

FRIENDLY ICE CREAM CORP  
Form 10-Q  
May 11, 2007

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-Q

(Mark One)

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

For the quarterly period ended April 1, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-13579

## FRIENDLY ICE CREAM CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

**Massachusetts**

(State or Other Jurisdiction of  
Incorporation or Organization)

**1855 Boston Road**

**Wilbraham, Massachusetts**  
(Address of Principal Executive Offices)

**04-2053130**

(IRS Employer  
Identification No.)

**01095**

(Zip Code)

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(413) 731-4000

(Registrant's Telephone Number, Including Area Code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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 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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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

Class

**Outstanding at April 30, 2007**

Common Stock, \$.01 par value

8,162,232 shares

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## FRIENDLY ICE CREAM CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)

	April 1, 2007	December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 21,860	\$ 25,077
Restricted cash	380	517
Accounts receivable, net	12,264	11,435
Inventories	15,967	17,059
Assets held for sale	896	896
Prepaid expenses and other current assets	3,375	3,127
<b>TOTAL CURRENT ASSETS</b>	<b>54,742</b>	<b>58,111</b>
DEFERRED INCOME TAXES	928	928
PROPERTY AND EQUIPMENT, net of accumulated depreciation and amortization	133,997	137,425
INTANGIBLE ASSETS AND DEFERRED COSTS, net of accumulated amortization	17,350	17,783
OTHER ASSETS	5,889	5,920
<b>TOTAL ASSETS</b>	<b>\$ 212,906</b>	<b>\$ 220,167</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term debt	\$ 1,592	\$ 1,563
Current maturities of capital lease and finance obligations	1,583	1,541
Accounts payable	20,532	22,247
Accrued salaries and benefits	9,394	8,230
Accrued interest payable	4,825	1,173
Insurance reserves	12,514	11,462
Other accrued expenses	16,296	22,475
<b>TOTAL CURRENT LIABILITIES</b>	<b>66,736</b>	<b>68,691</b>
CAPITAL LEASE AND FINANCE OBLIGATIONS, less current maturities	4,270	4,682
LONG-TERM DEBT, less current maturities	222,236	222,650
LIABILITY FOR PENSION BENEFITS	20,639	20,302
OTHER LONG-TERM LIABILITIES	31,845	30,738
COMMITMENTS AND CONTINGENCIES		
<b>STOCKHOLDERS DEFICIT:</b>		
Common stock	82	81
Additional paid-in capital	146,647	146,398
Accumulated other comprehensive loss	(23,514)	(23,514)
Accumulated deficit	(256,035)	(249,861)
<b>TOTAL STOCKHOLDERS DEFICIT</b>	<b>(132,820)</b>	<b>(126,896)</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT</b>	<b>\$ 212,906</b>	<b>\$ 220,167</b>

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	
	April 1, 2007	April 2, 2006
<b>REVENUES:</b>		
Restaurant	\$ 93,187	\$ 95,276
Foodservice	25,944	26,894
Franchise	3,495	3,545
<b>TOTAL REVENUES</b>	<b>122,626</b>	<b>125,715</b>
<b>COSTS AND EXPENSES:</b>		
Cost of sales	47,103	48,385
Labor and benefits	34,397	36,012
Operating expenses	25,012	23,999
General and administrative expenses	10,633	11,097
Write-downs of property and equipment	206	215
Depreciation and amortization	6,160	5,780
Gain on franchise sales of restaurant operations and properties		(866 )
Loss on disposals of other property and equipment, net	35	109
<b>OPERATING (LOSS) INCOME</b>	<b>(920 )</b>	<b>984</b>
Interest expense, net	4,924	5,420
<b>LOSS FROM CONTINUING OPERATIONS BEFORE PROVISION FOR INCOME TAXES</b>	<b>(5,844 )</b>	<b>(4,436 )</b>
Provision for income taxes	(94 )	
<b>LOSS FROM CONTINUING OPERATIONS</b>	<b>(5,938 )</b>	<b>(4,436 )</b>
<b>(LOSS) INCOME FROM DISCONTINUED OPERATIONS</b> , net of income tax effect of \$0 and \$0 for the three months ended April 1, 2007 and April 2, 2006, respectively	<b>(14 )</b>	<b>2,616</b>
<b>NET LOSS</b>	<b>\$ (5,952 )</b>	<b>\$ (1,820 )</b>
<b>BASIC AND DILUTED NET LOSS PER SHARE:</b>		
Loss from continuing operations	\$ (0.73 )	\$ (0.56 )
(Loss) income from discontinued operations	(0.00 )	0.33
Net loss	\$ (0.73 )	\$ (0.23 )
<b>WEIGHTED AVERAGE SHARES:</b>		
Basic and Diluted	8,122	7,901

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	
	April 1, 2007	April 2, 2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (5,952 )	\$ (1,820 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Stock compensation expense	214	79
Depreciation and amortization	6,160	5,780
Non-cash income from discontinued operations		(2,864 )
Write-downs of property and equipment	206	215
Loss (gain) on disposals of property and equipment, net	35	(772 )
Changes in operating assets and liabilities:		
Accounts receivable	(829 )	(1,031 )
Inventories	1,092	(199 )
Other assets	(80 )	1,471
Accounts payable	(1,715 )	(2,797 )
Accrued expenses and other long-term liabilities	910	4,637
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>41</b>	<b>2,699</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(2,530 )	(2,404 )
Proceeds from sales of property and equipment		5,794
<b>NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES</b>	<b>(2,530 )</b>	<b>3,390</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from borrowings under revolving credit facility		8,000
Repayments of debt	(385 )	(8,338 )
Payments of deferred financing costs	(9 )	(205 )
Repayments of capital lease and finance obligations	(370 )	(391 )
Stock options exercised	36	19
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(728 )</b>	<b>(915 )</b>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(3,217 )</b>	<b>5,174</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>25,077</b>	<b>14,597</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 21,860</b>	<b>\$ 19,771</b>
<b>SUPPLEMENTAL DISCLOSURES:</b>		
Cash paid (refunded) during the period for:		
Interest	\$ 1,269	\$ 1,528
Income taxes	232	(503 )

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. NATURE OF OPERATIONS

As of April 1, 2007, Friendly's operated 317 full-service restaurants and franchised 198 full-service restaurants and seven non-traditional units. The Company manufactures and distributes a full line of premium ice cream dessert products. These products are distributed to Friendly's restaurants, supermarkets and other retail locations in 12 states. The restaurants offer a wide variety of breakfast, lunch and dinner menu items as well as premium ice cream dessert products.

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.

Following is a summary of Company-operated and franchised units:

	For the Three Months Ended	
	April 1, 2007	April 2, 2006
<b>Company Units:</b>		
Beginning of period	316	314
Openings	1	1
Acquired from franchisees	1	
Acquired by franchisees		(1)
Closings	(1)	(2)
End of period	317	312
<b>Franchised Units:</b>		
Beginning of period	205	213
Openings	1	
Acquired by franchisees		1
Acquired from franchisees	(1)	
Closings		
End of period	205	214

**2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES***Interim Financial Information*

The accompanying condensed consolidated financial statements as of April 1, 2007 and for the three months ended April 1, 2007 and April 2, 2006 are unaudited, but have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments which are necessary for a fair presentation of the consolidated financial position, results of operations, cash flows and comprehensive loss of the Company have been included. Such adjustments consist solely of normal recurring accruals. Operating results for the three month periods ended April 1, 2007 and April 2, 2006 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 2006 Annual Report on Form 10-K for the fiscal year ended December 31, 2006 as amended ( 2006 Annual Report on Form 10-K/A ) should be read in conjunction with these condensed, consolidated financial statements. Capitalized terms not otherwise defined herein should be referenced to the 2006 Annual Report on Form 10-K/A.

*Use of Estimates in the Preparation of Financial Statements*

The preparation of financial statements in conformity with GAAP 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, recoverability of accounts receivable and notes receivable, pension and post-retirement medical and life insurance benefits expense, asset impairment analysis, income tax valuation allowances and tax contingency reserves. Actual amounts could differ significantly from the estimates.

*Inventories*

Inventories are stated at the lower of first-in, first-out cost or market and consisted of the following at April 1, 2007 and December 31, 2006 (in thousands):

	<b>April 1, 2007</b>	<b>December 31, 2006</b>
Raw materials	\$ 1,654	\$ 1,640
Goods in process	100	158
Finished goods	14,213	15,261
Total	\$ 15,967	\$ 17,059

*Other Accrued Expenses*

Other accrued expenses consisted of the following at April 1, 2007 and December 31, 2006 (in thousands):

	<b>April 1, 2007</b>	<b>December 31, 2006</b>
Accrued rent	\$ 4,992	\$ 5,178
Gift cards outstanding	2,915	4,317
Accrued meals and other taxes	2,443	2,241
Unearned revenues	1,147	1,153
Accrued advertising	916	1,150
Accrued construction costs	780	918
Accrued bonus	752	3,635
Current portion of deferred gains	638	638
Income taxes payable	467	1,962
All other	1,246	1,283
<b>Total</b>	<b>\$ 16,296</b>	<b>\$ 22,475</b>

*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. The Company records deferred tax assets to the extent it believes there will be sufficient future taxable income to utilize those assets prior to their expiration. To the extent deferred tax assets may be unable to be utilized, the Company records a valuation allowance against the potentially unrealizable amount and records a charge against earnings. The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations in several different tax jurisdictions. The Company is periodically reviewed by tax authorities regarding the amount of taxes due. These reviews include questions regarding the timing and amount of deductions. In evaluating the exposure associated with various filing positions, the Company records estimated reserves for probable exposures.

