants in a manner consistent with the Company's concept and standards or in compliance with franchise agreements. The success of the Company's franchising program will also be dependent upon certain other factors, certain of which are not within the control of the Company or its franchisees, including the availability of suitable sites on acceptable lease or purchase terms, permitting and regulatory compliance and general economic and business conditions.

RESTAURANT CARRYOUT OPERATIONS

Through dedicated carryout areas, Friendly's restaurants offer the Company's full line of frozen desserts, including soft serve ice cream products introduced in 1999, and certain of its food menu items. Reserved parking is available at many of the Company's freestanding restaurants to facilitate quick carryout service. Approximately 14% of the Company's average freestanding restaurant revenues are derived from its carryout business with a significant portion of these sales occurring during the afternoon and evening snack periods. In addition, approximately 3.0% of revenues come from sales of packaged frozen desserts in display cases within its restaurants.

RETAIL (PACKAGED GOODS) SALES

In 1989, the Company extended its premium packaged frozen dessert line from its restaurants into retail locations. The Company offers a branded product line that includes approximately 60 half-gallon varieties featuring premium ice cream shop flavors and unique sundae combinations, frozen yogurt, low fat ice cream and sherbet. Specialty flavors include Royal Banana Split, Cappuccino Dream-Registered Trademark- and Caramel Fudge Nut Blast-TM-. Proprietary products include the Jubilee Roll-Registered Trademark-, Wattamelon Roll-Registered Trademark- and Friendly's branded ice cream cakes and pies. The Company also licenses from Hershey the right to feature certain candy brands including Almond Joy-Registered Trademark-, Mr. Goodbar-Registered Trademark-, Reese's Pieces-Registered Trademark-, Reese's-Registered Trademark- Peanut Butter Cups and York-Registered Trademark- Peppermint Patties on packaged sundae cups.

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The Company focuses its marketing and distribution efforts in areas where it has high restaurant penetration and consumer awareness. During the initial expansion of its retail business in 1989 and 1990, Albany, Boston and Hartford/Springfield were primary markets of opportunity. The Company added the New York and Philadelphia markets to its retail distribution efforts in 1992 and 1993. Subsequently, distribution was expanded into the Ohio, Pittsburgh, Baltimore/Washington and Richmond markets.

The Company expects to continue building its retail business in its current retail markets. In these markets, the Company intends to increase shelf space with existing accounts and add new accounts by (i) capitalizing on its

integrated restaurant and retail consumer advertising and promotion programs, (ii) continuing new product introductions and (iii) improving trade merchandising initiatives. Additionally, the Company expects to continue to selectively enter new markets where its brand awareness is high according to market surveys.

The Company has developed a broker/distributor network designed to protect product quality through proper product handling and to enhance the merchandising of the Company's frozen desserts. The Company's experienced sales force manages this network to serve specific retailer needs on a market-by-market basis.

MARKETING

The Company's overall marketing strategy is to build on the equity of the brand so as to maximize and leverage its 66-year heritage and "touch" what consumers emotionally feel about Friendly's.

The Company's marketing objectives are to increase its share of visits from heavy casual and family dining users and to build top-of-mind awareness of Friendly's advertising and the Friendly's brand. Friendly's advertising builds on the past emotive connections and experiences of families and children with the brand to present current offers and new menu items. The Company's advertising, media, promotion and product strategies are focused against delivering on these objectives.

Media is planned and purchased on a market-by-market basis to maximize the efficiencies and opportunities in each market. The Company's primary advertising medium is spot television in Friendly's major markets with radio used in the secondary markets or as a frequency builder for special events. Media advertising is focused against the higher consumption months (March through December) with the highest levels during the summer period. The Company uses targeted local restaurant marketing programs to meet its marketing objectives in those markets where penetration does not allow for broadcast media advertising.

The Company believes that its integrated restaurant and retail (supermarket) marketing efforts provide significant support for the development of its retail business. Specifically, the retail business benefits from the overall awareness of the Friendly's brand generated by the ongoing restaurant advertising program. This combined with the use of a common advertising campaign for both restaurant and retail communications delivers a significantly higher level of consumer exposure and usage compared to the Company's packaged frozen dessert competitors, which have only retail distribution. In turn, sales of the Company's frozen dessert products through more than 3,500 retail locations provides additional consumer awareness which management believes benefit the restaurants. Advertising and promotion expenditures were approximately $19.7 million for 2001.

CERTAIN RISKS ASSOCIATED WITH THE FOOD SERVICE INDUSTRY

Food service businesses are often affected by changes in consumer tastes, national, regional and local economic conditions, demographic trends, traffic patterns, the cost and availability of labor, purchasing power, availability of products and the type, number and location of competing restaurants. The Company could also be substantially adversely affected by publicity resulting from food quality,

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illness, injury or other health concerns, alleged discrimination or other operating issues stemming from one location or a limited number of locations, whether or not the Company is liable. In addition, factors such as increased cost of goods, regional weather conditions and the potential scarcity of

experienced management and hourly employees may also adversely affect the food service industry in general and the results of operations and financial condition of the Company.

MANUFACTURING

As of December 30, 2001, the Company produced most of its frozen desserts in its Wilbraham, MA Company-owned manufacturing plant, which employed a total of approximately 230 people. During 2001, the Wilbraham plant operated at an average capacity of 79%, attaining 93% capacity for the months of June through August, and produced (i) over 15.9 million gallons of ice cream, sherbets and yogurt in bulk and half-gallons, (ii) 6.7 million sundae cups, (iii) 1.7 million frozen dessert rolls, pies and cakes and (iv) 1.1 million gallons of fountain syrups and toppings. The quality of the Company's products is important both to sustain Friendly's image and to enable the Company to satisfy customer expectations. Wherever possible, the Company "engineers in" quality by installing modern processes such as computerized mix-making equipment and monitoring devices to ensure all storage tanks and rooms are kept at proper temperatures for maximum quality.

PURCHASING AND DISTRIBUTION

The primary raw materials for the manufacture of the Company's frozen desserts are dairy components and sweeteners. The Company's purchasing department procures other food products such as coffee, beef, pork and poultry in large quantities and uses commodity option contracts to hedge its positions on many of the agricultural commodities. Additionally, the Company will forward-contract where appropriate for as long as two-year periods of time. Since not all of the Company's purchases are hedgeable or have adequate open interest to fully hedge the Company's needs, sudden price increases will pose substantial price risks, such as that which occurred in 1998 to the price of cream, which could have a material adverse affect on the Company in the future.

The purchasing department in conjunction with the Company's product development department evaluates the cost and quality of all major food items on a rotating schedule basis. The purchases of food and raw materials are made through numerous vendors, many with which the Company has a long-term relationship. Purchase contracts are executed with vendors on an annual, semi-annual, or monthly basis depending on the nature of the item to be purchased and the opportunities within the marketplace. In order to promote competitive pricing and uninterrupted supply, the Company routinely works with prospective vendors on existing products as well as on items that may make up a new menu offering. In order to maximize its purchasing power, the Company purchases direct from manufacturers and service providers and avoids as much as possible any third party participation.

The Company owns one distribution center and leases two others. The Company opened a new distribution facility in May 1999 in York, PA under an operating lease. The Company distributes most product lines to its restaurants, and its packaged frozen desserts to its retail customers, from warehouses in Chicopee and Wilbraham, MA and York, PA with a combined non-union workforce of approximately 200 employees. The Company's private truck fleet delivers most of the product lines required to 97% of the restaurants. During 2000 the Company contracted with a third party distributor to provide distribution services to restaurants located in the Florida market. Since May 1999, the Company has extended its distribution product lines to also include fresh produce and dairy items. The Company is currently distributing produce and dairy products to approximately 52% of its restaurants. The Chicopee, Wilbraham and York warehouses encompass approximately 60,000, 109,000 and 86,000 square feet, respectively. The Company believes that these distribution facilities operate at or above industry standards with respect to timeliness and accuracy of deliveries.

The Company has distributed its products since its inception to protect the product integrity of its frozen desserts. The Company delivers products to most restaurants using its own fleet of tractors and trailers, which display large-scale images of the Company's featured products. The entire fleet is specially built to be compatible with storage access doors, thus protecting frozen desserts from "temperature shock." The trailer fleet is designed to have individual temperature control for three distinct compartments. To provide additional economies to the Company, the truck fleet backhauls on over 35% of its delivery trips, bringing the Company's purchased raw materials and finished products back to the distribution centers.

