

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2007

OR

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

Commission File Number: 001-33174

CARROLS RESTAURANT GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-1287774
(I.R.S. Employer
Identification No.)

968 James Street
Syracuse, New York
(Address of principal executive office)

13203
(Zip Code)

Registrant's telephone number, including area code: (315) 424-0513

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:
Common Stock, Carrols Restaurant Group, Inc.,
par value \$.01 per share

Name on each exchange on which registered:
The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Commission File Number: 0-25629

CARROLS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-0958146
(I.R.S. Employer
Identification Number)

968 James Street
Syracuse, New York
(Address of principal executive offices)

13203
(Zip Code)

Registrant's telephone number including area code: (315) 424-0513

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

Carrols Corporation meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form with reduced disclosure format pursuant to General Instruction H(2) of Form 10-Q.

Indicate by check mark whether either of the registrants (1) have 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 were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, or non-accelerated filers. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act, (Check one):

Large accelerated filers Accelerated filers Non-accelerated filers

Indicate by check mark whether either of the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act) Yes No

As of November 2, 2007, Carrols Restaurant Group, Inc. had 21,550,827 shares of its common stock, \$.01 par value outstanding. As of November 2, 2007, all outstanding equity securities of Carrols Corporation, which consisted of 10 shares of its common stock, were owned by Carrols Restaurant Group, Inc.

[Table of Contents](#)

CARROLS RESTAURANT GROUP, INC.
FORM 10-Q
QUARTER ENDED SEPTEMBER 30, 2007

	<u>Page</u>
PART I FINANCIAL INFORMATION	
Item 1 Carrols Restaurant Group, Inc. and Subsidiary - Consolidated Financial Statements (unaudited):	
Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006	3
Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2007 and 2006	4
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2007 and 2006	5
Notes to Consolidated Financial Statements	6
Carrols Corporation and Subsidiaries - Consolidated Financial Statements (unaudited):	
Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006	17
Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2007 and 2006	18
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2007 and 2006	19
Notes to Consolidated Financial Statements	20
Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations	40
Item 3 Quantitative and Qualitative Disclosures About Market Risk	56
Item 4 Controls and Procedures	57
PART II OTHER INFORMATION	
Item 1 Legal Proceedings	57
Item 1A Risk Factors	57
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds	57
Item 3 Default Upon Senior Securities	57
Item 4 Submission of Matters to a Vote of Security Holders	57
Item 5 Other Information	57
Item 6 Exhibits	58

PART I—FINANCIAL INFORMATION

ITEM 1—INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars, except share and per share amounts)
(Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,622	\$ 3,939
Trade and other receivables	4,720	5,364
Inventories	4,939	4,677
Prepaid rent	2,755	4,130
Prepaid expenses and other current assets	6,990	5,367
Refundable income taxes	—	2,806
Deferred income taxes	4,549	4,539
Total current assets	31,575	30,822
Property and equipment, net	195,121	182,742
Franchise rights, net (Note 4)	80,856	83,268
Goodwill (Note 4)	124,934	124,934
Intangible assets, net (Note 4)	959	1,175
Franchise agreements, at cost less accumulated amortization of \$5,562 and \$5,431, respectively	5,683	5,793
Deferred income taxes	11,445	11,136
Other assets	12,181	12,989
Total assets	<u>\$ 462,754</u>	<u>\$ 452,859</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Current portion of long-term debt (Note 5)	\$ 1,654	\$ 2,477
Accounts payable	21,068	17,860
Accrued interest	3,539	7,861
Accrued payroll, related taxes and benefits	17,670	18,445
Accrued income taxes payable	331	—
Accrued real estate taxes	4,037	4,102
Other liabilities	11,791	10,623
Total current liabilities	60,090	61,368
Long-term debt, net of current portion (Note 5)	300,881	297,432
Lease financing obligations (Note 9)	54,393	58,571
Deferred income—sale-leaseback of real estate	30,428	31,391
Accrued postretirement benefits (Note 8)	6,948	6,370
Other liabilities (Note 7)	23,196	23,494
Total liabilities	475,936	478,626
Commitments and contingencies (Note 12)		
Stockholders' deficit:		
Preferred stock, par value \$.01; authorized 20,000,000 shares, issued and outstanding--none	—	—
Voting common stock, par value \$.01; authorized 100,000,000 shares, issued and outstanding—21,550,827 shares at both dates	216	216
Additional paid-in capital	(2,061)	(3,108)
Accumulated deficit	(10,195)	(21,733)
Accumulated other comprehensive loss	(1,001)	(1,001)
Treasury stock, at cost	(141)	(141)
Total stockholders' deficit	(13,182)	(25,767)
Total liabilities and stockholders' deficit	<u>\$ 462,754</u>	<u>\$ 452,859</u>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(In thousands of dollars, except share and per share amounts)
(Unaudited)

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Revenues:				
Restaurant sales	\$ 203,181	\$ 189,254	\$ 591,164	\$ 561,719
Franchise royalty revenues and fees	328	343	997	1,002
Total revenues	<u>203,509</u>	<u>189,597</u>	<u>592,161</u>	<u>562,721</u>
Costs and expenses:				
Cost of sales	58,866	53,000	169,062	158,299
Restaurant wages and related expenses (including stock- based compensation expense of \$45, \$0, \$121 and \$0, respectively)	59,519	55,047	174,029	164,007
Restaurant rent expense	11,101	9,004	32,687	27,183
Other restaurant operating expenses	30,276	28,577	86,230	82,466
Advertising expense	7,458	6,608	24,442	20,768
General and administrative (including stock-based compensation expense of \$314, \$0, \$ 947 and \$0, respectively)	12,327	11,841	38,778	36,192
Depreciation and amortization	8,107	8,397	23,685	25,177
Impairment losses (Note 3)	1,810	588	1,879	832
Other income (Note 10)	(303)	(1,389)	(650)	(1,389)
Total operating expenses	<u>189,161</u>	<u>171,673</u>	<u>550,142</u>	<u>513,535</u>
Income from operations	14,348	17,924	42,019	49,186
Interest expense	7,690	10,216	23,647	34,616
Loss on extinguishment of debt (Note 5)	—	—	1,485	—
Income before income taxes	6,658	7,708	16,887	14,570
Provision for income taxes (Note 6)	1,795	2,580	5,349	4,828
Net income	<u>\$ 4,863</u>	<u>\$ 5,128</u>	<u>\$ 11,538</u>	<u>\$ 9,742</u>
Basic and diluted net income per share (Note 13)	<u>\$ 0.23</u>	<u>\$ 0.32</u>	<u>\$ 0.54</u>	<u>\$ 0.61</u>
Basic weighted average common shares outstanding (Note 13)	21,550,827	15,887,186	21,550,827	15,892,329
Diluted weighted average common shares outstanding (Note 13)	21,555,020	15,887,186	21,559,524	15,892,329

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(In thousands of dollars)
(Unaudited)

	2007	2006
Cash flows provided from operating activities:		
Net income	\$ 11,538	\$ 9,742
Adjustments to reconcile net income to net cash provided from operating activities:		
Gain on disposals of property and equipment	(57)	—
Stock-based compensation expense	1,068	—
Depreciation and amortization	23,685	25,177
Amortization of deferred financing costs	940	1,098
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,460)	(897)
Impairment losses	1,879	832
Gain on settlements of lease financing obligations	(163)	(120)
Accretion of interest on lease financing obligations	397	281
Deferred income taxes	(319)	159
Loss on extinguishment of debt	1,485	—
Changes in other operating assets and liabilities	3,987	2,196
Net cash provided from operating activities	41,364	36,852
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,241)	(20,370)
Restaurant remodeling	(5,850)	(4,885)
Other restaurant capital expenditures	(6,825)	(5,478)
Corporate and restaurant information systems	(1,840)	(1,324)
Total capital expenditures	(40,756)	(32,057)
Properties purchased for sale-leaseback	(2,461)	(2,663)
Proceeds from sale-leaseback transactions	7,036	31,693
Proceeds from sales of other properties	1,623	—
Net cash used for investing activities	(34,558)	(3,027)
Cash flows used for financing activities:		
Repayment of term loans under prior credit facility	(118,400)	—
Borrowings on revolving credit facility	45,500	—
Repayments on revolving credit facility	(44,300)	—
Proceeds from new senior credit facility	120,000	—
Scheduled principal payments on term loans	—	(1,650)
Principal pre-payments on term loans	—	(23,200)
Principal payments on capital leases	(262)	(305)
Expenses from initial public offering	(21)	—
Financing costs associated with issuance of debt	(1,228)	—
Settlement of lease financing obligations	(4,412)	(15,215)
Net cash used for financing activities	(3,123)	(40,370)
Net increase (decrease) in cash and cash equivalents	3,683	(6,545)
Cash and cash equivalents, beginning of period	3,939	9,331
Cash and cash equivalents, end of period	\$ 7,622	\$ 2,786
Supplemental disclosures:		
Interest paid on long-term debt	\$ 22,932	\$ 24,752
Interest paid on lease financing obligations	\$ 3,700	\$ 8,665
Increase (decrease) in accruals for capital expenditures	\$ (348)	\$ 601
Income taxes paid, net	\$ 3,064	\$ 2,753
Non-cash reduction of assets under lease financing obligations due to lease amendments	\$ —	\$ 24,707
Non-cash reduction of lease financing obligations due to lease amendments	\$ —	\$ 37,544
Capital lease obligations incurred	\$ 88	\$ —

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands of dollars except share and per share amounts)

1. Basis of Presentation

Basis of Consolidation. The unaudited consolidated financial statements presented herein include the accounts of Carrols Restaurant Group, Inc. (“Carrols Restaurant Group” or the “Company”) and its wholly-owned subsidiary Carrols Corporation (“Carrols”). Carrols Restaurant Group is a holding company and conducts all of its operations through Carrols and its wholly-owned subsidiaries. Unless the context otherwise requires, Carrols Restaurant Group, Carrols and the direct and indirect subsidiaries of Carrols are collectively referred to as the “Company.” All intercompany transactions have been eliminated in consolidation.

The difference between the consolidated financial statements of Carrols Restaurant Group and Carrols is primarily due to additional rent expense of approximately \$6 per year for Carrols Restaurant Group and the composition of stockholders’ deficit.

Business Description. At September 30, 2007 the Company operated, as franchisee, 325 quick-service restaurants under the trade name “Burger King” in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2007, the Company also owned and operated 83 Pollo Tropical restaurants of which 80 were located in Florida and three were located in the New York City metropolitan area and franchised a total of 27 Pollo Tropical restaurants, consisting of 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2007, the Company owned and operated 147 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico and one in Georgia.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 31, 2006 and January 1, 2006 will be referred to as the fiscal years ended December 31, 2006 and 2005, respectively. Similarly, all references herein to the three and nine months ended September 30, 2007 and October 1, 2006 will be referred to as the three and nine months ended September 30, 2007 and September 30, 2006, respectively. The years ended December 31, 2006 and 2005 each contained 52 weeks and the three and nine months ended September 30, 2007 and 2006 contained 13 and 39 weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2007 and 2006 have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission and do not include certain of the information and the footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of such financial statements have been included. The results of operations for the three and nine months ended September 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2006 contained in the Company’s 2006 Annual Report on Form 10-K. The December 31, 2006 balance sheet data is derived from those audited financial statements.

Use of Estimates. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Significant items subject to such estimates include: accrued occupancy costs, insurance liabilities, legal obligations, income taxes, evaluation for impairment of goodwill, long-lived assets and Burger King franchise rights, lease accounting matters and stock-based compensation. Actual results could differ from those estimates.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

2. Stock-Based Compensation

The Company adopted an incentive stock plan in 2006 (the "2006 Plan") under which incentive stock options, non-qualified stock options and restricted shares may be granted to employees and non-employee directors. In December 2006, the Company granted incentive stock options, non-qualified stock options and restricted shares under the 2006 Plan. The stock options granted to employees generally vest 20% per year and expire seven years from the date of grant. Restricted shares granted to employees generally vest 33% per year for three years and restricted shares granted to non-employee directors generally vest at 20% per year.

Stock-based compensation related to these grants was \$0.4 million and \$1.1 million in the three and nine months ended September 30, 2007, respectively and the income tax benefit recognized in the consolidated statement of operations for stock-based compensation was \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2007, respectively. There were no stock options issued or stock-based compensation expense recorded in the three or nine months ended September 30, 2006.

As of September 30, 2007, the total non-vested stock-based compensation expense relating to the stock options and restricted stock was approximately \$4.5 million and the Company expects to record an additional \$0.4 million as compensation expense for the remainder of 2007. The remaining weighted average vesting period for the stock options is 3.64 years and for the restricted shares is approximately 2.77 years at September 30, 2007.

Stock Options

A summary of all option activity for the nine months ended September 30, 2007 was as follows:

	2006 Plan			Aggregate Intrinsic Value (in thousands) (1)
	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Life	
Options outstanding at January 1, 2007	1,241,750	\$ 14.30		
Options granted	10,500	15.81		
Options forfeited	(25,800)	14.30		
Options outstanding at September 30, 2007	<u>1,226,450</u>	\$ 14.31	6.26	\$ —
Expected to vest at September 30, 2007	<u>1,210,360</u>	\$ 14.31	6.26	\$ —
Options exercisable at September 30, 2007	<u>—</u>	\$ —	—	\$ —

- (1) The aggregate intrinsic value was calculated using the difference between the market price of the Company's common stock at September 30, 2007 and the exercise price for only those awards that have an exercise price that is less than the market price of the Company's common stock at September 30.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2007 was as follows:

	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at January 1, 2007	75,800	\$ 13.00
Shares granted	8,200	\$ 14.58
Shares forfeited	(5,700)	\$ 13.05
Nonvested at September 30, 2007	<u>78,300</u>	\$ 13.16

The fair value of restricted shares granted is determined based on the Company's closing stock price on the date of grant.

3. Impairment of Long-Lived Assets

The Company reviews its long-lived assets, principally property and equipment, for impairment at the restaurant level. If an indicator of impairment exists for any of its assets, an estimate of undiscounted future cash flows from the related long-lived assets is compared to that long-lived asset's carrying value. If the carrying value is greater than the undiscounted cash flow, the Company then determines the fair value of the asset. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value.

During the third quarter of 2007 the Company impaired an underperforming Pollo Tropical restaurant located in Brooklyn, New York for \$1.7 million. This restaurant was subsequently closed in the fourth quarter of 2007.

For the three and nine months ended September 30, 2007 and 2006, the Company recorded impairment losses on long-lived assets for its segments as follows:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Burger King	\$ 54	\$ —	\$ 68	\$ 224
Pollo Tropical	1,657	—	1,657	—
Taco Cabana	99	588	154	608
	<u>\$ 1,810</u>	<u>\$ 588</u>	<u>\$ 1,879</u>	<u>\$ 832</u>

4. Goodwill, Franchise Rights and Intangible Assets

Goodwill. Goodwill is reviewed for impairment annually, or more frequently when events and circumstances indicate that the carrying amounts may be impaired. The Company performs its annual impairment assessment as of December 31 and does not believe circumstances have changed since the last assessment date which would make it necessary to reassess their values. Goodwill balances are summarized below:

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Burger King</u>	<u>Total</u>
Goodwill at September 30, 2007 and December 31, 2006	\$56,307	\$67,177	\$1,450	\$124,934

Burger King Franchise Rights. Amounts allocated to franchise rights for each Burger King acquisition are amortized using the straight-line method over the average remaining term of the acquired franchise agreements at January 1, 2002 plus one twenty-year renewal period. The Company assesses the potential impairment of franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If an indicator of impairment exists, an estimate of the aggregate undiscounted future cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each Burger King acquisition. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value. There were no impairment charges related to franchise rights for the three and nine months ended September 30, 2007 and 2006.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

Amortization expense related to Burger King franchise rights was \$805 and \$804 for the three months ended September 30, 2007 and 2006, respectively. Amortization expense related to Burger King franchise rights was \$2,412 for both of the nine months ended September 30, 2007 and 2006, respectively. The estimated amortization expense for the year ending December 31, 2007 and for each of the five succeeding years is \$3,216.

Intangible Assets. The Company acquired four Taco Cabana restaurants from a franchisee in 2005. Under Emerging Issues Task Force Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination" ("EITF 04-1"), certain reacquired rights, including the right to the acquirer's trade name, are required to be recognized as intangible assets apart from goodwill. The Company allocated \$1.6 million of the purchase price to this intangible asset. The Company recorded amortization expense relating to the intangible asset of approximately \$72 for each of the three months ended September 30, 2007 and 2006, respectively. Amortization for each of the nine months ended September 30, 2007 and 2006 was \$216. The Company expects the annual amortization expense for the year ending December 31, 2007 and for each of the five years ending 2008 through 2012 to be \$289, \$211, \$133, \$125, \$117 and \$99, respectively.

	<u>September 30, 2007</u>		<u>December 31, 2006</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Intangible assets	\$ 1,610	\$ 651	\$ 1,610	\$ 435

5. Long-Term Debt

Long-term debt at September 30, 2007 and December 31, 2006 consisted of the following:

	<u>September 30, 2007</u>	<u>December 31, 2006</u>
Collateralized:		
Revolving Credit facility	\$ 1,200	\$ —
Senior Credit Facility-Term loan B facility	—	118,400
Senior Credit Facility-Term loan A facility	120,000	
Unsecured:		
9% Senior Subordinated Notes	180,000	180,000
Capital leases	1,335	1,509
	<u>302,535</u>	<u>299,909</u>
Less: current portion	(1,654)	(2,477)
	<u>\$ 300,881</u>	<u>\$ 297,432</u>

On March 9, 2007, Carrols terminated its senior credit facility and entered into a new senior credit facility with a syndicate of lenders. Carrols' new senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if Carrols' 9% Senior Subordinated Notes due 2013 are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all outstanding borrowings and other obligations under Carrols' prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. The Company also recorded a \$1.5 million loss on extinguishment of debt in the nine months ended September 30, 2007 for the write-off of deferred financing costs related to the prior senior credit facility.

Both term loan and revolving credit borrowings under the new senior credit facility bear interest at a per annum rate, at Carrols' option, of either:

- 1) the applicable margin ranging from 0% to 0.25% based on Carrols' senior leverage ratio (as defined in the new senior credit facility) plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or
- 2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on Carrols' senior leverage ratio.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

Term loan A borrowings shall be due and payable in quarterly installments, beginning on June 30, 2008 as follows:

- 1) four quarterly installments of \$1.5 million beginning on June 30, 2008;
- 2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;
- 3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and
- 4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the new senior credit facility, Carrols is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an amount up to 50% of Excess Cash Flow depending upon Carrols' Total Leverage Ratio (as such terms are defined in the new senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by Carrols therefrom, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, Carrols' obligations under the new senior credit facility are guaranteed by the Company and all of Carrols' material subsidiaries and are collateralized by a pledge of Carrols' common stock and the stock of each of Carrols' material subsidiaries. The new senior credit facility contains certain covenants, including, without limitation, those limiting the Carrols' ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of its business, engage in transactions with related parties, make certain investments or pay dividends. In addition, Carrols is required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the new senior credit facility). The Company was in compliance with the covenants under its senior credit facility as of September 30, 2007.

