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

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
AMENDMENT NO. 2

/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.

INTRODUCTORY NOTE--RESTATEMENTS

Friendly Ice Cream Corporation (the "Company"), as a result of an extensive review of its accounting policies determined that its policy for recording restaurant advertising expense included in operating expenses although proper for annual reporting, needed to be revised for the Company's quarterly reporting. Accordingly, Note 21, "Quarterly Financial Data (unaudited)" to the consolidated financial statements contained in the Company's 2001 Annual Report on Form 10-K has been restated to reflect this accounting change. This Form 10-K/A does not modify or update any other information.

PART I - FINANCIAL INFORMATION

ITEM 4. CONTROLS AND PROCEDURES

As of December 30, 2001, an evaluation was performed under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of December 30, 2001. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to 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

CERTIFICATIONS

I, Donald N. Smith, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: October 30, 2002

/s/ Donald N. Smith
CHIEF EXECUTIVE OFFICER

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I, Paul V. Hoagland, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: October 30, 2002

/s/ Paul V. Hoagland
CHIEF FINANCIAL OFFICER,
TREASURER AND ASSISTANT CLERK

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Note: This Report of Independent Public Accountants is a copy of a previously issued Report of Arthur Andersen LLP, Independent Public Accountants, and it has not been reissued by Arthur Andersen. This Report was originally filed as part of the Form 10-K of Friendly Ice Cream Corporation for the fiscal year ended December 30, 2001, and the consent of Arthur Andersen, dated February 11, 2002, was filed as an exhibit thereto. The registrant has been unable to obtain a reissued Report of Arthur Andersen or a currently dated consent to the incorporation of this previously issued Report of Arthur Andersen into the Registration Statement on Form S-8, File Nos. 333-40195, 333-40197 and 333-40199, or any subsequent registration statement under the Securities Act of 1933 into which this Form 10-K/A may be incorporated by reference. While the extent of any resulting limitations on recovery against Arthur Andersen is unclear, Arthur Andersen may not be liable under Section 11 of the Securities Act because it has not consented in connection with this filing to being named an expert in any present or future filing into which this Form 10-K/A may be incorporated by reference, or the lack of a currently dated consent could limit the time within which any such action could be brought against Arthur Andersen for liabilities arising under Section 11 of the Securities Act.

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

ARTHUR ANDERSEN LLP

Hartford, Connecticut
February 11, 2002

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS)

	DECEMBER 30, 2001	DECEMBER 31, 2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 16,342	$ 14,584
Restricted cash	--	1,737
Accounts receivable	9,969	6,157
Inventories	12,987	11,570
Deferred income taxes	7,659	10,395
Prepaid expenses and other current assets	3,736	2,799
TOTAL CURRENT ASSETS	50,693	47,242
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization	169,489	226,865
INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization of $9,077 and $11,142 at December 30, 2001 and December 31, 2000, respectively	21,208	21,529
OTHER ASSETS	11,172	2,050
TOTAL ASSETS	$ 252,562	$ 297,686
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 1,068	$ 13,029
Current maturities of capital lease and finance obligations	1,851	2,143
Accounts payable	20,505	20,100
Accrued salaries and benefits	9,436	10,956

Accrued interest payable	1,543	3,515
Insurance reserves	13,333	13,095
Restructuring reserve	3,056	5,571
Other accrued expenses	19,260	14,262
TOTAL CURRENT LIABILITIES	70,052	82,671
DEFERRED INCOME TAXES	10,584	13,276
CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities	6,267	8,223
LONG-TERM DEBT, less current maturities	232,797	275,435
OTHER LONG-TERM LIABILITIES	28,876	18,064
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT:		
Common stock, $.01 par value; authorized 50,000,000 shares at December 30, 2001 and December 31, 2000; 7,353,435 and 7,393,857 shares issued and outstanding at December 30, 2001 and December 31, 2000, respectively	74	74
Preferred stock, $.01 par value; authorized 1,000,000 shares at December 30, 2001 and December 31, 2000; no shares issued and outstanding at December 30, 2001 and December 31, 2000	--	--
Additional paid-in capital	139,290	138,988
Accumulated deficit	(235,378)	(239,045)
TOTAL STOCKHOLDERS' DEFICIT	(96,014)	(99,983)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$ 252,562	$ 297,686

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2 2000
REVENUES	$561,873	$598,858	$685,844
COSTS AND EXPENSES:			
Cost of sales	197,846	196,181	206,293
Labor and benefits	157,312	187,641	228,492
Operating expenses	115,822	121,951	142,097
General and administrative expenses	36,312	41,233	46,413
Restructuring expenses, net (Note 9)	636	12,056	--
Relocation of manufacturing and distribution facility (Note 17)	--	--	1,175
Write-downs of property and equipment (Note 5)	800	20,834	1,913
Depreciation and amortization	29,027	30,750	34,989

Gain on franchise sales of restaurant operations and properties	(4,591)	(5,307)	(2,574
Gains on sales of other property and equipment, net	(2,021)	(5,507)	(534
OPERATING INCOME (LOSS)	30,730	(974)	27,580
Interest expense, net of capitalized interest of $93, $109 and $397 and interest income of $581, $219 and $132 for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively	27,310	31,053	33,694
Recovery of write-down of joint venture (Note 19)	--	--	(896
INCOME (LOSS) BEFORE (PROVISION FOR) BENEFIT FROM INCOME TAXES, EXTRAORDINARY ITEM AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	3,420	(32,027)	(5,218
(Provision for) benefit from income taxes	(300)	21,221	5,937
INCOME (LOSS) BEFORE EXTRAORDINARY ITEM AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	3,120	(10,806)	719
Extraordinary item, net of income tax expense of $380 (Note 20)	547	--	--
Cumulative effect of change in accounting principle, net of income tax benefit of $222 (Note 3)	--	--	(319
NET INCOME (LOSS)	$ 3,667	$(10,806)	$ 400
BASIC AND DILUTED INCOME (LOSS) PER SHARE:			
Income (loss) before extraordinary item and cumulative effect of change in accounting principle	$ 0.43	$ (1.45)	$ 0.09
Extraordinary item, net of income tax expense	0.07	--	--
Cumulative effect of change in accounting principle, net of income tax benefit	--	--	(0.04
Net income (loss)	$ 0.50	$ (1.45)	$ 0.05
WEIGHTED AVERAGE SHARES:			
Basic	7,363	7,429	7,491
Diluted	7,398	7,429	7,499

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT

(DOLLARS IN THOUSANDS)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	ACCUM OT COMPRE INC
	SHARES	AMOUNT			
BALANCE, DECEMBER 27, 1998	7,461,600	$75	$137,896	$(228,639)	$

Comprehensive income (loss):					
Net income	--	--	--	400	
Translation adjustment	--	--	--	--	
Total comprehensive income (loss)	--	--	--	400	
Stock compensation expense	19,092	--	563	--	
BALANCE, JANUARY 2, 2000	7,480,692	75	138,459	(228,239)	
Net loss and comprehensive loss	--	--	--	(10,806)	
Shares forfeited in connection with Restricted Stock Plan	(86,835)	(1)	1	--	
Stock compensation expense	--	--	528	--	
BALANCE, DECEMBER 31, 2000	7,393,857	74	138,988	(239,045)	
Net income and comprehensive income	--	--	--	3,667	
Shares forfeited in connection with Restricted Stock Plan	(41,422)	--	--	--	
Stock options exercised	1,000	--	4	--	
Stock compensation expense	--	--	298	--	
BALANCE, DECEMBER 30, 2001	7,353,435	$74	$139,290	$(235,378)	$

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2000
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ 3,667	$(10,806)	$ 40
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Extraordinary item, net of income tax expense	(547)	--	-
Cumulative effect of change in accounting principle, net of income tax benefit	--	--	31
Stock compensation expense	298	528	56
Relocation of manufacturing and distribution facility	--	--	1,03
Depreciation and amortization	29,027	30,750	34,98
Write-downs of property and equipment	800	20,834	1,91
Deferred income tax benefit	(336)	(21,209)	(5,81
Gain on asset retirements and sales	(6,184)	(7,785)	(1,97
Recovery of write-down of joint venture	--	--	(6
Changes in operating assets and liabilities:			
Accounts receivable	(3,308)	(2,234)	1,64
Inventories	(1,417)	(218)	4,20
Other assets	(5,461)	3,687	(1,82

Accounts payable	405	(5,973)	(38
Accrued expenses and other long-term liabilities	(1,472)	(10,535)	(44
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	15,472	(2,961)	34,55
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(13,922)	(18,773)	(41,38
Proceeds from sales of property and equipment	56,675	43,822	17,46
Proceeds from sale of joint venture	--	--	1,15
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	42,753	25,049	(22,77
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	134,405	125,000	109,00
Repayments of debt	(184,749)	(142,641)	(117,97
Payments related to deferred financing costs	(4,048)	--	-
Repayments of capital lease and finance obligations	(2,079)	(1,925)	(1,75
Stock options exercised	4	--	-
NET CASH USED IN FINANCING ACTIVITIES	(56,467)	(19,566)	(10,73
EFFECT OF EXCHANGE RATE CHANGES ON CASH	--	--	(6
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,758	2,522	97
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	14,584	12,062	11,09
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 16,342	$ 14,584	$ 12,06
SUPPLEMENTAL DISCLOSURES:			
Cash paid (refunded) during the year for:			
Interest	$ 28,433	$ 30,436	$ 31,13
Income taxes	239	56	(38
Capital lease obligations incurred	--	3,674	-
Capital lease obligations terminated	170	984	6
Notes received from sales of property and equipment	4,250	577	60

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION

In September 1988, The Restaurant Company ("TRC") and another investor acquired Friendly Ice Cream Corporation ("FICC"). Subsequent to the acquisition, Friendly Holding Corporation ("FHC") was organized to hold the outstanding common stock of FICC, and in March 1996, FHC was merged into FICC. Additionally, in March 1996, TRC distributed its shares of FICC's voting common stock to TRC's shareholders and FICC deconsolidated from TRC.

