CARROLS RESTAURANT GROUP, INC.
Form 10-Q
August 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-Q

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

For the quarterly period ended July 1, 2012
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	16-1287774
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
968 James Street Syracuse, New York	13203
(Address of principal executive office)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer (Do not check if smaller reporting company)	o	Smaller reporting company	o

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

As of August 3, 2012, Carrols Restaurant Group, Inc. had 23,677,820 shares of its common stock, $.01 par value, outstanding.

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CARROLS RESTAURANT GROUP, INC.
FORM 10-Q
QUARTER ENDED JULY 1, 2012

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PART I—FINANCIAL INFORMATION

ITEM 1—INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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

	July 1, 2012	January 1, 2012
ASSETS		
Current assets:		
Cash	$58,048	$24,661
Trade and other receivables	4,121	6,673
Inventories	6,941	5,601
Prepaid rent	3,007	4,077
Prepaid expenses and other current assets	3,328	5,522
Refundable income taxes	2,554	2,239
Deferred income taxes	3,106	3,484
Total current assets	81,105	52,257
Restricted cash (Note 7)	20,000	—
Property and equipment, net	123,981	190,310
Franchise rights, net (Note 6)	100,110	67,238
Goodwill (Note 6)	1,450	124,934
Franchise agreements, at cost less accumulated amortization of $6,703 and $6,504, respectively	14,348	5,225
Deferred financing fees	5,404	8,670
Other assets	3,103	9,758
Total assets	$349,501	$458,392
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt (Note 7)	$1,028	$6,553
Accounts payable	15,069	14,759
Accrued interest	1,641	7,178
Accrued payroll, related taxes and benefits	12,538	21,796
Accrued real estate taxes	3,513	4,812
Other liabilities	8,646	8,779
Total current liabilities	42,435	63,877
Long-term debt, net of current portion (Note 7)	159,899	261,966
Lease financing obligations	1,195	10,064
Deferred income—sale-leaseback of real estate	18,810	37,372
Deferred income taxes	7,609	2,234
Accrued postretirement benefits	1,862	2,055
Other liabilities (Note 9)	11,760	21,667
Total liabilities	243,570	399,235
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, par value $.01; authorized 20,000,000 shares, issued and outstanding—100 shares and zero, respectively (Note 12)	—	—

Voting common stock, par value $.01; authorized—100,000,000 shares, issued—23,176,920 and 22,135,663 shares, respectively, and outstanding—22,742,011 and 21,750,237 shares, respectively	227	218
Additional paid-in capital	67,298	6,954
Retained earnings	37,394	51,041
Accumulated other comprehensive income	1,153	1,085
Treasury stock, at cost	(141)	(141)
Total stockholders' equity	105,931	59,157
Total liabilities and stockholders' equity	$349,501	$458,392

The accompanying notes are an integral part of these unaudited consolidated financial statements.
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CARROLS RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
THREE AND SIX MONTHS ENDED JULY 1, 2012 AND JULY 3, 2011
(In thousands of dollars, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Revenues:			—	
Restaurant sales	$122,104	$88,595	$207,554	$170,217
Costs and expenses:				
Cost of sales	38,877	26,497	64,999	50,468
Restaurant wages and related expenses	37,446	27,457	65,314	54,387
Restaurant rent expense	7,979	5,692	13,662	11,402
Other restaurant operating expenses	18,221	13,295	31,864	26,476
Advertising expense	4,604	3,698	7,300	7,082
General and administrative (including stock-based compensation expense of $177, $266, $279 and $522, respectively)	8,081	4,880	14,279	9,975
Depreciation and amortization	6,346	3,959	11,039	7,788
Impairment and other lease charges (Note 5)	101	155	127	971
Other income	—	(342)	—	(448)
Total operating expenses	121,655	85,291	208,584	168,101
Income (loss) from operations	449	3,304	(1,030)	2,116
Interest expense	2,640	2,328	3,555	4,689
Loss on extinguishment of debt	1,509	—	1,509	—
Income (loss) from continuing operations before income taxes	(3,700)	976	(6,094)	(2,573)
Provision (benefit) for income taxes (Note 8)	(2,782)	676	(2,273)	(2,041)
Net income (loss) from continuing operations	(918)	300	(3,821)	(532)
Income from discontinued operations, net of income taxes	668	5,208	44	8,286
Net income (loss)	$(250)	$5,508	$(3,777)	$7,754
Basic net income (loss) per share (Note 13):				
Continuing operations	$(0.04)	$0.01	$(0.17)	$(0.02)
Discontinued operations	$0.03	$0.24	$0.00	$0.38
Diluted net income (loss) per share (Note 13):				
Continuing operations	$(0.04)	$0.01	$(0.17)	$(0.02)
Discontinued operations	$0.03	$0.24	$0.00	$0.38
Shares used in computing net income (loss) per share:				
Basic weighted average common shares outstanding	22,742,257	21,663,181	22,413,285	21,652,950
Diluted weighted average common shares outstanding	22,742,257	22,160,514	22,413,285	21,652,950
Other comprehensive income (loss), net of tax:				
Net income (loss)	$(250)	$5,508	$(3,777)	$7,754
Change in valuation of interest rate swap, net of tax expense of $68 and $42, respectively	106	—	68	—
Comprehensive income (loss)	$(144)	$5,508	$(3,709)	$7,754