As of December 31, 2006 the Company remained in a three-year cumulative loss position and expected to record valuation allowances on future tax benefits until it can sustain an appropriate level of profitability. However, the Company incurred approximately \$1,093,000 of federal tax liabilities for 2005 and 2006 combined. Approximately \$928,000 of the \$1,093,000 would be available for refund if 2007 results in a loss for income tax purposes. As a result, the valuation allowances as of December 31, 2006 of \$27,429,000 reduced the carrying value of net deferred tax assets to \$928,000. Should the Company's future profitability provide sufficient evidence, in accordance with SFAS No. 109, to support the ultimate realization of income tax benefits attributable to net operating loss ( NOL ) and credit carryforwards and other deductible temporary differences, a reduction in the valuation allowance may be recorded and the carrying value of deferred tax assets may be restored, resulting in a non-cash credit to earnings.

*Lease Guarantees and Contingencies*

Primarily as a result of the Company's strategy to sell Company-operated restaurants to franchisees, the Company remains liable for certain lease assignments and guarantees. These leases have varying terms, the latest of which expires in 2020. As of April 1, 2007, the potential amount of undiscounted payments the Company could be required to make in the event of non-payment by the primary lessees was \$6,203,000. The present value of these potential payments discounted at the Company's pre-tax cost of debt at April 1, 2007 was \$4,699,000. The Company generally has cross-default provisions with franchisees that would put them in default of their franchise agreement in the event of non-payment under the lease. The Company believes these cross-default provisions significantly reduce the risk that the Company will be required to make payments under these leases and, historically, the Company has not been required to make such payments. Accordingly, no liability has been recorded for exposure under such leases at April 1, 2007 and December 31, 2006.

*Net Loss Per Share*

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted net 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. There were no common stock equivalents included in diluted net loss per share for the three months ended April 1, 2007 and April 2, 2006. 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 240,000 and 316,000 for the three months ended April 1, 2007 and April 2, 2006, respectively.

*Stock-Based Compensation*

Prior to January 2, 2006, the Company accounted for stock-based compensation for employees under Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company had adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation and the disclosures required by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. In accordance with APB Opinion No. 25, the Company generally recognized no stock-based compensation cost, as all options granted during that period had an exercise price equal to the market value of the stock on the date of grant.

On December 16, 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 123 (revised 2004), Share-Based Payment ( SFAS No. 123R ). SFAS No. 123R supersedes APB Opinion No. 25 and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS No. 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values at the date of grant. Pro forma disclosure is no longer an alternative.

On January 2, 2006 (the first day of its 2006 fiscal year), the Company adopted SFAS No. 123R using the modified prospective method as permitted under SFAS No. 123R. Under this transition method, compensation cost recognized in the three months ended April 1, 2007 and April 2, 2006 included: (a) compensation cost for all share-based payments granted prior to but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R.

### 3. STOCK BASED COMPENSATION

#### *Equity Compensation Plans*

The Company currently grants stock awards under the following equity compensation plans:

*1997 Stock Option Plan ( 1997 Plan )* - The 1997 Plan was adopted by the Company's Board of Directors and stockholders in November 1997 and was subsequently amended on March 27, 2000 and October 24, 2001. Under the 1997 Plan, the Company's Board of Directors may grant options to purchase up to 1,034,970 shares of common stock to employees, executive officers and directors. The 1997 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 ( SARs ). The Compensation Committee of the Board of Directors determines the employees who will receive awards under the 1997 Plan and the terms of such awards. The exercise price of a stock option or SAR granted or awarded under the 1997 Plan may not be less than the fair market value of one share of common stock on the date the stock option or SAR is granted.

*The 2003 Equity Incentive Plan (the 2003 Incentive Plan )* - On April 9, 2003, the Board of Directors adopted an equity incentive plan, which was approved by shareholders on May 14, 2003. On May 10, 2006, the shareholders approved an amendment to the 2003 Incentive Plan to increase the number of shares of common stock reserved for issuance under the 2003 Incentive Plan from 307,000 to 607,000 shares. The 2003 Incentive 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), SARs, bonus stock, stock units, performance shares, performance units, restricted stock and restricted stock units. The Compensation Committee of the Board of Directors determines the employees who will receive awards under the 2003 Incentive Plan and the terms of such awards. The exercise price of a stock option or SAR granted or awarded under the 2003 Incentive Plan may not be less than the fair market value of one share of common stock on the date the stock option or SAR is granted.

*Key Executive Stock Option* - On January 8, 2007, as a material inducement to the employment of George M. Condos, the Company's President and Chief Executive Officer, the Company granted Mr. Condos stock options to purchase an aggregate of 75,000 shares of the Company's common stock, at an exercise price of \$11.80 per share (equal to the closing price of the Company's common stock on the American Stock Exchange on the date of grant). These stock options were granted outside of any of the Company's equity incentive and stock option plans, pursuant to an exemption from stockholder approval set forth in Section 711 of the American Stock Exchange Company Guide. The stock options vest in three equal annual installments and expire five years after the date of grant.

Options issued pursuant to the 1997 Plan and the 2003 Incentive Plan generally vest over three years, and have a five year expiration date.

## Grant-Date Fair Value

The Company uses the Black-Scholes option pricing model to calculate the grant-date fair value of an award. The fair value of options granted during the three months ended April 1, 2007 and April 2, 2006 were calculated using the following estimated weighted average assumptions:

	Three Months Ended			
	April 1, 2007		April 2, 2006	
Options granted	136,720		145,409	
Weighted-average exercise price	\$ 13.02		\$ 8.10	
Weighted-average grant date fair value	\$ 4.90		\$ 3.82	
Assumptions:				
Risk free interest rate	4.45%-4.6	6%	4.68	%
Expected life (in years)	4		4	
Expected volatility	40.13	%	54.86	%
Expected dividend yield	0.00	%	0.00	%

Risk-free interest rate the yield on zero-coupon U.S. Treasury securities for a period that is commensurate with the expected term assumption is used as the risk-free interest rate.

Expected life the Company uses historical employee exercise and option expiration data to estimate the expected life assumption for the Black-Scholes grant-date valuation. The Company believes that this historical data is currently the best estimate of the expected life of a new option.

Expected volatility the Company is responsible for estimating volatility and has used historical volatility to estimate the grant-date fair value of stock options. Management considered the guidance in SFAS No. 123R and believes that the historical estimated volatility is materially indicative of expectations about future volatility.

Expected dividend yield the Company has not paid any dividends in the last five years and currently intends to retain any earnings to finance future growth and, therefore, does not anticipate paying any cash dividends on its common stock in the foreseeable future.

*Expense*

The Company used the straight-line attribution method to recognize expense for all options granted. Stock-based compensation is included in general and administrative expenses in the accompanying condensed consolidated statements of operations.

The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The term *forfeitures* is distinct from *cancellations* or *expirations* and represents only the unvested portion of the surrendered option. In September 2006, John Cutter, the Company's former President and Chief Executive Officer, resigned. As of December 31, 2006, the Company adjusted its stock compensation expense to reflect his forfeitures. The Company currently expects, based on an analysis of its historical forfeitures, that approximately 95% of its options will actually vest and therefore has applied an annual forfeiture rate of 5% to options granted as of April 1, 2007. This analysis will be re-evaluated quarterly and the forfeiture rate will be adjusted as necessary. Ultimately, the actual expense recognized over the vesting period will only be for those shares that vest.

*Option Activity*

A summary of the stock option activity under the Company's equity compensation plans as of April 1, 2007 and changes during the three-month period then ended is presented below:

	<b>Options Outstanding</b>	<b>Weighted- Average Remaining Contractual Life in Years</b>	<b>Weighted- Average Exercise Price</b>	<b>Aggregate Intrinsic Value</b>
Options outstanding at December 31, 2006	452,280		\$ 8.83	
Granted	136,720		\$ 13.02	
Cancelled	(800 )		\$ 17.37	
Forfeited	(7,776 )		\$ 8.31	
Exercised	(3,250 )		\$ 11.26	
Options outstanding at April 1, 2007	577,174	3.55	\$ 9.80	\$ 4,509,485
Options fully vested and exercisable at April 1, 2007	321,331	2.80	\$ 8.75	\$ 2,048,561

During the three months ended April 1, 2007 and April 2, 2006, the total intrinsic value of options exercised (i.e., the difference between the market price at exercise and the price paid by the employee to exercise the options) was \$9,518 and \$14,648, respectively, and the total amount of cash received from exercise of stock options was \$36,607 and \$19,090, respectively.

As of April 1, 2007, there was \$1,094,000 of unrecognized compensation cost related to unvested stock options. That cost is expected to be recognized over a weighted-average period of 2.44 years.