In November 1997, FICC completed a public offering of five million shares of its common stock (the "Common Stock Offering") for net proceeds of $81,900,000 and a public offering of $200,000,000 of Senior Notes (the "Senior Notes") (collectively, the "Offerings"). Concurrent with the Offerings, FICC entered into a new senior secured credit facility consisting of (i) $90,000,000 of term loans, (ii) a $55,000,000 revolving credit facility and (iii) a $15,000,000 letter of credit facility (collectively, the "Old Credit Facility"). Proceeds from the Offerings and the Old Credit Facility were primarily used to repay the $353,700,000 outstanding under FICC's then existing credit facility (collectively, the "Recapitalization").

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

References herein to "Friendly's" or the "Company" refer to Friendly Ice Cream Corporation, its predecessor and its consolidated subsidiaries; references herein to "FICC" refer to Friendly Ice Cream Corporation and not its subsidiaries; and 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.

2. NATURE OF OPERATIONS

As of December 30, 2001, Friendly's owned and operated 393 full-service restaurants and franchised 161 restaurants and six non-traditional units. The Company manufactures and distributes a full line of frozen dessert products. These products are distributed to Friendly's restaurants, supermarkets and other retail locations in 17 states. The restaurants offer a wide variety of breakfast, lunch and dinner menu items as well as frozen dessert products. For the years ended December 30, 2001, December 31, 2000 and January 2, 2000, restaurant sales were approximately 80%, 85% and 90%, respectively, of the Company's revenues. As of December 30, 2001, December 31, 2000 and January 2, 2000, approximately 89%, 89% and 88%, respectively, of the Company-owned restaurants were located in the Northeast United States. As a result, a severe or prolonged economic recession in this geographic area may adversely affect the Company more than certain of its competitors which are more geographically diverse.

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION--

The consolidated financial statements include the accounts of FICC and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

FISCAL YEAR--

Friendly's fiscal year ends on the last Sunday in December, unless that day is earlier than December 27, in which case the fiscal year ends on the following Sunday. The fiscal year ended January 2, 2000 included 53 weeks. All other years presented include 52 weeks.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS--

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future facts and circumstances could alter management's estimates with respect to the carrying values of long-lived assets and the adequacy of insurance and restructuring reserves.

REVENUE RECOGNITION--

The Company recognizes restaurant revenue upon receipt of payment from the customer and retail revenue upon shipment of product. Franchise royalty income, based on net sales of franchisees, is payable monthly and is recorded on the accrual method. Initial franchise fees are recorded as revenue upon completion of all significant services, generally upon opening of the restaurant.

CASH AND CASH EQUIVALENTS--

The Company considers all investments with an original maturity of three months or less when purchased to be cash equivalents.

ACCOUNTS RECEIVABLE--

Accounts receivable are net of allowances for doubtful accounts totaling $588,000 and $413,000 as of December 30, 2001 and December 31, 2000, respectively.

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVENTORIES--

Inventories are stated at the lower of first-in, first-out cost or market. Inventories at December 30, 2001 and December 31, 2000 were (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Raw materials	$ 1,269	$ 1,307
Goods in process	73	66
Finished goods	11,645	10,197
Total	$12,987	$11,570

RESTRICTED CASH--

Restaurant Insurance Corporation ("RIC"), an insurance subsidiary, was required by the reinsurer of RIC to hold assets in trust whose value is at least equal to certain of RIC's outstanding estimated insurance claim liabilities. Accordingly, as of December 31, 2000, cash of approximately $1,737,000 was restricted. There was no restricted cash as of December 30, 2001.

PROPERTY AND EQUIPMENT--

Property and equipment are carried at cost. Depreciation of property and equipment is computed using the straight-line method over the following estimated useful lives:

Buildings--30 years
Building improvements and leasehold improvements--lesser of lease term or 20 years
Equipment--3 to 10 years

At December 30, 2001 and December 31, 2000, property and equipment included (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Land	$ 33,635	$ 53,907
Buildings and improvements	82,005	113,719
Leasehold improvements	38,294	36,737
Assets under capital leases	11,057	12,717
Equipment	234,243	252,788
Construction in progress	5,845	5,698
Property and equipment	405,079	475,566
Less: accumulated depreciation and amortization	(235,590)	(248,701)
Property and equipment, net	$ 169,489	$ 226,865

Major renewals and betterments are capitalized. Replacements and maintenance and repairs which do not extend the lives of the assets are charged to operations as incurred.

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

LONG-LIVED ASSETS--

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," the Company reviews its license agreement for the right to use various trademarks and tradenames (see Note 4) for impairment on a quarterly basis. The Company recognizes an impairment has occurred when the carrying value of the license agreement exceeds the estimated future undiscounted cash flows of the trademarked products.

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

RESTAURANT PRE-OPENING COSTS--

In April 1998, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 98-5, "Reporting on the Costs of Start-Up Activities." SOP No. 98-5 requires entities to expense as incurred all start-up and pre-opening costs that are not otherwise capitalizable as long-lived assets and is effective for fiscal years beginning after December 15, 1998. In accordance with this statement, on December 28, 1998, the Company expensed previously deferred restaurant pre-opening costs of approximately $541,000. This transaction was reflected as a cumulative effect of a change in accounting principle of $319,000, net of the income tax benefit of $222,000, in the accompanying consolidated statement of operations for the year ended January 2, 2000.

OTHER ASSETS--

Other assets includes notes receivable of $4,397,000 (see Notes 10 and 17) and $680,000, which are net of allowances for doubtful accounts totaling $914,000 and $520,000 as of December 30, 2001 and December 31, 2000, respectively. Also included in other assets as of December 30, 2001 and December 31, 2000 are payments made to the fronting insurance carrier of approximately $1,000,000 to establish a loss escrow fund for policy years from September 2, 1991 through September 2, 2000.

INSURANCE RESERVES--

The Company is self-insured through retentions or deductibles for the majority of its workers' compensation, automobile, general liability, employer's liability, product liability and group health insurance programs. Self-insurance amounts vary up to $500,000 per occurrence. Insurance with third parties, some of which is then reinsured through RIC, is in place for claims in excess of these self-insured amounts. RIC assumed 100% of the risk from $500,000 to $1,000,000 per occurrence through September 2, 2000 for the Company's workers' compensation, general liability, employer's liability and product liability insurance. Subsequent to September 2, 2000, the Company discontinued its use of RIC as a captive insurer for new claims. The Company and RIC's liability for estimated incurred

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

losses are actuarially determined and recorded in the accompanying consolidated financial statements on an undiscounted basis.

INCOME TAXES--

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. A valuation allowance is recorded for deferred tax assets whose realization is not likely.

ADVERTISING--

The Company expenses advertising costs as incurred. For the years ended December 30, 2001, December 31, 2000 and January 2, 2000, advertising expenses were approximately $19,687,000, $17,955,000 and $21,508,000, respectively.

EARNINGS PER SHARE--

Basic earnings per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated by dividing net income (loss) by the weighted average number of shares of common stock and common stock equivalents outstanding during the year. Common stock equivalents are dilutive stock options and warrants that are assumed exercised for calculation purposes. The number of common stock options which could dilute basic earnings per share in the future, that were not included in the computation of diluted earnings per share because to do so would have been antidilutive, was 538,000, 503,000 and 157,000 for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively.

Presented below is the reconciliation between basic and diluted weighted average shares (in thousands):

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Basic weighted average number of shares outstanding	7,363	7,429	7,491
Assumed exercise of stock options	35	--	8
Diluted weighted average number of shares outstanding	7,398	7,429	7,499

STOCK-BASED COMPENSATION--

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

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

3. SUMMARY OF BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

(CONTINUED)

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 is 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.

RECLASSIFICATIONS--

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

4. INTANGIBLE ASSETS AND DEFERRED COSTS

Intangible assets and deferred costs, net of accumulated amortization, as of December 30, 2001 and December 31, 2000, were (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Marks license agreement for the right to use various trademarks and service marks amortized over its 40-year life on a straight-line basis............	$12,433	$12,900
Deferred financing costs amortized over the terms of the related loans on an effective yield basis.....	7,990	7,973
Other...	785	656
Intangible assets and deferred costs, net..........	$21,208	$21,529

Upon the sale of the Company by Hershey Foods Corporation ("Hershey") in 1988, all of the trademarks and service marks (the "Marks") used in the Company's business at that time which did not contain the word "Friendly" as a component of such Marks were licensed by Hershey to the Company. The Marks license agreement is being amortized over its term of 40 years, which expires on September 2, 2028. The Company reviews the estimated future cash flows related to each trademarked product on a quarterly basis to determine whether any impairment has occurred. For the years ended December 30, 2001, December 31, 2000 and January 2, 2000, no impairments have been recorded.