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

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CARROLS RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands of dollars)
(Unaudited)

	Common Stock Shares	Preferred Stock	Voting Common Stock	Additional Paid-In Capital	Retained Earnings	Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at January 2, 2011	21,632,402	$—	$ 216	$ 3,474	$39,823	$ 1,535	$(141)	$44,907
Stock-based compensation	—	—	—	2,779	—	—	—	2,779
Exercise of stock options	97,376	—	1	550	—	—	—	551
Vesting of non-vested shares and excess tax benefits	20,459	—	1	151	—	—	—	152
Net income	—	—	—	—	11,218	—	—	11,218
Change in valuation of interest rate swap	—	—	—	—	—	(68)	—	(68)
Change in postretirement benefit obligations	—	—	—	—	—	(382)	—	(382)
Balance at January 1, 2012	21,750,237	$—	218	6,954	51,041	1,085	(141)	59,157
Stock-based compensation	—	$—	—	1,522	—	—	—	1,522
Exercise of stock options	69,824	—	—	295	—	—	—	295
Conversion of stock options	666,090	—	7	(7)	—	—	—	—
Vesting of non-vested shares and excess tax benefits	255,860	—	2	823	—	—	—	825
Issuance of preferred stock (Note 12)	—	—	—	57,711	—	—	—	57,711
Distribution of Fiesta Restaurant Group (Note 3)	—	—	—	—	(9,870)	—	—	(9,870)
Net loss for the six months ended July 1, 2012	—	—	—	—	(3,777)	—	—	(3,777)
Change in valuation of interest rate swap	—	—	—	—	—	68	—	68
Balance at July 1, 2012	22,742,011	$—	$ 227	$ 67,298	$37,394	$ 1,153	$(141)	$ 105,931

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

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CARROLS RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JULY 1, 2012 AND JULY 3, 2011
(In thousands of dollars)
(Unaudited)

	2012	2011
Cash flows provided from (used for) operating activities from continuing operations:		
Net income (loss)	$(3,777)	$7,754
Income from discontinued operations	(44)	(8,286)
Adjustments to reconcile net income (loss) to net cash provided from operating activities of continuing operations:		
Loss (gain) on disposals of property and equipment	9	(250)
Stock-based compensation	279	522
Impairment and other lease charges	127	971
Depreciation and amortization	11,039	7,788
Amortization of deferred financing costs	278	459
Amortization of deferred gains from sale-leaseback transactions	(882)	(918)
Accretion of interest on lease financing obligations	2	2
Deferred income taxes	(2,099)	2,182
Loss on extinguishment of debt	1,509	—
Changes in other operating assets and liabilities	11,846	5,901
Net cash provided from operating activities of continuing operations	18,287	16,125
Cash flows used for investing activities of continuing operations:		
Capital expenditures:		
New restaurant development	—	(1,572)
Restaurant remodeling	(6,556)	(3,497)
Other restaurant capital expenditures	(2,015)	(2,169)
Corporate and restaurant information systems	(8,717)	(1,431)
Total capital expenditures	(17,288)	(8,669)
Acquisition of restaurants from BKC, net of cash acquired	(12,135)	—
Increase in restricted cash balance	(20,000)	—
Proceeds from sales of other restaurant properties	2,082	572
Net cash used for investing activities of continuing operations	(47,341)	(8,097)
Cash flows provided from (used for) financing activities of continuing operations:		
Proceeds from issuance of senior secured second lien notes	150,000	—
Cash of Fiesta Restaurant Group deconsolidated as a result of spin-off	(5,490)	(5,704)
Borrowings on previous revolving credit facilities	19,200	32,700
Repayments on previous revolving credit facilities	(23,200)	(32,700)
Repayments of term loans under prior credit facility	(61,750)	—
Principal payments on term loans under prior credit facilities	(1,625)	(7,036)
Capital contribution to Fiesta Restaurant Group	(2,500)	—
Principal payments on capital leases	(81)	(5)
Excess tax benefits from stock-based compensation	825	—
Financing costs associated with issuance of debt	(5,378)	—
Proceeds from stock option exercises	295	185
Net cash provided from (used for) financing activities of continuing operations	70,296	(12,560)
Net increase in cash from continuing operations	41,242	(4,532)

