MRI™

MEXICAN RESTAURANTS, INC.

Unaudited Interim Consolidated Financial Statements and Footnotes

September 29, 2013

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
As of September 29, 2013 and December 30, 2012

	(unaudited) 9/29/2013	12/30/2012
ASSETS		
Current assets:		
Cash	$ 861,970	$ 1,249,409
Royalties receivable, net	41,023	57,605
Other receivables, net	80,932	115,859
Inventory	536,085	546,741
Prepaid expenses and other current assets	844,046	771,800
Assets related to discontinued operations, net	29,574	55,645
Total current assets	2,393,630	2,797,059
Property and equipment, net	11,879,826	10,959,831
Deferred tax assets	4,996,260	4,868,622
Other assets, net	184,642	88,659
Other assets related to discontinued operations	33,878	33,878
Total assets	$ 19,488,236	$ 18,748,049
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	$ -	$ 2,000,000
Accounts payable	2,555,629	2,417,019
Accrued sales and liquor taxes	80,612	107,404
Accrued payroll and related taxes	736,758	762,048
Accrued expenses	888,929	991,743
Income taxes payable	176,402	149,951
Current portion of liabilities associated with leasing and exit activities	34,910	181,367
Total current liabilities	4,473,240	6,609,532
Long-term debt	2,258,978	-
Liabilities associated with leasing and exit activities, net of current portion	-	11,111
Deferred gain	-	93,352
Deferred rent	1,452,988	1,595,439
Total liabilities	8,185,206	8,309,434
Commitments and contingencies	-	-
Stockholders' equity:		
Series A Convertible Preferred stock, $.01 par value, 1,000,000 shares authorized, 963,557 and 908,131 shares issued and outstanding at 9/29/13 and 12/30/12, respectively	9,639	9,081
Additional paid-in capital-preferred stock	1,096,186	1,003,628
Common stock, $0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued, 3,489,099 and 3,481,599 shares outstanding at 9/29/2013 and 12/30/2012, respectively	47,327	47,327
Additional paid-in capital-common stock	18,221,568	18,273,317
Retained earnings	2,948,417	2,191,819
Treasury stock at cost, 1,243,606 and 1,251,106 common shares at 9/29/2013 and 12/30/2012, respectively	(11,020,107)	(11,086,557)
Total stockholders' equity	11,303,030	10,438,615
Total liabilities and stockholders' equity	$ 19,488,236	$ 18,748,049

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

	13-Week Period Ended Sep 29, 2013	39-Week Period Ended Sep 29, 2013	13-Week Period Ended Sep 30, 2012	39-Week Period Ended Sep 30, 2012
Revenues:				
Restaurant sales	$ 16,538,081	$ 50,700,060	$ 16,920,493	$ 51,709,486
Franchise fees, royalties and other	104,662	304,193	112,074	311,294
	16,642,743	51,004,253	17,032,567	52,020,780
Costs and expenses:				
Cost of sales	4,745,854	14,599,881	4,970,842	14,991,519
Labor	5,629,353	17,289,168	5,770,005	17,646,944
Restaurant operating expenses	4,352,160	12,757,637	4,295,854	12,817,626
General and administrative	1,242,827	3,715,880	1,211,898	3,710,822
Depreciation and amortization	537,796	1,654,290	650,686	1,964,120
Restaurant closure expense	16,838	16,838	6,666	9,491
Loss on sale of property and equipment	1,178	10,343	658	26,452
	16,526,006	50,044,037	16,906,609	51,166,974
Operating income	116,737	960,216	125,958	853,806
Other income (expense):				
Interest income	2,966	9,313	4,958	6,578
Interest expense	(24,218)	(80,320)	(30,769)	(115,817)
Other, net	(7,684)	1,318	13,248	25,343
	(28,936)	(69,689)	(12,563)	(83,896)
Income before income taxes	87,801	890,527	113,395	769,910
Income tax benefit (expense)	73,294	(40,813)	1,966	(47,588)
Net income	$ 161,095	$ 849,714	$ 115,361	$ 722,322

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

	Preferred Stock	APIC-PS	Common Stock	APIC-CS	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balances at December 30, 2012	$9,081	$1,003,628	$47,327	$18,273,317	$2,191,819	($11,086,557)	$10,438,615
Dividends on preferred stock	558	92,558			(93,116)		-
Stock based compensation expense				14,701			14,701
Issuance of common stock for vested restricted stock				(66,450)		66,450	-
Net income					849,714		849,714
Balances at September 29, 2013	$9,639	$1,096,186	$47,327	$18,221,568	$2,948,417	($11,020,107)	$11,303,030