*Restricted Stock and Restricted Stock Unit Activity*

On December 2, 2005, 30,000 restricted stock units were issued to directors with a weighted average fair value of \$8.90 at grant date. On November 1, 2006, 30,000 restricted stock units were issued to directors with a weighted average fair value of \$10.61 at grant date. The restricted stock units were issued pursuant to and subject to the terms of the Company's 2003 Incentive Plan. Subject to the terms of the 2003 Incentive Plan, each restricted stock unit provides the holder with the right to receive one share of Common Stock of the Company when the restrictions lapse or vest. The restricted stock units granted to the directors vest three years after the date of grant if the recipient is a member of the Company's Board of Directors on such date, subject to accelerated vesting in the event of a change in control or the director's death, disability or retirement.

Pursuant to a long-term incentive plan for fiscal 2006 approved by the Compensation Committee of the Board of Directors under the Company's 2003 Incentive Plan, the Compensation Committee established target EBITDA levels for the Company for fiscal 2006 and target awards for each officer named below based on a percentage (ranging from 50% to 100%) of each such officer's base salary.

On February 28, 2007 the Compensation Committee determined that the Company exceeded the threshold EBITDA for fiscal 2006, and awarded shares of restricted Common Stock under the Company's 2003 Incentive Plan to each of the officers named below. The number of shares of restricted Common Stock issued to each officer listed below was determined by dividing the officer's 2006 Award Value (set forth below) by 90% of the closing price of the Company's Common Stock on the date of grant as reported on the American Stock Exchange. 25% of the shares of restricted Common Stock issued to each officer were fully vested upon issuance. The remaining 75% of the shares of restricted Common Stock will vest in three equal annual installments following issuance if the officer remains employed by the Company. The unvested shares will also fully vest upon a change in control, as provided in the 2003 Incentive Plan.

The following table sets forth for each officer listed below the 2006 Award Value and the number of shares of restricted Common Stock such officer received under the long-term incentive plan for fiscal 2006.

Name	Award Value	Number of Shares
Paul Hoagland	\$ 188,664	17,469
Gregory Pastore	\$ 79,207	7,334
Kenneth Green	\$ 91,304	8,454
Garrett Ulrich	\$ 91,690	8,490

During the three months ended April 1, 2007 and April 2, 2006, stock-based compensation cost of \$81,560 and \$21,894, respectively, was recorded related to the restricted stock units and shares of restricted Common Stock issued pursuant to the long-term incentive plan for fiscal 2006. As of April 1, 2007, there was \$788,560 of total unrecognized compensation cost related to unvested restricted stock units and shares of restricted Common Stock. That cost is expected to be recognized over a weighted-average period of 2.45 years.

*2007 Long-Term Incentive Plan*

On February 28, 2007 the Compensation Committee approved a long-term incentive plan for fiscal 2007 under the Company's 2003 Incentive Plan, pursuant to which the Compensation Committee established target EBITDA levels for the Company for fiscal 2007 and target awards for each officer named below based on a percentage (ranging from 50% to 100%) of each officer's base salary. The actual awards for each officer are payable in shares of restricted stock (representing approximately two-thirds of the value of the target award) and stock options to purchase shares of Common Stock (representing approximately one-third of the value of the target award).

With respect to the potential restricted stock awards, the Compensation Committee approved the issuance of restricted stock unit award agreements (the Restricted Stock Units Award Agreements) for each of the officers named below, pursuant to which each officer is eligible to receive a certain number of shares of restricted Common Stock of the Company calculated in accordance with the terms of the officer's individual Restricted Stock Unit Award Agreement. If the Company meets or exceeds a certain threshold EBITDA for fiscal 2007 (the 2007 Threshold EBITDA), then the officer will receive an award payable in shares of restricted Common Stock having a value determined based on the Company's actual EBITDA for fiscal 2007 compared to projected EBITDA for fiscal 2007 and the percentage (ranging from 50% to 150%) of the officer's target award applicable to those results (the 2007 Award Value). In the event of a Change in Control, as provided under the 2003 Incentive Plan, prior to the Compensation Committee's determination of the 2007 Award Value, the 2007 Threshold EBITDA shall be deemed to have been achieved and the 2007 Award Value shall be deemed to be equal to the target EBITDA for fiscal 2007. The number of shares of Common Stock to be issued to the officer, if any, will be calculated by dividing the 2007 Award Value by 90% of the closing price of the Company's Common Stock on the date of grant as reported by the American Stock Exchange (or such other exchange on which the Company's Common Stock is traded) (the Award Shares).

The following table sets forth the range of 2007 Award Values each officer may receive under the long-term incentive plan for fiscal 2007:

Name	Value of Award	
George M. Condos	\$ 159,125	To \$ 477,375
Paul Hoagland	\$ 83,670	To \$ 251,009
Gregory Pastore	\$ 35,477	To \$ 106,430
Kenneth Green	\$ 44,053	To \$ 132,158
Garrett Ulrich	\$ 41,071	To \$ 123,213

The 2007 Award Value will be determined, and the date of grant of any Award Shares will occur, upon the earlier of (i) the date of the Compensation Committee's first regularly scheduled meeting held after the completion of the Company's independent audit for fiscal 2007 and the Company's Audit Committee's recommendation to include the Company's audited financial statements in the Company's Annual Report on Form 10-K or (ii) immediately prior to the consummation of a Change in Control of the Company (the Issue Date). If the officer's employment with the Company or one of its affiliates is terminated due to death, disability, retirement, involuntary (with or without cause) or voluntary termination prior to the Issue Date, then the officer's Restricted Stock Unit Award Agreement shall terminate and the officer shall have no right to receive any Award Shares.

If Award Shares are issued to the officer, 25% of the shares of restricted Common Stock issued to each officer will be fully vested upon issuance. The remaining 75% of the shares of restricted Common Stock will vest in three equal annual installments following issuance if the officer remains employed by the Company. The unvested shares will also fully vest upon a change in control, as provided in the 2003 Incentive Plan.

During the three months ended April 1, 2007, stock-based compensation of \$45,000 was recorded related to the foregoing awards.

**4. EMPLOYEE BENEFIT PLANS**

The components of net periodic pension cost for the three months ended April 1, 2007 and April 2, 2006 were (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Interest cost	\$ 1,702	\$ 1,720
Expected return on assets	(1,975 )	(1,969 )
Net amortization of unrecognized net actuarial loss	610	719
<b>Net periodic pension cost</b>	<b>\$ 337</b>	<b>\$ 470</b>

The components of the net postretirement medical and life insurance benefit cost for the three months ended April 1, 2007 and April 2, 2006 were (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Service cost	\$ 36	\$ 41
Interest cost	105	95
Recognized actuarial loss	10	4
Net amortization of unrecognized prior service benefit	(36 )	(36 )
<b>Net postretirement benefit cost</b>	<b>\$ 115</b>	<b>\$ 104</b>

## 5. ASSET IMPAIRMENT AND DISCONTINUED OPERATIONS

SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, requires the results of operations of a component of an entity that is classified as held for sale or that has been disposed of to be reported as discontinued operations in the statement of operations if certain conditions are met. These conditions include commitment to a plan of disposal after the effective date of this statement, elimination of the operations and cash flows of the entity component from the ongoing operations of the Company and no significant continuing involvement in the operations of the entity component after the disposal transaction.

In accordance with SFAS No. 144, the results of operations of the eight properties that were disposed of during 2006 and any related net gain on the disposals, as well as the results of operations of three properties held for sale at April 1, 2007 were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for the three months ended April 1, 2007 and April 2, 2006.

During 2006, the Company closed one restaurant and committed to a plan to sell that restaurant. At April 1, 2007, this property met the criteria for held for sale as defined in SFAS No. 144. The results of operations associated with this restaurant were not material and therefore were reported within continuing operations in the accompanying condensed consolidated statements of operations for all periods presented.

For the three months ended April 1, 2007 and April 2, 2006, these discontinued results consisted of the following (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Net sales	\$	\$
Operating loss	\$ (14 )	\$ (248 )
Gain on disposals of property and equipment		2,864
Income tax benefit		
(Loss) income from discontinued operations	\$ (14 )	\$ 2,616

The table below identifies the components of the Loss on disposals of other property and equipment, net as shown in the accompanying condensed consolidated statements of operations (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Restaurant equipment assets retired due to replacement	\$ 35	\$ 75
Loss due to restaurant fire		30
All other		4
Loss on disposals of other property and equipment, net	\$ 35	\$ 109

During each of the three month periods ended April 1, 2007 and April 2, 2006, the Company determined that the carrying value of one operating restaurant property exceeded its estimated fair value less costs to sell and the carrying values were reduced by \$206,000 and \$215,000, respectively.

## 6. INCOME TAXES

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 ( *FIN 48* ), which clarifies the accounting for uncertainty in tax positions. *FIN 48* requires that the Company recognize in its financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit based on the technical merits of the position. The provisions of *FIN 48* are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings.

