MEXICAN RESTAURANTS, INC.

Unaudited Interim Consolidated Financial Statements and Footnotes

October 2, 2011

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	(unaudited) 10/2/2011	1/2/2011
ASSETS		
Current assets:		
Cash	$ 363,292	$ 319,449
Royalties receivable	127,050	101,800
Other receivables, net	737,994	457,933
Inventory	519,832	538,636
Prepaid expenses and other current assets	933,494	938,310
Assets related to discontinued operations, net	100,000	100,000
Total current assets	2,781,662	2,456,128
Property and equipment, net	13,836,059	14,921,126
Deferred tax assets	4,188,945	3,899,704
Other assets	207,625	162,770
Other assets related to discontinued operations	33,878	33,878
Total assets	$ 21,048,169	$ 21,473,606
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,480,049	$ 2,388,605
Accrued sales and liquor taxes	104,099	80,565
Accrued payroll and taxes	768,042	723,170
Accrued expenses	940,587	990,640
Income taxes payable	80,433	102,803
Current liabilities related to discontinued operations	-	3,180
Current portion of liabilities associated with leasing and exit activities	144,580	222,914
Total current liabilities	4,517,790	4,511,877
Long-term debt	3,250,000	4,400,000
Liabilities associated with leasing and exit activities, net of current portion	142,847	247,671
Deferred gain	364,250	520,357
Other liabilities	1,843,961	1,951,799
Total liabilities	10,118,848	11,631,704
Commitments and contingencies	-	-
Stockholders' equity:		
Series A Convertible Preferred stock, $.01 par value, 1,000,000 shares authorized, 822,211 shares issued and outstanding	8,223	-
Additional paid-in capital-preferred stock	949,589	-
Common stock, $0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued, 3,451,599 and 3,413,099 shares outstanding at 10/2/2011 and 1/2/2011, respectively	47,327	47,327
Additional paid-in capital-common stock	18,499,631	18,716,827
Warrants Outstanding	72,176	-
Retained earnings	2,704,732	2,771,215
Treasury stock at cost, 1,281,106 and 1,319,606 common shares at 10/2/2011 and 1/2/2011, respectively	(11,352,357)	(11,693,467)
Total stockholders' equity	10,929,321	9,841,902
Total liabilities and stockholders' equity	$ 21,048,169	$ 21,473,606

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

	13-Week Period Ended 10/2/2011	39-Week Period Ended 10/2/2011	13-Week Period Ended 10/3/2010	39-Week Period Ended 10/3/2010
Revenues:				
Restaurant sales	$ 16,836,892	$ 50,618,401	$ 16,474,078	$ 50,248,295
Franchise fees, royalties and other	97,983	368,769	125,138	366,826
	16,934,875	50,987,170	16,599,216	50,615,121
Costs and expenses:				
Cost of sales	5,062,440	15,022,459	4,865,024	14,764,153
Labor	5,665,550	17,356,798	5,759,678	17,311,669
Restaurant operating expenses	4,290,982	12,449,880	4,305,142	13,077,526
General and administrative	1,275,831	3,995,027	1,315,856	4,015,568
Depreciation and amortization	585,291	2,180,887	848,442	2,569,588
Impairment and restaurant closure expense	-	-	9,817	21,235
Loss on sale of property and equipment	11,634	43,619	10,922	24,300
	16,891,728	51,048,670	17,114,881	51,784,039
Operating income (loss)	43,147	(61,500)	(515,665)	(1,168,918)
Other income (expense):				
Interest income	541	1,606	541	12,887
Interest expense	(52,589)	(174,115)	(54,635)	(161,003)
Other, net	6,342	11,343	6,000	30,513
	(45,706)	(161,166)	(48,094)	(117,603)
Loss from continuing operations before income taxes	(2,559)	(222,666)	(563,759)	(1,286,521)
Income tax benefit	51,385	186,171	115,717	440,525
Income (loss) from continuing operations	48,826	(36,495)	(448,042)	(845,996)
Discontinued Operations:				
Restaurant closure expense	-	-	-	(181,543)
Loss from discontinued operations before income taxes	-	-	-	(181,543)
Income tax benefit	-	-	-	77,827
Loss from discontinued operations	-	-	-	(103,716)
Net income (loss)	$ 48,826	$ (36,495)	$ (448,042)	$ (949,712)