Net cash provided from operating activities of discontinued operations	3,834	9,188
Net cash used for investing activities of discontinued operations	(15,007)	(6,990)
Net cash provided from financing activities of discontinued operations	3,318	923
Net increase (decrease) in cash from discontinued operations	(7,855)	3,121
Net increase in cash	33,387	(1,411)
Cash, beginning of period	24,661	3,144
Cash, end of period	$58,048	$1,733
Supplemental disclosures:		
Interest paid on long-term debt	$8,508	$8,184
Interest paid on lease financing obligations	$52	$51
Accruals for capital expenditures	$839	$242
Income taxes paid (refunded), net	$4	$(515)
Capital lease obligations incurred	$10,870	$—

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

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

1. Basis of Presentation

Business Description. At July 1, 2012 Carrols Restaurant Group, Inc. ("Carrols Restaurant Group" or the "Company") operated, as franchisee, 574 restaurants under the trade name “Burger King” in 13 Northeastern, Midwestern and Southeastern states.

Basis of Consolidation. Carrols Restaurant Group is a holding company and conducts all of its operations through Carrols Corporation (“Carrols”) and its wholly-owned subsidiaries. The unaudited consolidated financial statements presented herein include the accounts of Carrols Restaurant Group and its wholly-owned subsidiary Carrols. Any reference to “Carrols LLC” refers to Carrols’ wholly-owned subsidiary, Carrols LLC, a Delaware limited liability company.

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.

Burger King Acquisition. On May 30, 2012, the Company completed the acquisition of 278 of Burger King Corporation's ("BKC") company-owned Burger King® restaurants located in Ohio, Indiana, Kentucky, Pennsylvania, North Carolina, South Carolina and Virginia (the "acquired restaurants"). See Note 2—Acquisition for further information.

Spin-Off. On May 7, 2012, the Company completed the spin-off of Fiesta Restaurant Group, Inc. ("Fiesta"), a wholly owned subsidiary of Carrols, through a pro-rata dividend to the shareholders of Carrols Restaurant Group of all of the outstanding shares of Fiesta's common stock (the "Spin-off"). As a result of the Spin-off, the results of operation and cash flows of Fiesta (including the Pollo Tropical and Taco Cabana segments) have been presented as discontinued operations for all periods presented. See Note 3—Discontinued Operations for further information.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to January 1. The fiscal year ended January 1, 2012 contained 52 weeks. The three and six months ended July 1, 2012 and July 3, 2011 each contained thirteen and twenty-six weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and six months ended July 1, 2012 and July 3, 2011 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 three and six months ended July 1, 2012 and July 3, 2011 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 January 1, 2012 contained in the Company’s 2011 Annual Report on Form 10-K, as amended. The January 1, 2012 balance sheet data is derived from those audited financial statements.

Fair Value of Financial Instruments. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. In determining fair value, the accounting standards establish a three level hierarchy for inputs used in measuring fair value as follows: Level 1 inputs are quoted prices in active markets for identical assets or liabilities; Level 2 inputs are observable for the asset or liability, either directly or indirectly, including quoted prices in active markets for similar assets or liabilities; and Level 3 inputs are unobservable and reflect our own assumptions. The following methods were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the fair value:

- Current Assets and Liabilities. The carrying value of cash, restricted cash, and accrued liabilities approximate fair value because of the short maturity of those instruments, which are considered Level 1.

- Carrols Restaurant Group 11.25% Senior Secured Second Lien Notes due 2018. The fair value of outstanding senior secured second lien notes is based on recent trading values, which are considered Level 2, and at July 1, 2012 was approximately $158.3 million.
- Carrols Restaurant Group Senior Secured Credit Facility. There were no outstanding borrowings under the senior secured credit facility at July 1, 2012. Market values for any borrowings would be considered Level 3.

See Note 5 for a discussion of the fair value measurement of non-financial assets.