The Company adopted the provisions of *FIN 48* on January 1, 2007. As a result of the implementation of *FIN 48* on January 1, 2007, the Company recognized an additional \$221,000 as a decrease to retained earnings. As of the date of adoption, the Company's unrecognized tax benefits totaled \$1,579,000, which would affect the Company's tax rate if recognized. During the three months ended April 1, 2007, the Company recognized \$94,000 in potential tax and interest associated with uncertain tax positions and settled one previously uncertain tax position which resulted in the payment of \$72,065 of tax and \$7,324 of interest.

The Company files numerous consolidated and separate income tax returns in the United States Federal jurisdiction and in many state jurisdictions. With few exceptions, the Company is no longer subject to US Federal and state and local income tax examinations for years before 2003.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within its operations as income tax expenses. As of the date of implementation of *FIN 48*, the Company had approximately \$580,000 accrued for interest and penalties. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

The Company anticipates that the total unrecognized tax benefits will decrease by approximately \$500,000 due to the settlement of ongoing state voluntary disclosure processes prior to March 30, 2008.

## 7. 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 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 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. The Company's foodservice operations manufactures premium ice cream dessert products and distributes such manufactured products and purchased finished goods to Company-operated and franchised restaurants. Additionally, it sells premium ice cream dessert products to distributors and retail 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 expenses of the following functions: legal, accounting, personnel not directly related to a segment, information systems and other headquarter activities.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that the financial results for the foodservice operating segment, prior to intersegment eliminations, have been prepared using a management approach, which is consistent with the basis and manner in which the Company's management internally reviews financial information. Using this approach, 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.

Adjusted EBITDA represents net income (loss) from continuing operations before (i) (provision for) benefit from income taxes, (ii) interest expense, net, (iii) depreciation and amortization, (iv) write-downs of property and equipment, (v) net periodic pension cost and (vi) other non-cash items. Adjusted EBITDA is a non-GAAP financial measure. The Company has included information concerning adjusted EBITDA in this Form 10-Q because the Company's management incentive plan pays bonuses based on achieving operating segment adjusted EBITDA targets and the Company believes that such information is used by certain investors as one measure of a company's historical ability to service debt. Adjusted EBITDA should not be considered as an alternative to, or more meaningful than, earnings (loss) from continuing operations or other traditional indications of the Company's operating performance.

Due to a reorganization of the finance group, positions within the foodservice accounting department were absorbed by various corporate finance departments. The costs related to those positions are now included in general and administrative corporate expenses. Results for the three months ended April 2, 2006 have been restated accordingly. Adjusted EBITDA and loss from continuing operations before benefit from income taxes have been restated to remove the costs associated with this department of \$120,000 during the three month period ended April 2, 2006.

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
	<b>(in thousands)</b>	
<b>Revenues:</b>		
Restaurant	\$ 93,187	\$ 95,276
Foodservice	53,588	54,958
Franchise	3,495	3,545
<b>Total</b>	<b>\$ 150,270</b>	<b>\$ 153,779</b>
<b>Intersegment revenues:</b>		
Restaurant	\$	\$
Foodservice	(27,644 )	(28,064 )
Franchise		
<b>Total</b>	<b>\$ (27,644 )</b>	<b>\$ (28,064 )</b>
<b>External revenues:</b>		
Restaurant	\$ 93,187	\$ 95,276
Foodservice	25,944	26,894
Franchise	3,495	3,545
<b>Total</b>	<b>\$ 122,626</b>	<b>\$ 125,715</b>

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	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
	<b>(in thousands)</b>	
<b>Adjusted EBITDA:</b>		
Restaurant	\$ 5,728	\$ 6,834
Foodservice	3,175	2,668
Franchise	2,116	2,418
Corporate	(5,539 )	(5,699 )
(Loss) gain on property and equipment, net	(34 )	758
Pension cost included in reporting segments	337	470
<b>Total</b>	<b>\$ 5,783</b>	<b>\$ 7,449</b>
<b>Interest expense, net-Corporate</b>	<b>\$ 4,924</b>	<b>\$ 5,420</b>
<b>Depreciation and amortization:</b>		
Restaurant	\$ 3,897	\$ 4,143
Foodservice	1,274	736
Franchise	137	68
Corporate	852	833
<b>Total</b>	<b>\$ 6,160</b>	<b>\$ 5,780</b>
<b>Other non-cash expenses:</b>		
Net periodic pension cost	\$ 337	\$ 470
Write-downs of property and equipment	206	215
<b>Total</b>	<b>\$ 543</b>	<b>\$ 685</b>
<b>Income (loss) from continuing operations before provision for income taxes:</b>		
Restaurant	\$ 1,831	\$ 2,691
Foodservice	1,901	1,932
Franchise	1,979	2,350
Corporate	(11,315 )	(11,952 )
Gain on property and equipment, net	(240 )	543
<b>Total</b>	<b>\$ (5,844 )</b>	<b>\$ (4,436 )</b>

	<b>For the Three Months Ended April 1, 2007 (in thousands)</b>	<b>For the Year Ended December 31, 2006</b>
<b>Capital expenditures, including assets acquired under capital leases:</b>		
Restaurant	\$ 1,757	\$ 16,068
Foodservice	692	4,306
Corporate	81	1,350
<b>Total</b>	<b>\$ 2,530</b>	<b>\$ 21,724</b>

	<b>April 1, 2007 (in thousands)</b>	<b>December 31, 2006</b>
<b>Total assets:</b>		
Restaurant	\$ 117,968	\$ 119,787
Foodservice	40,464	40,875
Franchise	11,472	11,827
Corporate	43,002	47,678
<b>Total</b>	<b>\$ 212,906</b>	<b>\$ 220,167</b>

## 8. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

FICC's obligation related to its \$175 million of 8.375% senior notes (the "Senior Notes") is guaranteed fully and unconditionally by one of FICC's wholly owned subsidiaries. There are no restrictions on FICC's ability to obtain dividends or other distributions of funds from this subsidiary, except those imposed by applicable law. The following supplemental financial information sets forth, on a condensed consolidating basis, balance sheets, statements of operations and statements of cash flows for FICC (the "Parent Company"), Friendly's Restaurants Franchise, LLC (the "Guarantor Subsidiary") and Friendly's International, Inc., Restaurant Insurance Corporation, Friendly's Realty I, LLC, Friendly's Realty II, LLC and Friendly's Realty III, LLC (collectively, the "Non-guarantor Subsidiaries"). All of the limited liability companies (the "LLCs") assets were 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 April 1, 2007 and December 31, 2006 and for the three months ended April 1, 2007 and April 2, 2006 were 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.

## Supplemental Condensed Consolidating Balance Sheet

As of April 1, 2007

(In thousands)

	Parent Company	Guarantor Subsidiary	Non- guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ 18,546	\$ 1,113	\$ 2,201	\$	\$ 21,860
Restricted cash			380		380
Accounts receivable, net	10,529	1,735			12,264
Inventories	15,967				15,967
Assets held for sale	896				896
Deferred income taxes		156		(156)	
Prepaid expenses and other current assets	3,899	49	7,785	(8,358)	3,375
Total current assets	49,837	3,053	10,366	(8,514)	54,742
Deferred income taxes	928	288		(288)	928
Property and equipment, net	93,902		40,095		133,997
Intangibles and deferred costs, net	15,381		1,969		17,350
Investments in subsidiaries	(287)	)		287	
Other assets	4,974	974	915	(974)	5,889
Total assets	\$ 164,735	\$ 4,315	\$ 53,345	\$ (9,489)	\$ 212,906
<b>Liabilities and Stockholders (Deficit) Equity</b>					
Current liabilities:					
Current maturities of long-term obligations	\$ 9,427	\$	\$ 1,524	\$ (7,776)	\$ 3,175
Accounts payable	20,532				20,532
Deferred income taxes	156			(156)	
Accrued expenses	39,349	2,739	1,523	(582)	43,029
Total current liabilities	69,464	2,739	3,047	(8,514)	66,736
Deferred income taxes	288			(288)	
Long-term obligations, less current maturities	180,240		46,266		226,506
Other long-term liabilities	47,563	683	5,212	(974)	52,484
Stockholders (deficit) equity	(132,820)	) 893	(1,180)	) 287	(132,820)
Total liabilities and stockholders (deficit) equity	\$ 164,735	\$ 4,315	\$ 53,345	\$ (9,489)	\$ 212,906

**Supplemental Condensed Consolidating Statement of Operations**  
**For the Three Months Ended April 1, 2007**  
(In thousands)

	Parent Company	Guarantor Subsidiary	Non- guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$ 120,183	\$ 2,443	\$	\$	\$ 122,626
Costs and expenses:					
Cost of sales	47,103				47,103
Labor and benefits	34,397				34,397
Operating expenses and write-downs of property and equipment	26,824		(1,606)	)	25,218
General and administrative expenses	9,478	1,155			10,633
Depreciation and amortization	5,626		534		6,160
Gain on franchise sales of restaurant operations and properties					
Loss on disposals of other property and equipment, net	35				35
Interest expense, net	3,877		1,047		4,924
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(7,157	) 1,288	25		(5,844 )
Benefit from (provision for) income taxes	488	(528	) (54	)	(94 )
(Loss) income from continuing operations	(6,669	) 760	(29	)	(5,938 )
Loss from discontinued operations	(14	)			(14 )
(Loss) income before equity in net income of consolidated subsidiaries	(6,683	) 760	(29	)	(5,952 )
Equity in net income of consolidated subsidiaries	731			(731	)
Net (loss) income	\$ (5,952	) \$ 760	\$ (29	) \$ (731	) \$ (5,952 )