5. WRITE-DOWNS OF PROPERTY AND EQUIPMENT

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 (see Note 9). The 151 restaurants in the restructuring were

5. WRITE-DOWNS OF PROPERTY AND EQUIPMENT (CONTINUED)
generally lower sales volume units operating in markets in which management believes the Company has a strong market penetration. 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 $7,800,000 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 $9,200,000 during the year ended December 31, 2000. In addition to these properties, during the year ended December 31, 2000, it was determined that the carrying values of an additional 12 properties exceeded their estimated fair values less costs to sell. The carrying values of these 12 properties were reduced by an aggregate of $2,700,000 and the carrying values of eight properties leased to Davco Restaurants, Inc ("Davco") were reduced by an aggregate of $1,100,000 (see Note 10). During the year ended December 30, 2001, it was determined that the carrying values of nine properties exceeded their estimated fair values less costs to sell. The carrying values of these nine properties were reduced by an aggregate of $800,000. During the year ended January 2, 2000, the carrying values of 19 properties were reduced by an aggregate of $1,913,000.

As of December 30, 2001, the Company had sold 63 of the 151 properties related to the March 2000 restructuring and terminated its lease obligations at 49 properties. 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 again. At December 30, 2001 and December 31, 2000, the carrying value of the remaining 14 and 73 properties to be disposed of related to the March 2000 restructuring was $1,000,000 and $7,000,000, respectively, and is reflected in the accompanying consolidated balance sheets as property and equipment, net. As a result of the sales of closed properties from the restructuring, the Company recognized gains of approximately $1,800,000 and $5,600,000 for the years ended December 30, 2001 and December 31, 2000, respectively. Based on information currently available, management believes that the carrying value of the remaining 14 properties to be disposed of as of December 30, 2001 is realizable.

At December 30, 2001 and December 31, 2000 there were 16 and 83 properties held for disposition, which included 14 and 73 properties related to the March 2000 restructuring.

The aggregate operating loss for the properties held for disposition as of December 30, 2001 was $757,000 and $1,008,000 for the years ended December 30, 2001 and December 31, 2000, respectively. The aggregate carrying value of the properties held for disposition at December 30, 2001 and December 31, 2000 was approximately $1,008,000 and $8,946,000, respectively, which is included in property and equipment, net in the accompanying consolidated balance sheets.

6. DEBT

Debt at December 30, 2001 and December 31, 2000 consisted of the following (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Senior Notes, 10 1/2%, due December 1, 2007	$178,727	$200,000
New Credit Facility:		
Revolving credit loans, due December 17, 2004	--	--
Mortgage loans, due February 1, 2002 through January 1, 2022	55,000	--
Old Credit Facility:		
Revolving credit loans	--	50,000
Term loans:		
Tranche A	--	6,873
Tranche B	--	19,866
Tranche C	--	11,725
Other	138	--
	233,865	288,464
Less: current portion	(1,068)	(13,029)
Total long-term debt	$232,797	$275,435

Principal payments due as of December 30, 2001, were as follows (in thousands):

YEAR	AMOUNT
2002	$ 1,068
2003	1,017
2004	1,107
2005	1,238
2006	1,367
Thereafter	228,068
Total	$233,865

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 $374,000 ($220,000, 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.

6. DEBT (CONTINUED)

In December 2001, the Company successfully completed a financial restructuring plan (the "Refinancing Plan") which included the repayment of $64,545,000 outstanding under the Old Credit Facility and the repurchase of approximately $21,300,000 in Senior Notes for $17,000,000 with the proceeds from $55,000,000 in long-term mortgage financing (the "Mortgage Financing") and a $33,700,000 sale and leaseback transaction (the "Sale/Leaseback Financing", see Note 7). In addition, FICC secured a new $30,000,000 revolving credit facility of which up to $20,000,000 is available to support letters of credit. The $30,000,000 commitment less 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, $15,373,000 was available for additional borrowing under the New Credit Facility. In connection with the Refinancing Plan, the Company wrote off unamortized financing costs and incurred other direct expenses totaling $3,400,000 ($2,000,000, net of tax), which are included in extraordinary items, net of income taxes, in the consolidated statement of operations for the year ended December 30, 2001.

The $200,000,000 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 $21,300,000 in aggregate principal amount of the Senior Notes for $17,000,000. The gain of $4,300,000 ($2,500,000, 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.

Three new limited liability corporations ("LLCs") were organized in connection with the Mortgage Financing. FICC is the sole member of each LLC and the LLCs are consolidated in the accompanying consolidated financial statements. 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 borrower under the Mortgage Financing.

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 Mortgage Financing has a maturity date of January 1, 2022 and is amortized over 20 years. Interest on $10,000,000 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 $45,000,000 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.

6. DEBT (CONTINUED)

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., and both subsidiaries 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 $14,627,000 and $10,199,000, 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 $15,373,000 and $9,801,000, respectively. The total average unused portions of the revolving credit commitments were $15,243,000 for the period from January 1, 2001 through December 18, 2001, $15,373,000 for the period from December 19, 2001 through December 30, 2001, $23,932,000 and $23,385,000 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. The financial covenant requirements, as defined under the New Credit Facility, and actual ratios/amounts as of and for the period ended December 30, 2001 were:

	DECEMBER 30, 2001	
	REQUIREMENT	ACTUAL
Leverage ratio................................	4.25 to 1	3.96 to 1

Interest coverage ratio......................	2.20 to 1	2.31 to 1
Fixed charge coverage ratio..................	1.15 to 1	1.26 to 1
Consolidated tangible net worth (deficit)......	$(120,000,000)	$(117,222,000)
Permitted capital expenditures (a)............	$ 14,000,000	$ 12,672,000
Consolidated EBITDA (b).......................	$ 60,000,000	$ 63,253,000

(a) The New Credit Facility's definition of permitted capital expenditures in the revolving credit agreement differs from the Company's total capital expenditures.

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

6. DEBT (CONTINUED)

(b) The New Credit Facility's definition of consolidated EBITDA in the revolving credit agreement allows non-cash losses and capitalized interest to be added back to net income (loss) which differs from the Company's internal EBITDA computation presented elsewhere herein.

The fair values of the Company's long-term debt at December 30, 2001 and December 31, 2000 were as follows (in thousands):

	DECEMBER 30, 2001		DECEMBER 31, 2000	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
Senior Notes.......................	$178,727	$175,081	$200,000	$115,000
Mortgage loans.....................	55,000	55,000	--	--
Term loans.........................	--	--	38,464	38,464
Revolving credit loans.............	--	--	50,000	50,000
Other loans........................	138	138	--	--
Total..............................	$233,865	$230,219	$288,464	$203,464

The Company believes the carrying value of the Company's financial instruments other than long-term debt approximated their respective fair values as of December 30, 2001 and December 31, 2000. The fair value of the Senior Notes was determined based on the actual trade prices occurring closest to December 30, 2001 and December 31, 2000. The Company believes that the carrying values of the term loans and revolving credit loans under the Old Credit Facility as of December 31, 2000 approximated fair value since the obligations had variable interest rates. 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 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 the Company for similar obligations.

7. LEASES

As of December 30, 2001, December 31, 2000 and January 2, 2000, the Company operated 393, 449 and 618 restaurants, respectively. These operations were conducted in premises owned or leased as follows:

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Land and building owned..................	114	178	256
Land leased and building owned...........	97	117	144
Land and building leased.................	182	154	218
	393	449	618

Restaurants in shopping centers are generally leased for a term of 10 to 20 years. Leases of freestanding restaurants generally are for a 15 or 20 year lease term and provide for renewal options for three or four five-year renewals at the then current fair market value. Some leases provide for minimum payments plus a percentage of sales in excess of stipulated amounts. Additionally, the Company leases certain equipment over lease terms from three to seven years.

7. LEASES (CONTINUED)

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 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.

Future minimum lease payments under noncancelable leases with an original term in excess of one year as of December 30, 2001 were (in thousands):

YEAR	OPERATING LEASES	CAPITAL LEASES AND FINANCE OBLIGATIONS

2002	$ 16,589	$ 2,616
2003	15,166	1,884
2004	14,495	1,056
2005	12,895	1,032
2006	10,899	785
Thereafter	85,400	4,866
Total future minimum lease payments	$155,444	12,239
Less amounts representing interest		(4,121)
Present value of minimum lease payments		8,118
Less current maturities of capital lease and finance obligations		(1,851)
Long-term maturities of capital lease and finance obligations		$ 6,267

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

7. LEASES (CONTINUED)

Capital lease and finance obligations reflected in the accompanying consolidated balance sheets have effective interest rates ranging from 8.00% to 12.00% and are payable in monthly installments through 2016. Maturities of such obligations as of December 30, 2001 were (in thousands):

YEAR	AMOUNT
2002	$1,851
2003	1,317
2004	572
2005	600
2006	415
Thereafter	3,363
Total	$8,118

Rent expense included in the accompanying consolidated statements of operations for operating leases was (in thousands):

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Minimum rentals	$16,004	$17,356	$18,301

Contingent rentals	1,139	1,217	2,146
Total	$17,143	$18,573	$20,447

8. INCOME TAXES

Prior to March 23, 1996, FICC and its subsidiaries were included in the consolidated federal income tax return of TRC. On March 23, 1996, FICC deconsolidated from TRC. Subsequently, certain shares of the Company's common stock were issued to FICC's lenders, which resulted in an ownership change pursuant to Internal Revenue Code Section 382, on March 26, 1996.