HUMAN RESOURCES AND TRAINING

The average Friendly's restaurant employs between two and four management team members, which may include one General Manager, one Assistant Manager, one Guest Service Supervisor and one General Manager Candidate. The General Manager is directly responsible for day-to-day operations. General Managers report to a District Manager who typically has responsibility for an average of seven to eight restaurants. District Managers report to a Regional Director who typically has responsibility for approximately 50 to 60 restaurants. Regional Directors report to the Senior Vice President, Restaurant Operations who oversees all Company and franchise restaurants.

The average Friendly's restaurant is staffed with four to 28 employees per shift, including the salaried restaurant management. Shift staffing levels vary by sales volume level, building configuration and time of day. The average restaurant typically utilized approximately 40,000 hourly-wage labor hours in 2001 in addition to salaried management.

EMPLOYEES

The total number of employees at the Company varies between 15,000 and 18,000 depending on the season of the year. As of December 30, 2001, the Company employed approximately 15,000 employees, of which approximately 14,000 were employed in Friendly's restaurants (including approximately 70 in field management), approximately 350 were employed at the Company's manufacturing and two distribution facilities and approximately 300 were employed at the Company's corporate headquarters and other offices. None of the Company's employees is a party to a collective bargaining agreement.

LICENSES AND TRADEMARKS

The Company is the owner or licensee of the trademarks and service marks (the "Marks") used in its business. The Marks "Friendly-Registered Trademark-" and "Friendly's-Registered Trademark-" are owned by the Company pursuant to registrations with the U.S. Patent and Trademark office.

Upon the sale of the Company by Hershey in 1988, all of the Marks used in the Company's business at that time which did not contain the word "Friendly" as a component of such Marks (the "1988 Non-Friendly Marks"), such as Fribble-Registered Trademark-, Fishamajig-Registered Trademark- and Clamboat-Registered Trademark-, were licensed by Hershey to the Company. The 1988 Non-Friendly Marks license has a term of 40 years expiring on September 2, 2028. Such license included a prepaid license fee for the term of the license, which is renewable at the Company's option for an additional term of 40 years and has a license renewal fee of $20.0 million.

Hershey also entered into non-exclusive licenses with the Company for certain candy trademarks used by the Company in its frozen dessert sundae cups

(the "Cup License") and pints (the "Pint License"). The Cup License and Pint License automatically renew for unlimited one-year terms subject to certain nonrenewal rights held by both parties. Hershey is subject to a noncompete provision in the sundae cup business for a period of two years if the Cup License is terminated by Hershey without cause, provided that the Company maintains its current level of market penetration in the sundae cup

business. However, Hershey is not subject to a noncompete provision if it terminates the Pint License without cause.

The Company also has a non-exclusive license agreement with Leaf, Inc. ("Leaf") for use of the Heath-Registered Trademark- Bar candy trademark. The term of the royalty-free Leaf license continues indefinitely subject to termination by Leaf upon 60 days notice. Excluding the Marks subject to the licenses with Hershey and Leaf, the Company is the owner of its Marks.

COMPETITION

The restaurant business is highly competitive and is affected by changes in the public's eating habits and preferences, population trends and traffic patterns, as well as by local and national economic conditions affecting consumer spending habits, many of which are beyond the Company's control. Key competitive factors in the industry are the quality and value of the food products offered, quality and speed of service, attractiveness of facilities, advertising, name brand awareness and image and restaurant location. Each of the Company's restaurants competes directly or indirectly with locally-owned restaurants as well as restaurants with national or regional images and, to a limited extent, restaurants operated by its franchisees. A number of the Company's significant competitors are larger or more diversified and have substantially greater resources than the Company. The Company's retail operations compete with national and regional manufacturers of frozen desserts, many of which have greater financial resources and more established channels of distribution than the Company. Key competitive factors in the retail food business include brand awareness, access to retail locations, price and quality.

GOVERNMENT REGULATION

The Company is subject to various federal, state and local laws affecting its business. Each Friendly's restaurant is subject to licensing and regulation by a number of governmental authorities, which include health, safety, sanitation, building and fire agencies in the state or municipality in which the restaurant is located. Difficulties in obtaining or failures to obtain required licenses or approvals, or the loss of such licenses and approvals once obtained, can delay, prevent the opening of, or close, a restaurant in a particular area. The Company is also subject to federal and state environmental regulations, but these have not had a material adverse effect on the Company's operations.

The Company's relationship with its current and potential franchisees is governed by the laws of the several states which regulate substantive aspects of the franchiser-franchisee relationship. Substantive state laws that regulate the franchiser-franchisee relationship presently exist or are being considered in a significant number of states, and bills may be introduced in Congress, which would provide for federal regulation of substantive aspects of the franchiser-franchisee relationship. These current and proposed franchise relationship laws limit, among other things, the rights of a franchiser to approve the transfer of a franchise, the ability of a franchiser to terminate or refuse to renew a franchise and the ability of a franchiser to designate sources of supply.

The Company's restaurant operations are also subject to federal and state

laws governing such matters as wages, hours, working conditions, civil rights and eligibility to work. Some states have set minimum wage requirements higher than the federal level. Significant numbers of hourly personnel at the Company's restaurants are paid at rates related to the federal minimum wage and, accordingly, increases in the minimum wage at a federal and/or state level could increase labor costs at the Company's restaurants. Other governmental initiatives such as mandated health insurance, if implemented, could adversely affect the Company as well as the restaurant industry in general. The Company is also subject to the Americans with Disabilities Act of 1990 which, among other things, may require certain renovations to its restaurants to meet federally-mandated requirements. The cost of these renovations is not expected to be material to the Company.

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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, 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.

ITEM 2. PROPERTIES

The table below identifies the location of the 554 restaurants operating as of December 30, 2001.

	COMPANY-OWNED/LEASED		FRANCHISED RESTAURANTS	
STATE	FREESTANDING RESTAURANTS	OTHER RESTAURANTS(A)	LEASED/ OWNED BY FRANCHISEE	LEASED TO FRANCHISEES BY FICC
Connecticut	37	10	--	--
Delaware	--	--	5	2
Florida	12	--	2	--
Maine	12	--	--	--
Maryland	--	1	20	11
Massachusetts	94	28	1	2
New Hampshire	12	4	--	--
New Jersey	35	11	9	--
New York	31	13	71	4
North Carolina	--	--	2	--
Ohio	21	1	1	2
Pennsylvania	38	9	15	1
Rhode Island	5	--	--	--
South Carolina	--	--	4	--
Tennessee	--	--	1	--
Vermont	9	1	--	--

Virginia......................	9	--	5	3
Total.........................	315	78	136	25

(a) Includes primarily malls and strip centers.

The 315 freestanding restaurants range in size from approximately 2,400 square feet to approximately 5,000 square feet. The 78 malls and strip center restaurants range in size from approximately 2,200 square feet to approximately 5,000 square feet. Of the 393 restaurants operated by the Company at December 30, 2001, the Company owned the buildings and the land for 114 restaurants, owned the buildings and leased the land for 97 restaurants and leased both the buildings and the land for 182 restaurants. The Company's leases generally provide for the payment of fixed monthly rentals and related occupancy costs (e.g., property taxes and insurance). Additionally, most mall and strip center leases require the payment of common area maintenance charges and incremental rent of between 3% and 6% of the restaurant's sales.

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In addition to the Company's restaurants, the Company owns (i) an approximately 260,000 square foot facility on 46 acres in Wilbraham, MA which houses the corporate headquarters, a manufacturing and distribution facility and a warehouse, (ii) approximately 13 acres of land in Troy, OH and (iii) an approximately 18,000 square foot restaurant construction and maintenance service facility located in Wilbraham, MA. The Company leases (i) an approximately 60,000 square foot distribution facility in Chicopee, MA, (ii) an approximately 86,000 square foot distribution and office facility in York, PA, (iii) an approximately 40,000 square foot facility in Ludlow, MA and (iv) on a short-term basis, space for its division and regional offices, its training and development center and other support facilities.

ITEM 3. LEGAL PROCEEDINGS

From time to time the Company is named as a defendant in legal actions arising in the ordinary course of its business. The Company is not party to any pending legal proceedings other than routine litigation incidental to its business. The Company does not believe that the resolutions of these claims will have a material adverse effect on the Company's consolidated financial condition or consolidated results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

None

EXECUTIVE OFFICERS

The executive officers of the Company and their respective ages and positions with the Company are as follows:

DONALD N. SMITH, 61, has been Chairman and Chief Executive Officer of the Company since September 1988. Mr. Smith also served as the Company's President from September 1988 to December 1998. Since 1986 Mr. Smith has been Chairman of the Board and Chief Executive Officer of The Restaurant Company and its predecessors, which owns and franchises a chain of mid-scale restaurants known as Perkins Restaurant and Bakery. Since 1998 he has also been the Chief Operating Officer of The Restaurant Company. Prior to joining The Restaurant Company, Mr. Smith was President and Chief Executive Officer for

Diversifoods, Inc. from 1983 to October 1985. From 1980 to 1983, Mr. Smith was Senior Vice President of PepsiCo., Inc. and was President of its Food Service Division. He was responsible for the operations of Pizza Hut Inc. and Taco Bell Corp., as well as North American Van Lines, Lee Way Motor Freight, Inc., PepsiCo Foods International and La Petite Boulangerie. Prior to 1980, Mr. Smith was President and Chief Executive Officer of Burger King Corporation and Senior Executive Vice President and Chief Operations Officer for McDonald's Corporation.