At September 30, 2007, \$120.0 million principal amount of term loan borrowings were outstanding under the term loan A facility and \$1.2 million of borrowings were outstanding under the revolving credit facility. After reserving \$16.0 million for letters of credit guaranteed by the facility, \$47.8 million was available for borrowings under the revolving credit facility at September 30, 2007.

On December 15, 2004, Carrols issued \$180 million of 9% Senior Subordinated Notes due 2013, which are referred to herein as the "senior subordinated notes". Restrictive covenants under the senior subordinated notes include limitations with respect to the Carrols' ability to issue additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. At both September 30, 2007 and December 31, 2006, \$180.0 million principal amount of the senior subordinated notes was outstanding.

6. Income Taxes

The income tax provision for the three and nine months ended September 30, 2007 and 2006 was comprised of the following:

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	2007	2006	2007	2006
Current	\$ 1,904	\$ 1,072	\$ 5,668	\$ 4,669
Deferred	(109)	1,508	(319)	159
	<u>\$ 1,795</u>	<u>\$ 2,580</u>	<u>\$ 5,349</u>	<u>\$ 4,828</u>

The provision for income taxes for the three and nine months ended September 30, 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5% as well as the effect of any discrete tax items occurring in those periods. In addition to the discrete tax adjustment discussed in the following paragraph, the Company also recorded in the three months ended September 30, 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards.

The Company adopted the provisions of Financial Standards Accounting Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", ("FIN 48"), an interpretation of FASB Statement No. 109 ("SFAS 109"), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in its consolidated financial statements. As of the adoption date of January 1, 2007, the Company had \$0.6 million of unrecognized

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.5 million of unrecognized tax benefits and \$0.1 million of accrued interest expired. The Company recorded this tax benefit as a discrete tax item in the third quarter of 2007. At September 30, 2007 the Company has no remaining unrecognized tax benefits. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2007, the Company had no accrued interest related to uncertain tax positions.

For the nine months ended September 30, 2007 the Company has recorded total discrete tax adjustments reducing income tax expense of \$0.8 million.

The provision for income taxes for the three and nine months ended September 30, 2006 was derived using an estimated effective annual income tax rate for 2006 of 33.5%. There were no discrete tax items affecting the provision for income taxes in the three and nine months ended September 30, 2006.

The tax years 2004-2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

On July 12, 2007, the Michigan Business Tax (the "MBT Act") was signed into law, which provides a comprehensive restructuring of Michigan's principal business taxes effective January 1, 2008. The MBT Act replaces the Michigan Single Business Tax that is scheduled to expire at the end of 2007. The effect of the MBT Act did not materially impact the Company's consolidated financial statements.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2007 and December 31, 2006 consisted of the following:

	September 30, 2007	December 31, 2006
Unearned purchase discounts	\$ 2,854	\$ 4,526
Accrued occupancy costs	9,476	8,683
Accrued workers' compensation costs	4,650	4,595
Other	6,216	5,690
	<u>\$ 23,196</u>	<u>\$ 23,494</u>

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At September 30, 2007 and December 31, 2006, the Company had \$0.6 million and \$0.7 million in lease liability reserves, respectively, for remaining locations that are included in accrued occupancy costs.

8. Postretirement Benefits

The Company provides postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management salaried employees. A December 31 measurement date is used for postretirement benefits.

The following summarizes the components of net periodic benefit cost:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Components of net periodic benefit cost:				
Service cost	\$ 124	\$ 118	\$ 370	\$ 354
Interest cost	101	85	304	251
Amortization of gains and losses	24	21	72	63
Amortization of unrecognized prior service cost	1	(8)	4	(22)
Net periodic postretirement benefit cost	<u>\$ 250</u>	<u>\$ 216</u>	<u>\$ 750</u>	<u>\$ 646</u>

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

During the three and nine months ended September 30, 2007, the Company made contributions of \$56 and \$172 to its postretirement plan to pay current benefits. The Company expects to make additional contributions during 2007.

On November 1, 2007 the Company amended its postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management personnel. The amendment included an elimination of life insurance benefits for active employees who retire after December 31, 2007 and increases in retiree contributions for both current and future retirees effective January 1, 2008. These amendments will reduce postretirement benefit obligations and costs beginning in the fourth quarter of 2007.

9. Lease Financing Obligations

The Company entered into sale-leaseback transactions in various years involving certain restaurant properties that did not qualify for sale-leaseback accounting and as a result, have been classified as financing transactions under Statement of Financial Accounting Standards ("SFAS") No. 98, "Accounting for Leases" ("SFAS 98"). Under the financing method, the assets remain on the Company's consolidated balance sheet and proceeds received by the Company from these transactions are recorded as a financing liability. Payments under these leases are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

During the second quarter of 2007, the Company exercised its right of first refusal under the leases for five restaurant properties previously accounted for as lease financing obligations and purchased these properties from the lessor. As a result, the Company reduced its lease financing obligations by \$4.4 million. The Company also recorded a gain of \$0.2 million as a reduction of interest expense which represented the net amount by which the lease financing obligations exceeded the purchase price of the restaurant properties acquired.

During the second and third quarters of 2006, the Company refinanced 14 restaurant properties previously accounted for as lease financing obligations and amended lease agreements for 34 restaurant properties to eliminate or otherwise cure the provisions that precluded the original sale-leaseback accounting. As a result of these transactions in 2006, the Company reduced its lease financing obligations by \$52.8 million, reduced its assets under lease financing obligations by \$36.2 million and recorded deferred gains of \$18.3 million which are being amortized as a reduction to rent expense over the remaining term of the underlying leases, which is generally 20 years.

As a result of these transactions, rent expense in the nine months ended September 30, 2007 includes an additional \$2.0 million of expense compared to the nine months ended September 30, 2006. Also as a result of these transactions, the nine months ended September 30, 2006 includes additional depreciation expense of \$0.6 million and additional interest expense of \$1.3 million and \$2.6 million as compared to the nine months ended September 30, 2007. Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2007 and 2006 was \$1.4 million and \$1.7 million, respectively and for the nine months ended September 30, 2007 and 2006 was \$4.2 million and \$8.9 million, respectively.

10. Other Income

In the first quarter of 2007, the Company recorded a gain of \$0.3 million related to sale of one of its Taco Cabana restaurant properties. In the third quarter of 2007, the Company recorded a gain of \$0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

During the third quarter of 2006, the Company reduced its lease liability reserves by \$0.3 million due to an increase in the Company's estimates for future sublease income at such locations and also reduced collection reserves previously established for a \$1.1 million note receivable related to the sale of leasehold improvements at two of the closed locations that were written off as part of the restructuring charge in 2001. This note was paid in full in the fourth quarter of 2006. The effect of these transactions is presented in other income in the Consolidated Statements of Operations.

11. Business Segment Information

The Company is engaged in the quick-service and quick-casual restaurant industry, with three restaurant concepts: Burger King operating as a franchisee and Pollo Tropical and Taco Cabana, both Company-owned concepts. The Company's Burger

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

King restaurants are all located in the United States, primarily in the Northeast, Southeast and Midwest. Pollo Tropical is a quick-casual restaurant chain featuring grilled marinated chicken and Caribbean style “made from scratch” side dishes. Pollo Tropical’s core markets are located in South and Central Florida. Taco Cabana is a quick-casual restaurant chain featuring fresh Mexican style food, including flame-grilled beef and chicken fajitas, quesadillas and other Tex-Mex dishes. Taco Cabana’s core markets are primarily located in Texas.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies. The following table includes Segment EBITDA which is the measure of segment profit or loss reported to the chief operating decision maker for purposes of allocating resources to the segments and assessing their performance. Segment EBITDA is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense and other income and expense.

The “Other” column includes corporate related items not allocated to reportable segments, including stock-based compensation expense. Other identifiable assets consist primarily of cash, certain other assets, corporate property and equipment, goodwill and deferred income taxes.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2007:					
Total revenues	\$ 42,560	\$ 61,254	\$ 99,695	\$ —	\$ 203,509
Cost of sales	13,697	18,532	26,637	—	58,866
Restaurant wages and related expenses	10,495	17,652	31,327	45	59,519
General and administrative expenses (1)	2,190	2,655	7,168	314	12,327
Depreciation and amortization	1,763	2,163	3,827	354	8,107
Segment EBITDA	7,776	7,348	9,197		
Capital expenditures, including acquisitions	5,202	5,043	2,437	347	13,029
September 30, 2006:					
Total revenues	\$ 38,239	\$ 58,062	\$ 93,296	\$ —	\$ 189,597
Cost of sales	12,178	16,835	23,987	—	53,000
Restaurant wages and related expenses	9,869	16,493	28,685	—	55,047
General and administrative expenses (1)	2,049	2,749	7,043	—	11,841
Depreciation and amortization	1,256	2,517	4,297	327	8,397
Segment EBITDA	6,489	9,854	9,177		
Capital expenditures, including acquisitions	5,047	4,795	1,771	322	11,935
Nine Months Ended					
September 30, 2007:					
Total revenues	\$ 126,846	\$ 180,222	\$ 285,093	\$ —	\$ 592,161
Cost of sales	41,238	53,485	74,339	—	169,062
Restaurant wages and related expenses	31,460	51,526	90,922	121	174,029
General and administrative expenses (1)	7,226	8,256	22,349	947	38,778
Depreciation and amortization	4,927	6,337	11,428	993	23,685
Segment EBITDA	21,862	22,723	23,416		
Capital expenditures, including acquisitions	18,442	13,086	7,388	1,840	40,756
September 30, 2006:					
Total revenues	\$ 115,303	\$ 171,983	\$ 275,435	\$ —	\$ 562,721
Cost of sales	37,151	49,860	71,288	—	158,299
Restaurant wages and related expenses	28,842	48,728	86,437	—	164,007
General and administrative expenses (1)	6,315	8,606	21,271	—	36,192
Depreciation and amortization	4,038	6,580	13,573	986	25,177
Segment EBITDA	21,792	25,669	26,345		
Capital expenditures, including acquisitions	13,050	11,633	6,050	1,324	32,057

Identifiable Assets:

At September 30, 2007	\$ 54,897	\$ 77,383	\$ 149,628	\$ 180,846	\$ 462,754
At December 31, 2006	46,617	71,601	155,272	179,369	452,859

- (1) For the Pollo Tropical and Taco Cabana segments, such amounts include general and administrative expenses related directly to each segment. For the Burger King segment such amounts include general and administrative expenses related directly to the Burger King segment as well as expenses associated with administrative support to all of the Company's segments including executive management, information systems and certain accounting, legal and other administrative functions.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

A reconciliation of segment EBITDA to consolidated net income is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Segment EBITDA:				
Pollo Tropical	\$ 7,776	\$ 6,489	\$21,862	\$21,792
Taco Cabana	7,348	9,854	22,723	25,669
Burger King	9,197	9,177	23,416	26,345
Subtotal	24,321	25,520	68,001	73,806
Less:				
Depreciation and amortization	8,107	8,397	23,685	25,177
Impairment losses	1,810	588	1,879	832
Interest expense	7,690	10,216	23,647	34,616
Loss on extinguishment of debt	-	-	1,485	-
Provision for income taxes	1,795	2,580	5,349	4,828
Stock-based compensation expense	359	-	1,068	-
Other income	(303)	(1,389)	(650)	(1,389)
Net income	<u>\$ 4,863</u>	<u>\$ 5,128</u>	<u>\$11,538</u>	<u>\$ 9,742</u>

12. Commitments and Contingencies

On November 16, 1998, the Equal Employment Opportunity Commission (“EEOC”) filed suit in the United States District Court for the Northern District of New York (the “Court”), under Title VII of the Civil Rights Act of 1964, as amended, against Carrols. The complaint alleged that Carrols engaged in a pattern and practice of unlawful discrimination, harassment and retaliation against former and current female employees. The EEOC identified approximately 450 individuals (which was subsequently increased to 511 individuals) that it believed represented the class of claimants and was seeking monetary and injunctive relief from Carrols.

On April 20, 2005, the Court issued a decision and order granting Carrols’ Motion for Summary Judgment that Carrols filed in January 2004. Subject to possible appeal by the EEOC, the case is dismissed, however the Court noted that it was not ruling on the claims, if any, that individual employees might have against Carrols. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements.

On February 27, 2006, Carrols filed a motion for summary judgment to dismiss all but between four and 17 of the individual claims. On July 10, 2006, in its response to that motion, the EEOC has asserted that, notwithstanding the Court’s dismissal of the case as a class action, the EEOC may still maintain some kind of collective action on behalf of these claimants. Oral argument before the Court was held on October 4, 2006 and the Company is awaiting the Court’s decision on Carrols’ summary judgment motion. Although the Company believes that the EEOC’s continued class litigation argument is without merit, it is not possible to predict the outcome of the pending motion.

On November 30, 2002, four former hourly employees commenced a lawsuit against Carrols in the United States District Court for the Western District of New York entitled Dawn Seever, et al. v. Carrols Corporation. The lawsuit alleges, in substance, that Carrols violated certain minimum wage laws under the Federal Fair Labor Standards Act and related state laws by requiring employees to work without recording their time and by retaliating against those who complained. The plaintiffs seek damages, costs and injunctive relief. They also seek to notify, and eventually certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for Carrols. As a result of the July 21, 2005 Status Conference, the parties agreed to withdraw Plaintiff’s Motions to Certify and for National Discovery, and Defendant’s Motion to Disqualify Counsel and related motions, to allow both sides limited additional discovery. Carrols has since filed a Motion for Summary Judgment as to the existing plaintiffs that the Court has under consideration. On January 19, 2007, plaintiffs re-filed the Motion to certify and for National Discovery. Carrols has opposed such Motions. Carrols has also moved to disqualify the Plaintiffs from representing the class and to strike the purported evidence presented in support of the motion to certify. The various motions are scheduled for hearing on November 19, 2007. It is too early to evaluate the likelihood of an unfavorable outcome or estimate the amount or range of potential loss, if any. Consequently, it is not possible to predict what adverse

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars except share and per share amounts)

impact, if any, this case could have on the Company's consolidated financial statements. Carrols intends to continue to contest this case vigorously.

The Company is a party to various other litigation matters incidental to the conduct of business. The Company does not believe that the outcome of any of these other matters will have a material adverse effect on its consolidated financial statements.

13. Net Income Per Share

Basic net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding plus the dilutive effect of outstanding stock options using the treasury stock method.

The computation of diluted net income per share excludes options to purchase 1,226,450 shares of common stock in the three months ended September 30, 2007 because the exercise price of these options was greater than the average market price of the common shares in the period and therefore, are antidilutive. In addition, options to purchase 1,232,950 shares of common stock are excluded from the computation of diluted net income per share in the nine months ended September 30, 2007 as they were antidilutive under the treasury stock method.

In connection with the Company's initial public offering in 2006, the Company authorized an 11.288 for-one stock split on November 21, 2006 which became effective on December 8, 2006. Accordingly, basic and diluted shares for all periods presented have been calculated based on the average shares outstanding, as adjusted for the stock split.

The following table is a reconciliation of the income and share amounts used in the calculation of basic net income per share and diluted net income per share:

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Basic net income per share:				
Net income	\$ 4,863	\$ 5,128	\$ 11,538	\$ 9,742
Weighted average common shares outstanding	21,550,827	15,887,186	21,550,827	15,892,329
Basic net income per share	\$ 0.23	\$ 0.32	\$ 0.54	\$ 0.61
Diluted net income per share:				
Net income for diluted net income per share	\$ 4,863	\$ 5,128	\$ 11,538	\$ 9,742
Shares used in computing basic net income per share	21,550,827	15,887,186	21,550,827	15,892,329
Dilutive effect of restricted shares	4,193	—	8,697	—
Shares used in computing diluted net income per share	<u>21,555,020</u>	<u>15,887,186</u>	<u>21,559,524</u>	<u>15,892,329</u>
Diluted net income per share	<u>\$ 0.23</u>	<u>\$ 0.32</u>	<u>\$ 0.54</u>	<u>\$ 0.61</u>

14. Recent Accounting Developments

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. SFAS 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is evaluating the impact the adoption of SFAS 157 will have on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the impact the adoption of SFAS 159 will have on its consolidated financial statements.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, Definition of Settlement in FASB Interpretation No. 48 (the "FSP"). The FSP provides guidance about how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. Under the FSP, a tax position could be effectively settled if a taxing authority has completed all of its required or expected examination procedures, if the entity does not intend to appeal or litigate the result and it is remote that the taxing authority would examine or re-examine the tax position. Application of the FSP shall be upon the initial adoption date of FIN 48. The FSP did not have a material impact on the Company's consolidated financial statements.