As a result of the change of ownership and limitations under Section 382 of the Internal Revenue Code, the portion of the total federal Net Operating Loss ("NOL") carryforwards that were generated prior to March 26, 1996 ("Old NOLs") could only be used to offset current or future income to the extent that an equivalent amount of net unrealized built-in-gains, which existed at March 26, 1996, were recognized by March 25, 2001. As a result of this limitation, as of January 2, 2000, a valuation allowance of $7,454,000 existed against the deferred tax asset resulting from $21,298,000 of federal NOLs generated prior to March 26, 1996.

During the year ended December 31, 2000 the Company realized gains in excess of $21,298,000, which were unrealized as of the date of the first ownership change. Accordingly, the valuation allowance on federal Old NOLs of $7,454,000 was eliminated during the year ended December 31, 2000. As of December 30, 2001, the Company had aggregate federal NOL carryforwards of approximately $13,000,000, which expire between 2010 and 2019. As of December 30, 2001 and December 31, 2000, full valuation allowances of $11,295,000 and $11,583,000, respectively, existed related to state NOL carryforwards due to restrictions on the usage of state NOL carryforwards and short carryforward periods for certain states.

8. INCOME TAXES (CONTINUED)

The (provision for) benefit from income taxes for the years ended December 30, 2001, December 31, 2000 and January 2, 2000 were as follows (in thousands):

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Current (provision) benefit:			
Federal	$(295)	$ 38	$ 104
State	(341)	(26)	18
Total current (provision) benefit	(636)	12	122
Deferred (provision) benefit:			
Federal	(498)	19,214	5,718

State	454	1,995	319
Total deferred (provision) benefit	(44)	21,209	6,037
Total (provision for) benefit from income taxes	$(680)	$21,221	$6,159

A reconciliation of the difference between the statutory federal income tax rate and the effective income tax rate follows:

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Statutory federal income tax rate	35%	35%	35%
State income taxes net of federal benefit	6	6	6
Effect of change in valuation allowance	(7)	23	40
Tax credits	(23)	3	15
Nondeductible expenses	4	(1)	(4)
Other	1	--	15
Effective tax rate	16%	66%	107%

Deferred tax assets and liabilities are determined as the difference between the financial statement and tax bases of the assets and liabilities multiplied by the enacted tax rates in effect for the year in

8. INCOME TAXES (CONTINUED)

which the differences are expected to reverse. Significant deferred tax assets (liabilities) at December 30, 2001 and December 31, 2000 were as follows (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Property and equipment	$(23,448)	$(31,181)
Net operating loss carryforwards (net of valuation allowance of $11,295 and $11,583 at December 30, 2001 and December 31, 2000, respectively)	4,757	14,020
Insurance reserves	8,245	6,878
Inventories	269	1,370
Pension	(2,164)	284
Intangible assets	(5,098)	(5,287)
Tax credit carryforwards	7,869	6,262

Deferred gain	4,489	--
Other	2,156	4,773
Net deferred tax liability	$ (2,925)	$ (2,881)

9. RESTRUCTURINGS

On October 10, 2001, the Company eliminated approximately 70 positions at corporate headquarters. The purpose of the reduction was to streamline functions and reduce redundancy amongst its business segments. In addition, approximately 30 positions in the restaurant construction and fabrication areas were eliminated by December 30, 2001. The Company believes the outsourcing of such activities will be more cost effective in the future. Annual salaries and fringe benefits associated with these 100 positions was approximately $5,600,000. As a result of the elimination of the positions and the outsourcing of certain functions, the Company reported a pre-tax restructuring charge of approximately $2,536,000 for severance, rent and unusable construction supplies due solely to the outsourcing in the year ended December 30, 2001.

In March 2000, the Company's Board of Directors approved a restructuring plan that provided for the immediate closing of 81 restaurants at the end of March 2000 and the disposition of an additional 70 restaurants over the next 24 months. In connection with the restructuring plan, the Company eliminated approximately 150 management and administrative positions in the field organization and at corporate headquarters. As a result of the March 2000 plan, the Company reported a pre-tax restructuring charge of approximately $12,056,000 for severance, rent, utilities and real estate taxes, demarking, lease termination costs and certain other costs associated with the closing of the locations, along with a pre-tax write-down of property and equipment for these locations of approximately $17,008,000 in the year ended December 31, 2000. Due to earlier than anticipated lease terminations, the Company reduced this reserve by $1,900,000 during the year ended December 30, 2001.

9. RESTRUCTURINGS (CONTINUED)

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

	FOR THE YEAR ENDED DECEMBER 31, 2000		
	EXPENSE	COSTS PAID	RESTRUCTURIN RESERVE AS O DECEMBER 31, 2
Severance pay	$ 1,503	$(1,429)	$ 74
Rent	5,490	(1,905)	3,585
Utilities and real estate taxes	1,632	(527)	1,105
Demarking	760	(622)	138
Lease termination costs	718	(598)	120
Environmental costs	404	(404)	--
Inventory	111	(106)	5
Equipment	727	(727)	--

Outplacement services..................................	160	(160)	--
Other..	551	(7)	544
Total..	$12,056	$(6,485)	$5,571

FOR THE YEAR ENDED DECEMBER 30, 2001

	RESTRUCTURING RESERVE AS OF DECEMBER 31, 2000	EXPENSE	COSTS PAID	RESERVE REDUCTION	REST RESE DECEMB
Severance pay....................	$ 74	$1,186	$ (753)	$ 9	$
Rent.............................	3,585	440	(1,169)	(1,538)	
Utilities and real estate taxes..........................	1,105	--	(583)	(337)	
Demarking........................	138	--	(138)	--	
Lease termination costs..........	120	--	(120)	--	
Environmental costs..............	--	--	--	--	
Inventory........................	5	--	(5)	--	
Equipment........................	--	515	(35)	--	
Outplacement services............	--	143	(103)	(34)	
Other............................	544	252	(245)	--	
Total............................	$5,571	$2,536	$(3,151)	$(1,900)	$

Based on information currently available, management believes that the restructuring reserve as of December 30, 2001 is adequate and not excessive.

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

10. FRANCHISE TRANSACTIONS

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 loans, 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.

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

10. FRANCHISE TRANSACTIONS (CONTINUED)

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, 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 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.

11. EMPLOYEE BENEFIT PLANS

Substantially all of the employees of the Company are covered by a non-contributory defined benefit cash balance pension plan. Plan benefits are based on years of service and participant compensation during their years of employment. The Company accrues the cost of its pension plan over its employees' service lives.

Under the cash balance plan, a nominal account for each participant is established. The Company makes an annual contribution to each participant's account based on current wages and years of service. Each account earns a specified rate of interest which is adjusted annually. Plan expenses may also be paid from the assets of the plan.

For the years ended December 30, 2001 and December 31, 2000, the reconciliation of the projected benefit obligation was (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Beginning of year benefit obligation................	$81,876	$79,175
Service cost....................................	2,841	3,145
Interest cost...................................	6,247	6,251
Actuarial loss..................................	2,780	3,146
Disbursements...................................	(8,401)	(9,841)
End of year benefit obligation.....................	$85,343	$81,876

In 1997, pension benefits were reduced to certain employees. In 1998, death benefits were increased. The effect of these amendments is being amortized over the remaining employee service period of active plan participants.

11. EMPLOYEE BENEFIT PLANS (CONTINUED)

The reconciliation of the funded status of the pension plan as of December 30, 2001 and December 31, 2000 included the following components (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Projected benefit obligation.......................	$ 85,343	$ 81,876
Fair value of plan assets..........................	100,123	113,577

Funded status	14,780	31,701
Unrecognized prior service cost	(4,402)	(5,207)
Unrecognized net actuarial gain	(4,701)	(26,200)
Prepaid benefit cost	$ 5,677	$ 294

The reconciliation of the fair value of assets of the plan as of December 30, 2001 and December 31, 2000 was (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Beginning of year fair value of assets	$113,577	$124,614
Actual return on plan assets	(4,664)	(1,682)
Disbursements	(8,401)	(9,841)
Other	(389)	486
End of year fair value of assets	$100,123	$113,577

The components of net pension benefit for the years ended December 30, 2001, December 31, 2000 and January 2, 2000 were (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Service cost	$ 2,841	$ 3,145	$ 4,090
Interest cost	6,247	6,251	6,269
Expected return on assets	(12,177)	(11,628)	(10,291)
Net amortization:			
Unrecognized prior service cost	(805)	(805)	(805)
Unrecognized net actuarial gain	(1,489)	(1,899)	--
Net pension benefit	$ (5,383)	$ (4,936)	$ (737)

A summary of the Company's key actuarial assumptions as of December 30, 2001, December 31, 2000 and January 2, 2000 follows:

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Discount rate	7.25%	7.50%	8.00%
Salary increase rate	3.75-5.25%	3.75-5.25%	3.75-5.25%
Expected long-term rate of return	10.0%	10.5%	10.5%

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

11. EMPLOYEE BENEFIT PLANS (CONTINUED)

The Company's Employee Savings and Investment Plan (the "Plan") covers all eligible employees and is intended to be qualified under Sections 401(a) and 401(k) of the Internal Revenue Code. For the years ended December 30, 2001 and December 31, 2000, the Company made matching contributions at the rate of 75% of the first 2% of the participant's contributions and 50% of the next 4% of the participant's contributions for employees of certain job classifications. For other employees of the Company, the Company made matching contributions at the rate of 75% of the first 2% of the participant's contributions and 50% of the next 2% of the participant's contributions. All employee contributions are fully vested. Company contributions are vested at the completion of five years of service or at retirement, death, disability or termination at age 65 or over, as defined by the Plan. Company contributions and administrative expenses for the Plan were approximately $837,000, $974,000 and $1,083,000 for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively.

12. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Company provides health care and life insurance benefits to certain groups of employees upon retirement. Eligible employees may continue their coverages if they are receiving a pension benefit, are at least 55 years of age and have completed ten years of service. The plan requires contributions for health care coverage from participants who retired after September 1, 1989. Life insurance benefits are non-contributory. Benefits under the plan are provided through the Company's general assets.

The Company accrues the cost of postretirement benefits over the years employees provide services to the date of their full eligibility for such benefits. The reconciliation of the accumulated postretirement benefit obligation for the years ended December 30, 2001 and December 31, 2000 is as follows (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Beginning of year benefit obligation	$6,038	$5,589
Service cost	176	152
Interest cost	444	438
Actuarial loss	715	350
Disbursements	(575)	(491)
End of year benefit obligation	$6,798	$6,038

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

12. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

The reconciliation of the funded status of the postretirement plan as of December 30, 2001 and December 31, 2000 included the following components (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000
Accumulated postretirement benefit obligation.......	$(6,798)	$(6,038)
Fair value of plan assets..........................	--	--
Funded status......................................	(6,798)	(6,038)
Unrecognized prior service cost....................	(804)	(866)
Unrecognized net actuarial loss (gain).............	519	(195)
Accrued benefit liability..........................	$(7,083)	$(7,099)

The components of the net postretirement benefit cost for the years ended December 30, 2001, December 31, 2000 and January 2, 2000 were (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Service cost............................	$176	$152	$180
Interest cost...........................	444	438	430
Net amortization of prior service cost....	(61)	(62)	(62)
Net postretirement benefit cost..........	$559	$528	$548

A summary of the Company's key actuarial assumptions as of December 30, 2001, December 31, 2000 and January 2, 2000 follows:

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Discount rate............................	7.25%	7.50%	8.00%
Salary increase rate.....................	3.75-5.25%	3.75-5.25%	3.75-5.25%
Medical cost trend:			
First year............................	9.50%	5.25%	6.25%
Ultimate..............................	5.50%	5.25%	5.25%
Years to reach ultimate................	4	1	2

A one-percentage-point increase in the assumed health care cost trend rate would have increased postretirement benefit expense by approximately $64,000, $58,000 and $60,000 and would have increased the accumulated postretirement benefit obligation by approximately $617,000, $518,000 and $454,000 for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively. A one-percentage-point decrease in the assumed health care cost trend rate would have decreased the postretirement benefit expense by approximately $58,000, $52,000 and $54,000 and would have decreased the accumulated postretirement benefit obligation by approximately $558,000, $470,000 and $414,000 for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, respectively.

13. INSURANCE RESERVES

At December 30, 2001 and December 31, 2000, insurance reserves of approximately $30,562,000 and $28,339,000, respectively, had been recorded. Insurance reserves at December 30, 2001 and December 31, 2000 included RIC's reserve for the Company's insurance liabilities of approximately $7,830,000 and $9,332,000, respectively. Reserves also included accruals related to post employment benefits and postretirement benefits other than pensions. While management believes these reserves are adequate, it is reasonably possible that the ultimate liabilities will exceed such estimates.

Classification of the reserves was as follows (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Current	$13,333	$13,095	$ 9,748
Long-term	17,229	15,244	17,246
Total	$30,562	$28,339	$26,994

Following is a summary of the activity in the insurance reserves for the years ended December 30, 2001, December 31, 2000 and January 2, 2000 (in thousands):

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
Beginning balance	$28,339	$ 26,994	$ 26,479
Provision	11,825	15,437	12,903
Payments	(9,602)	(14,092)	(12,388)
Ending balance	$30,562	$ 28,339	$ 26,994

The provision for insurance reserves each year is actuarially determined and reflects amounts for the current year as well as revisions in estimates to open reserves for prior years. Payments include amounts paid on open claims for all years.

14. STOCKHOLDERS' DEFICIT

In connection with the Recapitalization, FICC adopted a Restricted Stock Plan (the "Restricted Stock Plan"), pursuant to which 371,285 shares are authorized for issuance. The Restricted Stock Plan provides for the award of common stock, the vesting of which is subject to conditions and limitations established by the Board of Directors.

Such conditions may include continued employment with the Company or the achievement of performance measures. Upon the award of common stock, the participant has the rights of a stockholder, including but not limited to the right to vote such stock and the right to receive any dividends paid on such stock. The Board of Directors, in its sole discretion, may designate employees and persons providing material services to the Company as eligible for participation in the Restricted Stock Plan.

14. STOCKHOLDERS' DEFICIT (CONTINUED)

A summary of the shares issued under the Restricted Stock Plan is presented below:

	NUMBER OF SHARES
Shares outstanding at December 27, 1998	332,885
Granted	82,008
Forfeited	(62,916)
Shares outstanding at January 2, 2000	351,977
Forfeited	(86,835)
Shares outstanding at December 31, 2000	265,142
Forfeited	(41,422)
Shares outstanding at December 30, 2001	223,720

The shares issued vest on a straight-line basis over eight years or on an accelerated basis if certain performance criteria are met. The Company is recording the fair value of the shares issued at the issuance dates as compensation expense over the estimated vesting periods. During the years ended December 30, 2001, December 31, 2000, and January 2, 2000, the Company recorded stock compensation expense of approximately $298,000, $529,000 and $563,000, respectively, which is included in general and administrative expenses in the accompanying consolidated statements of operations.

In connection with the Recapitalization, the Board of Directors adopted a stock option plan (the "Stock Option Plan"), pursuant to which 395,000 shares of common stock options were authorized for issuance. On March 27, 2000 the Board of Directors amended the Stock Option Plan to increase the shares available by 439,970 options. On October 24, 2001 the Board of Directors again amended the Stock Option Plan to increase the shares available by 200,000 options. The Stock Option Plan provides for the issuance of nonqualified stock options and incentive stock options (which are intended to satisfy the requirements of Section 422 of the Internal Revenue Code) and stock appreciation rights. As of December 30, 2001, no stock appreciation rights had been issued. The Board of Directors will determine the employees who will receive awards under the Stock Option Plan and the terms of such awards. The exercise price of a stock option or stock appreciation right shall not be less than the fair market value of one share of common stock on the date the stock option or stock appreciation right is granted. The options expire ten years from the date of grant. Options issued prior to March 26, 2000 vest over five years, options issued subsequent to that date vest over three years.

14. STOCKHOLDERS' DEFICIT (CONTINUED)

A summary of the status of the Company's Stock Option Plan is presented below:

	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Options outstanding at December 27, 1998......	162,740	$12.42
Granted....................................	170,850	5.85
Forfeited..................................	(20,760)	10.49
Options outstanding at January 2, 2000........	312,830	9.09
Granted....................................	548,040	3.71
Forfeited..................................	(143,744)	6.65
Options outstanding at December 31, 2000......	717,126	5.46
Granted....................................	274,820	2.47
Forfeited..................................	(189,117)	4.96
Exercised..................................	(1,000)	3.88
Options outstanding at December 30, 2001......	801,829	$ 4.55

At December 30, 2001, December 31, 2000 and January 2, 2000, options were exercisable on 221,748, 76,618 and 33,390 shares of stock with a weighted average exercise price of $6.56, $10.50 and $13.23, respectively.

The following table summarizes information related to outstanding options as of December 30, 2001:

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AS OF DECEMBER 30, 2001	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE
$ 0.00 - $2.48.............	216,220	9.4	$ 2.16
2.48 - 4.95.............	417,731	8.4	3.72
4.95 - 7.43.............	108,834	6.9	5.87
7.43 - 9.90.............	6,044	6.7	9.31
9.90 - 12.38.............	550	6.6	12.00
17.33 - 19.80.............	50,600	5.6	17.38
22.28 - 24.75.............	1,850	6.4	24.75
	801,829	8.3	$ 4.55

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The Company applies APB No. 25 and related Interpretations in accounting for its plans. Under APB No. 25, no compensation cost has been recognized for its Stock Option Plan. Had compensation cost for the Company's stock plans been determined consistent with SFAS No. 123, the Company's net

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

14. STOCKHOLDERS' DEFICIT (CONTINUED)

income (loss) and basic and diluted net income (loss) per share for the years ended December 30, 2001, December 31, 2000 and January 2, 2000, would have been the following pro forma amounts:

	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
PRO FORMA:			
Income (loss) before extraordinary item and cumulative effect of change in accounting principle..................	$2,747,000	$(10,971,000)	$287,000
Extraordinary item, net of income tax expense..............................	547,000	--	--
Cumulative effect of change in accounting principle, net of income tax benefit...	--	--	(319,000)
Net income (loss)......................	$3,294,000	$(10,971,000)	$(32,000)
Basic and diluted income (loss) per share:			
Income (loss) before extraordinary item and cumulative effect of change in accounting principle..................	$ 0.37	$ (1.48)	$ 0.04
Extraordinary item, net of income tax expense..............................	0.07	--	--
Cumulative effect of change in accounting principle, net of income tax benefit...	--	--	(0.04)
Net income (loss) per share.............	$ 0.44	$ (1.48)	$ --

Fair value was estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

	2001	2000	1999
Risk free interest rate...........	4.24%-5.26%	5.24%-6.85%	5.66%-7.09%
Expected life.....................	6 years	7 years	7 years
Expected volatility...............	85.30%	82.32%	79.14%
Dividend yield....................	0.00%	0.00%	0.00%

Fair value.......................	$1.44-$3.18	$1.98-$3.56	$3.87-$7.15

Pursuant to a stockholder rights plan (the "Stockholder Rights Plan") that FICC adopted in connection with the Recapitalization, the Board of Directors declared a dividend distribution of one purchase right (a "Right") for each outstanding share of common stock. The Stockholder Rights Plan provides, in substance, that should any person or group (other than certain management and affiliates) acquire 15% or more of FICC's common stock, each Right, other than Rights held by the acquiring person or group, would entitle its holder to purchase a specified number of shares of common stock for 50% of their then current market value. Until a 15% acquisition has occurred, the Rights may be redeemed by FICC at any time prior to the termination of the Stockholder Rights Plan.