JOHN L. CUTTER, 57, has been President and Chief Operating Officer since December 1998. Prior to joining the Company, Mr. Cutter served as Chief Operating Officer at Boston Chicken, Inc. from 1997 through October 1998. From 1993 through 1997, he served as Chief Executive Officer and President of Boston Chicken Golden Gate, LLC, a franchisee of Boston Chicken, Inc. From 1991 through 1993, Mr. Cutter held the position of President and Chief Operating Officer for Nanco Restaurants, Inc. Prior to 1991, Mr. Cutter held the position of Group President at Saga Corporation/American Restaurant Group, Inc.

PAUL V. HOAGLAND, 49, has been Senior Vice President, Chief Financial Officer, Treasurer and Assistant Clerk since May 2001. Prior to joining the Company, Mr. Hoagland served as Executive Vice President and Chief Financial Officer with New England Restaurant Company, Inc. from 1992 to 2001. He also held a variety of executive positions with Burger King Corporation/Grand Metropolitan, including Vice President Finance--European Division and concluded his tenure with them as the

Operations Vice President for the Northeastern region. Mr. Hoagland began his career as a Controller for the I.T.T. Continental Baking Company.

MICHAEL A. MAGLIOLI, 56, has been Senior Vice President, Restaurant Operations since January 2002. He served as Vice President, Restaurant Operations from March 2000 to December 2001. Mr. Maglioli has been employed in various capacities with the Company since 1968. Mr. Maglioli's duties have included Restaurant Manager, District Manager, Division Manager, Regional Director and Regional Vice President.

ROBERT L. HOGAN, 58, has been Senior Vice President and Chief Marketing Officer since October 2000. Prior to joining the Company, Mr. Hogan served as Vice President--Marketing/Strategic Planning for New England Restaurant Company, Inc. from March 1999 through November 2000. From 1996 to 1999, he served as Vice President, Marketing for the Phoenix Restaurant Group, Inc., the owner and franchiser of the national Black-eyed Pea casual dining chain. From 1987 to 1996, Mr. Hogan functioned as the President of Pizza and Pipes Restaurants.

GARRETT J. ULRICH, 51, has been Vice President, Human Resources since September 1991. Prior to joining the Company, Mr. Ulrich held the position of Vice President, Human Resources for Dun & Bradstreet Information Services, North America from 1988 to 1991. From 1978 to 1988, Mr. Ulrich held various Human Resource executive and managerial positions at Pepsi Cola Company, a division of PepsiCo.

ALLAN J. OKSCIN, 50, has been Corporate Controller since 1989 and has been employed in various capacities with the Company since 1977. Mr. Okscin's duties have included Assistant Controller and several managerial positions in Financial Reporting, Financial Services and Internal Auditing. Mr. Okscin is a certified public accountant.

AARON B. PARKER, 44, has been Vice President, General Counsel and Clerk since October 2001. He served as Associate General Counsel and Clerk of the

Company from August 1997 to November 2001. He also served as Associate General Counsel and Assistant Clerk of the Company from 1989 to 1997, as well as the Company's Managing Director of International Business from 1994 to 1996. Mr. Parker served as Special Counsel to TRC from 1986 to 1996. Mr. Parker served as Associate General Counsel of TRC and its predecessors from 1986 through 1988. Prior to joining TRC, Mr. Parker was in private practice with the law firm of Wildman, Harrold, Allen, Dixon & McDonnell.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

On January 3, 2000, the Company was notified by The Nasdaq-Amex Group, a NASD Company, that the Company's shares, which were traded on the NASDAQ National Market, had failed to maintain a minimum bid price of $5.00 per share or greater for 30 consecutive trading days as required under NASDAQ rules. Since the Company's shares listed on NASDAQ did not trade at $5.00 or above for at least ten consecutive trading days before April 3, 2000, the Company's shares were de-listed from NASDAQ. Effective June 8, 2000, the Company's Common Stock began trading on the American Stock Exchange (AMEX) under the symbol "FRN". The following table sets forth the closing high and low sale price per share of the Company's Common Stock for the years ended December 30, 2001 and December 31, 2000, respectively:

MARKET PRICE OF COMMON STOCK

	HIGH	LOW
2001		
First Quarter	$3.38	$1.60
Second Quarter	2.75	1.60
Third Quarter	3.44	2.37
Fourth Quarter	5.15	2.30
2000		
First Quarter	$4.88	$3.00
Second Quarter	5.25	3.75
Third Quarter	5.00	3.63
Fourth Quarter	3.94	1.75

The number of shareholders of record of the Company's Common Stock as of February 1, 2002 was 524.

The Company currently intends to retain its earnings to finance future growth and, therefore, does not anticipate paying any cash dividends on its Common Stock in the foreseeable future. Any determination as to the payment of dividends will depend upon the future results of operations, capital requirements and financial condition of the Company and its subsidiaries and such other facts as the Board of Directors of the Company may consider, including any contractual or statutory restrictions on the Company's ability to pay dividends. The Company's New Credit Facility and the Indenture relating to its Senior Notes each limit the Company's ability to pay dividends on its Common Stock, and the Company is currently prohibited from paying any dividends (other than stock dividends) under these provisions. The Company has not paid any

dividends in the last five years.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table sets forth selected consolidated historical financial information of FICC and its subsidiaries, which has been derived from the Company's audited Consolidated Financial Statements for each of the five most recent years ended December 30, 2001. This information should be read in conjunction with the Consolidated Financial Statements and related Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere herein. See Note 3 of Notes to Consolidated Financial Statements for a discussion of the basis of the presentation and significant accounting policies of the consolidated historical financial information set forth below. No dividends were declared or paid for any period presented.

	FISCAL YEAR(A)				
(IN THOUSANDS, EXCEPT PER SHARE DATA)	2001	2000	1999	1998	1997
STATEMENT OF OPERATIONS DATA:					
Revenues:					
Restaurant	$447,953	$508,976	$618,433	$595,308	$593,67
Foodservice	104,746	81,172	62,421	55,533	51,76
Franchise	9,174	8,710	4,967	3,769	2,37
International	--	--	23	301	1,24
Total revenues	561,873	598,858	685,844	654,911	649,06
Costs and expenses:					
Cost of sales	197,846	196,181	206,293	204,786	197,33
Labor and benefits	157,312	187,641	228,492	211,581	208,36
Operating expenses	115,822	121,951	142,097	131,011	130,78
General and administrative expenses (b)	36,312	41,233	46,413	44,965	50,58
Restructuring expenses, net (c)	636	12,056	--	--	-
Expenses associated with Recapitalization (d)	--	--	--	--	71
Relocation of manufacturing and distribution facility (e)	--	--	1,175	945	-
Write-downs of property and equipment (c, f)	800	20,834	1,913	1,132	77
Depreciation and amortization	29,027	30,750	34,989	33,449	31,69
Gain on franchise sales of restaurant operations and properties (g)	(4,591)	(5,307)	(2,574)	(1,005)	(2,28
Gain on sales of other property and equipment, net	(2,021)	(5,507)	(534)	(193)	-
Operating income (loss)	30,730	(974)	27,580	28,240	31,09
Interest expense, net (h)	27,310	31,053	33,694	31,838	39,30
(Recovery of write-down of) write-down of and equity in net loss of joint venture (i)	--	--	(896)	4,828	1,53
Income (loss) before (provision for) benefit from income taxes, extraordinary item and cumulative effect of changes in					

accounting principles....................	3,420	(32,027)	(5,218)	(8,426)	(9,73
(Provision for) benefit from income taxes..................................	(300)	21,221	5,937	3,455	3,99
Income (loss) before extraordinary item and cumulative effect of changes in accounting principles....................	3,120	(10,806)	719	(4,971)	(5,74
Extraordinary item, net of income tax effect (j)..............................	547	--	--	--	-
Cumulative effect of changes in accounting principles, net of income tax effect (k)..................................	--	--	(319)	--	2,23
Net income (loss).........................	$ 3,667	$(10,806)	$ 400	$ (4,971)	$ (3,50

