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 September 30, 2001**

**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 October 19, 2001** |
|---|---|
| Common Stock, $.01 par value | 7,352,710 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)

| | September 30, 2001 (unaudited) | December 31, 2000 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 7,557 | $ 14,584 |
| Restricted cash | | 1,737 |
| Accounts receivable, net | 8,494 | 6,157 |
| Inventories | 15,394 | 11,570 |
| Deferred income taxes | 10,395 | 10,395 |
| Prepaid expenses and other current assets | 3,352 | 2,799 |
| TOTAL CURRENT ASSETS | 45,192 | 47,242 |
| | | |
| PROPERTY AND EQUIPMENT, net | 194,219 | 226,865 |
| INTANGIBLES AND DEFERRED COSTS, net | 19,783 | 21,529 |
| OTHER ASSETS | 10,261 | 2,050 |
| | | |
| TOTAL ASSETS | $ 269,455 | $ 297,686 |
| | | |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | $ 3,990 | $ 13,029 |
| Current maturities of capital lease and finance obligations | 1,885 | 2,143 |
| Accounts payable | 21,622 | 20,100 |
| Accrued salaries and benefits | 10,242 | 10,956 |
| Accrued interest payable | 7,103 | 3,515 |
| Insurance reserves | 13,764 | 13,095 |
| Restructuring reserve | 3,658 | 5,571 |

| | | | | |
|---|---|---|---|---|
| Other accrued expenses | | 14,842 | | 14,262 |
| TOTAL CURRENT LIABILITIES | | 77,106 | | 82,671 |
| | | | | |
| DEFERRED INCOME TAXES | | 15,373 | | 13,276 |
| CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities | | 6,722 | | 8,223 |
| LONG-TERM DEBT, less current maturities | | 251,350 | | 275,435 |
| OTHER LONG-TERM LIABILITIES | | 14,905 | | 18,064 |
| | | | | |
| COMMITMENTS AND CONTINGENCIES | | | | |
| | | | | |
| STOCKHOLDERS DEFICIT: | | | | |
| Common stock | | 74 | | 74 |
| Additional paid-in capital | | 139,223 | | 138,988 |
| Accumulated deficit | | (235,298) | | (239,045) |
| TOTAL STOCKHOLDERS DEFICIT | | (96,001) | | (99,983) |
| | | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT | $ | 269,455 | $ | 297,686 |

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 September 30, 2001 | For the Three Months Ended October 1, 2000 | For the Nine Months Ended September 30, 2001 | For the Nine Months Ended October 1, 2000 |
|---|---|---|---|---|
| REVENUES | $ 151,373 | $ 161,605 | $ 428,915 | $ 464,742 |
| COSTS AND EXPENSES: | | | | |
| Cost of sales | 54,840 | 54,081 | 149,757 | 149,146 |
| Labor and benefits | 39,674 | 47,822 | 120,684 | 145,397 |
| Operating expenses | 32,479 | 32,375 | 89,031 | 94,011 |
| General and administrative expenses | 8,393 | 8,857 | 27,070 | 30,424 |
| Restructuring costs | | | | 12,056 |
| Write-downs of property and equipment | 35 | 664 | 103 | 19,024 |
| Depreciation and amortization | 7,037 | 7,426 | 21,686 | 23,166 |
| (Gain) loss on franchise sales of restaurant operations and properties | (219) | 75 | (4,042) | (1,923) |
| Gain on disposition of other property and equipment | (317) | (960) | (2,559) | (1,005) |
| OPERATING INCOME (LOSS) | 9,451 | 11,265 | 27,185 | (5,554) |
| Interest expense, net | 6,464 | 7,594 | 20,967 | 23,495 |
| INCOME (LOSS) BEFORE (PROVISION FOR) BENEFIT FROM INCOME TAXES AND EXTRAORDINARY ITEM | 2,987 | 3,671 | 6,218 | (29,049) |
| (Provision for) benefit from income taxes | (1,125) | (425) | (2,250) | 16,790 |
| INCOME (LOSS) BEFORE EXTRAORDINARY ITEM | 1,862 | 3,246 | 3,968 | (12,259) |
| Extraordinary item, net of income tax benefit of $153 | (221) | | (221) | |
| NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) | $ 1,641 | $ 3,246 | $ 3,747 | $ (12,259) |
| BASIC NET INCOME (LOSS) PER SHARE: | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Income (loss) before extraordinary item | $ | 0.25 | $ | 0.44 | $ | 0.54 | $ | (1.65) |
| Extraordinary item, net of income tax benefit | | (0.03) | | | | (0.03) | | |
| Net income (loss) | $ | 0.22 | $ | 0.44 | $ | 0.51 | $ | (1.65) |
| | | | | | | | | |
| DILUTED NET INCOME (LOSS) PER SHARE: | | | | | | | | |
| Income (loss) before extraordinary item | $ | 0.25 | $ | 0.44 | $ | 0.54 | $ | (1.65) |
| Extraordinary item, net of income tax benefit | | (0.03) | | | | (0.03) | | |
| Net income (loss) | $ | 0.22 | $ | 0.44 | $ | 0.51 | $ | (1.65) |
| | | | | | | | | |
| WEIGHTED AVERAGE SHARES: | | | | | | | | |
| Basic | | 7,359 | | 7,409 | | 7,366 | | 7,439 |
| Diluted | | 7,416 | | 7,437 | | 7,382 | | 7,439 |