ITEM 1—INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CARROLS CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars except share and per share amounts)
(Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,622	\$ 3,939
Trade and other receivables	4,720	5,364
Inventories	4,939	4,677
Prepaid rent	2,755	4,130
Prepaid expenses and other current assets	6,990	5,367
Refundable income taxes	—	2,806
Deferred income taxes	4,549	4,539
Total current assets	31,575	30,822
Property and equipment, net	195,121	182,742
Franchise rights, net (Note 4)	80,856	83,268
Goodwill (Note 4)	124,934	124,934
Intangible assets, net (Note 4)	959	1,175
Franchise agreements, at cost less accumulated amortization of \$5,562 and \$5,431, respectively	5,683	5,793
Deferred income taxes	11,445	11,136
Other assets	12,181	12,989
Total assets	<u>\$ 462,754</u>	<u>\$ 452,859</u>
LIABILITIES AND STOCKHOLDER'S DEFICIT		
Current liabilities:		
Current portion of long-term debt (Note 5)	\$ 1,654	\$ 2,477
Accounts payable	21,068	17,860
Accrued interest	3,539	7,861
Accrued payroll, related taxes and benefits	17,670	18,445
Accrued income taxes payable	331	—
Accrued real estate taxes	4,037	4,102
Other liabilities	11,791	10,623
Total current liabilities	60,090	61,368
Long-term debt, net of current portion (Note 5)	300,881	297,432
Lease financing obligations (Note 9)	54,393	58,571
Deferred income—sale-leaseback of real estate	30,428	31,391
Accrued postretirement benefits (Note 8)	6,948	6,370
Other liabilities (Note 7)	23,159	23,462
Total liabilities	475,899	478,594
Commitments and contingencies (Note 12)		
Stockholder's deficit:		
Common stock, par value \$1; authorized 1,000 shares, issued and outstanding— 10 shares at both dates	—	—
Additional paid-in capital	(9,554)	(10,601)
Accumulated deficit	(2,590)	(14,133)
Accumulated other comprehensive loss	(1,001)	(1,001)
Total stockholder's deficit	(13,145)	(25,735)
Total liabilities and stockholder's deficit	<u>\$ 462,754</u>	<u>\$ 452,859</u>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(In thousands of dollars)
(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Revenues:				
Restaurant sales	\$203,181	\$189,254	\$591,164	\$561,719
Franchise royalty revenues and fees	328	343	997	1,002
Total revenues	<u>203,509</u>	<u>189,597</u>	<u>592,161</u>	<u>562,721</u>
Costs and expenses:				
Cost of sales	58,866	53,000	169,062	158,299
Restaurant wages and related expenses (including stock- based compensation expense of \$45, \$0, \$121 and \$0, respectively)	59,519	55,047	174,029	164,007
Restaurant rent expense	11,101	9,004	32,687	27,183
Other restaurant operating expenses	30,276	28,577	86,230	82,466
Advertising expense	7,458	6,608	24,442	20,768
General and administrative (including stock-based compensation expense of \$314, \$0, \$947 and \$0, respectively)	12,325	11,839	38,773	36,187
Depreciation and amortization	8,107	8,397	23,685	25,177
Impairment losses (Note 3)	1,810	588	1,879	832
Other income (Note 10)	(303)	(1,389)	(650)	(1,389)
Total operating expenses	<u>189,159</u>	<u>171,671</u>	<u>550,137</u>	<u>513,530</u>
Income from operations	14,350	17,926	42,024	49,191
Interest expense	7,690	10,216	23,647	34,616
Loss on extinguishment of debt (Note 5)	—	—	1,485	—
Income before income taxes	6,660	7,710	16,892	14,575
Provision for income taxes (Note 6)	1,795	2,580	5,349	4,828
Net income	<u>\$ 4,865</u>	<u>\$ 5,130</u>	<u>\$ 11,543</u>	<u>\$ 9,747</u>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(In thousands of dollars)
(Unaudited)

	2007	2006
Cash flows provided from operating activities:		
Net income	\$ 11,543	\$ 9,747
Adjustments to reconcile net income to net cash provided from operating activities:		
Gain on disposals of property and equipment	(57)	—
Stock-based compensation expense	1,068	—
Depreciation and amortization	23,685	25,177
Amortization of deferred financing costs	940	1,098
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,460)	(897)
Impairment losses	1,879	832
Gain on settlements of lease financing obligations	(163)	(120)
Accretion of interest on lease financing obligations	397	281
Deferred income taxes	(319)	159
Loss on extinguishment of debt	1,485	—
Changes in other operating assets and liabilities	3,982	2,191
Net cash provided from operating activities	41,364	36,852
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,241)	(20,370)
Restaurant remodeling	(5,850)	(4,885)
Other restaurant capital expenditures	(6,825)	(5,478)
Corporate and restaurant information systems	(1,840)	(1,324)
Total capital expenditures	(40,756)	(32,057)
Properties purchased for sale-leaseback	(2,461)	(2,663)
Proceeds from sale-leaseback transactions	7,036	31,693
Proceeds from sales of other properties	1,623	—
Net cash used for investing activities	(34,558)	(3,027)
Cash flows used for financing activities:		
Repayment of term loans under prior credit facility	(118,400)	—
Borrowings on revolving credit facility	45,500	—
Repayments on revolving credit facility	(44,300)	—
Proceeds from new senior credit facility	120,000	—
Scheduled principal payments on term loans	—	(1,650)
Principal pre-payments on term loans	—	(23,200)
Principal payments on capital leases	(262)	(305)
Expenses from initial public offering	(21)	—
Financing costs associated with issuance of debt	(1,228)	—
Settlement of lease financing obligations	(4,412)	(15,215)
Net cash used for financing activities	(3,123)	(40,370)
Net increase (decrease) in cash and cash equivalents	3,683	(6,545)
Cash and cash equivalents, beginning of period	3,939	9,331
Cash and cash equivalents, end of period	\$ 7,622	\$ 2,786
Supplemental disclosures:		
Interest paid on long-term debt	\$ 22,932	\$ 24,752
Interest paid on lease financing obligations	\$ 3,700	\$ 8,665
Increase (decrease) in accruals for capital expenditures	\$ (348)	\$ 601
Income taxes paid, net	\$ 3,064	\$ 2,753
Non-cash reduction of assets under lease financing obligation due to lease amendments	\$ —	\$ 24,707
Non-cash reduction of lease financing obligations due to lease amendments	\$ —	\$ 37,544
Capital lease obligations incurred	\$ 88	\$ —

The accompanying notes are an integral part of these unaudited consolidated financial statements.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands of dollars, except share amounts)

1. Basis of Presentation

Basis of Consolidation. The unaudited consolidated financial statements presented herein include the accounts of Carrols Corporation and its subsidiaries (“the Company”). The Company is a wholly-owned subsidiary of Carrols Restaurant Group, Inc. (“Carrols Restaurant Group”). All intercompany transactions have been eliminated in consolidation.

The difference between the consolidated financial statements of Carrols Corporation and Carrols Restaurant Group is primarily due to additional rent expense of approximately \$6 per year for Carrols Restaurant Group and the composition of stockholder’s deficit.

Business Description. At September 30, 2007 the Company operated, as franchisee, 325 quick-service restaurants under the trade name “Burger King” in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2007, the Company also owned and operated 83 Pollo Tropical restaurants of which 80 were located in Florida and three were located in the New York City metropolitan area and franchised a total of 27 Pollo Tropical restaurants, consisting of 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2007, the Company owned and operated 147 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico and one in Georgia.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 31, 2006 and January 1, 2006 will be referred to as the fiscal years ended December 31, 2006 and 2005, respectively. Similarly, all references herein to the three and nine months ended September 30, 2007 and October 1, 2006 will be referred to as the three and nine months ended September 30, 2007 and September 30, 2006, respectively. The years ended December 31, 2006 and 2005 each contained 52 weeks and the three and nine months ended September 30, 2007 and 2006 contained 13 and 39 weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2007 and 2006 have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission and do not include certain of the information and the footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of such financial statements have been included. The results of operations for the three and nine months ended September 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2006 contained in the Company’s 2006 Annual Report on Form 10-K. The December 31, 2006 balance sheet data is derived from those audited financial statements.

Use of Estimates. The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Significant items subject to such estimates include: accrued occupancy costs, insurance liabilities, legal obligations, income taxes, evaluation for impairment of goodwill, long-lived assets and Burger King franchise rights, lease accounting matters and stock-based compensation. Actual results could differ from those estimates.

Earnings Per Share Presentation. The guidance of SFAS No. 128, “Earnings Per Share,” requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market. The Company’s common stock is not publicly traded and therefore, earnings per share amounts are not presented.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

2. Stock-Based Compensation

Carrols Restaurant Group adopted an incentive stock plan in 2006 (the "2006 Plan") under which incentive stock options, non-qualified stock options and restricted shares may be granted to employees and non-employee directors. In December 2006, Carrols Restaurant Group granted incentive stock options, non-qualified stock options and restricted shares under the 2006 Plan. The stock options granted generally vest at 20% per year and expire seven years from the date of grant. Restricted shares granted to employees generally vest 33% per year for three years and restricted shares granted to non-employee directors generally vest at 20% per year.

Stock-based compensation related to these grants was \$0.4 million and \$1.1 million in the three and nine months ended September 30, 2007, respectively and the income tax benefit recognized in the consolidated statement of operations for stock-based compensation was \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2007, respectively. There were no stock options issued or stock-based compensation expense recorded in the three or nine months ended September 30, 2006.

As of September 30, 2007, the total non-vested stock-based compensation expense relating to the stock options and restricted stock was approximately \$4.5 million and the Company expects to record an additional \$0.4 million as compensation expense for the remainder of 2007. The remaining weighted average vesting period for the stock options is 3.64 years and for the restricted shares is approximately 2.77 years at September 30, 2007.

Stock Options

A summary of all option activity for the nine months ended September 30, 2007 was as follows:

	2006 Plan			
	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands) (1)
Options outstanding at January 1, 2007	1,241,750	\$ 14.30		
Options granted	10,500	15.81		
Options forfeited	(25,800)	14.30		
Options outstanding at September 30, 2007	<u>1,226,450</u>	\$ 14.31	6.26	\$ —
Expected to vest at September 30, 2007	<u>1,210,360</u>	\$ 14.31	6.26	\$ —
Options exercisable at September 30, 2007	<u>—</u>	\$ —	—	\$ —

- (1) The aggregate intrinsic value was calculated using the difference between the market price of Carrols Restaurant Group's common stock at September 30, 2007 and the exercise price for only those awards that have an exercise price that is less than the market price of the Carrols Restaurant Group's common stock at September 30.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2007 was as follows:

	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested at January 1, 2007	75,800	\$ 13.00
Shares granted	8,200	\$ 14.58
Shares forfeited	<u>(5,700)</u>	<u>\$ 13.05</u>
Nonvested at September 30, 2007	<u>78,300</u>	<u>\$ 13.16</u>

The fair value of restricted shares granted is determined based on the Company's closing stock price on the date of grant.

3. Impairment of Long-Lived Assets

The Company reviews its long-lived assets, principally property and equipment, for impairment at the restaurant level. If an indicator of impairment exists for any of its assets, an estimate of undiscounted future cash flows from the related long-lived assets is compared to that long-lived asset's carrying value. If the carrying value is greater than the undiscounted cash flow, the Company then determines the fair value of the asset. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value.

During the third quarter of 2007 the Company impaired an underperforming Pollo Tropical restaurant located in Brooklyn, New York for \$1.7 million. This restaurant was subsequently closed in the fourth quarter of 2007.

For the three and nine months ended September 30, 2007 and 2006, the Company recorded impairment losses on long-lived assets for its segments as follows:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Burger King	\$ 54	\$ —	\$ 68	\$ 224
Pollo Tropical	1,657	—	1,657	—
Taco Cabana	99	588	154	608
	<u>\$ 1,810</u>	<u>\$ 588</u>	<u>\$ 1,879</u>	<u>\$ 832</u>

4. Goodwill, Franchise Rights and Intangible Assets

Goodwill. Goodwill is reviewed for impairment annually, or more frequently when events and circumstances indicate that the carrying amounts may be impaired. The Company performs its annual impairment assessment as of December 31 and does not believe circumstances have changed since the last assessment date which would make it necessary to reassess their values. Goodwill balances are summarized below:

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Burger King</u>	<u>Total</u>
Goodwill at September 30, 2007 and December 31, 2006	\$56,307	\$67,177	\$1,450	\$124,934

Burger King Franchise Rights. Amounts allocated to franchise rights for each Burger King acquisition are amortized using the straight-line method over the average remaining term of the acquired franchise agreements at January 1, 2002 plus one twenty-year renewal period. The Company assesses the potential impairment of franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If an indicator of impairment exists, an estimate of the aggregate undiscounted future cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each Burger King acquisition. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value. There were no impairment charges related to franchise rights for the three and nine months ended September 30, 2007 and 2006.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

Amortization expense related to Burger King franchise rights was \$805 and \$804 for the three months ended September 30, 2007 and 2006, respectively. Amortization expense related to Burger King franchise rights was \$2,412 for both of the nine months ended September 30, 2007 and 2006, respectively. The estimated amortization expense for the year ending December 31, 2007 and for each of the five succeeding years is \$3,216.

Intangible Assets. The Company acquired four Taco Cabana restaurants from a franchisee in 2005. Under Emerging Issues Task Force Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination" ("EITF 04-1"), certain reacquired rights, including the right to the acquirer's trade name, are required to be recognized as intangible assets apart from goodwill. The Company allocated \$1.6 million of the purchase price to this intangible asset. The Company recorded amortization expense relating to the intangible asset of approximately \$72 for each of the three months ended September 30, 2007 and 2006, respectively. Amortization for each of the nine months ended September 30, 2007 and 2006 was \$216. The Company expects the annual amortization expense for the year ending December 31, 2007 and for each of the five years ending 2008 through 2012 to be \$289, \$211, \$133, \$125, \$117 and \$99, respectively

	<u>September 30, 2007</u>		<u>December 31, 2006</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Intangible assets	\$ 1,610	\$ 651	\$ 1,610	\$ 435

5. Long-term Debt

Long-term debt at September 30, 2007 and December 31, 2006 consisted of the following:

	<u>September 30, 2007</u>	<u>December 31, 2006</u>
Collateralized:		
Revolving Credit facility	\$ 1,200	\$ —
Senior Credit Facility-Term loan B facility	—	118,400
Senior Credit Facility-Term loan A facility	120,000	
Unsecured:		
9% Senior Subordinated Notes	180,000	180,000
Capital leases	1,335	1,509
	<u>302,535</u>	<u>299,909</u>
Less: current portion	(1,654)	(2,477)
	<u>\$ 300,881</u>	<u>\$ 297,432</u>

On March 9, 2007, the Company terminated its senior credit facility and entered into a new senior credit facility with a syndicate of lenders. The Company's new senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Company's 9% Senior Subordinated Notes due 2013 are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all outstanding borrowings and other obligations under the Company's prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. The Company also recorded a \$1.5 million loss on extinguishment of debt in the nine months ended September 30, 2007 for the write-off of deferred financing costs related to the prior senior credit facility.

Both term loan and revolving credit borrowings under the new senior credit facility bear interest at a per annum rate, at the Company's option, of either:

- 1) the applicable margin ranging from 0% to 0.25% based on the Company's senior leverage ratio (as defined in the new senior credit facility) plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on the Company's senior leverage ratio.

Term loan A borrowings shall be due and payable in quarterly installments, beginning on June 30, 2008 as follows:

- 1) four quarterly installments of \$1.5 million beginning on June 30, 2008;
- 2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;
- 3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and
- 4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the new senior credit facility, the Company is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an amount up to 50% of Excess Cash Flow depending upon the Company's Total Leverage Ratio (as such terms are defined in the new senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by the Company there from, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, the Company's obligations under the new senior credit facility are guaranteed by the Company and all of the Company's material subsidiaries and are collateralized by a pledge of the Company's common stock and the stock of each of the Company's material subsidiaries. The new senior credit facility contains certain covenants, including, without limitation, those limiting the Company's ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of its business, engage in transactions with related parties, make certain investments or pay dividends. In addition, the Company is required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the new senior credit facility). The Company was in compliance with the covenants under its new senior credit facility as of September 30, 2007.

At September 30, 2007, \$120.0 million principal amount of term loan borrowings were outstanding under the term loan A facility and \$1.2 million of borrowings were outstanding under the revolving credit facility. After reserving \$16.0 million for letters of credit guaranteed by the facility, \$47.8 million was available for borrowings under the revolving credit facility at September 30, 2007.

On December 15, 2004, the Company issued \$180 million of 9% Senior Subordinated Notes due 2013, which are referred to herein as the "senior subordinated notes." Restrictive covenants under the senior subordinated notes include limitations with respect to the Carrols' ability to issue additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. At both September 30, 2007 and December 31, 2006, \$180.0 million principal amount of the senior subordinated notes was outstanding.

6. Income Taxes

The income tax provision for the three and nine months ended September 30, 2007 and 2006 was comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Current	\$ 1,904	\$ 1,072	\$ 5,668	\$ 4,669
Deferred	(109)	1,508	(319)	159
	<u>\$ 1,795</u>	<u>\$ 2,580</u>	<u>\$ 5,349</u>	<u>\$ 4,828</u>

The provision for income taxes for the three and nine months ended September 30, 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5% as well as the effect of any discrete tax items occurring in those periods. In addition to the discrete tax adjustment discussed in the following paragraph, the Company also recorded in the three months ended September 30, 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards.

The Company adopted the provisions of Financial Standards Accounting Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", ("FIN 48"), an interpretation of FASB Statement No. 109 ("SFAS 109"), on

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in its consolidated financial statements. As of the adoption date of January 1, 2007, the Company had \$0.6 million of unrecognized tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.5 million of unrecognized tax benefits and \$0.1 million of accrued interest expired. The Company recorded this tax benefit as a discrete tax item in the third quarter of 2007. At September 30, 2007 the Company has no remaining unrecognized tax benefits. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2007, the Company had no accrued interest related to uncertain tax positions.

For the nine months ended September 30, 2007 the Company has recorded total discrete tax adjustments reducing income tax expense of \$0.8 million.

The provision for income taxes for the three and nine months ended September 30, 2006 was derived using an estimated effective annual income tax rate for 2006 of 33.5%. There were no discrete tax items affecting the provision for income taxes in the three and nine months ended September 30, 2006.

The tax years 2004-2006 remain open to examination by the major taxing jurisdictions to which the Company is subject.

On July 12, 2007, the Michigan Business Tax (the "MBT Act") was signed into law, which provides a comprehensive restructuring of Michigan's principal business taxes effective January 1, 2008. The MBT Act replaces the Michigan Single Business Tax that is scheduled to expire at the end of 2007. The effect of the MBT Act did not materially impact the Company's consolidated financial statements.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2007 and December 31, 2006 consisted of the following:

	<u>September 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Unearned purchase discounts	\$ 2,854	\$ 4,526
Accrued occupancy costs	9,476	8,683
Accrued workers' compensation costs	4,650	4,595
Other	6,179	5,658
	<u>\$ 23,159</u>	<u>\$ 23,462</u>

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At September 30, 2007 and December 31, 2006, the Company had \$0.6 million and \$0.7 million in lease liability reserves, respectively, for the remaining locations that are included in accrued occupancy costs.

8. Postretirement Benefits

The Company provides postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management salaried employees. A December 31 measurement date is used for postretirement benefits.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

The following summarizes the components of net periodic benefit cost:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Components of net periodic benefit cost:				
Service cost	\$ 124	\$ 118	\$ 370	\$ 354
Interest cost	101	85	304	251
Amortization of gains and losses	24	21	72	63
Amortization of unrecognized prior service cost	1	(8)	4	(22)
Net periodic postretirement benefit cost	<u>\$ 250</u>	<u>\$ 216</u>	<u>\$ 750</u>	<u>\$ 646</u>

During the three and nine months ended September 30, 2007, the Company made contributions of \$56 and \$172 to its postretirement plan to pay current benefits. The Company expects to make additional contributions during 2007.