	FISCAL YEAR(A)				
	2001	2000	1999	1998	1997
Basic and diluted income (loss) per share:					
Income (loss) before extraordinary item and cumulative effect of changes in accounting principles..................	$ 0.43	$ (1.45)	$ 0.09	$ (0.67)	$ (1.86
Extraordinary item, net of income tax effect................................	0.07	--	--	--	--
Cumulative effect of changes in accounting principles, net of income tax effect............................	--	--	(0.04)	--	0.72
Net income (loss).......................	$ 0.50	$ (1.45)	$ 0.05	$ (0.67)	$ (1.14
Other Data:					
EBITDA (1)................................	$ 60,855	$ 51,137	$ 65,045	$ 63,543	$ 72,363
Net cash provided by (used in) operating activities..............................	15,472	(2,961)	34,551	32,865	22,118
Net cash provided by (used in) investing activities..............................	42,753	25,049	(22,775)	(48,320)	(23,437
Net cash (used in) provided by financing activities..............................	(56,467)	(19,566)	(10,738)	11,405	(2,160
Capital expenditures:					
Cash..................................	$ 13,922	$ 18,773	$ 41,388	$ 51,172	$ 31,638
Non-cash (m)...........................	--	3,674	--	608	2,227
Total capital expenditures................	$ 13,922	$ 22,447	$ 41,388	$ 51,780	$ 33,865

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000	DECEMBER 27, 1998	DEC
BALANCE SHEET DATA:					

Working capital deficit..........	$(19,359)	$(35,429)	$(47,824)	$(30,657)	$
Total assets.....................	$252,562	$297,686	$356,370	$374,548	$
Total long-term debt and capital lease obligations, excluding current maturities..............	$239,064	$283,658	$300,345	$320,806	$
Total stockholders' deficit.......	$(96,014)	$(99,983)	$(89,705)	$(90,601)	$

(a) 1999 included 53 weeks of operations. All other years presented included 52 weeks of operations.

(b) General and administrative expenses included stock compensation expense of $298, $527, $563, $722 and $8,407 for 2001, 2000, 1999, 1998 and 1997, respectively.

(c) 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 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 in the year ended December 31, 2000. The Company reduced the restructuring reserve by $1,900 during the year ended December 30, 2001 since the reserve exceeded estimated remaining payments.

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

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restructuring charge of approximately $2,536 for severance, rent and unusable construction supplies in the year ended December 30, 2001.

(d) Included payroll taxes associated with stock compensation discussed in (b) and the write-off of deferred financing costs as a result of the Recapitalization in 1997.

(e) Costs associated with the relocation of manufacturing and distribution operations from Troy, OH to Wilbraham, MA and York, PA.

(f) 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 Company determined that the carrying values of certain of these properties exceeded their estimated fair values less costs to sell. Accordingly, the carrying values of 69 of the 81 locations closed at the end of March 2000 were reduced by an aggregate of $7,800 and the carrying values of 64 of the 70 locations which were to be disposed of over the next 24 months were reduced by an aggregate of $9,200. In addition to these properties, it was determined during 2000 that the carrying values of certain other properties exceeded their estimated fair values less costs to sell. The carrying values of these 12 properties were reduced by an aggregate of $2,700 and the carrying values of eight properties leased to

Davco were reduced by $1,100. 1998 included a $220 write-down related to equipment as a result of the closing of the Company's United Kingdom operations. All other write-downs of property and equipment related to property and equipment to be disposed of in the normal course of the Company's operations.

(g) Net gains recorded in connection with sales of equipment, operating rights and properties to franchisees.

(h) Interest expense was net of capitalized interest of $93, $109, $397, $525 and $250 and interest income of $581, $219, $132, $278 and $338 for 2001, 2000, 1999, 1998 and 1997, respectively.

(i) During 1999, the Company recovered approximately $827 of cash and $69 of equipment from its previous joint venture partner. 1998 included a $3,486 write-down of the investment in and advances to the joint venture to net realizable value based on the Company's decision to discontinue its direct investment in the joint venture. The Company's share of the joint venture's loss in 1998 and 1997 was $1,342 and $1,530, respectively.

(j) Extraordinary item, net represents the $4,300 gain on the repurchase of Senior Notes net of (i) $2,900 of deferred financing costs which were expensed as a result of the repayment of Tranche A of the term loans in July 2001 and the repayment of the Old Credit Facility and the repurchase of $21,300 of Senior Notes in December 2001, (ii) $500 of expenses associated with releasing mortgages, etc. in connection with the repayment of the Old Credit Facility and (iii) $400 of income taxes.

(k) Related to a change in accounting principle for pre-opening costs in 1999 and a change in accounting principle for pensions in 1997.

(l) EBITDA represents net income (loss) before (i) extraordinary item, net of income tax effect, (ii) cumulative effect of changes in accounting principles, net of income tax effect, (iii) (provision for) benefit from income taxes, (iv) (recovery of write-down of) write-down of and equity in net loss of joint venture, (v) interest expense, net, (vi) depreciation and amortization, (vii) write-downs of property and equipment and (viii) other non-cash items. The Company has included information concerning EBITDA in this Form 10-K 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 from operations or other traditional indications of a Company's operating performance.

(m) Non-cash capital expenditures represent the cost of assets acquired through the incurrence of capital lease obligations.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS OF THE COMPANY AND THE RELATED NOTES THERETO INCLUDED ELSEWHERE HEREIN.

OVERVIEW

Friendly's owns and operates 393 restaurants, franchises 161 full-service restaurants and six non-traditional units and manufactures a full line of frozen desserts distributed through more than 3,500 supermarkets and other retail locations in 17 states. The Company was publicly held from 1968 until

January 1979, at which time it was acquired by Hershey Foods Corporation ("Hershey"). Under Hershey's ownership, the number of Company restaurants increased from 601 to 849. Hershey subsequently sold the Company in September 1988 to The Restaurant Company ("TRC") in a highly-leveraged transaction (the "TRC Acquisition").

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

	FOR THE THREE MONTHS ENDED		FOR THE YEAR ENDED	
	DECEMBER 30, 2001	DECEMBER 31, 2000	DECEMBER 30, 2001	DECEMBER 31, 2000
Company Units:				
Beginning of period.........	394	471	449	618
Openings....................	1	--	1	2
Re-franchised closings......	(2)	(12)	(41)	(49)
Closings....................	--	(10)	(16)	(122)
End of Period...............	393	449	393	449
Franchised Units:				
Beginning of period.........	166	114	127	69
Re-franchised openings......	2	12	41	49
Openings....................	--	4	4	17
Closings....................	(1)	(3)	(5)	(8)
End of Period...............	167	127	167	127

Beginning in 1989, the new management focused on improving operating performance through revitalizing and renovating restaurants, upgrading and expanding the menu and improving management hiring, training, development and retention. Also in 1989, the Company introduced its signature frozen desserts into retail locations in the Northeast. Since the beginning of 1989, 47 new restaurants have been opened while 371 under-performing restaurants have been closed and 131 restaurants have been refranchised.

The high leverage associated with the TRC Acquisition has severely impacted the liquidity and profitability of the Company. As of December 30, 2001, the Company had a stockholders' deficit of $96.0 million. Cumulative net interest expense of $514.3 million since the TRC Acquisition has significantly contributed to the deficit. The Company's net income in 2001 of $3.7 million included $27.3 million of interest expense, net. The degree to which the Company is leveraged could have important consequences, including the following: (i) potential impairment of the Company's ability to obtain additional financing in the future; (ii) because borrowings under the Company's New Credit Facility and Mortgage Financing in part bear interest at floating rates, the Company could be adversely affected by any increase in prevailing rates; (iii) the Company is more leveraged than certain of its principal competitors, which may place the Company at a competitive disadvantage; and (iv) the

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Company's substantial leverage may limit its ability to respond to changing business and economic conditions and make it more vulnerable to a downturn in general economic conditions.

The Company's revenue, EBITDA and operating income have improved significantly since the TRC Acquisition. With the closing of 371 restaurants, average revenue per restaurant has increased 57% from $0.7 million in 1989 to $1.1 million in 2001. Foodservice operations manufactures frozen dessert products and distributes such manufactured products and purchased finished goods to both Company-owned and franchised restaurants. Additionally, it sells frozen dessert products to distributors and retail and institutional locations. Foodservice (franchise, retail and institutional) and franchise revenues have also increased from $1.4 million in 1989 to $113.9 million in 2001. EBITDA has increased 28.5% from $47.4 million in 1989 to $60.9 million in 2001. As a result of the closing of under-performing restaurants, the costs associated with the March 2000 restructuring, the growth of foodservice and other businesses and the commencement in July 1997 of the Company's franchising program, period-to-period comparisons may not be meaningful. Largely as a result of its high leverage and interest expense, the Company has reported net income (loss) of $3.7 million, ($10.8 million), $0.4 million, ($5.0 million) and ($3.5 million) for 2001, 2000, 1999, 1998 and 1997, respectively.