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

	Preferred Stock	APIC-PS	Common Stock	APIC-CS	Warrants o/s	Retained Earnings	Treasury Stock	Total Stockholders' equity
Balances at January 2, 2011	-	-	47,327	18,716,827	-	2,771,215	(11,693,467)	9,841,902
								-
Proceeds from issuance of preferred stock and warrants, net of transaction fees	8,223	949,589			72,176	(29,988)		1,000,000
								-
Issuance of common stock for vested restricted stock				(341,110)			341,110	-
								-
Stock based compensation expense				123,914				123,914
								-
Net loss						(36,495)		(36,495)
Balances at October 2, 2011	8,223	949,589	47,327	18,499,631	72,176	2,704,732	(11,352,357)	10,929,321

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

	39-Week Period Ended 10/2/2011	39-Week Period Ended 10/3/2010
Cash flows from operating activities:		
Net loss	$ (36,495)	$ (949,712)
Loss from discontinued operations	-	103,716
Loss from continuing operations	(36,495)	(845,996)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,180,887	2,569,588
Deferred gain amortization	(156,107)	(156,107)
Impairment and restaurant closure expense	-	21,235
Other non-cash income	-	(16,454)
Loss on sale of property & equipment	43,619	24,300
Stock based compensation expense	123,914	128,811
Excess tax expense - stock based compensation expense	-	30,564
Deferred income tax benefit	(289,241)	(558,937)
Changes in operating assets and liabilities, net of effects of business acquisitions:		
Royalties receivable	(25,250)	(36,918)
Other receivables	(280,061)	63,413
Inventory	18,804	13,847
Income taxes receivable/payable	(22,370)	445,082
Prepaid and other current assets	4,816	108,878
Other assets	(53,645)	(18,920)
Accounts payable	91,444	552,979
Accrued expenses and other liabilities	18,353	(235,394)
Liabilities associated with leasing and exit activities	(183,158)	(94,643)
Deferred rent and other long-term liabilities	(107,838)	(87,064)
Total adjustments	1,364,167	2,754,260
Net cash provided by continuing operations	1,327,672	1,908,264
Net cash used in discontinued operations	(3,180)	(104,121)
Net cash provided by operating activities	1,324,492	1,804,143
Cash flows from investing activities:		
Purchase of property and equipment	(1,134,519)	(1,640,857)
Proceeds from sale of property and equipment	3,870	7,024
Net cash used in continuing operations	(1,130,649)	(1,633,833)
Net cash used in investing activities	(1,130,649)	(1,633,833)
Cash flows from financing activities:		
Borrowings under line of credit agreement	-	1,250,000
Payments under line of credit agreement	(1,150,000)	(2,000,000)
Proceeds from issuance of preferred stock and warrants, net of transaction fees	1,000,000	-
Issuance of common stock from treasury	-	277,972
Excess tax expense-stock-based compensation expense	-	(30,564)
Net cash used in financing activities	(150,000)	(502,592)
Net increase (decrease) in cash	43,843	(332,282)
Cash at beginning of period	319,449	719,944
Cash at end of period	$ 363,292	$ 387,662
Supplemental disclosure of cash flow information:		
Cash paid during the period:		
Interest	$ 161,910	$ 145,553
Income taxes	$ 136,000	$ 275,418

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 October 2, 2011, and the consolidated statements of operations and cash flows for the 13-week and 39-week periods ended October 2, 2011 and October 3, 2010. The consolidated statements of operations for the 13-week and 39-week periods ended October 2, 2011 and October 3, 2010 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 2, 2011. 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

As of October 2, 2011, the Company had one equity-based compensation plan from which stock-based compensation awards can be granted to eligible employees, officers and directors, known as the 2005 Long Term Incentive Plan. A total of 425,000 shares have been authorized for issuance under this plan. The Company's 1996 Long Term Incentive Plan, its Stock Option Plan for Non-Employee Directors and its 1996 Manager's Stock Option Plan have each terminated in accordance with its terms, but there are still options which remain exercisable under these plans until the earlier of ten years from the date of grant or no more than 90 days after the optionee ceases to be an employee of the Company. These Company plans are described in more detail in Notes 3 of the "Audited Consolidated Financial Statements and Footnotes" for the fiscal year ended January 2, 2011.

On May 24, 2010, restricted stock grants in the amount of 10,000 shares to the Company's President were granted pursuant to a May 22, 2007 agreement, with such shares vesting over a four-year period.

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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 October 2, 2011 and October 3, 2010.

4. Long term debt

The Company entered into a Credit Agreement with Wells Fargo Bank, N.A. ("Wells Fargo") in June 2007 (as amended, the "Wells Fargo Agreement"). The Company was in compliance with all debt covenants of the Wells Fargo Agreement as of October 2, 2011.