**Supplemental Condensed Consolidating Statement of Cash Flows**  
**For the Three Months Ended April 1, 2007**  
(In thousands)

	Parent Company	Guarantor Subsidiary	Non- guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	\$ (749 )	\$ 315	\$ 633	\$ (158 )	\$ 41
Cash flows from investing activities:					
Purchases of property and equipment	(2,530 )				(2,530 )
Proceeds from sales of property and equipment					
Return of investment in subsidiary	125			(125 )	
Net cash used in investing activities	(2,405 )			(125 )	(2,530 )
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit facility					
Repayments of obligations	(385 )		(370 )		(755 )
Payments of deferred financing costs	(9 )				(9 )
Stock options exercised	36				36
Reinsurance payments made from deposits			(158 )	158	
Dividends paid			(125 )	125	
Net cash used in financing activities	(358 )		(653 )	283	(728 )
Net (decrease) increase in cash and cash equivalents	(3,512 )	315	(20 )		(3,217 )
Cash and cash equivalents, beginning of period	22,058	798	2,221		25,077
Cash and cash equivalents, end of period	\$ 18,546	\$ 1,113	\$ 2,201	\$	\$ 21,860
Supplemental disclosures:					
Interest paid	\$ 219	\$	\$ 1,050	\$	\$ 1,269
Income taxes paid	41	130	61		232

**Supplemental Condensed Consolidating Balance Sheet**  
**As of December 31, 2006**  
(In thousands)

	<b>Parent Company</b>	<b>Guarantor Subsidiary</b>	<b>Non- guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$ 22,057	\$ 798	\$ 2,222	\$	\$ 25,077
Restricted cash			517		517
Accounts receivable, net	9,593	1,842	7,776	(7,776)	11,435
Inventories	17,059				17,059
Assets held for sale	896				896
Deferred income taxes		156		(156)	
Prepaid expenses and other current assets	3,181	(2)	9	(61)	3,127
<b>Total current assets</b>	<b>52,786</b>	<b>2,794</b>	<b>10,524</b>	<b>(7,993)</b>	<b>58,111</b>
Deferred income taxes	928	288		(288)	928
Property and equipment, net	96,850		40,575		137,425
Intangibles and deferred costs, net	15,759		2,024		17,783
Investments in subsidiaries	107			(107)	
Other assets	5,005	851	915	(851)	5,920
<b>Total assets</b>	<b>\$ 171,435</b>	<b>\$ 3,933</b>	<b>\$ 54,038</b>	<b>\$ (9,239)</b>	<b>\$ 220,167</b>
<b>Liabilities and Stockholders (Deficit) Equity</b>					
<b>Current liabilities:</b>					
Current maturities of long-term obligations	\$ 9,387	\$	\$ 1,493	\$ (7,776)	\$ 3,104
Accounts payable	22,247				22,247
Accrued expenses	39,926	2,098	1,533	(217)	43,340
<b>Total current liabilities</b>	<b>71,560</b>	<b>2,098</b>	<b>3,026</b>	<b>(7,993)</b>	<b>68,691</b>
Long-term obligations, less current maturities	180,665		46,667		227,332
Other long-term liabilities	46,106	702	5,371	(1,139)	51,040
Stockholders (deficit) equity	(126,896)	1,133	(1,026)	(107)	(126,896)
<b>Total liabilities and stockholders (deficit) equity</b>	<b>\$ 171,435</b>	<b>\$ 3,933</b>	<b>\$ 54,038</b>	<b>\$ (9,239)</b>	<b>\$ 220,167</b>

**Supplemental Condensed Consolidating Statement of Operations**  
**For the Three Months Ended April 2, 2006**

(In thousands)

	Parent Company	Guarantor Subsidiary	Non- guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$ 123,097	\$ 2,618	\$	\$	\$ 125,715
Costs and expenses:					
Cost of sales	48,385				48,385
Labor and benefits	36,012				36,012
Operating expenses and write-downs of property and equipment	25,920		(1,706)	)	24,214
General and administrative expenses	9,942	1,155			11,097
Depreciation and amortization	5,237		543		5,780
Gain on franchise sales of restaurant operations and properties	(866)	)			(866)
Loss on disposals of other property and equipment, net	109				109
Interest expense, net	4,337		1,083		5,420
(Loss) income before benefit from (provision for) income taxes and equity in net income of consolidated subsidiaries	(5,979)	) 1,463	80		(4,436)
Benefit from (provision for) income taxes	654	(600)	(54)	)	
(Loss) income from continuing operations	(5,325)	) 863	26		(4,436)
Income from discontinued operations	2,616				2,616
(Loss) income before equity in net income of consolidated subsidiaries	(2,709)	) 863	26		(1,820)
Equity in net income of consolidated subsidiaries	889			(889)	)
Net (loss) income	\$ (1,820)	) \$ 863	\$ 26	\$ (889)	) \$ (1,820)

**Supplemental Condensed Consolidating Statement of Cash Flows**  
**For the Three Months Ended April 2, 2006**  
(In thousands)

	Parent Company	Guarantor Subsidiary	Non- guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	\$ 1,998	\$ 10	\$ 926	\$ (235 )	\$ 2,699
Cash flows from investing activities:					
Purchases of property and equipment	(2,404 )				(2,404 )
Proceeds from sales of property and equipment	5,794				5,794
Return of investment in subsidiary	282			(282 )	
Net cash provided by investing activities	3,672			(282 )	3,390
Cash flows from financing activities:					
Proceeds from revolving credit facility	8,000				8,000
Repayments of obligations	(8,405 )		(324 )		(8,729 )
Payments of deferred financing costs	(205 )				(205 )
Stock options exercised	19				19
Reinsurance payments made from deposits			(235 )	235	
Dividends paid			(282 )	282	
Net cash used in financing activities	(591 )		(841 )	517	(915 )
Net increase in cash and cash equivalents	5,079	10	85		5,174
Cash and cash equivalents, beginning of year	11,546	780	2,271		14,597
Cash and cash equivalents, end of year	\$ 16,625	\$ 790	\$ 2,356	\$	\$ 19,771
Supplemental disclosures:					
Interest paid	\$ 505	\$	\$ 1,023	\$	\$ 1,528
Income taxes (refunded) paid	(3,094 )	2,534	57		(503 )

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements of the Company and the notes thereto included elsewhere herein.*

**Forward Looking Statements**

Statements contained herein that are not historical facts constitute forward looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Words such as believes, plans, anticipates, expects, will and similar expressions are intended to identify forward looking statements. Forward looking statements include, but are not limited to, statements relating to the sufficiency of our capital resources, trends relating to our results of operations, changes in commodity prices, anticipated capital expenditures, and estimates and assumptions used in the preparation of our financial statements.

All forward looking statements are subject to known and unknown risks, uncertainties and other factors which could cause our or the foodservice industry's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. These factors include: our highly competitive business environment; exposure to fluctuating commodity prices; risks associated with the foodservice industry, such as changes in consumer tastes and adverse publicity resulting from food quality, illness, injury or other health concerns; the ability to retain and attract new and qualified employees; government regulations; high geographic concentration in the Northeast and its attendant weather patterns; conditions needed to meet restaurant re-imaging and new opening targets; risks and uncertainties arising out of accounting estimates and adjustments; our ability to service our debt and other obligations; our ability to meet ongoing financial covenants contained in our debt instruments, loan agreements, leases and other long-term commitments; unforeseen or increased costs associated with litigation and similar matters; and costs associated with improved service and other initiatives. On March 7, 2007, we announced that our Board of Directors is exploring strategic alternatives for enhancing shareholder value, including a possible sale of the Company. There is no assurance that the process will result in any specific transaction. However, the implementation of certain strategic alternatives could affect our current plans and strategies, and any forward-looking statements in this report are qualified by reference to our ongoing analysis. Other factors that could adversely affect our business and prospects are described in our filings with the Securities and Exchange Commission, including our 2006 Annual Report on Form 10-K/A.

Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as otherwise required by law, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this report to reflect any change in expectations or any change in events, conditions or circumstances on which any of our forward-looking statements are based.

**Overview**

We are a leading full-service, casual dining restaurant company and provider of premium ice cream products with locations primarily in the Northeast. As of April 1, 2007, we operated 317 full-service restaurants and franchised 198 full-service restaurants and seven non-traditional units, located in 16 states.

Our revenues are derived from three primary sources:

- Restaurant revenue, which consists of sales from Company-operated full-service restaurants;
- Foodservice revenue, which consists of sales of food and premium ice cream products that we distribute and sell to our franchisees and to more than 4,000 supermarkets and other retail locations in 12 states; and
- Franchise revenue, which consists of franchise fees, royalty income we receive from our franchisees, and other franchise income. Initial franchise fees typically range from \$30,000 to \$35,000 for each restaurant opened. Franchise royalties are generally 4% of each franchise restaurant's monthly net sales. Other franchise income includes rental income on any properties we own and lease or sublease to franchisees.