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.

2001 COMPARED TO 2000

REVENUES:

Total revenues decreased $37.0 million, or 6.2%, to $561.9 million in 2001 from $598.9 million in 2000. Restaurant revenues decreased $61.0 million, or 12.0%, to $448.0 million in 2001 from $509.0 million in 2000. Restaurant revenues decreased by $72.2 million due to the closing of 138 under-performing restaurants and the re-franchising of 90 additional locations over the past 24 months. Closing of restaurants accounted for $29.9 million of the restaurant revenue decline and re-franchising reduced restaurant revenues by an additional $42.3 million. Partially offsetting this decrease was a 2.6% increase in comparable restaurant revenues from 2000 to 2001. Revenues from the two locations open less than one year were $0.9 million. Foodservice (product sales to franchisees, retail and institutional) and other revenues increased by $23.5 million, or 28.9%, to $104.7 million in 2001 from $81.2 million in 2000. The increase in the number of franchised units accounted for $13.0 million of the increase, sales to foodservice retail supermarket customers increased by $9.4 million and sales to outside distributors increased by $1.1 million. On May 1, 2001, foodservice decreased its ice cream pricing to all restaurants. This resulted in decreased foodservice revenues of 3.2% for the year ended December 30, 2001. Franchise revenue increased $0.5 million, or 5.7%, to $9.2 million in 2001 compared to $8.7 million in 2000. The increase is largely the result of the difference in the number of franchised locations operating during both periods. There were 167 franchise units open at the end of 2001 compared to 127 franchise units open at the end of 2000.

COST OF SALES:

Cost of sales increased $1.7 million, or 0.8%, to $197.8 million in 2001 from $196.2 million in 2000. Cost of sales as a percentage of total revenues increased to 35.2% in 2001 from 32.8% 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. Additionally, the cost of cream, the principal ingredient used in making ice cream, was higher in 2001 when compared to 2000 and contributed to the rise in cost of sales as a percentage of total revenues, especially in foodservice's

retail supermarket business. In May 2001, the Company raised prices to its retail customers, which decreased cost of sales as a percentage of

revenues. For 2002, the Company believes that cream prices will be slightly higher than 2001. To minimize risk, alternative supply sources continue to be pursued.

LABOR AND BENEFITS:

Labor and benefits decreased $30.3 million, or 16.2%, to $157.3 million in 2001 from $187.6 million in 2000. Labor and benefits as a percentage of total revenues decreased to 28.0% in 2001 from 31.3% 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 138 under-performing Company-owned units over the past 24 months improved the relationship of restaurant labor and benefits to restaurant sales as well as to total revenues.

OPERATING EXPENSES:

Operating expenses decreased $6.2 million, or 5.0%, to $115.8 million in 2001 from $122.0 million in 2000. Operating expenses as a percentage of total revenues were 20.6% and 20.4% in 2001 and 2000, respectively. The increase as a percentage of total revenues resulted from higher costs for foodservice retail promotions and restaurant advertising in 2001 when compared to 2000.

GENERAL AND ADMINISTRATIVE EXPENSES:

General and administrative expenses were $36.3 million and $41.2 million in 2001 and 2000, respectively. General and administrative expenses as a percentage of total revenues decreased to 6.5% in 2001 from 6.9% in 2000. The decrease is primarily the result of the elimination of certain management and administrative positions associated with the Company's closing of 138 locations and the re-franchising of 90 locations over the past 24 months. In October 2001, the Company eliminated approximately 70 positions at corporate headquarters. In March 2000, the Company reduced certain management and administrative positions by approximately 80, announced the immediate closing of 81 restaurants and the planned closing of 70 additional restaurants and an on-going hiring freeze. In 2001, bonus expense increased $1.0 million when compared to 2000.

EBITDA:

As a result of the above, EBITDA (EBITDA represents net income (loss) before (i) extraordinary item, net of income tax effect, (ii) cumulative effect of change in accounting principle, net of income tax effect, (iii) (provision for) benefit from income taxes, (iv) (recovery of write-down of) write-down of and equity in net loss of joint venture, (v) interest expense, net, (vi) depreciation and amortization, (vii) write-downs of property and equipment and (viii) other non-cash items) increased $9.8 million, or 19.2%, to $60.9 million for the year ended December 30, 2001 from $51.1 million for 2000. EBITDA as a percentage of total revenues was 10.8% and 8.5% for 2001 and 2000, respectively.

RESTRUCTURING EXPENSES, NET:

Restructuring expenses, net were $0.6 million and $12.1 million for the years ended December 30, 2001 and December 31, 2000, respectively. The 2000 restructuring costs are 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 following 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. In 2001, the Company decided to continue to operate 25 of the 151 properties. The 2001 restructuring costs are the result of the costs associated with the Company eliminating approximately 100 corporate headquarters and construction positions.

The purpose of the reduction was to streamline functions and reduce redundancy amongst its business segments. The Company believes the outsourcing of such activities will be more cost effective in the future. Included in these costs are severance, rent on the facility used for construction and fabrication until lease termination, and other miscellaneous costs. The expense reported in 2001 includes $2.5 million associated with the elimination of headquarters and construction positions in 2001 partially offset by a $1.9 million reduction in the 2000 restructuring charge. The reduction of the 2000 charge in 2001 was the result of the reserve exceeding estimated remaining payments. The estimated reserve requirement is lower primarily due to earlier than anticipated lease terminations.

WRITE-DOWNS OF PROPERTY AND EQUIPMENT:

Write-downs of property and equipment were $0.8 million and $20.8 million in 2001 and 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 were to be closed over the following 24 months to their estimated net realizable value. During the year ended December 30, 2001, the Company made the decision to continue to operate 25 of the 70 properties that were to be closed over the following 24 months. Accordingly, the properties and related assets are no longer held for sale and the Company began depreciating the properties. As of December 30, 2001, there were 16 properties held for sale including one operating unit and 15 closed units, of which 14 relate to the March 2000 restructuring.

DEPRECIATION AND AMORTIZATION:

Depreciation and amortization decreased $1.7 million, or 5.6%, to $29.0 million in 2001 from $30.8 million in 2000. Depreciation and amortization as a percentage of total revenues was 5.2% and 5.1% in 2001 and 2000, respectively.

GAIN ON FRANCHISE SALES OF RESTAURANT OPERATIONS AND PROPERTIES:

Gain on franchise sales of restaurant operations and properties was $4.6 million and $5.3 million in 2001 and 2000, respectively. The Company recognized a gain of $4.3 million associated with the sale of 31 restaurants to a franchisee during the year ended December 30, 2001 as compared to the gain of $5.1 million associated with the sale of 41 restaurants to a franchisee during 2000. The Company also sold certain assets and rights in ten other restaurants to three additional franchisees during 2001 and eight other restaurants to three additional franchisees during 2000.

GAIN ON SALES OF OTHER PROPERTY AND EQUIPMENT, NET:

The gain on sales of other property and equipment, net was $2.0 million and $5.5 million in 2001 and 2000, respectively. The gain in 2001 primarily resulted from the sale of 24 closed locations during the year ended December 30, 2001 compared to the sale of 45 closed locations during the year ended December 31,

2000.

INTEREST EXPENSE, NET:

Interest expense, net of capitalized interest and interest income, decreased by $3.7 million, or 12.1%, to $27.3 million in 2001 from $31.1 million in 2000. The decrease is primarily impacted by the decrease in the average outstanding balance on the term loans in 2001 compared to 2000. Total outstanding debt, including capital lease obligations, was reduced from $298.8 million at December 31, 2000 to $242.0 million at December 30, 2001.

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(PROVISION FOR) BENEFIT FROM INCOME TAXES:

The provision for income taxes was $0.3 million, an effective tax rate of 8.8%, in 2001 compared to a benefit from taxes of $21.2 million, or 66.0%, for 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 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 federal net operating loss carryforwards. In 2001, the provision for income taxes was favorably impacted by reductions in the valuation allowance on state net operating loss carryforwards and state tax credits that resulted from the Company's refinancing in December 2001.

EXTRAORDINARY ITEM, NET OF INCOME TAXES:

Extraordinary item, net represents the $4.3 million gain on the repurchase of Senior Notes net of (i) $2.9 million of deferred financing costs which were expensed as a result of the repayment of Tranche A of the term loans in July 2001 and the repayment of the Old Credit Facility and the repurchase of $21.3 million of Senior Notes in December 2001, (ii) $0.5 million of expenses associated with releasing mortgages, etc. in connection with the repayment of the Old Credit Facility and (iii) $0.4 million of income taxes.