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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, evaluation for impairment of goodwill, long-lived assets and franchise rights and lease accounting matters. Actual results could differ from those estimates.
Subsequent Events. The Company conducted an evaluation of subsequent events through the issuance date of the Company's financial statements.

2. Acquisition

On May 30, 2012, the Company completed the acquisition of 278 of Burger King Corporation ("BKC") company-owned Burger King® restaurants for a purchase price consisting of (i) a 28.9% equity ownership interest in the Company (subject to certain limitations), (ii) $3.8 million for cash on hand and inventory at the acquired restaurants and (iii) $9.4 million of franchise fees and $3.8 million for BKC's assignment of its right of first refusal on franchisee restaurant transfers in 20 states ("ROFR") pursuant to an operating agreement with BKC entered into at closing. The ROFR is payable in quarterly payments over five years and the first quarterly payment of $0.2 million was made at closing. The Company also entered into new franchise agreements pursuant to the purchase and operating agreements and entered into leases with BKC for all of the acquired restaurants, including leases for 81 restaurants owned in fee by BKC and subleases for 197 restaurants under terms substantially the same as BKC's underlying leases for those properties. Pursuant to the operating agreement, the Company also agreed to remodel 455 Burger King restaurants to BKC's 20/20 restaurant image, including 57 restaurants in 2012, 154 restaurants in 2013, 154 restaurants in 2014 and 90 restaurants in 2015.

The acquisition is accounted for under the purchase method of accounting in accordance with ASC 805, "Business Combinations." The aggregate transaction value, net of cash acquired, was $74.7 million as follows:

Equity consideration - Issuance of 100 shares of Series A Convertible Preferred Stock	$57,711
Cash purchase price:	
Cash	417
Inventory	3,336
Franchise fees	9,443
Right of first refusal	3,805
Total estimated consideration	$74,712

The total cash consideration paid at closing is reconciled as follows:

Fair value of assets acquired, including cash acquired	$74,712
Less: Cash acquired	417
Less: equity consideration - issuance of 100 shares of Series A Convertible Preferred Stock	57,711
Less: additional consideration accrued but not paid	4,449
Net cash paid for the acquisition	$12,135

The value for the Series A Convertible Preferred Stock ("Preferred Stock") was based on 9.4 million shares of common stock, the number of common shares the preferred stock would be convertible into (without giving effect to the issuance limitation), at the stock price of $6.13 per share on the closing date of the acquisition. See Note

12—Preferred Stock for further information.

Under the purchase method of accounting, the aggregate purchase price is allocated to the net tangible and intangible assets based upon their estimated fair values on the acquisition date. The Company has engaged a third party valuation specialist to assist with the valuation of assets acquired. As the values of certain assets and liabilities are preliminary in nature, the fair values for the equity consideration, favorable/unfavorable leases, restaurant equipment, franchise rights and goodwill are subject to adjustment as additional information is obtained. For purposes of a preliminary allocation of the assets acquired and liabilities assumed, the excess of the purchase price over the estimated fair value of net tangible and intangible assets has been assigned to

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franchise rights. The preliminary fair value determination for restaurant equipment was based on the carrying value of equipment of BKC at the date of the acquisition and for restaurant equipment subject to capital lease the market value of such equipment. The amount paid for franchising fees was used for the preliminary fair value determination of such fees as the terms were at market rates. The purchase price allocations will be finalized within twelve months of the closing of the acquisition. When the valuations are finalized, changes to the preliminary valuation of assets acquired or liabilities assumed may result in material adjustments to the fair value of property and equipment, identifiable intangible assets acquired, including franchise rights, and any related goodwill or bargain purchase gain initially recorded.

The preliminary allocation of the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed in the acquisition based on their estimated fair values was as follows (in thousands):

Cash	$417
Inventory	3,336
Restaurant equipment	26,857
Restaurant equipment - subject to capital lease	10,870
Favorable/unfavorable leases	113
Capital lease obligation for equipment	(10,870)
Franchise fees	9,443
Franchise rights	34,546
Net assets acquired	$74,712

The results of operations of the acquired restaurants have been included in our consolidated statements of operations from May 31, 2012, the day following the closing of the acquisition. The acquired restaurants contributed revenues of $27.5 million in the second quarter. It is impracticable to disclose net earnings for the post-acquisition period for these acquired restaurants as net earnings of these restaurants were not tracked on a collective basis due to the integration of administrative functions, including field supervision. During the three and six months ended July 1, 2012, approximately $0.8 million and $1.2 million, respectively, of pretax transaction-related costs related to the acquisition were recorded in general and administrative expense.