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

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
<b><u>Company Units:</u></b>		
Beginning of period	316	314
Openings	1	1
Acquired from franchisees	1	
Acquired by franchisees		(1 )
Closings	(1 )	(2 )
End of period	317	312
<b><u>Franchised Units:</u></b>		
Beginning of period	205	213
Openings	1	
Acquired by franchisees		1
Acquired from franchisees	(1 )	
Closings		
End of period	205	214

***Discontinued Operations***

SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, requires the results of operations of a component of an entity that is classified as held for sale or that has been disposed of to be reported as discontinued operations in the statement of operations if certain conditions are met. These conditions include commitment to a plan of disposal after the effective date of this statement, elimination of the operations and cash flows of the entity component from our ongoing operations and no significant continuing involvement in the operations of the entity component after the disposal transaction.

In accordance with SFAS No. 144, the results of operations of the eight properties that were disposed of during 2006 and any related net gain on the disposals, as well as the results of operations of three properties held for sale at April 1, 2007 were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for the three months ended April 1, 2007 and April 2, 2006.

During 2006, we closed one restaurant and committed to a plan to sell that restaurant. At April 1, 2007, this property met the criteria for held for sale as defined in SFAS No. 144. The results of operations associated with this restaurant were not material and therefore were reported within continuing operations in the accompanying condensed consolidated statements of operations for all periods presented.

***Three Months Ended April 1, 2007 Compared With Three Months Ended April 2, 2006***

*Revenues:*

*Total revenues* Total revenues decreased \$3.1 million, or 2.5%, to \$122.6 million for the three months ended April 1, 2007 from \$125.7 million for the same quarter in 2006.

*Restaurant revenues* Restaurant revenues decreased \$2.1 million, or 2.2%, to \$93.2 million for the three months ended April 1, 2007 from \$95.3 million for the same period in 2006. Comparable Company-operated restaurant revenues during this period decreased by \$3.6 million, or 4.1%, compared to an increase of 4.8% experienced during the same period in 2006. Colder weather in 2007, especially at night, combined with a greater number of operating days with significant snow and rain events, had a negative impact on sales. The closing of six locations and the acquisition of six Company-operated locations by franchisees over the past 15 months resulted in declines of \$0.8 million and \$1.7 million, respectively, in restaurant revenues in the three months ended April 1, 2007 as compared to the same period in 2006. These decreases were partially offset by our opening three new restaurants and taking over operation of twelve formerly franchised restaurants over the past 15 months, which resulted in increased revenues of \$4.0 million. We began operating the twelve restaurants in December 2006 following a default and peaceful surrender by a former franchisee under its leases and franchise agreements with us. We are currently operating these restaurants while we search for a new franchisee to take over their operation. If the properties are not re-franchised, we may acquire or close the restaurants, at our option.

There was one new restaurant opened during each of the first quarters of 2007 and 2006.

*Foodservice revenues* Foodservice revenues (product sales to franchisees and retail customers) decreased \$1.0 million, or 3.5%, to \$25.9 million for the three months ended April 1, 2007 from \$26.9 million for the three months ended April 2, 2006. Sales to foodservice retail supermarket customers decreased \$0.7 million in the three months ended April 1, 2007 compared to the same period in 2006 primarily due to lower case volume of 5.8% and higher promotional trade spending and sales allowances of 0.7% of sales during the period. Franchised restaurant product revenue decreased \$0.3 million. Revenues from product sales to franchisees decreased due primarily to a lower average number of operating franchised restaurants throughout the quarter, 205 for the 2007 quarter compared to 214 for the 2006 quarter. The lower average number of operating franchised restaurants was primarily due to the default by a former franchisee under its leases and franchise agreements with us with respect to twelve franchised restaurants. We are currently operating these restaurants while we seek a substitute franchisee. Additionally, a 4.6% reduction in comparable franchised restaurant revenues was experienced during the three months ended April 1, 2007, compared to the 0.6% increase in comparable franchised restaurant revenues experienced in the three months ended April 2, 2006.

*Franchise revenues* Franchise revenues were \$3.5 million for both three month periods in 2007 and 2006.

Royalties of \$2.4 million decreased \$0.1 million for the three months ended April 1, 2007 as compared to the same period in 2006 due primarily to a lower average number of operating franchised restaurants throughout the quarter, 205 for the 2007 quarter compared to 214 for the 2006 quarter. Additionally, a 4.6% reduction in comparable franchised restaurant revenues was experienced during the three months ended April 1, 2007, compared to the 0.6% increase in comparable franchised restaurant revenues experienced in the three months ended April 2, 2006.

Initial franchise fees were minimal during the three months ended April 1, 2007 and April 2, 2006.

Rental income for leased and subleased franchise locations increased \$0.1 million, to a total of \$1.1 million, for the three months ended April 1, 2007 primarily due to increases in miscellaneous occupancy revenues, which were partially offset by a decrease in the number of operating franchised locations.

*Cost of sales:*

Cost of sales decreased \$1.3 million, or 2.6%, to \$47.1 million for the three months ended April 1, 2007 from \$48.4 million for the same period in 2006. Cost of sales as a percentage of total revenues was 38.4% and 38.5% for the three months ended April 1, 2007 and April 2, 2006, respectively. This improvement resulted primarily from a 0.8% improvement in cost of sales experienced within the foodservice segment, as the overall sales mix between restaurants and foodservice remained essentially the same year over year. The improvement in foodservice cost of sales more than offset the 0.3% increase experienced in restaurant cost of sales.

Restaurant cost of sales as a percentage of restaurant revenues increased to 27.1% for the three months ended April 1, 2007 from 26.8% for the same period in 2006. This increase was due primarily to normal increases in prices for commodities, as menu pricing was only marginally up year over year.

Foodservice cost of sales as a percentage of foodservice revenues decreased to 84.2% in the three months ended April 1, 2007 from 85.0% in the three months ended April 2, 2006. This improvement was primarily a result of lower cream costs in the 2007 period compared to the same period in 2006.

The cost of cream, the principal ingredient used in making ice cream, affects our costs of sales as a percentage of total revenues, especially in our foodservice retail business. The price of cream is directly affected by changes in the market price for AA butter traded on the Chicago Mercantile Exchange. As an example, a \$0.10 increase in the cost of a pound of AA butter affects our annual costs of sales by approximately \$0.9 million. This adverse impact may be offset by price increases or other factors. However, no assurance can be given that we will be able to offset any cost increases in the future and future increases in cream prices could have a material adverse effect on our results of operations. To minimize risk, alternative supply sources continue to be pursued.



The overall cost of cream was approximately \$0.3 million lower in the three month period ended April 1, 2007 (weighted average price of \$1.24 per pound) when compared to the same period in 2006 (weighted average price of \$1.35 per pound). Additionally, market losses on cash-settled butter futures contracts were \$0.4 million lower than the losses experienced on butter future contracts during the three months ended April 2, 2006. Approximately 70% of this \$0.7 million net cost of sales benefit on a year to date basis, or approximately \$0.5 million, was reported within our foodservice segment.

When available, we purchase butter option and/or futures contracts to minimize the impact of increases in the cost of cream. Our strategy related to hedging is never to hedge more than 50% of our needs using these instruments, so as not to put us in an uncompetitive position. Option contracts are offered in the months of March, May, July, September, October and December; however, there is often not enough open interest in them to allow us to buy even very limited coverage without paying high premiums. Our commodity option contracts and cash-settled butter futures contracts do not meet hedge accounting criteria as defined by SFAS No. 133, Accounting for Certain Derivative Instruments and Certain Hedging Activities, and its related amendment, SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, and accordingly, are marked to market each period with the resulting gains or losses recognized in cost of sales.

At April 1, 2007, we held 55 contracts, spread over the remaining months of 2007. These contracts correspond to approximately 20% of our anticipated cream purchases for the periods represented.

For the remainder of 2007, we expect that cream prices will be higher than the prices experienced for the same period in 2006 due to the spread in the futures market compared to the actual prices of last year.

*Labor and benefits:*

Labor and benefits, which were only reported within our restaurant segment, decreased \$1.6 million, or 4.5%, to \$34.4 million for the three months ended April 1, 2007 from \$36.0 million for the three months ended April 2, 2006. As a percentage of total revenues, labor and benefits decreased to 28.1% for the three months ended April 1, 2007 from 28.6% for the three months ended April 2, 2006. Labor and benefits, as a percentage of Company restaurant revenue only, decreased to 36.9% for the three months ended April 1, 2007 from 37.8% for the same period in 2006. The decrease was partially a result of lower general manager bonus of \$0.4 million resulting from the negative comparable restaurant revenues generated during the quarter. In addition, fringe benefits decreased by 0.4% of Company restaurant revenues, due mostly to a slight reduction in non-group related insurance costs such as workers compensation.