NET INCOME (LOSS):

Net income was $3.7 million in 2001 compared to a net loss of $10.8 million in 2000 for the reasons discussed above.

2000 COMPARED TO 1999

REVENUES:

Total revenues decreased $86.9 million, or 12.7%, to $598.9 million in 2000 from $685.8 million in 1999. Restaurant revenues decreased $109.4 million, or 17.7%, to $509.0 million in 2000 from $618.4 million in 1999. 1999 included a 53rd week of operations. The additional week contributed approximately $12.5 million in total revenues for the restaurant and foodservice (franchise, retail and institutional) segments. Restaurant revenues decreased by $109.4 million largely due to the closing of 122 under-performing restaurants and the re-franchising of an additional 49 locations. Closing of restaurants accounted for $54.8 million of the restaurant revenue decline and re-franchising reduced restaurant revenues by an additional $41.0 million. A decrease of 3.3% in sales from comparable restaurants added to the decline. The largest decrease in sales from comparable restaurants occurred during the summer months. The summer of 1999 had several weeks of 90-degree temperatures whereas the summer of 2000 did not. In addition, the Company introduced soft serve ice cream in May 1999, which had a favorable impact on revenues in 1999. Partially offsetting these decreases in restaurant revenues was the added revenue of $6.4 million

from restaurants open less than 18 months. Foodservice (product sales to franchisees, retail and institutional) revenues increased by $18.8 million, or 30.0%, to $81.2 million in 2000 from $62.4 million in 1999. The increase was primarily due to the increase in the number of franchise locations. Franchise revenues (royalties, fees and rent) increased $3.7 million or 74.0% to $8.7 million in 2000 from $5.0 million in 1999 due to the increase in the number of franchise locations. Included in the increase were approximately $1.0 million of fees in 2000 associated with the termination of the Davco franchise development agreement. There were 127 franchise units (including non-traditional units) open at December 31, 2000 compared to 69 franchise units open at January 2, 2000.

COST OF SALES:

Cost of sales decreased $10.1 million, or 4.9%, to $196.2 million in 2000 from $206.3 million in 1999. Cost of sales as a percentage of total revenues increased to 32.8% in 2000 from 30.1% in 1999. The higher food cost as a percentage of total revenues was primarily 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.

LABOR AND BENEFITS:

Labor and benefits decreased $40.9 million, or 17.9%, to $187.6 million in 2000 from $228.5 million in 1999. Labor and benefits as a percentage of total revenues was 31.3% for 2000 compared to 33.3% for 1999. The lower labor and benefits as a percentage of total revenues was primarily due to the increase in Foodservice sales to franchisees and retail customers, which do not have any associated restaurant labor and benefits. The closing of 122 lower volume restaurants in 2000 also resulted in a decline in restaurant labor as a percentage of total revenues. Partially offsetting the decreases were higher group insurance and workers' compensation insurance costs in 2000 compared to 1999.

OPERATING EXPENSES:

Operating expenses decreased $20.1 million, or 14.2%, to $122.0 million in 2000 from $142.1 million in 1999. The decline in the number of operating restaurants reduced restaurant expenses. The growth in Foodservice sales to franchisees also favorably impacted the comparison of operating expenses to revenues as increases in these revenues result in only minor increases in operating expenses. Partially offsetting the declines in restaurant operating expenses were increased costs in support of franchise operations. Selling expenses in support of retail supermarket sales were unchanged. Operating expenses as a percentage of total revenues decreased to 20.4% in 2000 from 20.7% in 1999.

GENERAL AND ADMINISTRATIVE EXPENSES:

General and administrative expenses decreased $5.2 million, or 11.2%, to $41.2 million in 2000 from $46.4 million in 1999. General and administrative expenses as a percentage of total revenues increased to 6.9% in 2000 from 6.8% in 1999. The March 2000 reduction of certain management and administrative positions associated with the closing of 81 restaurants and the planned closing of 70 additional restaurants benefited 2000 costs when compared to the prior year. Bonus expense was also higher in 2000 when compared to 1999.

EBITDA:

As a result of the above, EBITDA decreased $13.9 million, or 21.4%, to $51.1 million in 2000 from $65.0 million in 1999. EBITDA as a percentage of total revenues decreased to 8.5% in 2000 from 9.5% in 1999.

RESTRUCTURING EXPENSES, NET:

Restructuring expenses, net were $12.1 million for 2000 as a result of the costs associated with the Company's decision in March 2000 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 were severance, rent on closed restaurants until lease termination, utilities and real estate taxes, demarking, lease termination, environmental and other costs.

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RELOCATION OF MANUFACTURING AND DISTRIBUTION FACILITY:

Relocation of manufacturing and distribution facility expense relates to costs paid in connection with the relocation of manufacturing and distribution operations from Troy, OH to Wilbraham, MA and York, PA. The 1999 expense included a $1.0 million loss on the sale of the Troy, OH manufacturing facility and additional costs of $0.1 million associated with the relocation of the facility.

WRITE-DOWNS OF PROPERTY AND EQUIPMENT:

Write-downs of property and equipment increased $18.9 million to $20.8 million in 2000 from $1.9 million in 1999 as 153 properties were written down in 2000 and 19 properties were written down in 1999. The increase in write-downs is primarily the result of the non-cash write-down of 69 of the 81 under-performing restaurants, which were closed at the end of March 2000, and the non-cash write-down of 64 of the 70 additional restaurants to be closed, which were anticipated to close over a 24-month period. Of the 70 anticipated to close, 39 remained open at December 31, 2000.

DEPRECIATION AND AMORTIZATION:

Depreciation and amortization decreased $4.2 million, or 12.1%, to $30.8 million in 2000 from $35.0 million in 1999. Depreciation and amortization as a percentage of total revenues was 5.1% in 2000 and 1999.

GAIN ON FRANCHISE SALES OF RESTAURANT OPERATIONS AND PROPERTIES:

Gain on franchise sales of restaurant operations and properties for 2000 was $5.3 million compared to $2.6 million for 1999. The Company recognized a gain of $5.1 million associated with the sale of 41 restaurants to a franchisee during 2000. The Company also sold certain assets and rights in eight other restaurants to three additional franchisees during 2000. The gain on franchise sales of restaurant operations and properties for 1999 related to the sale of the equipment and operating rights for three existing restaurants to three franchisees along with the sale of the land and buildings associated with 13 previously franchised restaurants to an existing franchisee.

GAIN ON SALES OF OTHER PROPERTY AND EQUIPMENT, NET:

The gain on sales of other property and equipment, net was $5.5 million and $0.5 million for 2000 and 1999, respectively. The increase is the result of the Company selling restaurant properties in 2000.

INTEREST EXPENSE, NET:

Interest expense, net of capitalized interest and interest income, decreased by $2.6 million, or 7.8%, to $31.1 million in 2000 from $33.7 million in 1999. The decrease in interest expense, net was primarily due to a reduction in the average outstanding debt during 2000. Total outstanding debt, including capital leases, was reduced by $16.9 million to $298.8 million at December 31, 2000 from $315.7 million at January 2, 2000 as proceeds from assets sales were applied to the Company's term loans.

BENEFIT FROM INCOME TAXES:

The benefit from income taxes was $21.2 million, an effective tax rate of 66%, in 2000 compared to $5.9 million, or 114%, in 1999. The effective tax rate is higher than the statutory rate due to the reversal of valuation allowance on certain net operating loss ("NOL") carryforwards due to the elimination of certain restrictions on the NOLs.

CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET:

In accordance with Statement of Position ("SOP") No. 98-5, the Company recognized $0.3 million of expense, net of the related income tax benefit of $0.2 million, in 1999 related to previously deferred restaurant pre-opening costs.

NET (LOSS) INCOME:

Net loss was $10.8 million in 2000 compared to net income of $0.4 million in 1999 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 (used in) operating activities was $15.5 million, ($2.9) million and $34.6 million in 2001, 2000 and 1999, respectively. The increase in cash provided by operating activities during 2001 is primarily due to lower administrative costs due to a decrease in field management and headquarter salaries as a result of the 2000 restructuring, a reduction in the costs associated with the 2000 restructure properties as fewer restaurants were maintained during 2001 and less interest paid as a result of lower average outstanding debt balances during 2001.

