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

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the quarterly period ended March 31, 2002

OR

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

For the transition period from to

Commission File No. 0-3930

FRIENDLY ICE CREAM CORPORATION

(Exact name of registrant as specified in its charter)

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

1855 Boston Road
Wilbraham, Massachusetts 01095
(413) 543-2400
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at April 8, 2002**
Common Stock, $.01 par value	7,353,828 shares

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, the accompanying financial statements and related disclosures have been restated to reflect this accounting change. This Form 10-Q/A does not modify or update any disclosures except as required to reflect the results of the restatement discussed above on current period and prior period financial information.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

		March 31, 2002 (unaudited)		December 30, 2001
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	14,519	$	16,342
Accounts receivable		10,745		9,969
Inventories		16,903		12,987
Deferred income taxes		7,659		7,659
Prepaid expenses and other current assets		2,327		3,736
TOTAL CURRENT ASSETS		52,153		50,693
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization		163,352		169,489
INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization		20,763		21,208
OTHER ASSETS		12,263		11,172
TOTAL ASSETS	$	248,531	$	252,562
LIABILITIES AND STOCKHOLDERS DEFICIT				
CURRENT LIABILITIES:				
Current maturities of long-term debt	$	951	$	1,068
Current maturities of capital lease and finance obligations		1,858		1,851
Accounts payable		21,232		20,505
Accrued salaries and benefits		9,137		9,436
Accrued interest payable		6,238		1,543
Insurance reserves		12,950		13,333
Restructuring reserves		2,397		3,056
Other accrued expenses		12,636		19,260
TOTAL CURRENT LIABILITIES		67,399		70,052
DEFERRED INCOME TAXES		10,244		10,584
CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities		5,796		6,267

LONG-TERM DEBT, less current maturities		232,534		232,797
OTHER LONG-TERM LIABILITIES		28,897		28,876
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS DEFICIT:				
Common stock		74		74
Additional paid-in capital		139,373		139,290
Accumulated deficit		(235,786)		(235,378)
TOTAL STOCKHOLDERS DEFICIT		(96,339)		(96,014)
TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT	$	248,531	$	252,562

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	For the Three Months Ended March 31, 2002		For the Three Months Ended April 1, 2001	
REVENUES	$	131,486	$	125,719
COSTS AND EXPENSES:				
Cost of sales		45,994		42,060
Labor and benefits		37,918		39,676
Operating expenses		26,398		24,944
General and administrative expenses		8,599		9,332
Write-downs of property and equipment		120		
Depreciation and amortization		6,686		7,552
Loss (gain) on sales of other property and equipment, net		512		(1,981)
OPERATING INCOME		5,259		4,136
Interest expense, net		6,337		7,585
LOSS BEFORE BENEFIT FROM INCOME TAXES		(1,078)		(3,449)
Benefit from income taxes		670		1,514
NET LOSS AND COMPREHENSIVE LOSS	$	(408)	$	(1,935)
BASIC AND DILUTED NET LOSS PER SHARE	$	(0.06)	$	(0.26)
WEIGHTED AVERAGE BASIC AND DILUTED SHARES		7,353		7,376

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the Three Months Ended March 31, 2002	April 1, 2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (408)	$ (1,935)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Stock compensation expense	70	93
Depreciation and amortization	6,686	7,552
Write-downs of property and equipment	120	
Deferred income tax benefit	(340)	(1,514)
Loss (gain) on sales of other property and equipment, net	512	(1,981)
Changes in operating assets and liabilities:		
Accounts receivable	(776)	598
Inventories	(3,916)	(2,510)
Other assets	318	37
Accounts payable	727	(467)
Accrued expenses and other long-term liabilities	(3,386)	2,291
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(393)	2,164
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,563)	(2,026)
Proceeds from sales of property and equipment	964	5,246
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(599)	3,220
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings		8,000
Repayments of debt	(380)	(18,627)
Repayments of capital lease and finance obligations	(464)	(572)
Stock options exercised	13	
NET CASH USED IN FINANCING ACTIVITIES	(831)	(11,199)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,823)	(5,815)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	16,342	14,584
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 14,519	$ 8,769

SUPPLEMENTAL DISCLOSURES:				
Cash paid (refunded) during the period for:				
Interest	$	1,343	$	2,136
Income taxes		(3)		2