*Operating expenses:*

Operating expenses increased \$1.0 million, or 4.2%, to \$25.0 million for the three months ended April 1, 2007 from \$24.0 million for the three months ended April 2, 2006. Operating expenses as a percentage of total revenues were 20.4% and 19.1% in the 2007 and 2006 periods, respectively. A significant portion of these expenses (\$24.3 million in 2007 and \$22.9 million in 2006) were reported within our restaurant segment. In the three months ended April 1, 2007, these costs consisted of \$3.7 million in supplies, \$5.3 million in utilities, \$2.7 million in maintenance, \$2.7 million in advertising, \$5.6 million in occupancy and \$4.3 million in other restaurant expenses. The increase is primarily due to increases in advertising (\$0.5 million) resulting from two additional weeks of television advertising during the first quarter of 2007, occupancy (\$0.4 million), utility costs (\$0.3 million) and supplies (\$0.2 million). These increases were partially offset by lower selling expenses in the foodservice segment of \$0.5 million.

*General and administrative expenses:*

General and administrative expenses were \$10.6 million and \$11.1 million for the three months ended April 1, 2007 and April 2, 2006, respectively. General and administrative expenses as a percentage of total revenues decreased to 8.7% in the 2007 period from 8.8% in the 2006 period. The \$0.5 million decrease was primarily the result of lower salary, severance, fringe benefit, and bonus costs of \$0.7 million partially offset by increased legal fees and stock compensation expense of \$0.1 million and \$0.1 million, respectively.

*Write-downs of property and equipment:*

Write-downs of property and equipment were \$0.2 million in each of the three month periods ended April 1, 2007 and April 2, 2006. During each of the three month periods ended April 1, 2007 and April 2, 2006, we determined that the carrying value of one restaurant property exceeded its estimated fair value less costs to sell and each of the carrying values were reduced by \$0.2 million accordingly.

*Depreciation and amortization:*

Depreciation and amortization was \$6.2 million and \$5.8 million for the three months ended April 1, 2007 and April 2, 2006, respectively. Depreciation and amortization as a percentage of total revenues was 5.0% and 4.6% in the 2007 and 2006 periods, respectively. The increase in depreciation and amortization was primarily related to accelerated depreciation on equipment associated with the conversion of our 56 oz packaging format from the traditional brick container to the more contemporary and consumer-friendly square package.

*Gain on franchise sales of restaurant operations and properties:*

Gain on franchise sales of restaurant operations and properties was \$0.9 million in the three months ended April 2, 2006 associated with the sale of certain equipment assets, lease and sublease rights and franchise rights in one existing Friendly's restaurant. There was no gain on sales of restaurant operations and properties during the three months ended April 1, 2007.

*Loss on disposals of other property and equipment, net:*

The loss on disposals of other property and equipment, net was \$35 thousand and \$0.1 million for the three months ended April 1, 2007 and April 2, 2006, respectively. The table below identifies the components of the loss on disposals of other property and equipment, net as shown on the accompanying condensed consolidated statements of operations (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Restaurant equipment assets retired due to replacement	\$ 35	\$ 75
Loss due to restaurant fire		30
All other		4
Loss on disposals of other property and equipment, net	\$ 35	\$ 109

*Interest expense, net:*

Interest expense, net of capitalized interest and interest income, was \$4.9 million and \$5.4 million for the three months ended April 1, 2007 and April 2, 2006, respectively. The decrease in interest expense in the 2007 period compared to the same period in 2006 was primarily due to reduced amounts of interest on our revolving credit facility as there were no borrowings against the revolving credit facility during the 2007 period as compared to borrowings of \$8.0 million during the 2006 quarter. Total outstanding debt, including capital lease and finance obligations, decreased from \$233.2 million at April 2, 2006 to \$229.7 million at April 1, 2007.

*Provision for income taxes:*

As a result of the loss for each of the periods ended April 1, 2007 and April 2, 2006 and our intent to record valuation allowances on tax benefits until we can sustain an appropriate level of profitability, the benefit from income taxes from continuing operations was zero. However, \$0.1 million of tax expense relating to the accounting for uncertain tax positions was recognized in the three months ended April 1, 2007, resulting in an effective tax rate of (1.6)% for the three month period ended April 1, 2007 and 0% for the three months ended April 2, 2006.

*Loss from continuing operations:*

Loss from continuing operations was \$5.9 million and \$4.4 million for the three months ended April 1, 2007 and April 2, 2006, respectively, for the reasons discussed above.

*(Loss) income from discontinued operations:*

In accordance with SFAS No. 144, the results of operations of the eight properties that were disposed of during 2006 and any related net gain on the disposals, as well as the results of operations of three properties held for sale at April 1, 2007 were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for the three months ended April 1, 2007 and April 2, 2006.

During 2006, we closed one restaurant and committed to a plan to sell that restaurant. At April 1, 2007, this property met the criteria for held for sale as defined in SFAS No. 144. The results of operations associated with this restaurant were not material and therefore were reported within continuing operations in the accompanying condensed consolidated statements of operations for all periods presented.

For the three months ended April 1, 2007 and April 2, 2006, this consisted of the following (in thousands):

	<b>For the Three Months Ended</b>	
	<b>April 1, 2007</b>	<b>April 2, 2006</b>
Net sales	\$	\$
Operating loss	\$ (14 )	\$ (248 )
Gain on disposals of property and equipment		2,864
Income tax benefit		
(Loss) income from discontinued operations	\$ (14 )	\$ 2,616

**Liquidity and Capital Resources***General:*

Our primary sources of liquidity and capital resources are cash generated from operations and, if needed, borrowings under our \$35 million revolving credit facility (the Credit Facility). Additional sources of liquidity consist of capital and operating leases for financing leased restaurant locations (in malls and shopping centers and land or building leases), restaurant equipment, manufacturing equipment, distribution vehicles and computer equipment. Other sources of cash are sales of under-performing existing restaurant properties and other assets and sales of Company-operated locations to franchisees (to the extent our debt instruments permit). The amount of debt financing that we are able to incur is limited by the terms of our Credit Facility and 8.375% senior notes indenture. Below was the financing status of our operating restaurants and properties that we lease to our franchisees as of April 1, 2007:

	<b>Company Operated</b>	<b>Franchise Operated</b>
Owned land and building, mortgaged	59	12
Leased land, owned building, mortgaged	1	0
Sold and leased back	58	4
Owned land and building	18	4
Leased land, owned building	74	18
Leased land and building	107	8
<b>Total</b>	<b>317</b>	<b>46</b>

The Company-operated restaurants above not identified as owned land and building, mortgaged or sold and leased back secure our obligations under the Credit Facility. Of the 18 restaurant properties identified as owned land and building, five were available to be sold.

In addition to our 317 operating restaurants, we have four closed properties that are classified as held for sale in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

*Operating Cash Flows:*

Net cash provided by operating activities was \$41 thousand and \$2.7 million for the three months ended April 1, 2007 and April 2, 2006, respectively. In 2007, cash provided by operating activities included a net loss of \$6.0 million, offset by increases of \$6.6 million for other non-cash expenses of depreciation and amortization, write-downs of property and equipment and stock compensation expense. The net cash provided by operating activities was reduced by unfavorable changes in operating assets and liabilities primarily related to bonuses for fiscal 2006, which were paid in the first quarter of 2007.

We had a working capital deficit of \$12.0 million and \$10.6 million as of April 1, 2007 and December 31, 2006, respectively. Our working capital deficit includes assets classified as held for sale in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The working capital needs of companies engaged in the restaurant industry are generally low and as a result, restaurants are frequently able to operate with a working capital deficit because: (i) restaurant operations are conducted primarily on a cash (and cash equivalent) basis with a low level of accounts receivable; (ii) rapid turnover allows a limited investment in inventories; and (iii) cash from sales is usually received before related expenses for food, supplies and payroll are paid.

*Investing Cash Flows:*

Net cash used in investing activities was \$2.5 million for the three months ended April 1, 2007 as compared to net cash provided by investing activities of \$3.4 million for the three months ended April 2, 2006.

During the three months ended April 1, 2007 and April 2, 2006, we spent \$2.5 million and \$2.4 million, respectively on capital expenditures, of which \$1.8 million and \$2.2 million, respectively, was spent on restaurant operations. Capital expenditures were offset by net proceeds from the sales of property and equipment of \$5.8 million for the three months ended April 2, 2006. There were no proceeds received during the three months ended April 1, 2007.

As of January 1, 2006, we had 11 restaurants that were reported as held for sale in accordance with SFAS No. 144. During the three months ended April 2, 2006, we sold five of these restaurants. In accordance with SFAS No. 144, the results of operations of the five properties that were disposed of during the three months ended April 2, 2006 and the related net gain on the disposals, as well as the results of operations of the properties held for sale at April 2, 2006, were reported separately as discontinued operations in the accompanying condensed consolidated statements of operations for the three months ended April 2, 2006. Gross proceeds on the disposals of the five properties sold during the 2006 quarter were \$5.1 million. There were no properties sold during the 2007 quarter.

During the first quarter of 2006, we completed one transaction in which an existing franchisee purchased one existing Company-operated restaurant and agreed to develop a total of two new restaurants in future years. Gross proceeds from this transaction were \$1.2 million, of which \$0.1 million was for franchise fees and \$1.1 million was for the sale of certain assets and leasehold rights. There were no such transactions during 2007.