Accounts payable increased during 2001 by $0.4 million as compared to a decrease of $6.0 million during 2000 due to the timing of payments. Accrued expenses decreased by $1.5 million during 2001 primarily due to a change in the Company's vacation policy as compared to a $10.5 million decrease in accrued expenses during 2000. The decrease in 2000 was the result of a $3.0 million decrease in salaries and benefits accrued at December 31, 2000 directly related to the fewer number of restaurants and the decrease in headquarter salaries as a result of the 2000 restructuring, a $2.2 million decrease in unearned premiums in the Company's captive insurance company, a decrease in accrued food tax liability of $1.5 million due to fewer restaurants, a decrease in unearned franchise fees of $1.0 million as a result of the termination agreement with Davco, a decrease in accrued occupancy costs of $1.0 million as a direct result of the decrease in the number of operating restaurants from January 2, 2000 to December 31, 2000, a $0.9 million decrease in accrued costs for new restaurants as there were fewer restaurants being constructed in 2000 than in 1999 and a decrease in accrued interest of $0.5 million due to the reduction in the outstanding term loans as a result of the accelerated pay-downs from asset sales. Offsetting these decreases in 2000 was the establishment of the restructuring reserve and an increase of $2.5 million in Company general

liability and workers' compensation insurance as a result of recent experience.

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.

The Company requires capital principally to maintain existing restaurant and plant facilities, to continue to renovate and re-image existing restaurants, to convert restaurants, to construct new restaurants and for general corporate purposes. Since the TRC Acquisition and through December 30, 2001, the Company has spent $416.7 million on capital expenditures, including assets acquired under capital leases, of which $139.7 million was for the renovation of restaurants under its revitalization and re-imaging programs.

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Net cash provided by (used in) investing activities was $42.8 million in 2001, $25.0 million in 2000 and ($22.8 million) in 1999. Capital expenditures for restaurant operations, including assets acquired under capital leases, were approximately $10.8 million in 2001, $18.2 million in 2000 and $36.3 million in 1999. Capital expenditures were offset by proceeds from the sales of property and equipment of $56.7 million, $43.8 million and $17.5 million in 2001, 2000 and 1999, respectively.

The Company had a working capital deficit of $19.4 million as of December 30, 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.

In November 1997, the Company entered into a credit facility which included revolving credit loans, term loans and letters of credit (the "Old Credit Facility"). The Company had executed several amendments to the Old Credit Facility. The most recent amendment occurred on March 19, 2001. All of the then existing financial covenants were amended and a new financial covenant was added requiring minimum cumulative consolidated EBITDA, as defined, on a monthly basis. Additionally, interest rates on term loans, borrowings under the revolving credit facility and issued letters of credit increased 0.25% and an automatic increase in the interest rates occurred on August 2, 2001 of 0.25%. Also due to the March 19, 2001 amendment, the maturity dates of all obligations under the Old Credit Facility became November 15, 2002.

In July 2001, Tranche A of the term loans was prepaid and extinguished. Accordingly, the Company wrote-off the related unamortized financing costs of $0.2 million, net of the related income tax benefit, which is included in extraordinary item, net of income taxes in the consolidated statement of operations for the year ended December 30, 2001.

In December 2001, the Company successfully 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 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 million revolving credit facility of which up to

$20 million is available to support letters of credit. The $30 million commitment less issued letters of credit is available for borrowing to provide working capital and for other corporate needs (the "New Credit Facility"). As of December 30, 2001, $15.4 million was available for additional borrowings under the New Credit Facility. In connection with the Refinancing Plan, the Company wrote off unamortized financing costs and incurred other direct expenses totaling $3.4 million ($2.0 million net of tax), which are included in extraordinary item, net of income taxes in the consolidated statement of operations for the year ended December 30, 2001. The refinancing has improved the Company's financial condition by reducing total debt by approximately $30.8 million and by extending the average life of the Company's debt.

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

The Mortgage Financing has a maturity date of January 1, 2022 and is amortized over 20 years. Interest on $10 million of the Mortgage Financing is variable and is the sum of the 30-day LIBOR rate in effect (1.87375% at December 30, 2001) plus 6% on an annual basis. Changes in the interest rate are calculated monthly with the monthly payment amount adjusted annually. Changes in the monthly payment amounts owed due to interest rate changes are reflected in the principal balances which are

reamortized over the remaining life of the mortgages. The remaining $45 million of the Mortgage Financing bears interest at a fixed annual rate of 10.16%. Each promissory note may be prepaid in full. The variable rate notes are subject to prepayment penalties during the first five years. The fixed rate notes may not be prepaid without the Company providing the note holders with a yield maintenance premium.

The Mortgage Financing requires the Company to maintain 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 New Credit Facility is secured by substantially all of the assets of FICC and two of its six subsidiaries, Friendly's Restaurants Franchise Inc. and Friendly's International Inc. These two subsidiaries also guaranty FICC's obligations under the New Credit Facility. The New Credit Facility expires on December 17, 2004. As of December 30, 2001, there were no revolving credit loans outstanding.

The revolving credit loans bear interest at the Company's option at either (a) the Base Rate plus the applicable margin as in effect from time to time (the "Base Rate") (7.25% at December 30, 2001) or (b) the Eurodollar rate plus the applicable margin as in effect from time to time (the "Eurodollar Rate") (6.34% at December 30, 2001).

As of December 30, 2001 and December 31, 2000, total letters of credit issued were approximately $14.6 million and $10.2 million, respectively. During the years ended December 30, 2001, December 31, 2000 and January 2, 2000, 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.

As of December 30, 2001 and December 31, 2000, the unused portion of the revolving credit commitments was $15.4 million and $9.8 million, respectively. The total average unused portions of the revolving credit commitments were $15.2 million for the period from January 1, 2001 through December 18, 2001, $15.4 million for the period from December 19, 2001 through December 30, 2001, $23.9 million and $23.4 million for the years ended December 31, 2000 and January 2, 2000, respectively.

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

In connection with the 2001 Refinancing Plan, in December 2001, the Company entered into and accounted for the Sale/Leaseback Financing, which provided approximately $33,700,000 of proceeds to the Company. The Company sold 44 properties operating as Friendly's Restaurants and entered into a master lease with the buyer to lease the 44 properties for an initial term of 20 years under a triple net lease. There are four five-year renewal options and lease payments are subject to escalator provisions every five years based upon increases in the Consumer Price Index. The December 2001 agreement provided the Company the option to repurchase properties in certain default situations, as defined. In January 2002 the Company entered into an amended agreement for no consideration which eliminated the buy back provision. The amended agreement was effective December 19, 2001. In accordance with SFAS No. 66, "Accounting for Sales of Real Estate" and SFAS No. 98, "Accounting for Leases", the Company recognized losses of $428,000 on two properties which was included in gains on sales of other

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properties and equipment, net in the accompanying consolidated statement of operations for the year ended December 30, 2001. The gain of $11,377,000 on the remaining 42 properties was deferred and was included in other accrued expenses and other long-term liabilities in the accompanying consolidated balance sheet as of December 30, 2001. The deferred gain will be amortized in proportion to the rent charged to expense over the initial lease term.

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

The Company anticipates requiring capital in the future principally to maintain existing restaurant and plant facilities and to continue to renovate

and re-image existing restaurants. Capital expenditures for 2002 are anticipated to be $16.0 million in the aggregate, of which $12.0 million is expected to be spent on restaurant operations. The Company's actual 2002 capital expenditures may vary from these estimated amounts. The Company believes that the combination of the funds anticipated to be generated from operating activities and borrowing availability under the New Credit Facility will be sufficient to meet the Company's anticipated operating requirements, capital requirements and obligations associated with the restructuring.

On September 14, 2001, the Company entered into an agreement granting Revere Restaurant Group, Inc. ("Revere") certain limited exclusive rights to operate and develop Friendly's full-service restaurants in designated areas within Lehigh and Northampton counties, Pennsylvania (the "Revere Agreement"). Pursuant to the Revere Agreement, Revere purchased certain assets and rights in six existing Friendly's restaurants and committed to open an additional four restaurants over the next seven years. Gross proceeds from the sale were approximately $3.4 million of which approximately $0.2 million was for franchise fees for the initial six restaurants. The cash proceeds were used to fund operating activities of the Company.

On April 13, 2001, the Company executed an agreement granting J&B Restaurants Partners of Long Island Holding Co., LLC and its subsidiaries ("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 $20.0 million, of which approximately $4.3 million 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 loans, in each case under the Old 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 first five years with a balloon payment due at the end of five years.