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

FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Interim Financial Information -

The accompanying condensed consolidated financial statements as of March 31, 2002 and for the first quarters ended March 31, 2002 and April 1, 2001 are unaudited, but, in the opinion of management, include all adjustments which are necessary for a fair presentation of the consolidated financial position, results of operations, cash flows and comprehensive loss of Friendly Ice Cream Corporation (FICC) and subsidiaries (unless the context indicates otherwise, collectively, the Company). Such adjustments consist solely of normal recurring accruals. Operating results for the three month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the entire year due, in part, to the seasonality of the Company s business. Historically, higher revenues and operating income have been experienced during the second and third fiscal quarters. The Company s consolidated financial statements, including the notes thereto, which are contained in the 2001 Annual Report on Form 10-K should be read in conjunction with these condensed consolidated financial statements. Capitalized terms not otherwise defined herein should be referenced to the 2001 Annual Report on Form 10-K.

Use of Estimates in the Preparation of Financial Statements -

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The critical accounting policies and most significant estimates and assumptions relate to revenue recognition, insurance reserves, restructuring reserves, valuation allowances on net operating losses, pension and other post-retirement benefits expense and the volatility of cream prices. Actual amounts could differ significantly from the estimates.

Revenue Recognition -

The Company s revenues are derived primarily from the operation of full-service restaurants, the distribution and sale of frozen desserts through retail and institutional locations and franchising. The Company recognizes restaurant revenue upon receipt of payment from the customer and retail revenue upon shipment of product. Reserves for discounts and allowances from retail sales are estimated and accrued when revenue is recorded. Actual amounts could differ materially from the estimates. Franchise royalty income, based on net sales of franchisees, is payable monthly and is recorded on the accrual method. Initial franchise fees are recorded as revenue upon completion of all significant services, generally upon opening of the restaurant.

Insurance Reserves -

The Company is self - insured through retentions or deductibles for the majority of its workers compensation, automobile, general liability, employer s liability, product liability and group health insurance programs. Self-insurance amounts vary up to $500,000 per occurrence. Insurance with third parties, some of which is then reinsured through RIC, is in place for claims in excess of these self insured amounts. RIC reinsured 100% of the risk from $500,000 to $1,000,000 per occurrence through September 2, 2000 for the Company s workers compensation, general liability, employer s liability and product liability insurance. Subsequent to September 2, 2000, the Company discontinued its use of RIC as a captive insurer for new claims. The Company s and RIC s liability for estimated incurred losses are actuarially determined and recorded in the accompanying condensed consolidated financial statements on an undiscounted basis. Actual incurred losses may vary from the estimated incurred losses and could have a material affect on the Company s insurance expense.

Restructuring Reserves -

On October 10, 2001, the Company eliminated approximately 70 positions at corporate headquarters. In addition, approximately 30 positions in the restaurant construction and fabrication areas were eliminated by December 30, 2001. The purpose of the reduction was to streamline functions and reduce redundancy amongst its business segments. As a result of the elimination of the positions and the outsourcing of certain functions, the Company reported a pre-tax restructuring charge of approximately $2,536,000 for severance, rent and unusable construction supplies in the year ended December 30, 2001.

In March 2000, the Company s Board of Directors approved a restructuring plan that provided for the immediate closing of 81 restaurants at the end of March 2000 and the disposition of an additional 70 restaurants over the next 24 months. As a result of this plan, the Company reported a pre-tax restructuring charge of approximately $12,100,000 for severance, rent, utilities and real estate taxes, demarking, lease termination costs and certain other costs associated with the closing of the locations, along with a pre-tax write-down of property and equipment for these locations of approximately $17,000,000 in the year ended December 31, 2000. The Company reduced the restructuring reserve by $1,900,000 during the year ended December 30, 2001 since the reserve exceeded estimated remaining payments.

As of March 31, 2002, the remaining restructuring reserve was $2,397,000. The restructuring reserves may be increased or decreased based upon remaining payments, which could vary materially from the estimates depending upon the timing of store closings and other factors.

Income Taxes -

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. A valuation allowance is recorded for deferred tax assets whose realization is not likely. As of December 30, 2001 and March 31, 2002, a valuation allowance of $11,295,000 existed related to state NOL carryforwards due to restrictions on the usage of state NOL carryforwards and short carryforward periods for certain states. Taxable income by state for future periods is difficult to estimate. The amount and timing of any future taxable income may affect the usage of such carryforwards, which could result in a material change in the valuation allowance.