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 Nine Months Ended September 30, 2001 | For the Nine Months Ended October 1, 2000 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ 3,747 | $ (12,259) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Extraordinary item, net of income tax benefit | 221 | |
| Stock compensation expense | 235 | 429 |
| Depreciation and amortization | 21,686 | 23,166 |
| Write-downs of property and equipment | 103 | 19,024 |
| Deferred income tax expense (benefit) | 2,250 | (16,790) |
| Gain on asset retirements and sales | (6,710) | (3,562) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,337) | (1,940) |
| Inventories | (3,824) | (2,178) |
| Other assets | (3,204) | 2,608 |
| Accounts payable | 1,522 | 579 |
| Accrued expenses and other long-term liabilities | (1,119) | (2,883) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 12,570 | 6,194 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (8,440) | (12,808) |
| Proceeds from sales of property and equipment | 23,556 | 32,594 |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | 15,116 | 19,786 |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from borrowings | 51,405 | 74,000 |
| Repayments of debt | (84,529) | (101,678) |
| Repayments of capital lease and finance obligations | (1,589) | (1,344) |
| NET CASH USED IN FINANCING ACTIVITIES | (34,713) | (29,022) |
| | | |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (7,027) | (3,042) |
| | | |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 14,584 | 12,062 |
| | | |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 7,557 | $ 9,020 |

| | | |
|---|---|---|
| SUPPLEMENTAL DISCLOSURES: | | |
| Cash paid during the period for: | | |
| Interest | $ 16,699 | $ 18,101 |
| Income taxes | 3 | 62 |
| Capital lease obligations incurred | | 2,891 |
| Capital lease obligations terminated | 170 | 711 |
| Notes received from sales of property and equipment | 4,250 | 577 |

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**

*Interim Financial Information*

The accompanying condensed consolidated financial statements as of September 30, 2001 and for the third quarter and nine months ended September 30, 2001 and October 1, 2000 are unaudited, but, in the opinion of management, include all adjustments which are necessary for a fair presentation of the consolidated financial position, results of operations, cash flows and comprehensive income (loss) of Friendly Ice Cream Corporation ( FICC ) and subsidiaries (unless the context indicates otherwise, collectively, the Company ). Such adjustments consist solely of normal recurring accruals. Operating results for the three and nine month periods ended September 30, 2001 and October 1, 2000 are not necessarily indicative of the results that may be expected for the entire year due, in part, to the seasonality of the Company s business. Historically, higher revenues and operating income have been experienced during the second and third fiscal quarters. The Company s Consolidated Financial Statements, including the notes thereto, which are contained in the 2000 Annual Report on Form 10-K should be read in conjunction with these Condensed Consolidated Financial Statements.

*Refinancing Status and Debt -*

The Company entered into its existing credit facility in November 1997. The credit facility includes the revolving credit loan, term loans and letters of credit. Since 1997, the Company has executed several amendments to the credit facility. The most recent amendment occurred on March 19, 2001. All of the existing financial covenants were amended and a new financial covenant was added requiring minimum cumulative Consolidated EBITDA, as defined, on a monthly basis. Interest rates on term loans, borrowings under the revolving credit facility and issued letters of credit increased 0.25%. In addition, automatic increases in the interest rates will occur on August 2, 2001, January 2, 2002, April 1, 2002, September 30, 2002 and October 1, 2002 of 0.25%, 0.50%, 0.25%, 0.25% and 0.25%, respectively. Interest payments on all ABR loans, Eurodollar loans and issued letters of credit are required on a monthly basis rather than quarterly.

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

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

As of October 15, 2001, the Company has paid additional minimum cumulative prepayments of $6,793,000 on the term loans, which exceeds the minimum cumulative prepayment requirement.

Tranche A of the term loans was prepaid and extinguished during the third quarter ended September 30, 2001. Any remaining unpaid balances due on Tranches B and C of the term loans will be paid on November 15, 2002.

FICC paid an amendment fee of approximately $256,000 to the lenders contemporaneous with the execution of the seventh amendment. FICC paid an additional amendment fee (the Additional Fee ) of $441,459 on October 1, 2001 pursuant to the seventh amendment, which will be expensed over the remaining term of the credit facility using the effective yield method. If all obligations under the credit facility were satisfied before September 30, 2001, the Additional Fee would have been reduced to approximately $128,000. The Company believes that based on the terms of the seventh amendment, the Company has adequate cash and availability on its revolving credit facility to meet its obligations through September 30, 2002. Additionally, the Company believes that it can comply with the revised covenant requirements under the amendment through December 30, 2001.