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

Cash flows from operating activities:	39-Week Period Ended Sep 29, 2013	39-Week Period Ended Sep 30, 2012
Net income	$ 849,714	$ 722,322
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,654,290	1,964,120
Deferred gain amortization	(93,352)	(156,106)
Restaurant closure expense	16,838	9,491
Loss on sale of property & equipment	10,343	26,452
Stock based compensation expense	14,701	70,130
Deferred income tax benefit	(127,638)	(58,378)
Changes in operating assets and liabilities:		
Royalties receivable	16,582	38,335
Other receivables	34,927	3,760
Inventory	10,656	(9,449)
Income taxes payable	26,451	(31,737)
Prepaid and other current assets	(72,246)	120,060
Other assets	(114,990)	1,101
Accounts payable	121,772	(7,119)
Accrued expenses and other liabilities	(154,896)	(17,557)
Liabilities associated with leasing and exit activities	(157,568)	(92,281)
Deferred rent	(142,451)	(153,443)
Total adjustments	1,043,418	1,707,379
Net cash provided by continuing operations	1,893,133	2,429,701
Net cash provided by discontinued operations	26,071	35,963
Net cash provided by operating activities	1,919,204	2,465,664
Cash flows from investing activities:		
Purchase of property and equipment	(2,565,621)	(1,423,472)
Proceeds from sale of property and equipment	-	2,450
Net cash used in investing activities	(2,565,621)	(1,421,022)
Cash flows from financing activities:		
Borrowings under line of credit agreement	500,000	500,000
Payments under line of credit agreement	(1,000,000)	(1,500,000)
Borrowings under mortgage agreement	758,978	-
Net cash provided by (used in) financing activities	258,978	(1,000,000)
Net increase (decrease) in cash	(387,439)	44,642
Cash at beginning of period	1,249,409	804,816
Cash at end of period	$ 861,970	$ 849,458
Supplemental disclosure of cash flow information:		
Cash paid during the period:		
Interest	$ 65,501	$ 103,207
Income taxes	$ 142,000	$ 159,792

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO INTERIM 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 29, 2013, and the consolidated statements of operations and cash flows for the 13-week and 39-week periods ended September 29, 2013 and September 30, 2012. The consolidated statements of operations for the 13-week and 39-week periods ended September 29, 2013 and September 30, 2012 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 December 30, 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 December 30, 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 29, 2013 and September 30, 2012.

4. Long term debt

The Company entered into a credit agreement (the "Agreement") with a financial institution on June 28, 2013 which provided for a revolving credit note of up to $3 million and a development credit note of up to $1.5 million. At management's option, the credit notes bear 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 credit notes from the date of the Agreement. As of September 29, 2013, the Company's outstanding debt to the financial institution was $1.5 million and the entire balance matures on June 29, 2016. Under the 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 29, 2013.

In November 2012, the Company requested and received from its financial institution a limited waiver and consent amendment to its then existing loan agreement in order to build a new restaurant in Pasadena, Texas. As allowed by the amendment, the Company negotiated a loan with another financial institution for the construction of the new restaurant. The balance of the loan was $758,978 as of September 29, 2013. The loan allows for draws during the construction process with interest only payments during the first twelve months at LIBOR plus a stipulated percentage.

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 29, 2013, the Company recognized royalty income of approximately $5,100 and $16,400, respectively, related to this restaurant. For the 13-week and 39-week periods ended September 30, 2012, the Company recognized royalty income of approximately $5,500 and $16,400, respectively, related to this restaurant.

6. Discontinued operations and leasing exit activities

The assets and liabilities for all units that have been disposed of, either individually or in the aggregate, have been reclassified to assets related to discontinued operations, other assets related to discontinued operations or to liabilities associated with leasing and exit activities in the consolidated balance sheets.

As of September 29, 2013 and December 30, 2012, assets related to discontinued operations of $29,574 and $55,645 consisted of rents receivable from a subleased restaurant that ceased operations. 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.

As of September 29, 2013, current liabilities related to leasing and exit activities consisted of (i) $27,778 related to a non-interest bearing note payable made in 2011 to exit a lease (discussed in the following paragraph), and (ii) $7,132 related to costs incurred for the closure of an underperforming company-operated restaurant in December 2012.

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 and contains a penalty clause that increases the principal to $600,000 if the Company defaults on the note. As of September 29, 2013 and September 30, 2012, the Company owed $27,778 and $77,778 for this obligation. The balance of the obligation matures in February 2014.

7. Company-operated restaurant activities

The Company's primary source of revenues is the sale of food and beverages at company-operated restaurants. All of the company-operated restaurant sites are leased. Real estate for company-operated restaurants is typically leased under triple net leases that require the Company to pay real estate taxes and utilities, to maintain insurance with respect to the premises and in certain cases to pay contingent rent based on sales in excess of specified amounts. Generally the non-mall locations for the company-operated restaurants have initial terms of 10 to 20 years with renewal options. Two underperforming Casa Olé company-operated locations were closed during second quarter 2013. As of September 29, 2013, company-operated locations consisted of 48 restaurants.

8. Franchisee-operated restaurant activities

The Company also derives revenues from franchise fees, royalties and other franchise-related activities. The Company currently has six Casa Olé franchisees operating a total of 10 restaurants and one licensee operating one Monterey's restaurant. One underperforming Casa Olé franchise location was closed during first quarter 2013.

9. Subsequent events

During late-October 2013, the Company closed two Casa Ole restaurants located in Pasadena, Texas and opened a new Casa Ole in the same city in early-November. On the last day of October 2013, the Company closed one underperforming Mission Burrito restaurant. Management has evaluated subsequent events through November 15, 2013, the date which the financial statements were available to be issued.