The pro forma impact on the results of operations is included in the below table for periods prior to the date of the closing of the acquisition on May 30, 2012 in which the acquisition was not previously consolidated. The pro forma results of operations are not necessarily indicative of the results that would have occurred had the acquisition been consummated at the beginning of the periods presented, nor are they necessarily indicative of any future consolidated operating results. The following table summarizes the Company's unaudited proforma operating results (in thousands):

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Restaurant sales	$174,090	$164,068	$332,978	$315,496
Net loss from continuing operations	$(2,664)	$(967)`	$(8,937)	$(3,762)
Net loss per share from continuing operations, basic and diluted	$(0.12)	$(0.04)	$(0.40)	$(0.17)

This pro forma financial information does not give effect to any anticipated synergies, operating efficiencies or cost savings that may be associated with the acquisition or any integration costs we may incur related to the acquisition.

3. Discontinued Operations

On May 7, 2012, the Company completed the Spin-off of Fiesta, a wholly owned subsidiary of Carrols which included the Pollo Tropical and Taco Cabana restaurant brands, through the distribution in the form of a pro rata dividend of all of Fiesta's issued and outstanding common stock to Carrols Restaurant Group’s stockholders whereby each stockholder

of Carrols Restaurant Group on April 26, 2012 received one share of Fiesta's common stock for every one share of the Company's common stock held. As a result of the Spin-off, Fiesta is now an independent company whose common stock is traded on the NASDAQ Global Select Market under the symbol "FRGI." At the date of the Spin-off, the dividend of Fiesta common stock to our stockholders resulted in a distribution of net assets of $9.9 million to Fiesta. In connection with the Spin-off, on April 24, 2012, Carrols Restaurant Group and Carrols entered into several agreements with Fiesta that govern the Company's post Spin-off relationship with Fiesta, including a Separation and Distribution Agreement,

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Tax Matters Agreement, Employee Matters Agreement and Transition Services Agreement. Amounts earned by Carrols under the Transition Services Agreement were $1.0 million in the second quarter of 2012 and are expected to be approximately $4.4 million for all of 2012.
As a result of the Spin-off, the consolidated statements of operations and statements of cash flows related to Fiesta's businesses have been presented as discontinued operations for all periods presented. There are no remaining Fiesta assets and liabilities as of July 1, 2012 included in the consolidated balance sheet, however, Fiesta's assets and liabilities are included in the consolidated balance sheet at January 1, 2012.
The consolidated statements of operations for periods through the completion of the Spin-off included certain general and administrative expenses associated with administrative support to Fiesta for executive management, information systems and certain accounting, legal and other administrative functions, which had previously been allocated to Fiesta. The allocation of certain of these expenses do not qualify for classification within discontinued operations, and therefore are included as general and administrative expenses within continuing operations. In addition, certain expenses directly related to the Spin-off which had previously been allocated to both the Company and Fiesta have been included in discontinued operations.

The following table details Fiesta's revenues and income (loss) from operations which have been reported in discontinued operations:

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Revenues	$49,222	$121,249	$175,364	$236,865
Income (loss) from discontinued operations before income taxes	1,875	6,395	(744)	13,267
Provision for (benefit from) income taxes	1,207	1,187	(788)	4,981
Net income from discontinued operations	$668	$5,208	$44	$8,286

4. Stock-Based Compensation
In connection with the Spin-off of Fiesta, on March 5, 2012 Carrols Restaurant Group converted all of its outstanding vested stock options to shares of the Company's common stock and all of its outstanding non-vested stock options to non-vested shares of the Company's common stock. The non-vested shares will generally vest over the same period as the non-vested stock options.
Stock-based compensation expense for the three and six months ended July 1, 2012 was $0.2 million and $0.3 million, respectively. As of July 1, 2012, the total non-vested stock-based compensation expense relating to non-vested shares was approximately $1.2 million. The Company expects to record an additional $0.6 million as compensation expense for the remainder of 2012. At July 1, 2012, the remaining weighted average vesting period for non-vested shares was 2.0 years.