On November 1, 2007 the Company amended its postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management personnel. The amendment included an elimination of life insurance benefits for active employees who retire after December 31, 2007 and increases in retiree contributions for both current and future retirees effective January 1, 2008. These amendments will reduce postretirement benefit obligations and costs beginning in the fourth quarter of 2007.

9. Lease Financing Obligations

The Company entered into sale-leaseback transactions in various years involving certain restaurant properties that did not qualify for sale-leaseback accounting and as a result, have been classified as financing transactions under SFAS No. 98, "Accounting for Leases" ("SFAS 98"). Under the financing method, the assets remain on the Company's consolidated balance sheet and proceeds received by the Company from these transactions are recorded as a financing liability. Payments under these leases are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

During the second quarter of 2007, the Company exercised its right of first refusal under the leases for five restaurant properties previously accounted for as lease financing obligations and purchased these properties from the lessor. As a result, the Company reduced its lease financing obligations by \$4.4 million. The Company also recorded a gain of \$0.2 million as a reduction of interest expense which represented the net amount by which the lease financing obligations exceeded the purchase price of the restaurant properties acquired.

During the second and third quarters of 2006, the Company refinanced 14 restaurant properties previously accounted for as lease financing obligations and amended lease agreements for 34 restaurant properties to eliminate or otherwise cure the provisions that precluded the original sale-leaseback accounting. As a result of these transactions in 2006, the Company reduced its lease financing obligations by \$52.8 million, reduced its assets under lease financing obligations by \$36.2 million and recorded deferred gains of \$18.3 million which are being amortized as a reduction to rent expense over the remaining term of the underlying leases, which is generally 20 years.

As a result of these transactions, rent expense in the nine months ended September 30, 2007 includes an additional \$2.0 million of expense compared to nine months ended September 30, 2006. Also as a result of these transactions, the nine months ended September 30, 2006 includes additional depreciation expense of \$0.6 million and additional interest expense of \$1.3 million and \$2.6 million as compared to the nine months ended September 30, 2007. Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2007 and 2006 was \$1.4 million and \$1.7 million, respectively and for the nine months ended September 30, 2007 and 2006 was \$4.2 million and \$8.9 million, respectively.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

10. Other Income

In the first quarter of 2007, the Company recorded a gain of \$0.3 million related to sale of one of its Taco Cabana restaurant properties. In the third quarter of 2007, the Company recorded a gain of \$0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

During the third quarter of 2006, the Company reduced its lease liability reserves by \$0.3 million due to an increase in the Company's estimates for future sublease income at such locations and also reduced collection reserves previously established for a \$1.1 million note receivable related to the sale of leasehold improvements at two of the closed locations that were written off as part of the restructuring charge in 2001. This note was paid in full in the fourth quarter of 2006. The effect of these transactions is presented in other income in the Consolidated Statements of Operations.

11. Business Segment Information

The Company is engaged in the quick-service and quick-casual restaurant industry, with three restaurant concepts: Burger King operating as a franchisee and Pollo Tropical and Taco Cabana, both Company-owned concepts. The Company's Burger King restaurants are all located in the United States, primarily in the Northeast, Southeast and Midwest. Pollo Tropical is a quick-casual restaurant chain featuring grilled marinated chicken and Caribbean style "made from scratch" side dishes. Pollo Tropical's core markets are located in South and Central Florida. Taco Cabana is a quick-casual restaurant chain featuring fresh Mexican style food, including flame-grilled beef and chicken fajitas, quesadillas and other Tex-Mex dishes. Taco Cabana's core markets are primarily located in Texas.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies. The following table includes Segment EBITDA which is the measure of segment profit or loss reported to the chief operating decision maker for purposes of allocating resources to the segments and assessing their performance. Segment EBITDA is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense and other income and expense.

The "Other" column includes corporate related items not allocated to reportable segments, including stock-based compensation expense. Other identifiable assets consist primarily of cash, certain other assets, corporate property and equipment, goodwill and deferred income taxes.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2007:					
Total revenues	\$ 42,560	\$ 61,254	\$ 99,695	\$ —	\$ 203,509
Cost of sales	13,697	18,532	26,637	—	58,866
Restaurant wages and related expenses	10,495	17,652	31,327	45	59,519
General and administrative expenses (1)	2,188	2,655	7,168	314	12,325
Depreciation and amortization	1,763	2,163	3,827	354	8,107
Segment EBITDA	7,778	7,348	9,197		
Capital expenditures, including acquisitions	5,202	5,043	2,437	347	13,029
September 30, 2006:					
Total revenues	\$ 38,239	\$ 58,062	\$ 93,296	\$ —	\$ 189,597
Cost of sales	12,178	16,835	23,987	—	53,000
Restaurant wages and related expenses	9,869	16,493	28,685	—	55,047
General and administrative expenses (1)	2,047	2,749	7,043	—	11,839
Depreciation and amortization	1,256	2,517	4,297	327	8,397
Segment EBITDA	6,491	9,854	9,177		
Capital expenditures, including acquisitions	5,047	4,795	1,771	322	11,935
Nine Months Ended					
September 30, 2007:					
Total revenues	\$ 126,846	\$ 180,222	\$ 285,093	\$ —	\$ 592,161
Cost of sales	41,238	53,485	74,339	—	169,062
Restaurant wages and related expenses	31,460	51,526	90,922	121	174,029
General and administrative expenses (1)	7,221	8,256	22,349	947	38,773
Depreciation and amortization	4,927	6,337	11,428	993	23,685
Segment EBITDA	21,867	22,723	23,416		
Capital expenditures, including acquisitions	18,442	13,086	7,388	1,840	40,756
September 30, 2006:					
Total revenues	\$ 115,303	\$ 171,983	\$ 275,435	\$ —	\$ 562,721
Cost of sales	37,151	49,860	71,288	—	158,299
Restaurant wages and related expenses	28,842	48,728	86,437	—	164,007
General and administrative expenses (1)	6,310	8,606	21,271	—	36,187
Depreciation and amortization	4,038	6,580	13,573	986	25,177
Segment EBITDA	21,797	25,669	26,345		
Capital expenditures, including acquisitions	13,050	11,633	6,050	1,324	32,057
Identifiable Assets:					
At September 30, 2007	\$ 54,897	\$ 77,383	\$ 149,628	\$ 180,846	\$ 462,754
At December 31, 2006	46,617	71,601	155,272	179,369	452,859

- (1) For the Pollo Tropical and Taco Cabana segments, such amounts include general and administrative expenses related directly to each segment. For the Burger King segment such amounts include general and administrative expenses related directly to the Burger King segment as well as expenses associated with administrative support to all of the Company's segments including executive management, information systems and certain accounting, legal and other administrative functions.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

A reconciliation of segment EBITDA to consolidated net income is as follows:

	Six Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Segment EBITDA:				
Pollo Tropical	\$ 7,778	\$ 6,491	\$21,867	\$21,797
Taco Cabana	7,348	9,854	22,723	25,669
Burger King	9,197	9,177	23,416	26,345
Subtotal	24,323	25,522	68,006	73,811
Less:				
Depreciation and amortization	8,107	8,397	23,685	25,177
Impairment losses	1,810	588	1,879	832
Interest expense	7,690	10,216	23,647	34,616
Loss on extinguishment of debt	—	—	1,485	—
Provision for income taxes	1,795	2,580	5,349	4,828
Stock-based compensation expense	359	—	1,068	—
Other income	(303)	(1,389)	(650)	(1,389)
Net income	\$ 4,865	\$ 5,130	\$11,543	\$ 9,747

12. Commitments and Contingencies

On November 16, 1998, the Equal Employment Opportunity Commission (“EEOC”) filed suit in the United States District Court for the Northern District of New York (the “Court”), under Title VII of the Civil Rights Act of 1964, as amended, against the Company. The complaint alleged that the Company engaged in a pattern and practice of unlawful discrimination, harassment and retaliation against former and current female employees. The EEOC identified approximately 450 individuals (which were subsequently increased to 511 individuals) that it believed represented the class of claimants and was seeking monetary and injunctive relief from the Company.

On April 20, 2005, the Court issued a decision and order granting the Company’s Motion for Summary Judgment that the Company filed in January 2004. Subject to possible appeal by the EEOC, the case is dismissed, however the Court noted that it was not ruling on the claims, if any, that individual employees might have against the Company. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements.

On February 27, 2006, the Company filed a motion for summary judgment to dismiss all but between four and 17 of the individual claims. On July 10, 2006, in its response to that motion, the EEOC has asserted that, notwithstanding the Court’s dismissal of the case as a class action, the EEOC may still maintain some kind of collective action on behalf of these claimants. Oral argument before the Court was held on October 4, 2006 and the Company is awaiting the Court’s decision on the Company’s summary judgment motion. Although the Company believes that the EEOC’s continued class litigation argument is without merit, it is not possible to predict the outcome of the pending motion.

On November 30, 2002, four former hourly employees commenced a lawsuit against the Company in the United States District Court for the Western District of New York entitled Dawn Seever, et al. v. Carrols Corporation. The lawsuit alleges, in substance, that the Company violated certain minimum wage laws under the Federal Fair Labor Standards Act and related state laws by requiring employees to work without recording their time and by retaliating against those who complained. The plaintiffs seek damages, costs and injunctive relief. They also seek to notify, and eventually certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for the Company. As a result of the July 21, 2005 Status Conference, the parties agreed to withdraw Plaintiff’s Motions to Certify and for National Discovery, and Defendant’s Motion to Disqualify Counsel and related motions, to allow both sides limited additional discovery. The Company has since filed a Motion for Summary Judgment as to the existing plaintiffs that the Court has under consideration. On January 19, 2007, plaintiffs re-filed the Motion to certify and for National Discovery. The Company has opposed such Motions. The Company has also moved to disqualify the Plaintiffs from representing the class and to strike the purported evidence presented in support of the motion to certify. The various motions are scheduled for hearing on November 19, 2007. It is too early to evaluate the likelihood of an unfavorable outcome or estimate the amount or

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

range of potential loss, if any. Consequently, it is not possible to predict what adverse impact, if any, this case could have on the Company's consolidated financial statements. The Company intends to continue to contest this case vigorously.

The Company is a party to various other litigation matters incidental to the conduct of business. The Company does not believe that the outcome of any of these other matters will have a material adverse effect on its consolidated financial statements.

13. Recent Accounting Developments

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. SFAS 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is evaluating the impact the adoption of SFAS 157 will have on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS 159"). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the impact the adoption of SFAS 159 will have on its consolidated financial statements.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, Definition of Settlement in FASB Interpretation No. 48 (the "FSP"). The FSP provides guidance about how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. Under the FSP, a tax position could be effectively settled if a taxing authority has completed all of its required or expected examination procedures, if the entity does not intend to appeal or litigate the result and it is remote that the taxing authority would examine or re-examine the tax position. Application of the FSP shall be upon the initial adoption date of FIN 48. The FSP did not have a material impact on the Company's consolidated financial statements.

14. Guarantor Financial Statements

The Company's obligations under the senior subordinated notes are jointly and severally guaranteed in full on an unsecured senior subordinated basis by certain of the Company's subsidiaries ("Guarantor Subsidiaries"), all of which are directly or indirectly wholly-owned by the Company. These subsidiaries are:

- Cabana Beverages, Inc.
- Cabana Bevco LLC
- Carrols Realty Holdings Corp.
- Carrols Realty I Corp.
- Carrols Realty II Corp.
- Carrols J.G. Corp.
- Quanta Advertising Corp.
- Pollo Franchise, Inc.
- Pollo Operations, Inc.
- Taco Cabana, Inc.
- TP Acquisition Corp.
- TC Bevco LLC
- T.C. Management, Inc.
- TC Lease Holdings III, V and VI, Inc.
- Get Real, Inc.
- Texas Taco Cabana, L.P.
- TPAQ Holding Corporation

The following supplemental financial information sets forth on a consolidating basis, balance sheets as of September 30, 2007 and December 31, 2006 for the Parent Company Only, Guarantor Subsidiaries and for the Company and the related statements of operations and cash flows for the three and nine months ended September 30, 2007 and 2006.

CARROLS CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)
(in thousands of dollars, except share amounts)

For certain of the Company's sale-leaseback transactions, the Parent Company has guaranteed on an unsecured basis the rental payments of its subsidiaries. In accordance with Emerging Issues Task Force Issue No. 90-14, "Unsecured Guarantee by Parent of Subsidiary's Lease Payments in a Sale-Leaseback Transaction," the Company has included in the following guarantor financial statements amounts pertaining to these leases as if they were accounted for as financing transactions of the Guarantor Subsidiaries. These adjustments are eliminated in consolidation.

For purposes of the guarantor financial statements, the Company and its subsidiaries determine the applicable tax provision for each entity generally using the separate return method. Under this method, current and deferred taxes are allocated to each reporting entity as if it were to file a separate tax return. The rules followed by the reporting entity in computing its tax obligation or refund, including the effects of the alternative minimum tax, would be the same as those followed in filing a separate return with the Internal Revenue Service. However, for purposes of evaluating an entity's ability to realize its tax attributes, the Company assesses whether it is more likely than not that those assets will be realized at the consolidated level. Any differences in the total of the income tax provision (benefit) for the Parent Company only and the Guarantor Subsidiaries, as calculated on the separate return method and the consolidated income tax provision (benefit) are eliminated in consolidation.

The Company provides some administrative support to its subsidiaries related to executive management, information systems and certain accounting, legal and other administrative functions. For purposes of the guarantor financial statements, the Company allocates such corporate costs on a specific identification basis, where applicable, or based on revenues or the number of restaurants for each subsidiary. Management believes that these allocations are reasonable based on the nature of costs incurred.

CONSOLIDATING BALANCE SHEET
September 30, 2007
(In thousands of dollars)
(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 5,176	\$ 2,446	\$ —	\$ 7,622
Trade and other receivables	1,217	3,503	—	4,720
Inventories	2,993	1,946	—	4,939
Prepaid rent	1,028	1,727	—	2,755
Prepaid expenses and other current assets	2,939	4,051	—	6,990
Deferred income taxes	2,655	1,894	—	4,549
Total current assets	16,008	15,567	—	31,575
Property and equipment, net	61,933	187,690	(54,502)	195,121
Franchise rights, net	80,856	—	—	80,856
Goodwill	1,450	123,484	—	124,934
Intangible assets, net	—	959	—	959
Franchise agreements, net	5,683	—	—	5,683
Intercompany receivable (payable)	159,093	(159,650)	557	—
Investment in subsidiaries	37,204	—	(37,204)	—
Deferred income taxes	5,420	6,995	(970)	11,445
Other assets	7,573	6,357	(1,749)	12,181
Total assets	<u>\$375,220</u>	<u>\$ 181,402</u>	<u>\$ (93,868)</u>	<u>\$ 462,754</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)				
Current liabilities:				
Current portion of long-term debt	\$ 1,589	\$ 65	\$ —	\$ 1,654
Accounts payable	10,410	10,658	—	21,068
Accrued interest	3,539	—	—	3,539
Accrued payroll, related taxes and benefits	10,235	7,435	—	17,670
Accrued income taxes payable	331	—	—	331
Accrued real estate taxes	245	3,792	—	4,037
Other liabilities	8,524	3,267	—	11,791
Total current liabilities	34,873	25,217	—	60,090
Long-term debt, net of current portion	299,833	1,048	—	300,881
Lease financing obligations	14,892	107,929	(68,428)	54,393
Deferred income—sale-leaseback of real estate	16,590	5,725	8,113	30,428
Accrued postretirement benefits	6,948	—	—	6,948
Other liabilities	15,229	7,519	411	23,159
Total liabilities	388,365	147,438	(59,904)	475,899
Commitments and contingencies				
Stockholder's equity (deficit)	(13,145)	33,964	(33,964)	(13,145)
Total liabilities and stockholder's equity (deficit)	<u>\$375,220</u>	<u>\$ 181,402</u>	<u>\$ (93,868)</u>	<u>\$ 462,754</u>

CONSOLIDATING BALANCE SHEET
December 31, 2006
(In thousands of dollars)
(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 1,182	\$ 2,757	\$ —	\$ 3,939
Trade and other receivables	783	4,581	—	5,364
Inventories	2,997	1,680	—	4,677
Prepaid rent	2,203	1,927	—	4,130
Prepaid expenses and other current assets	1,920	3,447	—	5,367
Refundable income taxes	2,806	—	—	2,806
Deferred income taxes	2,653	1,886	—	4,539
Total current assets	14,544	16,278	—	30,822
Property and equipment, net	62,978	171,369	(51,605)	182,742
Franchise rights, net	83,268	—	—	83,268
Goodwill	1,450	123,484	—	124,934
Intangible assets, net	—	1,175	—	1,175
Franchise agreements, net	5,793	—	—	5,793
Intercompany receivable (payable)	151,907	(152,204)	297	—
Investment in subsidiaries	35,396	—	(35,396)	—
Deferred income taxes	5,215	6,619	(698)	11,136
Other assets	8,703	6,008	(1,722)	12,989
Total assets	<u>\$ 369,254</u>	<u>\$ 172,729</u>	<u>\$ (89,124)</u>	<u>\$ 452,859</u>
LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIT)				
Current liabilities:				
Current portion of long-term debt	\$ 2,295	\$ 182	\$ —	\$ 2,477
Accounts payable	7,783	10,077	—	17,860
Accrued interest	7,861	—	—	7,861
Accrued payroll, related taxes and benefits	11,034	7,411	—	18,445
Accrued real estate taxes	1,754	2,348	—	4,102
Other liabilities	7,123	3,500	—	10,623
Total current liabilities	37,850	23,518	—	61,368
Long-term debt, net of current portion	296,397	1,035	—	297,432
Lease financing obligations	19,419	103,060	(63,908)	58,571
Deferred income—sale-leaseback of real estate	18,548	4,812	8,031	31,391
Accrued postretirement benefits	6,370	—	—	6,370
Other liabilities	16,405	6,799	258	23,462
Total liabilities	394,989	139,224	(55,619)	478,594
Commitments and contingencies				
Stockholder's equity (deficit)	(25,735)	33,505	(33,505)	(25,735)
Total liabilities and stockholder's equity (deficit)	<u>\$ 369,254</u>	<u>\$ 172,729</u>	<u>\$ (89,124)</u>	<u>\$ 452,859</u>

CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended September 30, 2007
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenues:				
Restaurant sales	\$99,695	\$ 103,486	\$ —	\$ 203,181
Franchise royalty revenues and fees	—	328	—	328
Total revenues	<u>99,695</u>	<u>103,814</u>	<u>—</u>	<u>203,509</u>
Costs and expenses:				
Cost of sales	26,637	32,229	—	58,866
Restaurant wages and related expenses (including stock-based compensation expense of \$45)	31,374	28,145	—	59,519
Restaurant rent expense	5,951	3,841	1,309	11,101
Other restaurant operating expenses	15,105	15,171	—	30,276
Advertising expense	4,310	3,148	—	7,458
General and administrative (including stock based compensation expense of \$314)	6,890	5,435	—	12,325
Depreciation and amortization	4,037	4,379	(309)	8,107
Impairment losses	54	1,756	—	1,810
Other income	(303)	—	—	(303)
Total operating expenses	<u>94,055</u>	<u>94,104</u>	<u>1,000</u>	<u>189,159</u>
Income from operations	5,640	9,710	(1,000)	14,350
Interest expense	6,632	2,515	(1,457)	7,690
Intercompany interest allocations	(4,557)	4,557	—	—
Income before income taxes	3,565	2,638	457	6,660
Provision for income taxes	502	1,067	226	1,795
Equity income from subsidiaries	1,802	—	(1,802)	—
Net income	<u>\$ 4,865</u>	<u>\$ 1,571</u>	<u>\$ (1,571)</u>	<u>\$ 4,865</u>

CONSOLIDATING STATEMENT OF OPERATIONS
Three Months Ended September 30, 2006
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenues:				
Restaurant sales	\$93,296	\$ 95,958	\$ —	\$ 189,254
Franchise royalty revenues and fees	—	343	—	343
Total revenues	<u>93,296</u>	<u>96,301</u>	<u>—</u>	<u>189,597</u>
Costs and expenses:				
Cost of sales	23,987	29,013	—	53,000
Restaurant wages and related expenses	28,521	26,526	—	55,047
Restaurant rent expense	5,781	3,223	—	9,004
Other restaurant operating expenses	14,606	12,735	1,236	28,577
Advertising expense	4,017	2,591	—	6,608
General and administrative	6,463	5,376	—	11,839
Depreciation and amortization	4,452	4,247	(302)	8,397
Impairment losses	—	588	—	588
Other income	—	(1,389)	—	(1,389)
Total operating expenses	<u>87,827</u>	<u>82,910</u>	<u>934</u>	<u>171,671</u>
Income from operations	5,469	13,391	(934)	17,926
Interest expense	8,936	2,505	(1,225)	10,216
Intercompany interest allocations	(4,557)	4,557	—	—
Income before income taxes	1,090	6,329	291	7,710
Provision for income taxes	480	2,207	(107)	2,580
Equity income from subsidiaries	4,520	—	(4,520)	—
Net income	<u>\$ 5,130</u>	<u>\$ 4,122</u>	<u>\$ (4,122)</u>	<u>\$ 5,130</u>

CONSOLIDATING STATEMENT OF OPERATIONS
Nine months Ended September 30, 2007
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenues:				
Restaurant sales	\$ 285,093	\$ 306,071	\$ —	\$ 591,164
Franchise royalty revenues and fees	—	997	—	997
Total revenues	<u>285,093</u>	<u>307,068</u>	<u>—</u>	<u>592,161</u>
Costs and expenses:				
Cost of sales	74,339	94,723	—	169,062
Restaurant wages and related expenses (including stock-based compensation expense of \$121)	90,994	83,035	—	174,029
Restaurant rent expense	17,732	11,050	3,905	32,687
Other restaurant operating expenses	43,415	42,815	—	86,230
Advertising expense	12,920	11,522	—	24,442
General and administrative (including stock based compensation expense of \$947)	20,474	18,299	—	38,773
Depreciation and amortization	11,981	12,626	(922)	23,685
Impairment loss	68	1,811	—	1,879
Other income	(303)	(347)	—	(650)
Total operating expenses	<u>271,620</u>	<u>275,534</u>	<u>2,983</u>	<u>550,137</u>
Income from operations	13,473	31,534	(2,983)	42,024
Interest expense	20,449	7,542	(4,344)	23,647
Loss on extinguishment of debt	1,485	—	—	1,485
Intercompany interest allocations	(13,669)	13,669	—	—
Income before income taxes	5,208	10,323	1,361	16,892
Provision for income taxes	1,010	3,826	513	5,349
Equity income from subsidiaries	7,345	—	(7,345)	—
Net income	<u>\$ 11,543</u>	<u>\$ 6,497</u>	<u>\$ (6,497)</u>	<u>\$ 11,543</u>

CONSOLIDATING STATEMENT OF OPERATIONS
Nine months Ended September 30, 2006
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenues:				
Restaurant sales	\$ 275,435	\$ 286,284	\$ —	\$ 561,719
Franchise royalty revenues and fees	—	1,002	—	1,002
Total revenues	<u>275,435</u>	<u>287,286</u>	<u>—</u>	<u>562,721</u>
Costs and expenses:				
Cost of sales	71,288	87,011	—	158,299
Restaurant wages and related expenses	86,044	77,963	—	164,007
Restaurant rent expense	16,329	9,522	1,332	27,183
Other restaurant operating expenses	42,089	39,141	1,236	82,466
Advertising expense	11,676	9,092	—	20,768
General and administrative	19,451	16,736	—	36,187
Depreciation and amortization	14,057	11,706	(586)	25,177
Impairment losses	224	608	—	832
Other income	—	(1,389)	—	(1,389)
Total operating expenses	<u>261,158</u>	<u>250,390</u>	<u>1,982</u>	<u>513,530</u>
Income from operations	14,277	36,896	(1,982)	49,191
Interest expense	29,333	7,993	(2,710)	34,616
Intercompany interest allocations	(13,669)	13,669	—	—
Income (loss) before income taxes	(1,387)	15,234	728	14,575
Provision (benefit) for income taxes	(496)	5,336	(12)	4,828
Equity income from subsidiaries	10,638	—	(10,638)	—
Net income	<u>\$ 9,747</u>	<u>\$ 9,898</u>	<u>\$ (9,898)</u>	<u>\$ 9,747</u>

CONSOLIDATING STATEMENT OF CASH FLOWS
Nine months Ended September 30, 2007
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Cash flows provided from operating activities:				
Net income	\$ 11,543	\$ 6,497	\$ (6,497)	\$ 11,543
Adjustments to reconcile net income to net cash provided from operating activities:				
Gain on disposals of property and equipment	(122)	65	—	(57)
Stock-based compensation expense	794	274	—	1,068
Depreciation and amortization	11,981	12,626	(922)	23,685
Amortization of deferred financing costs	898	108	(66)	940
Amortization of unearned purchase discounts	(1,616)	—	—	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(889)	(267)	(304)	(1,460)
Impairment losses	68	1,811	—	1,879
Gain on settlements of lease financing obligations	(163)	—	—	(163)
Accretion of interest on lease financing obligations	46	351	—	397
Deferred income taxes	(208)	(234)	123	(319)
Loss on extinguishment of debt	1,485	—	—	1,485
Changes in other operating assets and liabilities	(8,441)	4,757	7,666	3,982
Net cash provided from operating activities	<u>15,376</u>	<u>25,988</u>	<u>—</u>	<u>41,364</u>
Cash flows used for investing activities:				
Capital expenditures:				
New restaurant development	(878)	(25,363)	—	(26,241)
Restaurant remodeling	(3,615)	(2,235)	—	(5,850)
Other restaurant capital expenditures	(2,895)	(3,930)	—	(6,825)
Corporate and restaurant information systems	(1,707)	(133)	—	(1,840)
Total capital expenditures	<u>(9,095)</u>	<u>(31,661)</u>	<u>—</u>	<u>(40,756)</u>
Properties purchased for sale-leaseback	—	(2,461)	—	(2,461)
Proceeds from sale-leaseback transactions	—	2,755	4,281	7,036
Proceeds from sales of other properties	644	979	—	1,623
Net cash used for investing activities	<u>(8,451)</u>	<u>(30,388)</u>	<u>4,281</u>	<u>(34,558)</u>
Cash flows provided from (used for) financing activities:				
Repayment of term loans under prior credit facility	(118,400)	—	—	(118,400)
Borrowings on revolving credit facility	45,500	—	—	45,500
Repayments on revolving credit facility	(44,300)	—	—	(44,300)
Proceeds from new senior credit facility	120,000	—	—	120,000
Principal payments on capital leases	(70)	(192)	—	(262)
Expenses from initial public offering	(21)	—	—	(21)
Financing costs associated with issuance of debt	(1,228)	(137)	137	(1,228)
Proceeds from lease financing obligations	—	4,418	(4,418)	—
Settlement of lease financing obligations	(4,412)	—	—	(4,412)
Net cash provided from (used for) financing activities	<u>(2,931)</u>	<u>4,089</u>	<u>(4,281)</u>	<u>(3,123)</u>
Net increase (decrease) in cash and cash equivalents	3,994	(311)	—	3,683
Cash and cash equivalents, beginning of period	1,182	2,757	—	3,939
Cash and cash equivalents, end of period	<u>\$ 5,176</u>	<u>\$ 2,446</u>	<u>\$ —</u>	<u>\$ 7,622</u>

CONSOLIDATING STATEMENT OF CASH FLOWS
Nine months Ended September 30, 2006
(In thousands of dollars)
(Unaudited)

	<u>Parent Company Only</u>	<u>Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Cash flows provided from operating activities:				
Net income	\$ 9,747	\$ 9,898	\$ (9,898)	\$ 9,747
Adjustments to reconcile net income to net cash provided from operating activities:				
Depreciation and amortization	14,057	11,706	(586)	25,177
Amortization of deferred financing costs	1,027	198	(127)	1,098
Amortization of unearned purchase discounts	(1,616)	—	—	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(505)	(160)	(232)	(897)
Impairment losses	224	608	—	832
Accretion of interest on lease financing obligations	(53)	343	(9)	281
Deferred income taxes	123	(222)	258	159
Gain on settlements of lease financing obligations, net	(309)	—	189	(120)
Changes in other operating assets and liabilities	2,815	(11,029)	10,405	2,191
Net cash provided from operating activities	<u>25,510</u>	<u>11,342</u>	<u>—</u>	<u>36,852</u>
Cash flows provided from (used for) investing activities:				
Capital expenditures:				
New restaurant development	(87)	(20,283)	—	(20,370)
Restaurant remodeling	(3,474)	(1,411)	—	(4,885)
Other restaurant capital expenditures	(2,489)	(2,989)	—	(5,478)
Corporate and restaurant information systems	(982)	(342)	—	(1,324)
Total capital expenditures	(7,032)	(25,025)	—	(32,057)
Properties purchased for sale-leaseback	(1,008)	(1,655)	—	(2,663)
Deposit on properties purchased for sale-leaseback	—	—	—	—
Proceeds from sales of other properties	10,348	10,801	10,544	31,693
Net cash provided from (used for) investing activities	<u>2,308</u>	<u>(15,879)</u>	<u>10,544</u>	<u>(3,027)</u>
Cash flows provided from (used for) financing activities:				
Scheduled principal payments on term loans	(1,650)	—	—	(1,650)
Principal payments on capital leases	(118)	(187)	—	(305)
Principal pre-payments on term loans	(23,200)	—	—	(23,200)
Settlement of lease financing obligations	(8,660)	(6,555)	—	(15,215)
Proceeds from lease financing obligations	—	11,130	(11,130)	—
Financing costs associated with issuance of debt and lease financing obligations	—	(586)	586	—
Net cash provided from (used for) financing activities	<u>(33,628)</u>	<u>3,802</u>	<u>(10,544)</u>	<u>(40,370)</u>
Net decrease in cash and cash equivalents	<u>(5,810)</u>	<u>(735)</u>	<u>—</u>	<u>(6,545)</u>
Cash and cash equivalents, beginning of period	7,493	1,838	—	9,331
Cash and cash equivalents, end of period	<u>\$ 1,683</u>	<u>\$ 1,103</u>	<u>\$ —</u>	<u>\$ 2,786</u>

ITEM 2—MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Throughout this Quarterly Report on Form 10-Q, we refer to Carrols Restaurant Group, Inc. as “Carrols Restaurant Group” and, together with its consolidated subsidiaries, as “we”, “our” and “us” unless otherwise indicated or the context otherwise requires. Any reference to “Carrols” refers to our wholly-owned subsidiary, Carrols Corporation, a Delaware corporation, and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires. This combined Quarterly Report on Form 10-Q is filed by both Carrols Restaurant Group and its wholly owned subsidiary, Carrols.

We use a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 31, 2006 and January 1, 2006 will be referred to as the fiscal years ended December 31, 2006 and 2005, respectively. Similarly, all references herein to the three and nine months ended September 30, 2007 and October 1, 2006 will be referred to as the three and nine months ended September 30, 2007 and September 30, 2006, respectively. The years ended December 31, 2006 and 2005 each contained 52 weeks and the three and nine months ended September 30, 2007 and 2006 each contained 13 and 39 weeks, respectively.

Introduction

Carrols Restaurant Group is a holding company and conducts all of its operations through its direct and indirect subsidiaries and has no assets other than the shares of capital stock of Carrols, its direct wholly-owned subsidiary. The following “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”) relates to the consolidated financial statements of Carrols Restaurant Group and the consolidated financial statements for Carrols presented in Item 1.

The difference between the consolidated financial statements of Carrols Restaurant Group and Carrols is primarily due to additional rent expense of approximately \$6,000 per year for Carrols Restaurant Group and the composition of stockholders’ deficit.

The following MD&A is written to help the reader understand our company. The MD&A is provided as a supplement to, and should be read in conjunction with, the Consolidated Financial Statements and the accompanying financial statement notes of each of Carrols Restaurant Group and Carrols appearing elsewhere in this report and our Annual Report on Form 10-K for the year ended December 31, 2006 as well as our previous quarterly reports on Form 10-Q for 2007. The overview provides our perspective on the individual sections of MD&A, which include the following:

Company Overview—a general description of our business and our key financial measures.

Recent and Future Events Affecting Our Results of Operations—a description of recent events that affect, and future events that may affect, our results of operations.

Executive Summary—an executive review of our performance for the three months ended September 30, 2007.

Liquidity and Capital Resources—an analysis of historical information regarding our sources of cash and capital expenditures, the existence and timing of commitments and contingencies, changes in capital resources and a discussion of cash flow items affecting liquidity.

Results of Operations—an analysis of our results of operations for the three and nine months ended September 30, 2007 compared to the three and nine months ended September 30, 2006.

Application of Critical Accounting Policies—an overview of accounting policies requiring critical judgments and estimates.

Effects of New Accounting Standards—a discussion of new accounting standards and any implications related to our financial statements.

Forward Looking Statements—cautionary information about forward-looking statements and a description of certain risks and uncertainties that could cause our actual results to differ materially from our historical results or our current expectations or projections.

Company Overview

We are one of the largest restaurant companies in the United States operating three restaurant brands in the quick-casual and quick-service restaurant segments with 555 restaurants located in 16 states as of September 30, 2007. We have been operating restaurants for more than 45 years. We own and operate two Hispanic restaurant brands, Pollo Tropical and Taco Cabana (together referred to by us as our Hispanic Brands), which we acquired in 1998 and 2000, respectively. We are also the largest Burger King franchisee, based on the number of restaurants, and have operated Burger King restaurants since 1976. As of September 30, 2007, our company-owned restaurants included 83 Pollo Tropical restaurants and 147 Taco Cabana restaurants, and we operated 325 Burger King restaurants under franchise agreements. We also franchise our Hispanic Brand restaurants with 30 franchised restaurants located in Puerto Rico, Ecuador and the United States as of September 30, 2007. We believe that the diversification and strength of our restaurant brands as well as the geographic dispersion of our restaurants provide us with stability and enhanced growth opportunities. Our primary growth strategy is to develop new company-owned Hispanic Brand restaurants. For the nine months ended September 30, 2007 and 2006, we had total revenues of \$592.2 million and \$562.7 million, respectively, and net income of \$11.5 million and \$9.7 million, respectively.

The following is an overview of the key financial measures discussed in our results of operations:

- *Restaurant sales* consist of food and beverage sales, net of discounts, at our company-owned Hispanic Brand restaurants and the Burger King restaurants we operate under franchise agreements. Restaurant sales are influenced by menu price increases, new restaurant openings, closures of underperforming restaurants, and changes in comparable restaurant sales. The changes in comparable restaurant sales noted below are calculated using only those restaurants open since the beginning of the earliest period being compared and for the entirety of both periods being compared. Restaurants are included in comparable restaurant sales after they have been open for 12 months for our Burger King restaurants and 18 months for our Pollo Tropical and Taco Cabana restaurants.
- *Cost of sales* consists of food, paper and beverage costs including packaging costs, less purchase discounts. Cost of sales is generally influenced by changes in commodity costs, the sales mix of items sold and the effectiveness of our restaurant-level controls to manage food and paper costs. For our Pollo Tropical and Taco Cabana restaurants, we have negotiated directly with local and national suppliers for the purchase of food, paper and beverage products and related supplies. Pollo Tropical and Taco Cabana restaurants' commodities are ordered from approved suppliers and are shipped via distributors directly to our restaurants. Key commodities, including chicken and beef, for our Pollo Tropical and Taco Cabana restaurants are generally purchased under annual contracts. For our Burger King restaurants we are a member of a national purchasing cooperative, Restaurant Services, Inc., a non-profit independent cooperative that serves as the purchasing agent for the commodities for the Burger King franchise system and contracts with various distributors to receive and ship orders directly to our restaurants.
- *Restaurant wages and related expenses* include all restaurant management and hourly productive labor costs, employer payroll taxes, restaurant-level bonuses and related benefits. Payroll and related benefits are subject to inflation, including minimum wage increases and increased costs for health insurance and workers' compensation insurance. A significant number of our hourly staff is paid at rates consistent with the applicable Federal or state minimum wage and, accordingly, increases in minimum wage rates will increase our labor costs. We are insured for workers' compensation, general liability and medical insurance claims under policies where we pay all claims, subject to annual stop-loss limitations both for individual claims and claims in the aggregate.
- *Restaurant rent expense* includes base rent, contingent rent and common area maintenance on our leases characterized as operating leases, reduced by the amortization of gains on sale-leaseback transactions.
- *Other restaurant operating expenses* include all other restaurant-level operating costs, the major components of which are royalty expenses for our Burger King restaurants, utilities, repairs and maintenance, real estate taxes and credit card fees.
- *Advertising expense* includes all promotional expenses including television, radio, billboards and other media. Pollo Tropical and Taco Cabana utilize an integrated, multi-level marketing approach that includes periodic chain-wide promotions, direct mail, in-store promotions, local store marketing and other strategies, including the use of radio and television advertising in their major markets. For our Burger King restaurants we are generally required to contribute 4% of restaurant sales to an advertising fund utilized by the Burger King franchise system for its advertising, promotional programs and public relations activities. We also supplement from time to time, on a discretionary basis, BKC's advertising and promotional activities with our own local advertising and promotions which may include the purchase of additional media or other forms of advertising.

