Unaudited Interim Consolidated Financial Statements and Footnotes

September 30, 2012

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	(unaudited) Sep 30, 2012	Jan 1, 2012
ASSETS		
Current assets:		
Cash	$ 849,458	$ 804,816
Royalties receivable, net	61,387	99,722
Other receivables, net	117,150	120,910
Inventory	539,987	530,537
Prepaid expenses and other current assets	854,434	974,495
Assets related to discontinued operations, net	64,037	100,000
Total current assets	2,486,454	2,630,480
Property and equipment, net	12,383,061	12,939,426
Deferred tax assets	4,564,438	4,506,060
Other assets, net	93,421	107,706
Other assets related to discontinued operations	33,878	33,878
Total assets	$ 19,561,251	$ 20,217,550
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	$ 2,000,000	$ -
Accounts payable	2,353,186	2,350,811
Accrued sales and liquor taxes	97,335	107,036
Accrued payroll and related taxes	782,964	715,351
Accrued expenses	985,970	1,061,439
Income taxes payable	103,625	135,362
Current portion of liabilities associated with leasing and exit activities	112,890	117,050
Total current liabilities	6,435,970	4,487,049
Long-term debt	-	3,000,000
Liabilities associated with leasing and exit activities, net of current portion	27,778	115,899
Deferred gain	156,108	312,215
Deferred rent	1,655,802	1,809,244
Total liabilities	8,275,657	9,724,407
Commitments and contingencies	-	-
Stockholders' equity:		
Series A Convertible Preferred stock, $.01 par value, 1,000,000 shares authorized, 890,181 and 838,790 shares issued and outstanding at 9/30/12 and 1/1/12, respectively	8,902	8,388
Additional paid-in capital-preferred stock	984,960	952,679
Common stock, $0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued, 3,475,099 and 3,463,099 shares outstanding at 9/30/2012 and 1/1/2012, respectively	47,327	47,327
Additional paid-in capital-common stock	18,363,350	18,399,540
Warrants Outstanding	72,176	72,176
Retained earnings	2,953,025	2,263,500
Treasury stock at cost, 1,257,606 and 1,269,606 common shares at 9/30/2012 and 1/1/2012, respectively	(11,144,147)	(11,250,467)
Total stockholders' equity	11,285,593	10,493,143
Total liabilities and stockholders' equity	$ 19,561,251	$ 20,217,550

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	13-Week Period Ended Sep 30, 2012	39-Week Period Ended Sep 30, 2012	13-Week Period Ended Oct 2, 2011	39-Week Period Ended Oct 2, 2011
Revenues:				
Restaurant sales	$ 16,920,493	$ 51,709,486	$ 16,836,892	$ 50,618,401
Franchise fees, royalties and other	112,074	311,294	97,983	368,769
	17,032,567	52,020,780	16,934,875	50,987,170
Costs and expenses:				
Cost of sales	4,970,842	14,991,519	5,062,440	15,022,459
Labor	5,770,005	17,646,944	5,665,550	17,356,798
Restaurant operating expenses	4,295,854	12,817,626	4,290,982	12,449,880
General and administrative	1,211,898	3,710,822	1,275,831	3,995,027
Depreciation and amortization	650,686	1,964,120	585,291	2,180,887
Restaurant closure expense	6,666	9,491	-	-
Loss on sale of property and equipment	658	26,452	11,634	43,619
	16,906,609	51,166,975	16,891,728	51,048,670
Operating income (loss)	125,958	853,805	43,147	(61,500)
Other income (expense):				
Interest income	4,958	6,578	541	1,606
Interest expense	(30,769)	(115,817)	(52,589)	(174,115)
Other, net	13,248	25,343	6,342	11,343
	(12,562)	(83,895)	(45,706)	(161,166)
Income (loss) before income taxes	113,395	769,910	(2,559)	(222,666)
Income tax (expense) benefit	1,966	(47,588)	51,385	186,171
Net income (loss)	$ 115,361	$ 722,322	$ 48,826	$ (36,495)

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Preferred Stock	APIC-PS	Common Stock	APIC-CS	Retained Earnings	Treasury Stock	Total Stockholders' equity
Balances at January 1, 2012	8,388	952,679	47,327	18,471,716	2,263,500	(11,250,467)	10,493,143
							-
Issuance of common stock for vested restricted stock				(106,320)		106,320	-
							-
Dividends on preferred stock	514	32,281			(32,795)		-
							-
Stock based compensation expense				70,130			70,130
							-
Net income					722,322		722,322
Balances at September 30, 2012	8,902	984,960	47,327	18,435,526	2,953,027	(11,144,147)	11,285,595