Stock Options/Non-vested Shares
A summary of all option activity for the six months ended July 1, 2012 was as follows:

	2006 Plan			
	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Life	Aggregate Intrinsic Value
Options outstanding at January 1, 2012	2,438,327	$9.33	3.2	$8,275
Granted	—	—		
Exercised	(69,824)	4.20		
Cancelled (1)	(2,348,950)	9.51		

Forfeited	(19,553)	6.58		
Options outstanding at July 1, 2012	—	$—	—	$—
Vested or expected to vest at July 1, 2012	—	$—	—	$—
Options exercisable at July 1, 2012	—	$—	—	$—

A summary of all non-vested shares activity for the six months ended July 1, 2012 was as follows:

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

	Shares		Weighted Average Grant Date Price
Nonvested at January 1, 2012	385,426		$7.54
Granted (1)	320,958		11.36
Vested (2)	(255,860	)	7.58
Forfeited	(15,614	)	9.33
Nonvested at July 1, 2012	434,910		$10.24

(1) Includes the conversion of all of outstanding vested stock options to shares of the Company's common stock and all of its outstanding non-vested stock options to non-vested shares of the Company's common stock as discussed above.

(2) Includes accelerated vesting of 200,000 non-vested shares of the Company's common stock of the former Chairman of the board of directors of Fiesta.

5. Impairment of Long-Lived Assets and Other Lease Charges

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 the undiscounted future cash flows over the life of the primary asset for each restaurant 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 and 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. For closed restaurant locations, the Company reviews the future minimum lease payments and related ancillary costs from the date of the restaurant closure to the end of the remaining lease term and records a lease charge for the lease liabilities to be incurred, net of any estimated sublease recoveries.

The Company determined the fair value of restaurant equipment, for those restaurants reviewed for impairment, based on current economic conditions and the Company’s history of using these assets in the operation of its business. These fair value asset measurements rely on significant unobservable inputs and are considered Level 3 in the fair value hierarchy.

During the three and six months ended July 1, 2012 and July 3, 2011, the Company recorded impairment charges of $$0.1 million, $0.1 million, $0.2 million and $1.0 million, respectively, related to certain underperforming restaurants.

6. Goodwill and Franchise Rights

Goodwill. The Company is required to review goodwill for impairment annually, or more frequently, when events and circumstances indicate that the carrying amount may be impaired. If the determined fair value of goodwill is less than the related carrying amount, an impairment loss is recognized. 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.

There have been no goodwill impairment losses during the six months ended July 1, 2012 or the year ended January 1, 2012. The change in goodwill balances is summarized below:

	Balance, January 1, 2012	Discontinued operations		Balance, July 1, 2012
Goodwill	$124,934	(123,484	)	$1,450

Franchise Rights. Amounts allocated to franchise rights for each acquisition of Burger King restaurants are amortized using the straight-line method over the average remaining term of the acquired franchise agreements 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 cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each 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. No impairment charges were recorded related to the Company's franchise rights for the three and six months ended July 1, 2012 and July 3, 2011.

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

Amortization expense related to franchise rights was $875 and $799 for the three months ended July 1, 2012 and July 3, 2011, respectively, and $1,673 and $1,598 for the six months ended July 1, 2012 and July 3, 2011, respectively. The Company estimates the amortization expense for the year ending December 30, 2012 to be $3,764 and for each of the five succeeding years to be $4,181. These estimates are based on a preliminary purchase price allocation of the acquisition discussed in Note 2.

7. Long-term Debt

Long-term debt at July 1, 2012 and January 1, 2012 consisted of the following:

	July 1, 2012	January 1, 2012
Collateralized:		
Carrols Restaurant Group 11.25% Senior Secured Second Lien Notes	$150,000	$—
Prior Carrols LLC Revolving Credit borrowings	—	4,000
Prior Carrols LLC Credit Facility-Term loan borrowings	—	63,375
Fiesta Restaurant Group 8.875% Senior Secured Second Lien Notes	—	200,000
Capital leases	10,927	1,144
	160,927	268,519
Less: current portion	(1,028)	(6,553)
	$159,899	$261,966

Carrols Restaurant Group Senior Secured Second Lien Notes. On May 30, 2012, Carrols Restaurant Group issued $150.0 million of 11.25% Senior Secured Second Lien Notes due 2018 (the "Notes") pursuant to an indenture dated as of May 30, 2012 governing such notes. Proceeds from the issuance of the Notes were used to repay $64.8 million of borrowings under the Carrols LLC senior credit facility, to pay $12.0 million related to the acquisition of Burger King restaurants from BKC, to pay $4.5 million for fees and expenses related to the offering of the Notes paid at closing and to fund a $20.0 million cash collateral account required under the Company's new senior credit facility discussed below. The remainder of the proceeds of $48.7 million will be used together with anticipated operating cash flow and the cash collateral account, as it becomes unrestricted, to fund the restaurant remodeling obligations committed to in connection with the acquisition, and to fund future payments to BKC for the ROFR acquired in the acquisition.