15. RELATED PARTY TRANSACTIONS

On October 12, 1998, Friendly's entered into an agreement with The Ice Cream Corporation ("TICC") which conditionally granted TICC exclusive rights to purchase and develop Friendly's full-service restaurants in the Lancaster and Chester counties of Pennsylvania (the "TICC Agreement"). The owners of TICC are family members of the Chairman of the Board of Directors and Chief Executive Officer of FICC. Pursuant to the TICC Agreement, TICC purchased at fair market value certain assets and rights in two existing restaurants and committed to open an additional ten restaurants by October 11, 2004 with an option to purchase an additional three restaurants. TICC paid to Friendly's $125,000 for development fees for certain of the additional restaurants discussed above and $25,000 for the option to purchase two additional existing restaurants. On March 21, 2001, TICC and Friendly's agreed to terminate their development agreement and TICC forfeited their exclusive development rights. The $112,500 of unearned development fees were offset against the amounts due from TICC for product purchases.

FICC's Chairman of the Board and Chief Executive Officer is an officer of TRC. FICC entered into subleases for certain land, buildings and equipment from a subsidiary of TRC. For the years ended December 30, 2001, December 31, 2000 and January 2, 2000, rent expense related to the subleases was approximately $219,000, $312,000 and $302,000, respectively. On May 11, 2001, FICC purchased the first lease position from the master lessee for one of these properties for $100,000 and terminated the sublease with the subsidiary of TRC for approximately $52,000.

In 1994, TRC Realty LLC (a subsidiary of TRC) entered into a ten-year operating lease for an aircraft for use by both the Company and TRC (which operates restaurants using the trademark Perkins Restaurant and Bakery ("Perkins")). In 1999, this lease was cancelled and TRC Realty LLC entered into a new ten-year operating lease for a new aircraft. The Company shares proportionately with Perkins in reimbursing TRC Realty LLC for leasing, tax and insurance expenses. In addition, the Company also incurs actual usage costs. Total expense for the years ended December 30, 2001, December 31, 2000 and January 2, 2000 was approximately $686,000, $927,000 and $568,000, respectively.

The Company purchased certain food products used in the normal course of business from a division of TRC. For the years ended December 30, 2001, December 31, 2000 and January 2, 2000, purchases were approximately $618,000, $759,000 and $967,000, respectively.

In July 2000, the pension plan sold a restaurant property located in Waldorf, Maryland to an independent third party. The Company, the occupant of the property, bought out the remaining full term of the lease for approximately $69,000. As a result of the sale, the pension plan realized a loss of approximately $108,000 in fiscal 2000.

In August 1999, the pension plan sold a restaurant property located in Randallstown, Maryland, to an independent third party. As a result of the sale, the pension plan realized a loss of $107,500 in 1999. The Company then contributed $107,500 to the pension plan, in settlement of its ongoing obligations under the lease. The Company received an opinion from outside legal counsel to the pension plan verifying that the transaction complied with the Employee Retirement Income Security Act of 1974 because it fell within a recognized exemption to 406(a)(1).

In June 1999, the Company sold a restaurant business (excluding the related property which was owned by the pension plan), located in Mt. Laurel, New Jersey, to a franchisee of Friendly's Restaurants Franchise, Inc., a subsidiary of FICC. Under the original lease agreement between the

15. RELATED PARTY TRANSACTIONS (CONTINUED)

Company and the pension plan, the Company leased the restaurant from the pension plan for approximately $63,000 per annum through June 2001. In conjunction with the Company's sale of the restaurant business to the franchisee, the Company subleased the property, with all of its rights, to the franchisee for an aggregate annual amount of $77,000 through July 31, 2001. Under the terms of the sublease agreement, the pension plan received rental income directly from the franchisee. On March 30, 2001, the franchisee exercised an option to purchase the property directly from the pension plan at fair market value of approximately $712,000.

16. COMMITMENTS AND CONTINGENCIES

The Company is a party to various legal proceedings arising in the ordinary course of business which management believes, after consultation with legal counsel, will not have a material adverse effect on the Company's consolidated financial position or future operating results.

As of December 30, 2001, the Company has commitments to purchase approximately $104,356,000 of raw materials, food products and supplies used in the normal course of business that cover periods of one to 12 months. Most of these commitments are noncancelable.

17. RELOCATION OF MANUFACTURING AND DISTRIBUTION FACILITY

On December 1, 1998, the Company announced a plan to relocate its manufacturing and distribution operations from Troy, OH to Wilbraham, MA and York, PA. The Company closed the Troy, OH manufacturing and distribution facility in May 1999 and transferred the operations to Wilbraham, MA and York, PA.

In December 1999, the Company sold the Troy, OH manufacturing facility for cash of $2,200,000 and a seven-year, 7.75% interest-bearing $600,000 note receivable due January 2007. The Company incurred a total loss on the sale of the property of $1,033,000 in 1999, which is included in relocation of manufacturing and distribution facility in the accompanying consolidated statements of operations.

18. SEGMENT REPORTING

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

The Company's restaurants target families with children and adults who desire a reasonably-priced meal in a full-service setting. The Company's menu offers a broad selection of freshly-prepared foods which appeal to customers throughout all dayparts. The menu currently features over 100 items comprised of a broad selection of breakfast, lunch, dinner and afternoon and evening snack items. Foodservice operations manufactures frozen dessert products and distributes such manufactured products and purchased finished goods to the Company's restaurants and franchised operations.

18. SEGMENT REPORTING (CONTINUED)

Additionally, it sells frozen dessert products to distributors and retail and institutional locations. The Company's franchise segment includes a royalty based on franchise restaurant revenue. In addition, the Company receives rental income from various franchised restaurants. The Company does not allocate general and administrative expenses associated with its headquarters operations to any business segment. These costs include general and administrative expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarters activities.

On May 1, 2001, foodservice decreased its ice cream pricing to all restaurants. This resulted in decreased foodservice revenues of 3.2% for the year ended December 30, 2001.

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

EBITDA represents net income (loss) before (i) 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 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 (loss) from operations or other traditional indications of a company's operating performance.

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
	(IN THOUSANDS)		
Revenues:			
Restaurant	$ 447,953	$ 508,976	$ 618,433
Foodservice	234,114	238,992	245,528
Franchise	9,174	8,710	4,967
International	--	--	23
Total	$ 691,241	$ 756,678	$ 868,951
Intersegment revenues:			
Restaurant	$ --	$ --	$ --
Foodservice	(129,368)	(157,820)	(183,107)
Franchise	--	--	--
International	--	--	--
Total	$(129,368)	$(157,820)	$(183,107)

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

18. SEGMENT REPORTING (CONTINUED)

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
	(IN THOUSANDS)		
External revenues:			
Restaurant	$ 447,953	$ 508,976	$ 618,433
Foodservice	104,746	81,172	62,421
Franchise	9,174	8,710	4,967
International	--	--	23
Total	$ 561,873	$ 598,858	$ 685,844
EBITDA:			
Restaurant	$ 53,986	$ 45,731	$ 56,453
Foodservice	13,496	24,600	26,894

Franchise	4,359	3,821	2,092
International	--	--	(83)
Corporate	(16,242)	(21,854)	(19,562)
Gain on property and equipment, net	5,892	10,895	1,038
Restructuring costs	(636)	(12,056)	(1,787)
Total	$ 60,855	$ 51,137	$ 65,045
Interest expense, net--Corporate	$ 27,310	$ 31,053	$ 33,694
Recovery of write-down of joint venture--Corporate	$ --	$ --	$ (896)
Depreciation and amortization:			
Restaurant	$ 18,914	$ 20,828	$ 25,901
Foodservice	3,449	3,477	3,656
Franchise	259	339	567
Corporate	6,405	6,106	4,865
Total	$ 29,027	$ 30,750	$ 34,989
Other non-cash expenses:			
Corporate	$ (298)	$ (527)	$ (563)
Write-downs of property and equipment	(800)	(20,834)	(1,913)
Total	$ (1,098)	$ (21,361)	$ (2,476)

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

18. SEGMENT REPORTING (CONTINUED)

	FOR THE YEARS ENDED		
	DECEMBER 30, 2001	DECEMBER 31, 2000	JANUARY 2, 2000
	(IN THOUSANDS)		
Income (loss) before income taxes, extraordinary item and cumulative effect of change in accounting principle:			
Restaurant	$ 35,072	$ 24,903	$ 30,552
Foodservice	10,047	21,123	23,238
Franchise	4,100	3,482	1,525
International	--	--	813
Corporate	(50,255)	(59,540)	(58,684)
Gain (loss) on property and equipment, net	5,092	(9,939)	(875)
Restructuring costs	(636)	(12,056)	(1,787)
Total	$ 3,420	$ (32,027)	$ (5,218)