The Company entered into a forbearance agreement with Wells Fargo on December 9, 2010. The forbearance agreement was effective from November 17, 2010 through January 31, 2011. Concurrent with the forbearance agreement, the Wells Fargo Agreement was amended primarily to reduce the revolver availability to $5.5 million effective November 17, 2010. On January 20, 2011, the forbearance agreement was amended to extend the forbearance period until February 15, 2011.

The Wells Fargo Agreement was amended on April 8, 2011. Under this amendment, Wells Fargo agreed to waive the third and fourth quarter 2010 defaults subject to amended terms and conditions to the Credit Agreement. The amended terms and conditions primarily include the following changes to the Credit Agreement: (1) the loan maturity date was extended to June 29, 2013, (2) the maximum available credit was reduced to $4,725,000 and will continue to be reduced by $275,000 on the first day of each fiscal quarter beginning July 4, 2011, (3) the rate for borrowing was increased, (4) the calculation of certain financial ratios was redefined and a new financial ratio was added, (5) the measurement periods and certain financial ratio limits were redefined and, (6) a $1,000,000 capital contribution was required.

On April 18, 2011, the Company paid $800,000 on its Wells Fargo line of credit. Cash proceeds from the issuance of the Series A Convertible Preferred Stock (discussed in footnote 5 below) was used to make the principal debt payment. On June 27, 2011 the Company paid $50,000 on its Wells Fargo line of credit. On July 29, 2011 the Company paid $150,000 on its Wells Fargo line of credit. On August 25, 2011 the Company paid $150,000 on its Wells Fargo line of credit. As of October 2, 2011, the Company's outstanding debt to Wells Fargo Bank was approximately $3.25 million.

At management's option, the revolving loan bears an interest rate equal to the Wells Fargo 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 Wells Fargo Agreement.

5. Sale of unregistered securities

On April 11, 2011, the Company received $1,000,000 in cash in exchange for 800,000 Series A Convertible Preferred Stock shares and non-transferable share warrants to purchase up to 125,000 common stock shares. The equity contribution was made pursuant to resolutions adopted by the Board of Directors on February 4, 2011. The Series A Convertible Preferred Stock has a par value of $.01 per share and a stated value of $1.25 per share and may be converted to Common Stock on a one-for-one basis. Dividends accrue at 8% per annum on the preferred stock with payment dates occurring on or before May 15, 2013 to be paid by issuing additional shares of Series A Convertible Preferred stock in lieu of cash. The holders of the Series A Convertible Preferred stock have voting rights provided by the Texas Business Organization Code as well as additional rights as defined in the designating resolutions. The non-transferable share warrants have an exercise price of $2.00 per share.

6. 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 periods ended October 2, 2011 and October 3, 2010, the Company recognized royalty income of $5,174 and $5,527, respectively, related to this restaurant. For the 39-week periods ended October 2, 2011 and October 3, 2010, the Company recognized royalty income of $16,355 and $16,863, respectively, related to this restaurant.

On March 31, 2010, the Company sold 113,458 shares of common stock from its treasury shares to Michael D. Domec, a director of the Company and the largest shareholder, for $277,972 or $2.45 per share. The per share price was based upon a weighted average based on the preceding 30 days, and the transaction was exempt from registration under Section 4(2) of the Securities Act of 1933. The Company used the proceeds to pay on its line of credit under the Wells Fargo Agreement.

7. Discontinued operations and leasing exit activities

The results of operations, assets and liabilities for all units that have been disposed of, 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.

As of October 2, 2011, assets related to discontinued operations of $100,000 consisted of rent receivable from a subleased restaurant that has 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.

Current and long-term liabilities related to leasing and exit activities consisted primarily of accrued closure costs related to two non-interest bearing notes payable made in 2011 to exit two leases (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 February 22, 2011, the Company entered into a "Promissory Note" along with a "Settlement and Release Agreement" to exit the lease related to a store that was closed in November 2010. This $150,000 non-interest bearing promissory note is included in liabilities associated with leasing and exit activities. A down payment of $40,000 was made on February 22, 2011 and the remaining balance of $110,000 is payable in twelve equal monthly installments beginning March 1, 2011.

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.

During the 39-week period ended October 3, 2010, the Company recognized $181,543 of restaurant closure costs related to the same store discussed in the preceding paragraph.

8. Franchisee activities

During the 39-week period ended October 2, 2011, three underperforming franchisee-operated Casa Ole restaurants representing approximately 9% of annualized royalties were closed. As of October 2, 2011, the Company had seven Casa Ole franchisees operating a total of 13 restaurants.

9. Subsequent events

The Company evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are available for issuance for either recognition or disclosure. The Company evaluated its financial statements for subsequent events through November 2, 2011, the date the financial statements were available for issuance. On October 3, 2011, the Company closed one underperforming Crazy Jose's restaurant.