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	39-Week Period Ended Sep 30, 2012	39-Week Period Ended Oct 2, 2011
Cash flows from operating activities:		
Net income (loss)	$ 722,322	$ (36,495)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,964,120	2,180,887
Deferred gain amortization	(156,107)	(156,107)
Restaurant closure expense	9,491	-
Loss on sale of property & equipment	26,452	43,619
Stock based compensation expense	70,130	123,914
Deferred income tax benefit	(58,378)	(289,241)
Changes in operating assets and liabilities:		
Royalties receivable	38,335	(25,250)
Other receivables	3,760	(145,499)
Inventory	(9,449)	18,804
Income taxes receivable/payable	(31,737)	(22,370)
Prepaid and other current assets	120,060	4,816
Other assets	1,101	(53,645)
Accounts payable	(7,119)	91,444
Accrued expenses and other liabilities	(17,557)	18,353
Liabilities associated with leasing and exit activities	(92,281)	(183,158)
Deferred rent	(153,443)	(107,838)
Total adjustments	1,707,379	1,498,729
Net cash provided by continuing operations	2,429,701	1,462,234
Net cash provided by (used in) discontinued operations	35,963	(3,180)
Net cash provided by operating activities	2,465,664	1,459,054
Cash flows from investing activities:		
Purchase of property and equipment	(1,423,472)	(1,134,519)
Proceeds from sale of property and equipment	2,450	3,870
Net cash used in investing activities	(1,421,022)	(1,130,649)
Cash flows from financing activities:		
Borrowings under line of credit agreement	500,000	-
Payments under line of credit agreement	(1,500,000)	(1,150,000)
Proceeds from issuance of preferred stock and warrants, net of transaction fees	-	1,000,000
Net cash used in financing activities	(1,000,000)	(150,000)

Net increase in cash		44,642		178,405
Cash at beginning of period		804,816		678,798
Cash at end of period	$	849,458	$	857,203
Supplemental disclosure of cash flow information:				
Cash paid during the period:				
Interest	$	103,207	$	161,910
Income taxes	$	159,792	$	136,000

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of presentation

In the opinion of Mexican Restaurants, Inc. (the "Company"), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals and adjustments) necessary for a fair presentation of the consolidated financial position and stockholders' equity as of September 30, 2012, and the consolidated statements of operations and cash flows for the 13-week and 39-week periods ended September 30, 2012 and October 2, 2011. The consolidated statements of operations for the 13-week and 39-week periods ended September 30, 2012 and October 2, 2011 are not necessarily indicative of the results to be expected for the full year or any other interim period. During the interim periods, the Company follows the accounting policies described in the notes to the consolidated financial statements in its "Audited Consolidated Financial Statements and Footnotes" for the year ended January 1, 2012. Reference should be made to such consolidated financial statements for information on such accounting policies and further financial detail.

The Company classifies as discontinued operations for all periods presented any component of the Company's business that the Company believes is probable of being sold within the next 12 months and that has operations and cash flows that are clearly distinguishable operationally and for financial reporting purposes. For those components, the Company has no significant continuing involvement after disposal, and their operations and cash flows are eliminated from ongoing operations. Sales of significant components of the Company's business not classified as discontinued operations are reported as a component of income from continuing operations.

2. Income taxes

In determining the provision for income taxes, the Company uses an estimated annual effective tax rate based on forecasted annual income and permanent items, statutory tax rates and tax planning opportunities in the various jurisdictions in which the Company operates. The impact of significant discrete items is separately recognized in the quarter in which they occur.

3. Stock-based compensation

The Company accounts for share-based awards through the measurement and recognition of compensation expense for all share-based payment awards to employees, directors, and consultants based on estimated fair values. Compensation expense is recognized for all stock-based compensation with future service requirements over the period that the recipient of the award provides service in exchange for the award. Stock options granted are recorded at estimated fair value using an option-pricing model or other applicable valuation technique. Restricted stock shares granted are recorded at estimated fair value based upon the quoted market value of the Company's common stock on the date of grant. The fair value of each share is expensed over the period during which the related restrictions lapse. The Company's stock-based compensation plans are described in more detail in Note 3 of the "Audited Consolidated Financial Statements and Footnotes" for the fiscal year ended January 1, 2012.