The Notes mature and are payable on May 15, 2018. Interest is payable semi-annually on May 15 and November 15, beginning November 15, 2012. The Notes are guaranteed by Carrols Restaurant Group’s material subsidiaries and are secured by second-priority liens on substantially all of Carrols Restaurant Group’s and its material subsidiaries’ assets (including a pledge of all of the capital stock and equity interests of its material subsidiaries).

The Notes are redeemable at the option of Carrols Restaurant Group in whole or in part at any time after May 15, 2015 at a price of 105.625% of the principal amount plus accrued and unpaid interest, if any, if redeemed before May 15, 2016, 102.813% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 15, 2016 but before May 15, 2017 and 100% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 15, 2017. Prior to May 15, 2015, Carrols Restaurant Group may redeem some or all of the Notes at a redemption price of 100% of the principal amount of each note plus accrued and unpaid interest, if any, and a make-whole premium. In addition, the indenture governing the Notes also provides that the Company may redeem up to 35% of the Notes using the proceeds of certain equity offerings completed before May 15, 2015.

The Notes are jointly and severally guaranteed, unconditionally and in full by the Company's material subsidiaries which are directly or indirectly 100% owned by the Company. Separate condensed consolidating information is not included because the Company is a holding company that has no independent assets or operations. There are no significant restrictions on the ability of the Company or any of the guarantor subsidiaries to obtain funds from its

respective subsidiaries. All consolidated amounts in the Company's financial statements are representative of the combined guarantors.

The indenture governing the Notes includes certain covenants, including limitations and restrictions on Carrols Restaurant Group and its material subsidiaries who are guarantors under such indenture to, among other things: incur indebtedness or issue preferred stock; incur liens; pay dividends or make distributions in respect of capital stock or make certain other restricted payments or investments; sell assets; agree to payment restrictions affecting certain subsidiaries; enter into transaction with affiliates; or merge, consolidate or sell substantially all of the Company's assets.

The indenture covering the Notes and the security agreement provide that any capital stock and equity interests of any of the Company's material subsidiaries will be excluded from the collateral to the extent that the par value, book value or market value of such capital stock or equity interests exceeds 20% of the aggregate principal amount of the Notes then outstanding.

The indenture governing the Notes contains customary default provisions, including without limitation, a cross default provision pursuant to which it is an event of default under these notes and the indenture if there is a default under any indebtedness of Carrols Restaurant Group having an outstanding principal amount of $15.0 million or more which results in the acceleration of such indebtedness prior to its stated maturity or is caused by a failure to pay principal when due. Carrols Restaurant Group was in compliance as of July 1, 2012 with the restrictive covenants of the indenture governing the Notes.

Carrols Restaurant Group Senior Credit Facility. On May 30, 2012, Carrols Restaurant Group entered into a senior credit facility, which provides for aggregate revolving credit borrowings of up to $20.0 million (including $15.0 million available for letters of credit) maturing on May 30, 2017. The senior credit facility also provides for incremental borrowing increases of up to $25.0 million, in the aggregate.

Under the senior credit facility (all terms not otherwise defined herein are defined in Carrols Restaurant Group's senior credit facility), Carrols Restaurant Group has deposited $20.0 million in an account with the Administrative Agent as collateral for the senior credit facility until the date on which its Adjusted Leverage Ratio is less than 6.00x for two consecutive fiscal quarters (the “Cash Collateral Release Date"). This amount is classified as restricted cash on the consolidated balance sheet as of July 1, 2012.

Prior to the Cash Collateral Release Date, revolving credit borrowings under the facility bear interest at a rate per annum, at Carrols Restaurant Group’s option, of:

(i) the Alternate Base Rate plus the applicable margin of 0.75% or

(ii) the LIBOR Rate plus the applicable margin of 1.75%

Following the Cash Collateral Release Date, borrowings under the senior credit facility will bear interest at a rate per annum, at Carrols Restaurant Group’s option, of

(i) the Alternate Base Rate plus the applicable margin of 2.50% to 3.25% based on Carrols Restaurant Group’s Adjusted Leverage Ratio, or

(ii) the LIBOR Rate plus the applicable margin of 3.50% to 4.25% based on Carrols Restaurant Group’s Adjusted Leverage Ratio.

Carrols Restaurant Group’s obligations under the senior credit facility are guaranteed by its material subsidiaries and are secured by first priority liens on substantially all of the assets of Carrols Restaurant Group and its material subsidiaries, including a pledge of all of the capital stock and equity interests of the material subsidiaries.