The Company is undertaking a refinancing plan (collectively, the Refinancing Plan ), which has the following three principal components:

(i) obtaining a new revolving credit facility from one or more financial institutions for $35 million;

(ii) obtaining $55 million in loans from GE Capital Franchise Finance Corporation which will be secured by first mortgage liens upon 75 of the Company s restaurants; and

(iii) entering into a sale and leaseback arrangement with one or more financial institutions involving 45 of the Company s restaurants that is expected to provide the Company up to $37.5 million in cash.

The Company would use the proceeds of these financings to repay the amounts outstanding on its existing credit facility ($55,114,000 as of September 30, 2001), to increase working capital and, to the extent the proceeds of the financings are sufficient, after giving effect to the foregoing, to finance a tender offer for a portion of the Company s senior notes (the Notes ). The Company has obtained a commitment letter from GE Capital Franchise Finance Corporation relating to the mortgage financing, but the Company does not have any commitments or other agreements from any financial institutions relating to the new revolving credit facility or the sale and leaseback arrangements described above. The commitment letter received is contingent upon obtaining a new revolving credit facility. The closing of each of the three financings described above will be subject, among other things, to the negotiation of definitive agreements and other definitive documentation. There can be no assurance that the Company will be able to successfully implement any of the components of the Refinancing Plan. The availability of funds from the closing of these transactions will be a condition to the Company s ability to purchase any Notes.

*Inventories -*

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

| | **September 30, 2001** | **December 31, 2000** |
|---|---|---|
| Raw materials | $ 2,983 | $ 1,307 |
| Goods in process | 145 | 66 |
| Finished goods | 12,266 | 10,197 |
| Total | $ 15,394 | $ 11,570 |

*Reclassifications -*

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

**2. EARNINGS PER SHARE**

Basic net income (loss) per share is calculated by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing earnings available to common stockholders by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. Common stock equivalents are dilutive stock options that are assumed exercised for calculation purposes. The number of common stock equivalents which could dilute basic earnings per share in the future, that were not included in the computation of diluted earnings per share because to do so would have been antidilutive, was 21,833 for the nine months ended October 1, 2000.

Presented below is the reconciliation between basic and diluted weighted average shares for the three and nine months ended September 30, 2001 and October 1, 2000 (in thousands):

| | For the Three Months Ended | | | |
|---|---|---|---|---|
| | Basic | | Diluted | |
| | September 30, 2001 | October 1, 2000 | September 30, 2001 | October 1, 2000 |
| Weighted average number of common shares outstanding during the period | 7,359 | 7,409 | 7,359 | 7,409 |
| Assumed exercise of stock options | | | 57 | 28 |
| Weighted average number of shares outstanding | 7,359 | 7,409 | 7,416 | 7,437 |

| | For the Nine Months Ended | | | |
|---|---|---|---|---|
| | Basic | | Diluted | |
| | September 30, 2001 | October 1, 2000 | September 30, 2001 | October 1, 2000 |
| Weighted average number of common shares outstanding during the period | 7,366 | 7,439 | 7,366 | 7,439 |
| Assumed exercise of stock options | | | 16 | |
| Weighted average number of shares outstanding | 7,366 | 7,439 | 7,382 | 7,439 |

**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 restaurant revenues of 4.7% and 3.0% for the third quarter and nine months ended September 30, 2001, respectively.

7

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

| | For the Three Months Ended September 30, 2001 | For the Three Months Ended October 1, 2000 | For the Nine Months Ended September 30, 2001 | For the Nine Months Ended October 1, 2000 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Revenues: | | | | |
| Restaurant | $ 118,931 | $ 137,462 | $ 345,029 | $ 399,685 |
| Foodservice | 64,263 | 65,265 | 176,332 | 182,920 |
| Franchise | 2,535 | 1,763 | 7,197 | 5,805 |
| Total | $ 185,729 | $ 204,490 | $ 528,558 | $ 588,410 |
| Intersegment revenues: | | | | |
| Restaurant | $ | $ | $ | $ |
| Foodservice | (34,356) | (42,885) | (99,643) | (123,668) |
| Franchise | | | | |
| Total | $ (34,356) | $ (42,885) | $ (99,643) | $ (123,668) |
| External revenues: | | | | |
| Restaurant | $ 118,931 | $ 137,462 | $ 345,029 | $ 399,685 |
| Foodservice | 29,907 | 22,380 | 76,689 | 59,252 |
| Franchise | 2,535 | 1,763 | 7,197 | 5,805 |
| Total | $ 151,373 | $ 161,605 | $ 428,915 | $ 464,742 |
| EBITDA: | | | | |
| Restaurant | $ 15,425 | $ 16,129 | $ 40,626 | $ 39,835 |
| Foodservice | 2,616 | 6,407 | 10,505 | 18,991 |
| Franchise | 1,482 | 581 | | |