[Table of Contents](#)

- *General and administrative expenses* are comprised primarily of (1) salaries and expenses associated with corporate and administrative functions that support the development and operations of our restaurants, (2) legal and professional fees, including external auditing and related costs, (3) stock-based compensation expense and (4) costs associated with being a publicly-held company.
- *Segment EBITDA*, which is the measure of segment profit or loss used by our chief operating decision maker for purposes of allocating resources to our segments and assessing their performance, is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense, other income and expense and loss on extinguishment of debt. Segment EBITDA may not be necessarily comparable to other similarly titled captions of other companies due to differences in methods of calculation. Segment EBITDA for our Burger King restaurants includes general and administrative expenses related directly to the Burger King segment as well as the expenses associated with administrative support to all three of our segments including executive management, information systems and certain accounting, legal and other administrative functions.
- *Depreciation and amortization* primarily includes the depreciation of fixed assets, including equipment and leasehold improvements utilized in our restaurants, depreciation of assets under lease financing obligations and the amortization of Burger King franchise rights and franchise fees.
- *Interest expense* consists primarily of interest expense associated with the our 9% Senior Subordinated Notes due 2013 (“the Notes”), borrowings under our senior credit facility, amortization of deferred financing costs and imputed interest expense on certain leases entered into in connection with sale-leaseback transactions which are accounted for as lease financing obligations. Interest expense also includes any gains and losses from the settlement of lease financing obligations.

Recent and Future Events Affecting our Results of Operations

Initial Public Offering

In December 2006, we and certain selling stockholders completed an initial public offering (the “IPO”) of 5,666,666 and 5,333,334 shares of our common stock, respectively, (including 1,000,000 shares sold by the selling stockholders upon the underwriters’ exercise of its over-allotment option) at an initial public offering price of \$13.00 per share. We received net proceeds of approximately \$65.4 million from the sale by us of shares of our common stock in the offering after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us. We contributed the net proceeds from the IPO to Carrols, which used such funds to repay approximately \$68.0 million principal amount of term loan borrowings under our prior senior credit facility.

New Senior Credit Facility

On March 9, 2007, Carrols terminated the prior senior credit facility and entered into a loan agreement governing our new senior credit facility with a syndicate of lenders. Carrols’ new senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Notes are not refinanced by June 30, 2012) and a \$65.0 million revolving credit facility maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all outstanding borrowings and other obligations under the Carrols’ prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. For a more detailed discussion of the new senior credit facility, see “Liquidity and Capital Resources.”

Due to the reduction of outstanding debt as a result of our IPO and also to lower LIBOR margin percentages under the new senior credit facility of approximately 1%, we anticipate that interest expense in the fourth quarter of 2007 will be lower than in the fourth quarter of 2006. In addition, we recorded a pretax charge of \$1.5 million in the first quarter of 2007 related to the write off of unamortized deferred financing costs associated with the prior senior credit facility.

Issuance of Stock Options and Restricted Shares

In connection with the IPO, we granted options to purchase 1,241,750 shares of our common stock and issued 75,800 shares of restricted stock under our 2006 Stock Incentive Plan to certain of our employees and directors in December 2006. In the three and nine months ended September 30, 2007, stock-based compensation expense was \$0.4 million and \$1.1 million, respectively. We will record total compensation expense of approximately \$1.5 million in 2007 and additional compensation expense over the next four fiscal years. In addition, we will likely incur additional stock-based compensation expense in future periods for any additional stock option and restricted share grants we make.

[Table of Contents](#)

Public Company Costs

As a public company, we will incur significant legal, accounting and other costs that we have not previously incurred as a private company. The Sarbanes-Oxley Act of 2002 and related rules of the Securities and Exchange Commission and The NASDAQ Stock Market regulate corporate governance practices of public companies. We expect that compliance with these public company requirements, including ongoing costs to comply with Section 404 of the Sarbanes-Oxley Act, which includes documenting, reviewing and testing our internal controls, will increase our general and administrative costs. These costs will also include the costs of our independent registered public accounting firm to issue an opinion on the effectiveness of our internal controls on an annual basis. We will also incur higher costs for director and officer liability insurance. We anticipate additional expenses in 2007 as a consequence of becoming a public company of approximately \$2.0 million to \$2.1 million.

Future Burger King Restaurant Closures

We evaluate the performance of our Burger King restaurants on an ongoing basis. Such evaluation includes many factors, including our assessment of the anticipated future operating results of the restaurant, the cost of required capital improvements that we would need to commit for such restaurants and the location of the restaurant in its current market. If we determine that a Burger King restaurant is underperforming, we may elect to close such restaurant. We closed eight Burger King restaurants in 2006 and three Burger King restaurants in the first nine months of 2007. Excluding any Burger King restaurants which we may relocate under a new franchise agreement in the same market area, we currently anticipate that we will likely elect to close two Burger King restaurants in the fourth quarter of 2007 and seven Burger King restaurants in 2008. Based on the operating results of such closed restaurants, we believe that the future impact on our consolidated results of operations as a result of such restaurant closures will not be material, although there can be no assurance in this regard. Our determination of whether to close such restaurants is subject to further evaluation and may change. We may also elect to close additional Burger King restaurants in the future.

Lease Financing Obligations

We have, in the past, entered into sale-leaseback transactions involving certain restaurant properties that have been classified as financing transactions under Statement of Financial Accounting Standards ("SFAS") No. 98, "Accounting for Leases" ("SFAS 98"). Under the financing method, the assets remain on our consolidated balance sheet and continue to be depreciated and proceeds received by us from these transactions are recorded as a financing liability. Payments under these leases are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

During the second and third quarter of 2006, we exercised our right of first refusal under the leases for 14 restaurant properties and purchased these 14 restaurant properties from the respective lessors. Concurrently with these purchases, the properties were sold in qualified sale-leaseback transactions. We recorded deferred gains representing the amounts by which the sales prices exceeded the net book value of the underlying assets. Deferred gains are being amortized as an adjustment to rent expense over the term of the leases, which is generally 20 years.

In the second and third quarter of 2006 we also amended lease agreements for 34 restaurant properties, all of which were previously accounted for as lease financing obligations, to eliminate or otherwise cure the provisions that precluded the original sale-leaseback accounting under SFAS 98. As a result of such amendments, we recorded these sale-leaseback transactions as sales, removed all of the respective assets under lease financing obligations and related liabilities from our consolidated balance sheet and recognized gains from the sales, which were generally deferred and are being amortized as an adjustment to rent expense over the remaining term of the underlying leases.

As a result of the above transactions that occurred during the second and third quarter of 2006, we reduced our lease financing obligations by \$52.8 million, reduced our assets under lease financing obligations by \$36.2 million and recorded deferred gains of \$18.3 million.

During the second quarter of 2007, we exercised our right of first refusal under the leases for five restaurant properties previously accounted for as lease financing obligations and purchased these properties from the lessor. As a result, we reduced our lease financing obligations by \$4.4 million.

The effect of the recharacterization of all of the transactions described above as qualified sales under SFAS 98 and the payments associated with the related operating leases as restaurant rent expense, rather than as payments of interest and

[Table of Contents](#)

principal associated with lease financing obligations, has been to reduce interest expense, reduce depreciation expense and increase restaurant rent expense.

Postretirement Benefits

On November 1, 2007 the Company amended its postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management personnel. The amendment included an elimination of life insurance benefits for active employees who retire after December 31, 2007 and increases in retiree contributions for both current and future retirees effective January 1, 2008. These amendments will reduce future postretirement benefit obligations and costs beginning in the fourth quarter of 2007.

Executive Summary - Operating Performance for the Three Months Ended September 30, 2007

In the first nine months of 2007, we have opened seven new Pollo Tropical restaurants and seven new Taco Cabana restaurants and closed three Burger King restaurants and three Taco Cabana restaurants.

Total revenues in the third quarter of 2007 increased 7.3% to \$203.5 million from \$189.6 million in the third quarter of 2006. Revenues from our Hispanic Brand restaurants increased 7.8% to \$103.8 million in the third quarter of 2007 from \$96.3 million in the third quarter of 2006 and revenues from our Burger King restaurants increased 6.9% to \$99.7 million in the third quarter of 2007 from \$93.3 million in the third quarter of 2006.

Pollo Tropical revenues increased 11.3% to \$42.6 million during the third quarter of 2007 from \$38.2 million in the third quarter of 2006 due primarily to the opening of 13 new Pollo Tropical restaurants since the beginning of the third quarter of 2006 and a comparable restaurant sales increase at our Pollo Tropical restaurants of 2.3% in the third quarter of 2007.

Taco Cabana revenues increased 5.5% to \$61.3 million during the third quarter of 2007 from \$58.1 million in the third quarter of 2006 due to the opening of twelve new Taco Cabana restaurants since the beginning of the third quarter of 2006. Comparable restaurant sales at Taco Cabana increased 1.2% in the third quarter of 2007.

Total restaurant sales at our Burger King restaurants increased \$6.4 million in the third quarter of 2007 due to a comparable restaurant sales increase of 7.8% driven primarily from a 6.0% increase in customer traffic, offset in part from the closure of five Burger King restaurants since the beginning of the third quarter of 2006.

Restaurant operating margins were negatively impacted in the third quarter of 2007 by higher food costs which increased 1.0%, as a percentage of total restaurant sales, when compared to the third quarter of 2006. This was primarily a result of higher beef and cheese costs at our Burger King and Taco Cabana restaurants, as well as less significant increases in nearly all of other key commodities as well as lower margins on new menu items introduced in 2007 at our Pollo Tropical restaurants.

Advertising expenditures increased 0.4%, as a percentage of total restaurant sales, in the third quarter of 2007 due to the timing of expenditures at our Pollo Tropical and Taco Cabana restaurants.

General and administrative expenses were \$12.3 million in the third quarter of 2007, or 6.1% of restaurant sales, compared to \$11.8 million, or 6.3% of total restaurant sales, in the third quarter of 2006 mostly due to higher costs associated with being a public entity and stock compensation expense of \$0.3 million in the third quarter of 2007.

Interest expense decreased \$2.5 million to \$7.7 million in the third quarter of 2007 from \$10.2 million in the third quarter of 2006 primarily due to lower average outstanding debt balances from the prepayments of borrowings under our prior senior credit facility since the beginning of the third quarter of 2006, including the repayment of \$68.0 million in term loan borrowings from the proceeds of our IPO in December 2006. In addition, our operating subsidiary, Carrols, completed the refinancing of its senior credit facility the first quarter of 2007. As a result of the refinancing, LIBOR margins on our senior secured borrowings were lowered by approximately 1%.

During the third quarter of 2007 we incurred an impairment charge of \$1.7 million associated with an underperforming Pollo Tropical restaurant located in Brooklyn, New York. This restaurant was subsequently closed in the fourth quarter of 2007.

Net income was \$4.9 million in the third quarter of 2007 compared to \$5.1 million in the third quarter of 2006.

Liquidity and Capital Resources

We do not have significant receivables or inventory and receive trade credit based upon negotiated terms in purchasing food products and other supplies. We are able to operate with a substantial working capital deficit because:

- restaurant operations are primarily conducted on a cash basis;
- rapid turnover results in a limited investment in inventories; and
- cash from sales is usually received before related liabilities for food, supplies and payroll become due.

Interest payments under our debt obligations, capital expenditures and payments related to our lease obligations represent significant liquidity requirements for us. We believe cash generated from our operations, availability of borrowing under our revolving credit facility and proceeds from anticipated sale-leaseback transactions will provide sufficient cash availability to cover our anticipated working capital needs, capital expenditures (which include new restaurant development and represent a major investment of cash for us), and debt service requirements for the next twelve months.

Operating activities. Net cash provided from operating activities for the nine months ended September 30, 2007 was \$41.4 million due primarily to net income of \$11.5 million, depreciation and amortization expense of \$23.7 million and non-cash impairment losses of \$1.9 million. In the first quarter of 2007 we also recorded a non-cash pretax loss of \$1.5 million on early extinguishment of debt from the write-off of previously deferred financing costs related to our prior senior credit facility. Net cash provided from operating activities for the nine months ended September 30, 2006 was \$36.9 million due primarily to net income of \$9.7 million, depreciation and amortization expense of \$25.2 million and non-cash impairment losses of \$0.8 million.

Our income tax payments included in operating activities in 2006 were reduced due to the utilization of tax credit carryforwards. For tax years beginning in 2007, we have available Federal alternative minimum tax credit carryforwards of \$1.0 million.

Investing activities including capital expenditures and qualified sale-leaseback transactions. Net cash used for investing activities was \$34.6 million and \$3.0 million for the nine months ended September 30, 2007 and 2006, respectively. Capital expenditures represent a major investment of cash for us and for the nine months ended September 30, 2007 and 2006 were \$40.8 million and \$32.1 million, respectively. Our capital expenditures for the nine months ended September 30, 2007 and 2006 included expenditures for the development of new Pollo Tropical and Taco Cabana restaurants of \$25.4 million and \$20.3 million, respectively.

In the first nine months of 2007, we sold four restaurant properties in sale-leaseback transactions for net proceeds of \$7.0 million. In the first nine months of 2006, we sold 21 restaurant properties in sale-leaseback transactions for net proceeds of \$31.7 million. In the first nine months of 2007 we also sold one Taco Cabana property for net proceeds of \$1.0 million and one non-operating Burger King property for net proceeds of \$0.6 million. The net proceeds from these sales were used to reduce outstanding borrowings under our senior credit facility. We also had expenditures related to the purchase of restaurant properties to be sold in sale-leaseback transactions of \$2.5 million and \$2.7 million in the nine months ended September 30, 2007 and 2006, respectively.

Our capital expenditures are primarily for (1) new restaurant development, which includes the purchase of related real estate; (2) restaurant remodeling, which includes the renovation or rebuilding of the interior and exterior of our existing restaurants, including expenditures associated with Burger King franchise renewals; (3) other restaurant capital expenditures, which include capital restaurant maintenance expenditures for the ongoing reinvestment and enhancement of our restaurants; and (4) corporate and restaurant information systems.

The following table sets forth our capital expenditures for the periods presented (in thousands):

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Burger King</u>	<u>Other</u>	<u>Consolidated</u>
Nine months ended September 30, 2007:					
New restaurant development	\$14,908	\$10,455	\$ 878	\$ —	\$ 26,241
Restaurant remodeling	2,235	—	3,615	—	5,850
Other restaurant capital expenditures (1)	1,299	2,631	2,895	—	6,825
Corporate and restaurant information systems	—	—	—	1,840	1,840
Total capital expenditures	<u>\$18,442</u>	<u>\$13,086</u>	<u>\$7,388</u>	<u>\$1,840</u>	<u>\$ 40,756</u>
Number of new restaurant openings	7	7	—		14
Nine months ended September 30, 2006:					
New restaurant development	\$10,826	\$ 9,457	\$ 87	\$ —	\$ 20,370
Restaurant remodeling	1,150	261	3,474	—	4,885
Other restaurant capital expenditures (1)	1,074	1,915	2,489	—	5,478
Corporate and restaurant information systems	—	—	—	1,324	1,324
Total capital expenditures	<u>\$13,050</u>	<u>\$11,633</u>	<u>\$6,050</u>	<u>\$1,324</u>	<u>\$ 32,057</u>
Number of new restaurant openings	4	7	—		11

- 1) Excludes restaurant repair and maintenance expenses included in other restaurant operating expenses in our consolidated financial statements. For the nine months ended September 30, 2007 and 2006, total restaurant repair and maintenance expenses were approximately \$14.0 million and \$13.3 million, respectively.

[Table of Contents](#)

In 2007, we anticipate that total capital expenditures will range from \$61 million to \$63 million, although the actual amount of capital expenditures may differ from these estimates. These capital expenditures are expected to include approximately \$39 million to \$40 million for the development of new restaurants and purchase of related real estate. In 2007, we currently anticipate that we will open a total of eight to nine new Pollo Tropical restaurants, of which seven were opened as of September 30, 2007, eight new Taco Cabana restaurants, of which seven were opened as of September 30, 2007, and also incur expenditures for three new Burger King restaurants that will open in first quarter of 2008, resulting from the relocation of existing units within their current market areas. Capital expenditures in 2007 also are expected to include expenditures of approximately \$19 million to \$20 million for the ongoing reinvestment in our three restaurant concepts for remodeling costs and capital maintenance expenditures, and approximately \$3 million in other capital expenditures, including capital expenditures related to the replacement and upgrade of our point-of-sale systems.

In 2008 we currently anticipate to open ten to thirteen new Pollo Tropical restaurants and twelve to fourteen new Taco Cabana restaurants. We also currently anticipate closing one Taco Cabana restaurant and having a net reduction of four to five Burger King restaurants in 2008, which contemplates the opening of five to seven new Burger King restaurants, three or four of which will be relocations of existing restaurants within their current market areas.

Financing activities. Net cash used for financing activities for the first nine months of 2007 and 2006 was \$3.1 million and \$40.4 million, respectively. During the nine months ended September 30, 2007 we acquired five properties whose leases were previously accounted for as lease financing obligations and settled lease financing obligations of \$4.4 million. On March 9, 2007, Carrols entered into a new senior credit facility and terminated its prior senior credit facility. Term loan A borrowings of \$120.0 million and an additional \$4.3 million of revolver borrowings under the new senior credit facility were used to repay all outstanding borrowings under the prior senior credit facility and to also pay certain fees and expenses incurred in connection with the new senior credit facility. We incurred \$1.2 million of financing costs related to the new senior credit facility that were deferred.

In the first nine months of 2006, we made total principal payments on borrowings under our prior senior credit facility of \$24.9 million which included voluntary principal repayments of \$23.2 million. We also made payments of \$17.2 million, which were comprised of \$15.2 million to settle lease financing obligations and \$2.0 million of interest, in connection with acquiring 14 leased properties previously accounted for as lease financing obligations.

New Senior Credit Facility. Our new senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Notes are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012.

Both term loan and revolving credit borrowings under the new senior credit facility bear interest at a per annum rate, at our option, of either:

- 1) the applicable margin ranging from 0% to 0.25% based on our senior leverage ratio (as defined in the new senior credit facility), plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or
- 2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on our senior leverage ratio.