Pension and Other Post-Retirement Benefits -

The determination of the Company s obligation and expense for pension and other post-retirement benefits is dependent upon the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among other things, the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs. In accordance with accounting principles generally accepted in the United States, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in such future periods. While FICC believes that the assumptions used are appropriate, significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other post-retirement obligations and expense.

Volatility of Cream Prices -

The cost of cream, the principal ingredient used in making ice cream, affects cost of sales as a percentage of total revenues, especially in foodservice s retail business. The Company believes that cream prices will be slightly higher in 2002 than in 2001. A $0.10 increase in the cost of a pound of AA butter adversely affects the Company s annual cost of sales by approximately $1,100,000. To minimize risk, alternative supply sources continue to be pursued. However, no assurance can be given that the Company will be able to offset any cost increases in the future and future increases in cream could have a material adverse effect on the Company s results of operations.

Debt -

In December 2001, the Company completed a financial restructuring plan (the Refinancing Plan) which included the repayment of $64,545,000 outstanding under the Old Credit Facility and the repurchase of approximately $21,300,000 in Senior Notes for $17,000,000 with the proceeds from $55,000,000 in long-term mortgage financing (the Mortgage Financing) and a $33,700,000 sale and leaseback transaction (the Sale/Leaseback Financing). In addition, FICC secured a new $30,000,000 revolving credit facility of which up to $20,000,000 is available to support letters of credit. The $30,000,000 commitment less outstanding letters of credit is available for borrowing to provide working capital and for other corporate needs (the New Credit Facility).

Inventories -

Inventories are stated at the lower of first-in, first-out cost or market. Inventories as of March 31, 2002 and December 30, 2001 were as follows (in thousands):

	March 31, 2002	December 30, 2001
Raw materials	$ 828	$ 1,269
Goods in process	142	73
Finished goods	15,933	11,645
Total	$ 16,903	$ 12,987

Reclassifications -

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

2. NET LOSS PER SHARE

Basic loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated by dividing net loss by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. Common stock equivalents are dilutive stock options and warrants that are assumed exercised for calculation purposes. The number of common stock options which could dilute basic earnings per share in the future, that were not included in the computation of diluted loss per share because to do so would have been antidilutive, was 389,000 and 650,000 for the three months ended March 31, 2002 and April 1, 2001, respectively.

3. SEGMENT REPORTING

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

The Company s restaurants target families with children and adults who desire a reasonably-priced meal in a full-service setting. The Company s menu offers a broad selection of freshly-prepared foods which appeal to customers throughout all dayparts. The menu currently features over 100 items comprised of a broad selection of breakfast, lunch, dinner and afternoon and evening snack items. Foodservice operations manufactures frozen dessert products and distributes such manufactured products and purchased finished goods to the Company s restaurants and franchised operations. Additionally, it sells frozen dessert products to distributors and retail and institutional locations. The Company s franchise segment includes a royalty based on franchise restaurant revenue. In addition, the Company receives rental income from various franchised restaurants. The Company does not allocate general and administrative expenses associated with its headquarters operations to any business segment. These costs include general and administrative expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarters activities.

On May 1, 2001, foodservice decreased its ice cream pricing to all restaurants. This resulted in decreased foodservice revenues of 3.9% for the three months ended March 31, 2002.

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

EBITDA represents net income (loss) before (i) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) write-downs of property and equipment and (v) other non-cash items. The Company has included information concerning EBITDA in this Form 10-Q because it believes that such information is used by certain investors as one measure of a company s historical ability to service debt. EBITDA should not be considered as an alternative to, or more meaningful than, earnings (loss) from operations or other traditional indications of a company s operating performance.

	For the Three Months Ended			
	March 31, 2002		April 1, 2001	
	(in thousands)			
Revenues:				
Restaurant	$	104,256	$	107,145
Foodservice		54,133		47,822
Franchise		2,129		1,561
Total	$	160,518	$	156,528
Intersegment revenues:				
Restaurant	$		$	
Foodservice		(29,032)		(30,809)
Franchise				
Total	$	(29,032)		