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The following represents the contractual obligations and commercial commitments of the Company as of December 30, 2001 (in thousands):

		PAYMENTS DUE BY PERIOD			
CONTRACTUAL OBLIGATIONS:	TOTAL	2002	2003-2004	2005-2006	THEREA
Long-Term Debt	$233,865	$ 1,068	$ 2,124	$ 2,605	$228,
Capital Lease Obligations	12,239	2,616	2,940	1,817	4,
Operating Leases	155,444	16,589	29,661	23,794	85,
Purchase Commitments	104,356	104,356	--	--	

		AMOUNT OF COMMITMENT EXPIRATION BY PERI			
OTHER COMMERCIAL COMMITMENTS:	TOTAL	2002	2003-2004	2005-2006	THEREA
Revolving Credit Facility	$ 15,373	$ --	$15,373	$ --	$
Letters of Credit	14,627	14,627	--	--	

NET OPERATING LOSS CARRYFORWARDS

As of December 30, 2001, the Company has federal net operating loss ("NOL") carryforwards of approximately $13.0 million. The NOLs expire, if unused, between 2010 and 2019. In addition, the NOL carryforwards are subject to adjustment upon review by the Internal Revenue Service.

INFLATION

The inflationary factors which have historically affected the Company's results of operations include increases in the costs of cream, sweeteners, purchased food, labor and other operating expenses. Approximately 14% of wages paid in the Company's restaurants are impacted by changes in the federal or state minimum hourly wage rate. Accordingly, changes in the federal or state minimum hourly wage rates directly affect the Company's labor cost. The Company is able to minimize the impact of inflation on occupancy costs by owning the underlying real estate for approximately 29% of its restaurants. The Company and the restaurant industry typically attempt to offset the effect of inflation, at least in part, through periodic menu price increases and various cost reduction programs. However, no assurance can be given that the Company will be able to offset such inflationary cost increases in the future.

SEASONALITY

Due to the seasonality of frozen dessert consumption, and the effect from time to time of weather on patronage of the restaurants, the Company's revenues and EBITDA are typically higher in its second and third 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 August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 modifies the rules for accounting for the impairment or disposal of long-lived assets. The new rules are effective for the Company on December 31, 2001. Management

does not believe that the impact of adopting SFAS No. 144 will have a material effect on the Company's consolidated financial statements.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangibles." SFAS No. 142 modifies the rules for accounting for goodwill and other intangible assets. The new rules become effective on December 31, 2001. The impact of adopting SFAS No. 142 will not have any effect on the Company's consolidated financial statements and the Company will continue to amortize its license agreement related to certain trademarked products over the term of the license agreement.

In April 2001, the FASB reached consensus on Emerging Issues Task Force ("EITF") Issue No. 00-25, "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products." EITF Issue No. 00-25 is effective for quarters beginning after December 15,

2001, with prior financial statements restated if practicable. EITF Issue No. 00-25 requires that consideration from a vendor to a retailer be recorded as a reduction in revenue unless certain criteria are met. Arrangements within the scope of this Issue include slotting fees, cooperative advertising arrangements and buy-downs. As a result of EITF Issue No. 00-25, certain costs previously recorded as expense have been reclassified and offset against revenue. The Company adopted EITF Issue No. 00-25 on October 1, 2001. As a result, the Company recorded retail selling expenses of $1,856,000, $881,000 and $1,028,000 as reductions in retail revenue for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively. Revenues prior to the adoption date were reclassified to conform with the current presentation.

In May 2000, the Emerging Issues Task Force issued EITF Issue 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 Issue No. 00-14 on July 3, 2000. As a result, in the prior years, the Company reclassified certain retail selling expenses against retail revenue, for periods prior to the adoption date, to conform with the current presentation.

In 2001, the EITF codified and expanded its consensus opinions in EITF Issue No. 00-25 and EITF Issue No. 00-14, as well as aspects of EITF Issue No. 00-22, "Accounting for Points and Certain Other Time-Based Sales Incentive Offers, and Offers for Free Products or Services to be Delivered in the Future," which are now all encompassed in EITF Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products." EITF Issue No. 01-09 did not generally result in any changes to the effective dates of the previously reached consensus opinions.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS No. 137, "Accounting for Derivatives and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 133 established 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 in earnings. The cumulative effect upon adoption as of January 1, 2001 of approximately $77,000 was recorded as income in the accompanying consolidated statement of operations as cost of sales. It was not separately reported as a cumulative effect of change in accounting principle since the amount was not significant. Additionally, net losses of approximately $163,000 were recorded during the

year ended December 30, 2001 related to the change in fair value. The fair market value of derivatives at December 30, 2001 was approximately $22,000.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS

The Company has market risk exposure to interest rates on its fixed and variable rate debt obligations. The Company does not enter into contracts for trading purposes. The information below summarizes the Company's market risk

associated with its debt obligations as of December 30, 2001. The table presents principal cash flows and related average interest rates by expected year of maturity. For variable rate debt obligations, the average variable rates are based on implied forward rates as derived from appropriate monthly spot rate observations as of year-end. The Company believes that the carrying value of the Mortgage Financing as of December 30, 2001 approximated the fair value based on the proximity of the transaction to the Company's fiscal year end. The Company believes that the carrying value of the other debt as of December 30, 2001 approximated the fair value based on the terms of the obligation and the rates then currently available to FICC for similar obligations.

EXPECTED YEAR OF MATURITY
(In thousands)

	2002	2003	2004	2005	2006	THE
Liabilities:						
Fixed Rate:						
Senior Notes..............	$ --	$ --	$ --	$ --	$ --	$1
Fixed Interest Rate.......	--	--	--	--	--	
Mortgage loans............	$ 720	$ 797	$ 870	$ 977	$1,083	$
Fixed Interest Rate.......	10.16%	10.16%	10.16%	10.16%	10.16%	
Other Debt................	$ 138	$ --	$ --	$ --	$ --	$
Fixed Interest Rate.......	8.25%	--	--	--	--	
Variable Rate:						
Mortgage loans............	$ 210	$ 220	$ 237	$ 261	$ 284	$
Average Interest Rates....	8.58%	10.68%	11.78%	12.24%	12.48%	

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For a listing of consolidated financial statements which are included in this document see page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

PART III

ITEM 10. DIRECTORS OF THE REGISTRANT

Information regarding directors and Section 16(a) Compliance is incorporated herein by reference from the Sections entitled "Proposal 1-Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" of the Company's definitive proxy statement which will be filed no later than 120 days after December 30, 2001.

ITEM 11. EXECUTIVE COMPENSATION

Incorporated herein by reference from the Sections entitled "Proposal 1--Election of Directors--Director Compensation" and "Executive Compensation" of the Company's definitive proxy statement which will be filed no later than

120 days after December 30, 2001.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Incorporated herein by reference from the Section entitled "Stock Ownership" of the Company's definitive proxy statement which will be filed no later than 120 days after December 30, 2001.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated herein by reference from the Section entitled "Executive Compensation--Certain Relationships and Related Transactions" of the Company's definitive proxy statement which will be filed no later than 120 days after December 30, 2001.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. Financial statements:

For a listing of consolidated financial statements which are included in this document, see page F-1.

2. Schedules:

The following consolidated financial statement schedule and Report of Independent Public Accountants thereon is included pursuant to Item 14(d): Schedule II--Valuation and Qualifying Accounts. All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

(b) Exhibits:

The exhibit index is incorporated by reference herein.

(c) Reports on Form 8-K:

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

NAME	TITLE (CAPACITY)	DATE
/s/ DONALD N. SMITH Donald N. Smith	Chairman of the Board and Chief Executive Officer (Principal Executive Officer and Director)	February 14,
/s/ PAUL V. HOAGLAND Paul V. Hoagland	Senior Vice President, Chief Financial Officer, Treasurer and Assistant Clerk (Principal Financial and Accounting Officer)	February 14,
/s/ CHARLES A. LEDSINGER, JR. Charles A. Ledsinger, Jr.	Director	February 14,
/s/ STEVEN L. EZZES Steven L. Ezzes	Director	February 14,
/s/ BURTON J. MANNING Burton J. Manning	Director	February 14,
/s/ MICHAEL J. DALY Michael J. Daly	Director	February 14,

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of Friendly Ice Cream Corporation:

We have audited the accompanying consolidated balance sheets of Friendly Ice Cream Corporation (a Massachusetts corporation) and subsidiaries as of December 30, 2001 and December 31, 2000, and the related consolidated statements of operations, changes in stockholders' deficit and cash flows for each of the three years in the period ended December 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Friendly Ice Cream Corporation and subsidiaries as of December 30, 2001 and December 31, 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 30, 2001, in conformity with accounting principles generally accepted in the United States.

As explained in Note 3 to the consolidated financial statements, effective December 28, 1998, the Company changed its method of accounting for restaurant pre-opening costs.

/s/ ARTHUR ANDERSEN LLP