Term loan A borrowings shall be due and payable in quarterly installments, beginning on June 30, 2008 as follows:

- 1) four quarterly installments of \$1.5 million beginning on June 30, 2008;
- 2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;
- 3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and

[Table of Contents](#)

- 4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the new senior credit facility, Carrols is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an amount up to 50% of Excess Cash Flow depending upon Carrols' Total Leverage Ratio (as such terms are defined in the new senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by Carrols therefrom, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, obligations under the new senior credit facility are guaranteed by us and all of Carrols' material subsidiaries and are collateralized by a pledge of Carrols' common stock and the stock of each of Carrols' material subsidiaries. The new senior credit facility contains certain covenants, including, without limitation, those limiting our ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of our business, engage in transactions with related parties, make certain investments or pay dividends. In addition, we are required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the new senior credit facility). Carrols was in compliance as of September 30, 2007 with the covenants in the new senior credit facility.

Notes. On December 15, 2004 Carrols issued \$180.0 million of 9% Senior Subordinated Notes due 2013. The Notes bear interest at a rate of 9% payable semi-annually on January 15 and July 15 and mature on January 15, 2013. The Notes are redeemable at the option of Carrols' in whole or in part on or after January 15, 2009 at a price of 104.5% of the principal amount if redeemed before January 15, 2010, 102.25% of the principal amount if redeemed after January 15, 2010 but before January 15, 2011 and at 100% of the principal amount after January 15, 2011.

The Notes are unsecured and guaranteed by Carrols' material subsidiaries. Restrictive covenants under the Notes include limitations with respect to, among other things, Carrols and its material subsidiaries' ability to incur additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. Carrols was in compliance as of and for the nine months ended September 30, 2007 with the restrictive covenants in the indenture governing the Notes.

Indebtedness. At September 30, 2007, we had total debt outstanding of \$356.9 million, comprised of \$180.0 million of Notes, term loan borrowings of \$120.0 million under the new senior credit facility, \$1.2 million of borrowings under the revolving credit facility, lease financing obligations of \$54.4 million and capital lease obligations of \$1.3 million. After reserving \$16.0 million for letters of credit guaranteed by our senior credit facility, \$47.8 million was available for borrowings under the revolving credit facility at September 30, 2007.

Contractual Obligations

A table of our contractual obligations as of December 31, 2006 was included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Other than the change in timing of principal payments under our new senior credit facility discussed above, which does not have a principal payment due until 2008 under the Term loan A facility, there have been no significant changes to our contractual obligations during the nine months ended September 30, 2007.

[Table of Contents](#)

Results of Operations

Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006

The following table sets forth, for the three months ended September 30, 2007 and 2006, selected operating results as a percentage of consolidated restaurant sales:

	<u>2007</u>	<u>2006</u>
Restaurant sales:		
Pollo Tropical	20.8%	20.1%
Taco Cabana	30.1%	30.6%
Burger King	49.1%	49.3%
Total restaurant sales	100.0%	100.0%
Costs and expenses:		
Cost of sales	29.0%	28.0%
Restaurant wages and related expenses	29.3%	29.1%
Restaurant rent expense	5.5%	4.8%
Other restaurant operating expenses	14.9%	15.1%
Advertising expense	3.7%	3.5%
General and administrative (including stock-based compensation expense)	6.1%	6.3%

Since July 1, 2006 through September 30, 2007 we have opened 13 new Pollo Tropical restaurants and twelve new Taco Cabana restaurants. During the same period we closed five Burger King restaurants, four Taco Cabana restaurants and one Pollo Tropical restaurant.

Restaurant Sales. Total restaurant sales for the third quarter of 2007 increased \$13.9 million, or 7.4%, to \$203.2 million from \$189.3 million in the third quarter of 2006 due to sales increases at our Hispanic Brand restaurants of \$7.5 million, or 7.8% and a sales increase of 7.8% at our comparable Burger King restaurants. Restaurant sales at our Hispanic Brand restaurants were \$103.5 million in the third quarter of 2007.

Pollo Tropical restaurant sales increased \$4.3 million, or 11.4%, to \$42.3 million in the third quarter of 2007 due primarily to the opening of 13 new Pollo Tropical restaurants since the beginning of the third quarter of 2006, which contributed \$3.9 million in additional sales in the third quarter of 2007 compared to the third quarter of 2006. Sales also increased 2.3% at our comparable Pollo Tropical restaurants in the third quarter of 2007.

Taco Cabana restaurant sales increased \$3.2 million, or 5.5%, to \$61.2 million in the third quarter of 2007 due primarily to the opening of twelve new Taco Cabana restaurants since the beginning of the third quarter of 2006 which contributed \$3.4 million of additional sales in the third quarter of 2007 compared to the third quarter of 2006. Sales also increased 1.2% at our comparable Taco Cabana restaurants in the third quarter of 2007.

Burger King restaurant sales increased \$6.4 million to \$99.7 million in the third quarter of 2007 due to a comparable restaurant sales increase of 7.8% at our Burger King restaurants in the third quarter of 2007 driven in part by a 6.0% increase

[Table of Contents](#)

in customer traffic. This increase was offset in part from the closure of five Burger King restaurants since the beginning of the third quarter of 2006.

Operating Costs and Expenses. Cost of sales (food and paper costs), as a percentage of total restaurant sales, increased to 29.0% in the third quarter of 2007 from 28.0% in the third quarter of 2006. Pollo Tropical cost of sales, as a percentage of Pollo Tropical restaurant sales, increased to 32.4% in the third quarter of 2007 from 32.1% in the third quarter of 2006 due primarily to lower margins on new menu items introduced in the second quarter of 2007 (0.5% of Pollo Tropical sales in the second quarter of 2007). Higher commodity prices pertaining to our Pollo Tropical restaurants in the third quarter of 2007 (0.7% of Pollo Tropical sales) and higher costs related to restaurants in new markets were offset by the effect of menu price increases made in the last twelve months (1.4% of Pollo Tropical sales). Taco Cabana cost of sales, as a percentage of Taco Cabana restaurant sales, increased to 30.3% in the third quarter of 2007 from 29.0% in the third quarter of 2006 due to higher commodity prices (2.4% of Taco Cabana sales) including higher beef and cheese prices (1.7% of Taco Cabana sales in the third quarter of 2007) partially offset by higher margins on menu item promotions in the third quarter of 2007 (0.5% of Taco Cabana sales) and menu price increases (0.7% of Taco Cabana sales). Burger King cost of sales, as a percentage of Burger King restaurant sales, increased to 26.7% in the third quarter of 2007 from 25.7% in the third quarter of 2006 due primarily to higher commodity prices (1.9% of Burger King sales in the third quarter of 2007), including higher beef, chicken and cheese prices, partially offset by the effect of menu price increases made during the last twelve months (1.1% of Burger King sales).

Restaurant wages and related expenses, as a percentage of total restaurant sales, increased to 29.3% in the third quarter of 2007 from 29.1% in the third quarter of 2006. Pollo Tropical restaurant wages and related expenses, as a percentage of Pollo Tropical restaurant sales, decreased to 24.8% in the third quarter of 2007 from 26.0% in the third quarter of 2006 due to lower medical insurance claim costs (0.6% of Pollo Tropical sales) and lower workers' compensation claim costs (0.5% of Pollo Tropical sales). Taco Cabana restaurant wages and related expenses, as a percentage of Taco Cabana restaurant sales, increased to 28.8% in the third quarter of 2007 from 28.4% in the third quarter of 2006 due primarily to the effect of increases in fixed labor costs on relatively flat sales volumes. Burger King restaurant wages and related expenses, as a percentage of Burger King restaurant sales, increased to 31.5% in the third quarter of 2007 from 30.7% in the second quarter of 2006 due primarily to higher medical insurance claim costs (0.6% of Burger King sales).

Restaurant rent expense, as a percentage of total restaurant sales, increased to 5.5% in the third quarter of 2007 from 4.8% in the third quarter of 2006 due primarily to the reduction in restaurant rent accruals in the third quarter of 2006 related to the termination of a Taco Cabana restaurant lease (0.4% of total restaurant sales) and due to the effect of sale-leaseback transactions entered into since the beginning of the third quarter of 2006.

Other restaurant operating expenses, as a percentage of total restaurant sales, decreased to 14.9% in the third quarter of 2007 from 15.1% in the third quarter of 2006. Pollo Tropical other restaurant operating expenses, as a percentage of Pollo Tropical restaurant sales, was 13.3% in both the third quarter of 2007 and 2006. Taco Cabana other restaurant operating expenses, as a percentage of Taco Cabana restaurant sales, increased to 15.6% in the third quarter of 2007 from 15.4% in the third quarter of 2006 due primarily to higher repair and maintenance expenses to enhance the appearance of our Taco Cabana restaurants (0.4% of Taco Cabana sales) and the timing of new restaurant opening costs (0.2% of Taco Cabana sales) substantially offset by lower electricity utility costs (0.5% of Taco Cabana sales). Burger King other restaurant operating expenses, as a percentage of Burger King restaurant sales, decreased to 15.2% in the third quarter of 2007 from 15.7% in the third quarter of 2006 due to the effect of a 7.8% comparable restaurant sales increase in the third quarter of 2007 on relatively fixed operating costs.

[Table of Contents](#)

Advertising expense, as a percentage of total restaurant sales, increased to 3.7% in the third quarter of 2007 from 3.5% in the third quarter of 2006. Pollo Tropical advertising expense, as a percentage of Pollo Tropical restaurant sales, decreased to 1.5% in the third quarter of 2007 from 1.8% in the third quarter of 2006 due primarily to the timing of promotions. Pollo Tropical advertising costs are currently expected to be approximately 2.4% for all of 2007, but there can be no assurance in this regard. Taco Cabana advertising expense, as a percentage of Taco Cabana restaurant sales, increased to 4.1% in the third quarter of 2007 from 3.3% in the third quarter of 2006 due primarily to the timing of promotions. Taco Cabana advertising costs are currently expected to be approximately 4.1% for all of 2007, but there can be no assurance in this regard. Burger King advertising expense, as a percentage of Burger King restaurant sales was 4.3% in both the third quarter of 2007 and the third quarter of 2006.

General and administrative expenses increased \$0.5 million in the third quarter of 2007 due to stock-based compensation expense of \$0.3 million in the third quarter of 2007 and additional costs associated with being a public entity. There was no stock-based compensation expense in the third quarter of 2006. As a percentage of total restaurant sales, general and administrative expenses decreased to 6.1% in the third quarter of 2007 from 6.3% in the third quarter of 2006.

Segment EBITDA. As a result of the factors above, Segment EBITDA for our Pollo Tropical restaurants increased to \$7.8 million in the third quarter of 2007 from \$6.5 million in the third quarter of 2006. Segment EBITDA for our Taco Cabana restaurants decreased to \$7.3 million in the third quarter of 2007 from \$9.9 million in the third quarter of 2006. Segment EBITDA for our Burger King restaurants was \$9.2 million in both the third quarter of 2007 and the third quarter of 2006.

Depreciation and Amortization and Impairment Losses. Depreciation and amortization expense decreased to \$8.1 million in the third quarter of 2007 from \$8.4 million in the third quarter of 2006 due primarily to lower depreciation associated with our Burger King restaurants. Impairment losses were \$1.8 million in the third quarter of 2007 of which \$1.7 million related to property and equipment for an underperforming Pollo Tropical restaurant located in Brooklyn, New York and \$0.1 million related to property and equipment of certain underperforming Taco Cabana and Burger King restaurants. Impairment losses were \$0.6 million in the third quarter of 2006 and were related to property and equipment of certain underperforming Taco Cabana restaurants.

Interest Expense. Interest expense decreased \$2.5 million to \$7.7 million in the third quarter of 2007 from \$10.2 million in the third quarter of 2006 due to lower average debt balances in the third quarter of 2007 from the prepayments of borrowings since the beginning of the third quarter of 2006 under our prior senior credit facility, including the repayment of \$68.0 million principal amount of term loan borrowings from the IPO proceeds received by us in December 2006. In addition, we had lower LIBOR borrowing margins in the third quarter of 2007 of approximately 1% on our floating rate borrowings under our new senior credit facility. The weighted average interest rate on our long-term debt, excluding lease financing obligations, decreased to 8.1% in the third quarter of 2007 from 8.3% in the third quarter of 2006.

Provision for Income Taxes. The provision for income taxes for third quarter of 2007 was derived using an estimated effective annual income tax rate for all of 2007 of 36.5% as well as the effect of any discrete tax items occurring in the period. We adopted the provisions of Financial Standards Accounting Board ("FASB") Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ("FIN 48") and interpretation of FASB Statement No. 109 ("SFAS 109") on January 1, 2007. As of the adoption date of January 1, 2007, we had \$0.6 million of unrecognized tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.5 million of unrecognized tax benefits expired. We recorded this tax benefit as a discrete tax item in the third quarter of 2007. We also recorded as a discrete tax item in the third quarter of 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards. The provision for income taxes in the third quarter of 2006 was derived using an estimated effective annual income tax rate for 2006 of 33.5%. There were no discrete tax items occurring in the third quarter of 2006.

Net Income. As a result of the foregoing, net income was \$4.9 million in the third quarter of 2007 as compared to \$5.1 million in the third quarter of 2006.

[Table of Contents](#)

Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006

The following table sets forth, for the nine months ended September 30, 2007 and 2006, selected operating results as a percentage of consolidated restaurant sales:

	2007	2006
Restaurant sales:		
Pollo Tropical	21.3%	20.4%
Taco Cabana	30.5%	30.6%
Burger King	48.2%	49.0%
Total restaurant sales	100.0%	100.0%
Costs and expenses:		
Cost of sales	28.6%	28.2%
Restaurant wages and related expenses	29.4%	29.2%
Restaurant rent expense	5.5%	4.8%
Other restaurant operating expenses	14.6%	14.7%
Advertising expense	4.1%	3.7%
General and administrative (including stock-based compensation expense)	6.6%	6.4%

Since January 1, 2006 through September 30, 2007 we have opened 15 new Pollo Tropical restaurants and 16 new Taco Cabana restaurants. During the same period we closed eleven Burger King restaurants, four Taco Cabana restaurants and one Pollo Tropical restaurant.

Restaurant Sales. Total restaurant sales for the first nine months of 2007 increased \$29.4 million, or 5.2%, to \$591.2 million from \$561.7 million in the first nine months of 2006 due to sales increases at our Hispanic Brand restaurants of \$19.8 million, or 6.9%, and a 4.6% sales increase at our comparable Burger King restaurants. Restaurant sales at our Hispanic Brand restaurants were \$306.1 million in the first nine months of 2007.

Pollo Tropical restaurant sales increased \$11.6 million, or 10.1%, to \$126.0 million in the first nine months of 2007 due primarily to the opening of 15 new Pollo Tropical restaurants since the beginning of 2006, which contributed \$11.1 million in additional sales in the first nine months of 2007 compared to the first nine months of 2006. Comparable restaurant sales at our Pollo Tropical restaurants also increased 1.1% in the first nine months of 2007.

Taco Cabana restaurant sales increased \$8.2 million, or 4.8%, to \$180.0 million in the first nine months of 2007 due primarily to the opening of 16 new Taco Cabana restaurants since the beginning of 2006 which contributed \$10.4 million of additional sales in the first nine months of 2007 compared to the first nine months of 2006. This increase was partially offset by a decrease in comparable restaurant sales at our existing Taco Cabana restaurants of 0.1% in the first nine months of 2007 and the closure of four Taco Cabana restaurants since the beginning of 2006.

Burger King restaurant sales increased by \$9.7 million to \$285.1 million in the first nine months of 2007 due to a comparable restaurant sales increase of 4.6% at our Burger King restaurants in the first nine months of 2007 from primarily increases in customer traffic. This increase was offset in part from the closure of eleven Burger King restaurants since the beginning of 2006.

Operating Costs and Expenses. Cost of sales (food and paper costs), as a percentage of total restaurant sales, increased to 28.6% in the first nine months of 2007 from 28.2% in the first nine months of 2006. Pollo Tropical cost of sales, as a percentage of Pollo Tropical restaurant sales, increased to 32.7% in the first nine months of 2007 from 32.5% in the first nine months of 2006 due primarily to lower margins on new menu items introduced in the first nine months of 2007 (0.5% of Pollo Tropical sales) and higher commodity costs, substantially offset by the effect of menu price increases since the beginning of 2006 (1.1% of Pollo Tropical sales). Taco Cabana cost of sales, as a percentage of Taco Cabana restaurant sales, increased to 29.7% in the first nine months of 2007 from 29.0% in the first nine months of 2006 due to higher commodity prices (1.5% of Taco Cabana sales) including higher beef and cheese prices (0.9% of Taco Cabana sales) partially offset by higher margins on menu item promotions in the first nine months of 2007 (0.4% of Taco Cabana sales) and the effect of menu price increases since the beginning of 2006 (0.5% of Taco Cabana sales). Burger King cost of sales, as a percentage of Burger King restaurant sales, increased to 26.1% in the first nine months of 2007 from 25.9% in the first nine months of 2006 due to higher commodity prices (1.1% of Burger King sales) substantially offset by the effect of menu price increases since the beginning of 2006 (1.0% of Burger King sales).

Restaurant wages and related expenses, as a percentage of total restaurant sales, increased to 29.4% in the first nine months of 2007 from 29.2% in the first nine months of 2006. Pollo Tropical restaurant wages and related expenses, as a percentage of Pollo Tropical restaurant sales, decreased to 25.0% in the first nine months of 2007 from 25.2% in the first nine

[Table of Contents](#)

months of 2006 due primarily to lower workers compensation claim costs (0.2% of Pollo Tropical sales). The effect of increases in restaurant hourly labor rates in response to labor market conditions in Florida including an increase in the Florida minimum wage rate were substantially offset by the effect of menu price increases. Taco Cabana restaurant wages and related expenses, as a percentage of Taco Cabana restaurant sales, increased to 28.6% in the first nine months of 2007 from 28.4% in the first nine months of 2006 due to the effect of increases in fixed labor costs on flat sales volumes, offset in part by lower restaurant level bonus accruals (0.2% of Taco Cabana sales). Burger King restaurant wages and related expenses, as a percentage of Burger King restaurant sales, increased to 31.9% in the first nine months of 2007 from 31.4% in the first nine months of 2006 due primarily to higher medical insurance claim costs (0.5% of Burger King sales).

Restaurant rent expense, as a percentage of total restaurant sales, increased to 5.5% in the first nine months of 2007 from 4.8% in the first nine months of 2006 due primarily to the recharacterization of leases late in the second quarter of 2006 and third quarter of 2006 as qualified sale-leaseback transactions rather than as lease financing obligations which increased rent expense by \$2.0 million in the first nine months of 2007 compared to the first nine months of 2006 (0.3% of total restaurant sales). Rent expense also increased as a percentage of total restaurant sales due to the reduction in restaurant rent accruals in the third quarter of 2006 related to the termination of a Taco Cabana restaurant lease (0.2% of total restaurant sales) and the effect of sale-leaseback transactions entered into since the beginning of 2006.