The Company receives a tax deduction for certain stock option exercises during the period in which the options are exercised. These deductions are generally for the excess of the price for which the options were sold over the exercise prices of the options. No stock options were exercised during the 13-week and 39-week periods ended September 30, 2012 and October 2, 2011.

4. Long term debt

The Company entered into a credit agreement (the "Agreement") with a financial institution in June 2007 which provided for a revolving loan of up to $10 million. Over the years, the available credit has been reduced in accordance with amendments to the Agreement. As of September 30, 2012, the amended Agreement provided for a revolving loan of up to $3.075 million which will be reduced by $275,000 on the first day of each fiscal quarter. At management's option, the revolving loan bears an interest rate equal to the Base Rate plus a stipulated percentage or LIBOR plus a stipulated percentage. Accordingly, the Company is impacted by changes in the Base Rate and LIBOR. The Company is subject to a non-use fee of 0.50% on the unused portion of the revolver from the date of the Agreement. As of September 30, 2012, the Company's outstanding debt to the financial institution was $2.0 million and the entire balance matures on June 29, 2013. Under the amended Agreement, the Company is subject to certain debt covenants that if violated would cause the loan to become due sooner than the stipulated maturity date. The Company was in compliance with all debt covenants of the agreement as of September 30, 2012. The Company is currently negotiating with its financial institution the extension of its revolving loan.

5. Related party transactions

The Company's Vice Chairman of the Board of Directors owns a Casa Olé franchise restaurant for which the Company receives royalties. For the 13-week and 39-week periods ended September 30, 2012, the Company recognized royalty income of $5,499 and $16,371, respectively, related to this restaurant. For the 13-week and 39-week periods ended October 2, 2011, the Company recognized royalty income of $5,174 and $16,355 respectively, related to this restaurant.

6. Discontinued operations and leasing exit activities

The results of operations, assets and liabilities for all units that have been disposed of that are material to the financial statements, either individually or in the aggregate, are reclassified to discontinued operations and to liabilities associated with leasing and exit activities in the consolidated statements of operations and balance sheets for all periods presented.

On May 3, 2012, the Company entered into a settlement agreement and promissory note receivable with a sublessee for past due rents totaling $175,000. A down payment of $25,000 was received along with a $150,000 promissory note receivable to be paid over a period of four years. As of September 30, 2012, assets related to discontinued operations of $64,037 (net of allowance) consisted of rent receivable related to the promissory note.

Other assets related to discontinued operations of $33,878 consisted of security deposits for leases in the state of Michigan that were assigned to a third party in 2009 and which expire in 2019.

Current and long-term liabilities related to leasing and exit activities consisted primarily of accrued closure costs related to a non-interest bearing note payable made in 2011 to exit a lease (see details below) and of rent differential for two other closed restaurants for which the Company has subleased the restaurants. Rent differential represents the difference between the Company's future contractual lease payment obligations for closed restaurants and contractual future rent payments to be received in accordance with the terms of the subleases.

On May 2, 2011, the Company entered into a "Promissory Note" along with a "Compromise Settlement and Release Agreement" to exit the lease related to a store that had been subleased. This $200,000 non-interest bearing promissory note is included in liabilities associated with leasing and exit activities. The principal balance is due in thirty-six equal monthly installments beginning April 1, 2011 and contains a penalty clause that increases the principal to $600,000, if the Company defaults on the note.

7. Company-operated restaurant activities

One underperforming company-operated Casa Ole restaurant was closed in June 2012 (the operating lease had expired). As of September 30, 2012, company-operated locations consisted of 52 restaurants.

8. Franchisee-operated restaurant activities

On April 3, 2012, the Company entered into a promissory note receivable with one of its franchisees for past due royalties of approximately $56,000 to be paid over a period of three years.

As of September 30, 2012, the Company had seven Casa Ole franchisees operating a total of 13 restaurants.

9. Subsequent events

The Company requested and received from its financial institution a limited waiver and consent amendment to its loan agreement in order to build a new restaurant in Pasadena, Texas. The Company has negotiated a mortgage for the new restaurant, and the new restaurant will replace an existing restaurant. The lease for the existing restaurant will expire on June 30, 2013.

Management has evaluated subsequent events through November 13, 2012, the date which the financial statements were available to be issued.