	FOR THE YEARS ENDED	
	DECEMBER 30, 2001	DECEMBER 31, 2000
Capital expenditures, including assets acquired under capital leases:		
Restaurant	$ 10,821	$ 18,245
Foodservice	2,090	2,667
Corporate	1,011	1,535
Total	$ 13,922	$ 22,447
Total assets:		
Restaurant	$148,475	$199,223
Foodservice	38,474	33,880
Franchise	7,076	3,745
Corporate	58,537	60,838
Total	$252,562	$297,686

19. CLOSING OF INTERNATIONAL OPERATIONS

Effective October 15, 1998, Friendly's International, Inc. ("FII"), a subsidiary of FICC, entered into an agreement that provided for the sale of the Company's 50% equity interest in its China joint venture to the joint venture partner and the settlement of FICC's advances to the joint venture for an aggregate of approximately $2,300,000 in notes and $335,000 of equipment. On February 25, 1999, FII received an initial payment of approximately $1,150,000 and arranged for the shipment of the equipment to the United States. Accordingly, the Company recorded a write-down of approximately $3,486,000 as of December 27, 1998 to eliminate the Company's remaining investment in and advances to the joint venture. During the year ended January 2, 2000, the Company received from its joint venture partner $827,000 of cash and $69,000 of equipment as payment for the dissolution of the joint

19. CLOSING OF INTERNATIONAL OPERATIONS (CONTINUED)

venture partnership, which were recorded as recovery of write-down of joint venture in the accompanying consolidated statement of operations for the year ended January 2, 2000.

20. EXTRAORDINARY ITEM, NET OF INCOME TAXES

Extraordinary item, net represents the $4,300,000 gain on the repurchase of Senior Notes net of (i) $2,900,000 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 $21,300,000 of Senior Notes in December 2001, (ii) $500,000 of expenses associated with releasing mortgages, etc. in connection with the repayment of the Old Credit Facility and (iii) $400,000 of income taxes.

21. QUARTERLY FINANCIAL DATA (UNAUDITED)

	QUARTER ENDED			
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	APRIL 1, 2001	JULY 1, 2001	SEPTEMBER 30, 2001	DECEMBER 2001
2001 (a)				
Revenues (b)	$125,719	$151,823	$151,373	$132,95
Operating income	4,136	13,598	9,451	3,54
(Loss) income before extraordinary item (c)	(1,935)	4,041	1,862	(84
Net (loss) income	(1,935)	4,041	1,641	(8
Basic and diluted (loss) income per share:				
(Loss) income before extraordinary item	$ (0.26)	$ 0.55	$ 0.25	$ (0.1
Net (loss) income	$ (0.26)	$ 0.55	$ 0.22	$ (0.0
Weighted average shares:				
Basic	7,376	7,364	7,359	7,35
Diluted	7,376	7,370	7,416	7,35

	APRIL 2, 2000	JULY 2, 2000	OCTOBER 1, 2000	DECEMBER 2000
2000 (a)				
Revenues (b)	$144,089	$159,048	$161,605	$134,1
Operating (loss) income	(27,672)	10,853	11,265	4,5
Net (loss) income	(18,510)	3,005	3,246	1,4
Basic and diluted (loss) income per share:				
Net (loss) income	$ (2.48)	$ 0.40	$ 0.44	$ 0.
Weighted average shares:				
Basic	7,471	7,438	7,409	7,3
Diluted	7,471	7,498	7,437	7,3

(a) During the year ended December 30, 2001 the Company recorded restructuring costs of $2,536,000 as a result of the Company's restructuring plan announced in October 2001. During the year ended

21. QUARTERLY FINANCIAL DATA (UNAUDITED) (CONTINUED)

December 31, 2000, the Company recorded restructuring costs of $12,056,000 and write-downs of property and equipment of $17,008,000 as a result of the

Company's restructuring plan announced in March 2000. The Company reduced the March 2000 restructuring reserve by $1,900,000 during the year ended December 30, 2001.

(b) In April 2001, the Emerging Issues Task Force issued EITF No. 00-25, "Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products." The Company adopted EITF No. 00-25 on October 1, 2001 and as a result offset certain retail selling expenses against retail revenue for all periods presented.

(c) See Note 20 for discussion of the $547,000 extraordinary item, net.

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

FICC's obligation related to the Senior Notes are guaranteed fully and unconditionally by one of FICC's wholly owned subsidiaries. There are no restrictions on FICC's ability to obtain dividends or other distributions of funds from this subsidiary, except those imposed by applicable law. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for FICC (the "Parent Company"), Friendly's Restaurants Franchise, Inc. (the "Guarantor Subsidiary") and Friendly's International, Inc., Restaurant Insurance Corporation, and the three new LLC subsidiaries, Friendly's Realty I, LLC, Friendly's Realty II, LLC and Friendly's Realty III, LLC (collectively, the "Non-guarantor Subsidiaries"). All of the LLCs' assets are owned by the LLCs, which are separate entities with separate creditors which will be entitled to be satisfied out of the LLCs' assets. Separate complete financial statements and other disclosures of the Guarantor Subsidiary as of December 30, 2001 and December 31, 2000 and for the years ended December 30, 2001 and December 31, 2000 are not presented because management has determined that such information is not material to investors.

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

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 30, 2001
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
ASSETS					
Current assets:					
Cash and cash equivalents.........	$ 15,116	$ 104	$ 1,122	$ --	$
Accounts receivable, net..........	9,468	501	--	--	
Inventories......................	12,987	--	--	--	

Deferred income taxes	7,448	99	--	112	
Prepaid expenses and other current assets	8,704	1,002	3,560	(9,530)	
Total current assets	53,723	1,706	4,682	(9,418)	
Deferred income taxes	--	350	1,327	(1,677)	
Property and equipment, net	117,564	--	51,925	--	1
Intangibles and deferred costs, net	18,271	--	2,937	--	
Investments in subsidiaries	5,061	--	--	(5,061)	
Other assets	10,258	4,863	6,229	(10,178)	
Total assets	$204,877	$6,919	$67,100	$(26,334)	$2
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY					
Current liabilities:					
Current maturities of long-term obligations	$ 5,489	$ --	$ 930	$ (3,500)	$
Accounts payable	20,505	--	--	--	
Accrued expenses	43,853	1,042	7,491	(5,758)	
Total current liabilities	69,847	1,042	8,421	(9,258)	
Deferred income taxes	12,149	--	--	(1,565)	
Long-term obligations, less current maturities	190,308	--	54,070	(5,314)	2
Other long-term liabilities	28,587	1,095	4,330	(5,136)	
Stockholders' (deficit) equity	(96,014)	4,782	279	(5,061)	(
Total liabilities and stockholders' (deficit) equity	$204,877	$6,919	$67,100	$(26,334)	$2

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 30, 2001
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Revenues	$554,252	$7,621	$ --	$ --	$5
Costs and expenses:					
Cost of sales	197,846	--	--	--	1
Labor and benefits	157,312	--	--	--	1
Operating expenses and write-downs of property and equipment	115,906	191	525	--	1
General and administrative expenses	31,679	4,633	--	--	
Restructuring expenses, net	636	--	--	--	
Depreciation and amortization	28,886	--	141	--	

Gain on franchise sales of restaurant operations and properties........................	(4,591)	--	--	--	
Gain on sales of other property and equipment, net....................	(2,021)	--	--	--	
Interest expense (income)...........	27,866	--	(556)	--	
Income (loss) before benefit from (provision for) income taxes, extraordinary item and equity in net income of consolidated subsidiaries......................	733	2,797	(110)	--	
Benefit from (provision for) income taxes............................	799	(1,147)	48	--	
Income (loss) before extraordinary item and equity in net income of consolidated subsidiaries.........	1,532	1,650	(62)	--	
Extraordinary item, net of income tax expense.......................	547	--	--	--	
Income (loss) before equity in net income of consolidated subsidiaries......................	2,079	1,650	(62)	--	
Equity in net income of consolidated subsidiaries......................	1,588	--	--	(1,588)	
Net income (loss)..................	$ 3,667	$1,650	$(62)	$(1,588)	$

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 30, 2001
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CON
Net cash provided by operating activities........................	$ 15,212	$ 71	$ 2,413	$(2,224)	$
Cash flows from investing activities:					
Purchases of property and equipment.......................	(13,922)	--	(52,061)	52,061	
Proceeds from sales of property and equipment.......................	108,736	--	--	(52,061)	
Investment in subsidiaries.........	(3)	--	--	3	
Net cash provided by (used in) investing activities..............	94,811	--	(52,061)	3	
Cash flows from financing activities:					

Proceeds from borrowings...........	79,405	--	55,000	--
Repayments of obligations..........	(186,828)	--	--	--
Payments related to deferred financing costs.................	(1,107)	--	(2,941)	--
Reinsurance deposits received......	--	--	1,280	(1,280)
Reinsurance payments made from deposits........................	--	--	(3,504)	3,504
Stock options exercised............	4	--	--	--
Contribution of capital............	--	--	3	(3)
Net cash (used in) provided by financing activities..............	(108,526)	--	49,838	2,221
Net increase in cash and cash equivalents........................	1,497	71	190	--
Cash and cash equivalents, beginning of year...........................	13,619	33	932	--
Cash and cash equivalents, end of year.............................	$ 15,116	$104	$ 1,122	$ --
Supplemental disclosures:				
Interest paid (received)...........	$ 29,183	$ --	$ (750)	$ --
Income taxes (received) paid.......	(422)	596	65	--
Capital lease obligations terminated......................	170	--	--	--
Note received from the sale of property and equipment...........	4,250	--	--	--