Other restaurant operating expenses, as a percentage of total restaurant sales, decreased slightly to 14.6% in the first nine months of 2007 from 14.7% in the first nine months of 2006. Pollo Tropical other restaurant operating expenses, as a percentage of Pollo Tropical restaurant sales, decreased to 12.6% in the first nine months of 2007 from 12.9% in the first nine months of 2006 due primarily to lower utility costs (0.2% of Pollo Tropical sales) and lower general liability claim costs (0.2% of Pollo Tropical sales). Taco Cabana other restaurant operating expenses, as a percentage of Taco Cabana restaurant sales, were 14.9% in each of the first nine months of 2007 and 2006 as lower utility costs (0.5% of Taco Cabana sales) were offset by higher repair and maintenance expenses (0.3% of Taco Cabana sales) and other restaurant level expenses. Burger King other restaurant operating expenses, as a percentage of Burger King restaurant sales decreased to 15.2% in the first nine months of 2007 from 15.3% in the first nine months of 2006 due primarily to lower utility costs (0.2% of Burger King sales).

Advertising expense, as a percentage of total restaurant sales, increased to 4.1% in the first nine months of 2007 from 3.7% in the first nine months of 2006. Pollo Tropical advertising expense, as a percentage of Pollo Tropical restaurant sales, increased to 2.4% in the first nine months of 2007 from 1.7% in the first nine months of 2006 due to the timing of radio expenditures in 2007 and promotional costs associated with the introduction of new menu items. Pollo Tropical advertising costs are currently expected to be approximately 2.4% for all of 2007, but there can be no assurance in this regard. Taco Cabana advertising expense, as a percentage of Taco Cabana restaurant sales, increased to 4.7% in the first nine months of 2007 from 4.2% in the first nine months of 2006 due primarily to the timing of promotions. Taco Cabana advertising costs are currently expected to be approximately 4.1% for all of 2007, but there can be no assurance in this regard. Burger King advertising expense, as a percentage of Burger King restaurant sales, increased to 4.5% in the first nine months of 2007 from 4.2% in the first nine months of 2006 due to increased promotional activities in certain of our Burger King markets in the first half of 2007.

General and administrative expenses increased \$2.6 million in the first nine months of 2007 or, as a percentage of total restaurant sales, to 6.6% in the first nine months of 2007 from 6.4% in the first nine months of 2006 due primarily to stock-based compensation expense of \$0.9 million in the first nine months of 2007 and additional costs associated with being a public entity. There was no stock-based compensation expense in the first nine months of 2006.

Segment EBITDA. As a result of the factors above, Segment EBITDA for our Pollo Tropical restaurants increased to \$21.9 million in the first nine months of 2007 from \$21.8 million in the first nine months of 2006. Segment EBITDA for our Taco Cabana restaurants decreased to \$22.7 million in the first nine months of 2007 from \$25.7 million in the first nine months of 2006. Segment EBITDA for our Burger King restaurants decreased to \$23.4 million in the first nine months of 2007 from \$26.3 million in the first nine months of 2006.

Depreciation and Amortization and Impairment Losses. Depreciation and amortization expense decreased \$1.5 million to \$23.7 million in the first nine months of 2007 from \$25.2 million in the first nine months of 2006 due in part to the recharacterization of leases as qualified sale-leasebacks rather than lease financing obligations late in the second quarter of 2006 and third quarter of 2006, which lowered depreciation \$0.6 million in the first nine months of 2007 compared to the first nine months of 2006, and also due to lower depreciation associated with our Burger King restaurants. Impairment losses were \$1.9 million in the first nine months of 2007, of which \$1.7 million pertained to property and equipment at an underperforming Pollo Tropical restaurant in Brooklyn, New York. Impairment losses were \$0.8 million in the first nine months of 2006 and were related to property and equipment of certain underperforming Taco Cabana restaurants of \$0.6 million and property and equipment for planned closings of Burger King restaurants of \$0.2 million.

[Table of Contents](#)

Interest Expense. Interest expense decreased \$11.0 million to \$23.6 million in the first nine months of 2007 from \$34.6 million in the first nine months of 2006. The reduction in interest expense in the first nine months of 2007 was due in part to the recharacterization of leases as qualified sale-leasebacks rather than lease financing obligations late in the second quarter of 2006 and third quarter of 2006, which decreased interest expense by \$2.6 million compared to the first nine months of 2006. In addition, interest expense in the first nine months of 2006 also includes \$1.7 million of settlement losses on lease financing obligations as compared to \$0.2 million in settlement gains on lease financing obligations in the first nine months of 2007. Interest expense on lease financing obligations, including settlement gains and losses, was \$4.2 million in the first nine months of 2007 compared to \$8.9 million in the first nine months of 2006.

We also had lower average debt balances in the first nine months of 2007 from the prepayments of borrowings under our prior senior credit facility throughout 2006, including the repayment of \$68.0 million principal amount of term loan borrowings from the IPO proceeds received by us in December 2006. In addition, we had lower LIBOR borrowing margins of approximately 1% on our floating rate borrowings under our new senior credit facility. The weighted average interest rate on our long-term debt, excluding lease financing obligations, for the first nine months of 2007 and 2006 was 8.2% and 8.3%, respectively.

Provision for Income Taxes. The provision for income taxes in the first nine months of 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5% plus discrete tax items recorded in the first nine months of 2007, the effect of which reduced income tax expense by \$0.8 million. The provision for income taxes in the first nine months of 2006 was derived using an estimated effective annual income tax rate for 2006 of 33.5%. There were no discrete tax items recorded in the first nine months of 2006.

Net Income. As a result of the foregoing, net income was \$11.5 million in the first nine months of 2007 compared to \$9.7 million in the first nine months of 2006.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements other than our operating leases, which are primarily for our restaurant properties and not recorded on our consolidated balance sheet.

Application of Critical Accounting Policies

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by the application of our accounting policies. Our significant accounting policies are described in the "Significant Accounting Policies" footnote in the notes to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2006. Critical accounting estimates are those that require application of management's most difficult, subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods.

Sales recognition at our company-owned and operated restaurants is straightforward as customers pay for products at the time of sale and inventory turns over very quickly. Payments to vendors for products sold in the restaurants are generally settled within 30 days. The earnings reporting process is covered by our system of internal controls and generally does not require significant management estimates and judgments. However, critical accounting estimates and judgments, as noted below, are inherent in the assessment and recording of accrued occupancy costs, insurance liabilities, legal obligations, income taxes, the valuation of goodwill and intangible assets for impairment, assessing impairment of long-lived assets and lease accounting matters. While we apply our judgment based on assumptions believed to be reasonable under the circumstances, actual results could vary from these assumptions. It is possible that materially different amounts would be reported using different assumptions.

Accrued occupancy costs. We make estimates of accrued occupancy costs pertaining to closed restaurant locations on an ongoing basis. These estimates require assessment and continuous evaluation of a number of factors such as the remaining contractual period under our lease obligations, the amount of sublease income we are able to realize on a particular property and estimates of other costs such as property taxes. Differences between actual future events and prior estimates could result in adjustments to these accrued costs. At September 30, 2007 we had three non-operating restaurant properties.

Insurance liabilities. We are insured for workers' compensation, general liability and medical insurance claims under policies where we pay all claims, subject to annual stop-loss limitations both for individual claims and claims in the

[Table of Contents](#)

aggregate. At September 30, 2007, we had \$8.7 million accrued for these insurance claims. We record insurance liabilities based on historical and industry trends, which are continually monitored, and adjust accruals as warranted by changing circumstances. Since there are many estimates and assumptions involved in recording these insurance liabilities, including the ability to estimate the future development of incurred claims based on historical trends, differences between actual future events and prior estimates and assumptions could result in adjustments to these liabilities.

Legal obligations. In the normal course of business, we must make estimates of potential future legal obligations and liabilities which require the use of management's judgment. Management may also use outside legal advice to assist in the estimating process. However, the ultimate outcome of various legal issues could be different than management estimates and adjustments to income could be required.

Income taxes. We record income tax liabilities utilizing known obligations and estimates of potential obligations. We are required to record a valuation allowance if it is more likely than not that the value of estimated deferred tax assets are different from those recorded. This would include making estimates and judgments on future taxable income, the consideration of feasible tax planning strategies and existing facts and circumstances. When the amount of deferred tax assets to be realized is expected to be different from that recorded, the asset balance and income statement would reflect any change in valuation in the period such determination is made.

Evaluation of Goodwill. We must evaluate our recorded goodwill under SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") on an ongoing basis. We have elected to conduct our annual impairment review of goodwill assets at December 31. Our review at December 31, 2006 indicated there has been no impairment as of that date. This annual evaluation of goodwill requires us to make estimates and assumptions to determine the fair value of our reporting units including projections regarding future operating results of each restaurant over its remaining lease term and market values. These estimates may differ from actual future events and if these estimates or related projections change in the future, we may be required to record impairment charges for these assets.

Impairment of Long-lived Assets. We assess the potential impairment of long-lived assets, principally property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We determine if there is impairment at the restaurant level by comparing undiscounted future cash flows from the related long-lived assets with their respective carrying values. In determining future cash flows, significant estimates are made by us with respect to future operating results of each restaurant over its remaining lease term. If assets are determined to be impaired, the impairment charge is measured by calculating the amount by which the asset carrying amount exceeds its fair value. This process of assessing fair values requires the use of estimates and assumptions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Impairment of Burger King Franchise Rights. We assess the potential impairment of Burger King franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We determine if there is impairment by comparing the aggregate undiscounted future cash flows from those acquired restaurants with the respective carrying value of franchise rights for each Burger King acquisition. In determining future cash flows, significant estimates are made by us with respect to future operating results of each group of acquired restaurants over their remaining franchise life. If acquired franchise rights are determined to be impaired, the impairment charge is measured by calculating the amount by which the franchise rights carrying amount exceeds its fair value. This process requires the use of estimates and assumptions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Lease Accounting. Judgments made by management for our lease obligations include the lease term including the determination of renewal options that are reasonably assured which can affect the classification of a lease as capital or operating for accounting purposes, the term over which related leasehold improvements for each restaurant are amortized, and any rent holidays and/or changes in rental amounts for recognizing rent expense over the term of the lease. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

We also must evaluate under SFAS 98 sales of our restaurants which occur in sale-leaseback transactions to determine the proper accounting for the proceeds of such sales either as a sale or a financing. This evaluation requires certain judgments in determining whether or not clauses in the lease or any related agreements constitute continuing involvement under SFAS 98. These judgments must also consider the various interpretations of SFAS 98 since its issuance in 1989. For those sale-leasebacks that are accounted for as financing transactions, we must estimate our incremental borrowing rate, or another rate in cases where the incremental borrowing rate is not appropriate to utilize, for purposes of determining interest expense and the resulting amortization of the lease financing obligation. Changes in the determination of the incremental borrowing rates or other rates utilized in connection with the accounting for lease financing transactions could have a significant effect on the interest expense and underlying balance of the lease financing obligations.

[Table of Contents](#)

In addition, if a purchase option exists for any properties subject to a lease financing obligation, the purchase option is evaluated for its probability of exercise on an ongoing basis. This evaluation considers many factors including, without limitation, our intentions, the fair value of the underlying properties, our ability to acquire the property, economic circumstances and other available alternatives to us for the continued use of the property. These factors may change and be considered differently in future assessments of probability.

Stock-based Compensation. Beginning in 2006, we account for stock-based compensation in accordance with SFAS No. 123(R), “Share-Based Payment” (“SFAS No. 123(R)”). As required by SFAS No. 123(R), stock-based compensation is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using the Black-Scholes model which requires the use of certain assumptions. The assumptions include the risk-free rate of interest, expected dividend yield, expected volatility, and the expected life of the award. The risk-free rate of interest is based on the zero coupon U.S. Treasury rates appropriate for the expected term of the award. There are no expected dividends as we do not currently plan to pay dividends on our common stock. Expected stock price volatility is based on the implied volatility of a peer group that had actively traded stock during the period immediately preceding the share-based award grant. This period is equal in length to the award’s expected term as we currently do not have our own historical stock price data. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations.

Effects of New Accounting Standards

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. SFAS 157 is effective for our fiscal year beginning January 1, 2008. We are evaluating the impact the adoption of SFAS 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Liabilities – Including an amendment of FASB Statement No. 115” (“SFAS 159”). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for our fiscal year beginning January 1, 2008. We are currently evaluating the impact the adoption of adopting SFAS 159 will have on our consolidation financial statements.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, Definition of Settlement in FASB Interpretation No. 48 (the “FSP”). The FSP provides guidance about how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. Under the FSP, a tax position could be effectively settled if a taxing authority has completed all of its required or expected examination procedures, if the entity does not intend to appeal or litigate the result and it is remote that the taxing authority would examine or re-examine the tax position. Application of the FSP shall be upon the initial adoption date of FIN 48. Our adoption of the FSP did not have any impact on our consolidated financial statements.

Forward Looking Statements

This Quarterly Report on Form 10-Q contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are predictive in nature or that depend upon or refer to future events or conditions are forward-looking statements. These statements are often identified by the words “may,” “might,” “will,” “should,” “anticipate,” “believe,” “expect,” “intend,” “estimate,” “hope” or similar expressions. In addition, expressions of our strategies, intentions or plans are also forward looking statements. These statements reflect management’s current views with respect to future events and are subject to risks and uncertainties, both known and unknown. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their date. There are important factors that could cause actual results to differ materially from those in forward-looking statements, many of which are beyond our control. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and

[Table of Contents](#)

uncertainties, and that actual results may differ materially from those projected or implied in the forward-looking statements. We believe important factors that could cause actual results to differ materially from our expectations include the following, in addition to other risks and uncertainties discussed herein and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and uncertainties discussed in Part I - Item1A "Risk Factors" :

- *Competitive conditions;*
- *Regulatory factors;*
- *Environmental conditions and regulations;*
- *General economic conditions, particularly at the retail level;*
- *Weather conditions;*
- *Fuel prices;*
- *Significant disruptions in service or supply by any of our suppliers or distributors;*
- *Changes in consumer perception of dietary health and food safety;*
- *Labor and employment benefit costs;*
- *The outcome of pending or future legal proceedings;*
- *Our ability to manage our growth and successfully implement our business strategy;*
- *The risks associated with the expansion of our business;*
- *General risks associated with the restaurant industry;*
- *Our inability to integrate any businesses we acquire;*
- *Our borrowing costs and credit ratings, which may be influenced by the credit ratings of our competitors;*
- *The availability and terms of necessary or desirable financing or refinancing and other related risks and uncertainties;*
- *The risk of events similar to those of September 11, 2001 or an outbreak or escalation of any insurrection or armed conflict involving the United States or any other national or international calamity; and*
- *Factors that affect the restaurant industry generally, including recalls if products become adulterated or misbranded, liability if product consumption causes injury, ingredient disclosure and labeling laws and regulations, reports of cases of "mad cow" disease, avian flu, e coli and other food borne illnesses, and the possibility that consumers could lose confidence in the safety and quality of certain food products, as well as recent publicity concerning the health implications of obesity and transfatty acids.*

Inflation

The inflationary factors that have historically affected our results of operations include increases in food and paper costs, labor and other operating expenses, and most recently, energy costs. Wages paid in our restaurants are impacted by changes in the Federal and state hourly minimum wage rates. Accordingly, changes in the Federal and state hourly minimum wage rates directly affect our labor costs. We typically attempt to offset the effect of inflation, at least in part, through periodic menu price increases and various cost reduction programs. However, no assurance can be given that we will be able to offset such inflationary cost increases in the future.

ITEM 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

There were no material changes from the information presented in Item 7A included in our Annual Report on Form 10-K for the year ended December 31, 2006 with respect to our market risk sensitive instruments.

ITEM 4—CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Our senior management is responsible for establishing and maintaining disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report, with the participation of our Chief Executive Officer and Chief Financial Officer, as well as other key members of management. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2007.

No change occurred in our internal control over financial reporting during the third quarter of 2007 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

There were no material changes to the disclosure made in our Annual Report on Form 10-K for the year ended December 31, 2006 regarding these matters.

Item 1A. Risk Factors

Part I — Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 describes important factors that could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this Form 10-Q or presented elsewhere by management from time-to-time. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Default Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

[Table of Contents](#)

Item 6. Exhibits

(a) The following exhibits are filed as part of this report.

Exhibit No.

31.1	Chief Executive Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc.
31.2	Chief Financial Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc.
31.3	Chief Executive Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation.
31.4	Chief Financial Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation.
32.1	Chief Executive Officer's Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc.
32.2	Chief Financial Officer's Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc.
32.3	Chief Executive Officer's Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation.
32.4	Chief Financial Officer's Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation.

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.

CARROLS RESTAURANT GROUP, INC.

Date: November 9, 2007

/s/ ALAN VITULI

(Signature)

Alan Vituli

Chairman of the Board and
Chief Executive Officer

Date: November 9, 2007

/s/ PAUL R. FLANDERS

(Signature)

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

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.

CARROLS CORPORATION

Date: November 9, 2007

/s/ ALAN VITULI

(Signature)

Alan Vituli

Chairman of the Board and
Chief Executive Officer

Date: November 9, 2007

/s/ PAUL R. FLANDERS

(Signature)

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

CERTIFICATIONS

I, Alan Vituli, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carrols Restaurant Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ ALAN VITULI

Alan Vituli

Chairman of the Board and Chief Executive Officer

CERTIFICATIONS

I, Paul R. Flanders, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carrols Restaurant Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ PAUL R. FLANDERS

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

CERTIFICATIONS

I, Alan Vituli, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carrols Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/S/ ALAN VITULI

Alan Vituli

Chairman of the Board and Chief Executive Officer

CERTIFICATIONS

I, Paul R. Flanders, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carrols Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2007

/s/ PAUL R. FLANDERS

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

**CERTIFICATE PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, Alan Vituli, Chief Executive Officer of Carrols Restaurant Group, Inc. (the "Company"), hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ALAN VITULI

Alan Vituli

Chairman of the Board and Chief Executive Officer

November 9, 2007

**CERTIFICATE PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, Paul R. Flanders, Chief Financial Officer of Carrols Restaurant Group, Inc. (the "Company"), hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ PAUL R. FLANDERS

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

November 9, 2007

**CERTIFICATE PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, Alan Vituli, Chief Executive Officer of Carrols Corporation (the "Company"), hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ALAN VITULI

Alan Vituli

Chairman of the Board and Chief Executive Officer

November 9, 2007

**CERTIFICATE PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned, Paul R. Flanders, Chief Financial Officer of Carrols Corporation (the "Company"), hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Company's Quarterly Report on Form 10-Q for the period ended September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ PAUL R. FLANDERS

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer

November 9, 2007