*Borrowings and Credit Facility:*

*8.375% Senior Notes.* In March 2004, we issued \$175 million of 8.375% senior notes (the Senior Notes) in a private offering to finance the redemption in full of our then outstanding 10.5% senior notes. The Senior Notes are unsecured senior obligations of FICC, guaranteed on an unsecured senior basis by FICC's Friendly's Restaurants Franchise, LLC subsidiary, but are effectively subordinated to all secured indebtedness of FICC, including the indebtedness incurred under our Credit Facility. The Senior Notes mature on June 15, 2012. Interest on the Senior Notes is payable at 8.375% per annum semi-annually on June 15 and December 15 of each year. The Senior Notes are redeemable, in whole or in part, at any time on or after June 15, 2008 at FICC's option at redemption prices from 104.188% to 100.00%, based on the redemption date. In addition, at any time prior to June 15, 2007, FICC may redeem, subject to certain conditions, up to 35% of the aggregate principal amount of the Senior Notes with the proceeds of one or more qualified equity offerings, as defined, at a redemption price of 108.375% of the principal amount, plus accrued interest.

*Revolving Credit Facility.* We have a \$35 million Credit Facility which is available for borrowings to provide working capital, for issuances of letters of credit and for other corporate needs. As of April 1, 2007 and December 31, 2006, total letters of credit outstanding were \$15.5 million and \$15.5 million, respectively. During 2007 and 2006, there were no drawings against the letters of credit. The revolving credit loans bear interest at our option at either (a) the base rate plus the applicable margin as in effect from time to time (the Base Rate) (10.25% at April 1, 2007) or (b) the Eurodollar rate plus the applicable margin as in effect from time to time (the Eurodollar Rate) (9.32% at April 1, 2007). As of April 1, 2007 and December 31, 2006, there were no revolving credit loans outstanding. As of April 1, 2007 and December 31, 2006, \$19.5 million and \$19.5 million, respectively, was available for borrowing.

The Credit Facility includes certain restrictive covenants including limitations on indebtedness, restricted payments such as dividends and stock repurchases, liens, mergers, investments and sales of assets and of subsidiary stock. Additionally, the Credit Facility limits the amount which we may spend on capital expenditures, restricts the use of proceeds from certain asset sales, obligates us to repay outstanding amounts during certain periods of time during the year, and requires that we comply with certain financial covenants. We were in compliance with the covenants in the Credit Facility as of April 1, 2007.



*Mortgage Financings.*

We have outstanding mortgage loans in connection with our \$45 million fixed interest rate mortgage financing completed in December 2001 (the Fixed Rate Mortgages ), and our \$8.5 million variable interest rate mortgage financing completed in December 2005 (the Variable Rate Mortgages ), and together with the Fixed Rate Mortgages, the Mortgage Financings ). The Fixed Rate Mortgages bear interest at a fixed annual rate of 10.16%, have a maturity date of January 1, 2022 and are amortized over 20 years. The interest rate of the Variable Rate Mortgages is the sum of the 90-day LIBOR rate in effect (5.35% at April 1, 2007) plus 4% on an annual basis. Changes in the interest rate for the Variable Rate Mortgages are calculated monthly and recognized annually when the monthly payment amount is adjusted. Changes in the monthly payment amounts owed due to interest rate changes for the Variable Rate Mortgages are reflected in the principal balances, which are re-amortized over the remaining life of the mortgages. The Variable Rate Mortgages have a maturity date of January 1, 2020 and are amortized over 14 years. All of the Mortgage Financings are subject to annual covenants, including various minimum fixed charge coverage ratios. We were in compliance with the covenants for the Variable Rate Mortgages and Fixed Rate Mortgages as of December 31, 2006.

*Capital Expenditures.*

We anticipate requiring capital in the future principally to maintain existing restaurant and plant facilities and to continue to renovate and re-image existing restaurants. We anticipate that capital expenditures for 2007 will be between \$20.0 million and \$23.0 million in the aggregate, of which we expect to spend between \$17.0 million and \$20.0 million on restaurants. Our actual 2007 capital expenditures may vary from these estimated amounts. We believe that the combination of the funds generated from operating activities and borrowing availability under our Credit Facility will be sufficient to meet our anticipated operating requirements, debt service requirements, lease obligations and capital requirements.

*Contractual Obligations and Commitments.*

There have been no material changes to our contractual obligations and commitments from those disclosed in our 2006 Annual Report on Form 10-K/A.

**Seasonality**

Due to the seasonality of ice cream consumption, and the effect from time to time of weather on patronage of the restaurants, our revenues and operating income are typically higher in our second and third quarters.

**Geographic Concentration**

Approximately 94% of our Company-operated restaurants are located, and substantially all of our retail sales are generated, in the Northeast. As a result, a severe or prolonged economic recession or changes in demographic mix, employment levels, population density, weather, real estate market conditions or other factors specific to this geographic region may adversely affect us more than certain of our competitors which are more geographically diverse.

### **Critical Accounting Estimates**

The discussion and analysis of our consolidated financial condition and results of operations are based upon our interim condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, insurance reserves, recoverability of accounts receivable and notes receivable, stock compensation expense, income tax valuation allowances and pension and other post-retirement benefits expense. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

The critical accounting estimates that we believe affect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements presented in this report are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to the consolidated financial statements included in our 2006 Annual Report on Form 10-K/A. There has been no material change to our critical accounting estimates from those disclosed in our 2006 Annual Report on Form 10-K/A.

Actual results may differ from these estimates under different assumptions or conditions. Any differences may have a material impact on our financial condition and results of operations. For a discussion of how these and other factors may affect our business, see the Forward Looking Statements above and other factors included in our other filings with the Securities and Exchange Commission.

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### Recently Issued Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 ( *FIN 48* ), which clarifies the accounting for uncertainty in tax positions. *FIN 48* requires that we recognize in our financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit based on the technical merits of the position. The provisions of *FIN 48* are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings.

We adopted the provisions of *FIN 48* on January 1, 2007. As a result of the implementation of *FIN 48* on January 1, 2007, we recognized an additional \$0.2 million as a decrease to retained earnings. As of the date of adoption, our unrecognized tax benefits totaled \$1.6 million, which would affect our tax rate if recognized. During the three months ended April 1, 2007, we recognized approximately \$0.1 million in potential tax and interest associated with uncertain tax positions and settled one previously uncertain tax position which resulted in the payment of \$72,065 of tax and \$7,324 of interest.

We file numerous consolidated and separate income tax returns in the United States Federal jurisdiction and in many state jurisdictions. With few exceptions, we are no longer subject to US Federal and state and local income tax examinations for years before 2003.

We recognize potential accrued interest and penalties related to unrecognized tax benefits within our operations as income tax expenses. As of the date of implementation of *FIN 48*, we had approximately \$0.6 million accrued for interest and penalties. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

We anticipate that the total unrecognized tax benefits will decrease by approximately \$0.5 million due to the settlement of ongoing state voluntary disclosure processes prior to March 30, 2008.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our market risk exposure since the filing of the 2006 Annual Report on Form 10-K/A.

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**Item 4. Controls and Procedures**

As of April 1, 2007, our management, under the supervision and with the participation of our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of April 1, 2007.

There were no significant changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1A. Risk Factors**

There have been no material changes to our risk factors from those disclosed in our 2006 Annual Report on Form 10-K/A.

**Item 5. Other Information**

On May 9, 2007, we amended our change of control agreements with Messrs. George M. Condos, Kenneth D. Green, Gregory A. Pastore and Garrett J. Ulrich. Mr. Condos' change of control agreement was amended to extend the period of time that he will be entitled to receive his salary continuation payments, health benefits and outplacement services, from one year to two years if, during the term of his agreement, his employment is terminated by us within 60 days after a change of control. Messrs. Green, Pastore and Ulrich's change of control agreements were amended to provide for salary continuation payments in an amount equal to such employee's base compensation (as defined in the agreement) for a period of two years, in lieu of a lump sum cash payment in an aggregate amount equal to the person's base compensation for a one year period, and to provide continued health benefits and outplacement services for the two year period. These agreements were also amended to provide that we may delay or accelerate the salary continuation payments to the extent we determine it is necessary to comply with Section 409A of the Internal Revenue Code. All other provisions of their agreements remain in full force and effect.

**Item 6. Exhibits**

(a) Exhibits

The exhibit index is incorporated by reference herein.

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**SIGNATURES**

Pursuant to the requirements of the Securities 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: Executive Vice President of Administration  
and Chief Financial Officer  
(Principal Financial Officer)

Date: May 11, 2007

**EXHIBIT INDEX**

- 3.2 Amended and Restated Bylaws, as amended.
- 10.1 Form of 2003 Incentive Plan Restricted Stock Agreement for officers\*.
- 10.2 Form of 2003 Incentive Plan Restricted Stock Unit Award Agreement for officers\*.
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by George M. Condos.
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Paul V. Hoagland.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by George M. Condos and Paul V. Hoagland.

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\* Management Contract or Compensatory Plan or Arrangement

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