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FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

SUPPLEMENTAL CONDENSED CONSOLIDATING BALANCE SHEET
AS OF DECEMBER 31, 2000
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
ASSETS					
Current assets:					
Cash and cash equivalents.........	$ 13,619	$ 33	$ 932	$ --	$
Restricted cash...................	--	--	1,737	--	
Accounts receivable..............	5,649	508	--	--	
Inventories.......................	11,570	--	--	--	
Deferred income taxes............	10,258	43	--	94	
Prepaid expenses and other current assets.........................	7,435	551	4,057	(9,244)	
Total current assets...............	48,531	1,135	6,726	(9,150)	
Deferred income taxes..............	--	506	1,327	(1,833)	
Property and equipment, net.........	226,865	--	--	--	2
Intangible assets and deferred costs, net.......................	21,529	--	--	--	

Investments in subsidiaries.........	3,500	--	--	(3,500)	
Other assets........................	1,135	3,614	5,729	(8,428)	
Total assets........................	$301,560	$5,255	$13,782	$(22,911)	$2
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY					
Current liabilities:					
Current maturities of long-term obligations....................	$ 19,172	$ --	$ --	$ (4,000)	$
Accounts payable..................	20,100	--	--	--	
Accrued expenses..................	43,683	648	8,082	(5,014)	
Total current liabilities...........	82,955	648	8,082	(9,014)	
Deferred income taxes...............	15,015	--	--	(1,739)	
Long-term obligations, less current maturities........................	288,472	--	--	(4,814)	2
Other liabilities...................	15,101	1,475	5,332	(3,844)	
Stockholders' (deficit) equity......	(99,983)	3,132	368	(3,500)	(
Total liabilities and stockholders' (deficit) equity.................	$301,560	$5,255	$13,782	$(22,911)	$2

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)
FOR THE YEAR ENDED DECEMBER 31, 2000
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CONS
Revenues............................	$591,719	$7,139	$ --	$ --	$5
Costs and expenses:					
Cost of sales.....................	196,181	--	--	--	1
Labor and benefits................	187,641	--	--	--	1
Operating expenses and write-downs of property and equipment.......	142,504	--	281	--	1
General and administrative expenses........................	36,499	4,734	--	--	
Restructuring expenses............	12,056	--	--	--	
Depreciation and amortization.....	30,750	--	--	--	
Gain on franchise sales of restaurant operations and properties........................	(5,307)	--	--	--	
Gain on sales of other property and equipment.........................	(5,507)	--	--	--	
Interest expense (income)...........	31,791	--	(738)	--	
(Loss) income before benefit from (provision for) income taxes and equity in net income of					

consolidated subsidiaries.........	(34,889)	2,405	457	--	(
Benefit from (provision for) income taxes............................	22,372	(986)	(165)	--	
(Loss) income before equity in net income of consolidated subsidiaries......................	(12,517)	1,419	292	--	(
Equity in net income of consolidated subsidiaries......................	1,711	--	--	(1,711)	
Net (loss) income..................	$(10,806)	$1,419	$ 292	$(1,711)	$(

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

22. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)
SUPPLEMENTAL CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 30, 2000
(IN THOUSANDS)

	PARENT COMPANY	GUARANTOR SUBSIDIARY	NON-GUARANTOR SUBSIDIARIES	ELIMINATIONS	CON
Net cash (used in) provided by operating activities...............	$ (1,538)	$19	$1,087	$(2,529)	$
Cash flows from investing activities:					
Purchases of property and equipment.......................	(18,773)	--	--	--	
Proceeds from sales of property and equipment.......................	43,822	--	--	--	
Net cash provided by investing activities........................	25,049	--	--	--	
Cash flows from financing activities:					
Proceeds from borrowings...........	125,000	--	--	--	
Repayments of obligations..........	(144,566)	--	--	--	(
Reinsurance deposits received......	--	--	2,133	(2,133)	
Reinsurance payments made from deposits........................	--	--	(4,662)	4,662	
Net cash used in financing activities........................	(19,566)	--	(2,529)	2,529	
Net increase (decrease) in cash and cash equivalents..................	3,945	19	(1,442)	--	
Cash and cash equivalents, beginning of year...........................	9,674	14	2,374	--	
Cash and cash equivalents, end of year.............................	$ 13,619	$33	$ 932	$ --	$

Supplemental disclosures:					
Interest paid (received)..........	$ 31,314	$--	$ (878)	$ --	$
Income taxes (received) paid.......	(1,174)	903	327	--	
Capital lease obligations incurred........................	3,674	--	--	--	
Capital lease obligations terminated......................	984	--	--	--	
Note received from sale of property and equipment..................	577	--	--	--	

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS
ON FINANCIAL STATEMENT SCHEDULE

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

We have audited in accordance with auditing standards generally accepted in the United States, the consolidated balance sheets of Friendly Ice Cream 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, included in this Form 10-K, and have issued our report thereon dated February 11, 2002. Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule II--Valuation and Qualifying Accounts is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. The information reflected in the schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states, in all material respects, the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

/s/ ARTHUR ANDERSEN LLP

ARTHUR ANDERSEN LLP

Hartford, Connecticut
February 11, 2002

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ANNUAL REPORT ON FORM 10-K
ITEM 14(D)

SCHEDULE II--VALUATION AND QUALIFYING ACCOUNTS
FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES
FOR THE YEARS ENDED DECEMBER 30, 2001, DECEMBER 31, 2000 AND JANUARY 2, 2000
(IN THOUSANDS)

COLUMN A	COLUMN B	COLUMN C		COLUMN D	C
DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS	C

2001				
Reserve for restructuring costs...........	$5,571	$ 636	$ --	$3,151
Allowance for doubtful accounts--accounts receivable.............................	$ 413	$ 246	$ --	$ 71
Allowance for doubtful accounts--notes receivable.............................	$ 520	$ 414	$ --	$ 20
2000				
Reserve for restructuring costs...........	$ --	$12,056	$ --	$6,485
Allowance for doubtful accounts--accounts receivable.............................	$ 191	$ 253	$ --	$ 31
Allowance for doubtful accounts--notes receivable.............................	$ 100	$ 420	$ --	$ --
1999				
Allowance for doubtful accounts--accounts receivable.............................	$ 164	$ 42	$ --	$ 15
Allowance for doubtful accounts--notes receivable.............................	$ 50	$ 50	$ --	$ --
Reserve for relocation of manufacturing and distribution facility...............	$ 945	$ 142	$ --	$1,087

EXHIBIT INDEX

3.1 Restated Articles of Organization of Friendly Ice Cream Corporation (the "Company"). (Incorporated by reference from Exhibit 3.1 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).

3.2 Amended and Restated By-laws of the Company (Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).

4.1 Credit Agreement among the Company, Fleet Bank, N.A and certain other banks and financial institutions ("Credit Agreement") dated as of December 17, 2001.**

4.2 Loan Agreement between the Company's subsidiary, Friendly's Realty I, LLC and G.E Franchise Finance Corporation dated as of December 17, 2001.**

4.3 Loan Agreement between the Company's subsidiary, Friendly's Realty II, LLC and G.E Franchise Finance Corporation dated as of December 17, 2001.**

4.4	Loan Agreement between the Company's subsidiary, Friendly's Realty III, LLC and G.E Franchise Finance Corporation dated as of December 17, 2001.**
4.5	Senior Note Indenture between Friendly Ice Cream Corporation, Friendly's Restaurants Franchise, Inc. and The Bank of New York, as Trustee (Incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).
4.6	Rights Agreement between the Company and The Bank of New York, a Rights Agent (Incorporated by reference from Exhibit 4.3 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.1	The Company's Stock Option Plan (Incorporated by reference from Exhibit 10.1 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).*
10.2	The Company's Restricted Stock Plan (Incorporated by reference from Exhibit 10.2 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).*
10.3	Purchase Agreement between Realty Income Corporation as buyer and Company as seller dated December 13, 2001.**
10.9	Sublease between SSP Company, Inc. and the Company, as amended, for the Chicopee, Massachusetts Distribution Center (Incorporated by reference from Exhibit 10.9 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.10	TRC Management Contract between the Company and The Restaurant Company (Incorporated by reference from Exhibit 10.10 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.11	Aircraft Reimbursement Agreement between the Company and TRC Realty Co (Incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 27, 1998, File No. 0-3930).
10.12	License Agreement between the Company and Hershey Foods Corporation for 1988 Non-Friendly Marks (Incorporated by reference from Exhibit 10.12 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
10.13	Agreement between Company and Gerald E. Sinsigalli executed October 10, 2001.***
21.1	Subsidiaries of the Company (Incorporated by reference from Exhibit 21.1 to the Company's Registration Statement on Form S-1, Reg. No. 333-34633).
23.1	Consent of Arthur Andersen LLP.
99.1	Explanation concerning absence of current Written Consent of Arthur Andersen LLP.

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*    --Management Contract or Compensatory Plan or Arrangement
**   --Filed with original report
***  --Filed with Form 10-K/A Amendment No. 1
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