Under the senior credit facility, Carrols Restaurant Group will be required to make mandatory prepayments of borrowings in the event of dispositions of assets, debt issuances and insurance and condemnation proceeds (all subject to certain exceptions).

The senior credit facility contains certain covenants, including, without limitation, those limiting Carrols Restaurant Group’s and its material subsidiaries' ability to, among other things, incur indebtedness, incur liens, sell or acquire assets or businesses, change the character of its business in all material respects, engage in transactions with related parties, make certain investments, make certain restricted payments or pay dividends. In addition, the senior credit facility requires Carrols Restaurant Group to meet certain financial ratios, including Fixed Charge Coverage Ratio and Adjusted Leverage Ratio (all as defined under the senior credit facility), however the Company is not required to be in compliance with such ratios so long as the senior credit facility is cash collateralized.

The senior credit facility contains customary default provisions, including that the lenders may terminate their obligation to advance and may declare the unpaid balance of borrowings, or any part thereof, immediately due and payable upon the occurrence and during the continuance of customary defaults which include, without limitation,

payment default, covenant defaults, bankruptcy type defaults, cross-defaults on other indebtedness, judgments or upon the occurrence of a change of control.

After reserving $4.8 million for letters of credit issued under the facility for workers' compensation and other insurance policies, $15.2 million was available for borrowing under the revolving credit facility at July 1, 2012.

Prior Carrols LLC Senior Credit Facility. On August 5, 2011 Carrols LLC entered into a senior secured credit facility, which

provided for $65.0 million aggregate term loan borrowings and a revolving credit facility which provided for aggregate borrowings of up to $20.0 million (including $10.0 million available for letters of credit) both maturing on August 5, 2016.

The term loan borrowings under the prior Carrols LLC senior secured credit facility were payable in consecutive quarterly principal payments of $1.625 million. This credit facility was paid off in connection with the issuance of the Notes in 2012.

8. Income Taxes

The provision (benefit) for income taxes for the three and six months ended July 1, 2012 and July 3, 2011 was comprised of the following:

	Three Months Ended July 1, 2012		Six Months Ended July 1, 2012	
	2012	2011	2012	2011
Current	$1,115	$(1,506)	$(174)	$(4,223)
Deferred	(3,897)	2,182	(2,099)	2,182
	$(2,782)	$676	$(2,273)	$(2,041)

The benefit for income taxes for the three and six months ended July 1, 2012 was derived using an estimated effective annual income tax rate for all of 2012 of 42.9%, which excludes any discrete tax adjustments. Discrete tax adjustments decreased the benefit for income taxes by $0.3 million in both the three and six months ended July 1, 2012.

The provision (benefit) for income taxes for the three and six months ended July 3, 2011 was derived using an effective annual income tax rate for 2011 of 76.7%, which excludes any discrete tax adjustments. The 2011 effective tax rate is higher than 2012 due to a disproportional level of employment related tax credits in 2011. Discrete tax adjustments decreased the provision for income taxes by $0.1 million in both the three and six months ended July 3, 2011.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of July 1, 2012 and January 1, 2012, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions.

The tax years 2008-2011 remain open to examination by the major taxing jurisdictions to which the Company is subject. Although it is not reasonably possible to estimate the amount by which unrecognized tax benefits may increase within the next twelve months due to the uncertainties regarding the timing of any examinations, the Company does not expect unrecognized tax benefits to significantly change in the next twelve months.

9. Other Liabilities, Long-Term

Other liabilities, long-term, at July 1, 2012 and January 1, 2012 consisted of the following:

	July 1, 2012	January 1, 2012
Accrued occupancy costs	$4,829	$14,296
Accrued workers’ compensation and general liability claims	1,411	3,208
Deferred compensation	258	965
Obligation to BKC for right of first refusal	2,853	—
Other	2,409	3,198
	$11,760	$21,667

Accrued occupancy costs include obligations pertaining to closed restaurant locations, contingent rent and accruals to expense operating lease rental payments on a straight-line basis over the lease term.

10. Commitments and Contingencies

Lease Guarantees. As of July 1, 2012, the Company is a guarantor under 38 Fiesta restaurant property leases, with lease terms expiring on various dates through 2030, and is the primary lessee on five Pollo Tropical restaurant property leases, which it subleases to Fiesta. The Company is fully liable for all obligations under the terms of the leases in the event that Fiesta fails to pay any sums due under the lease, subject to indemnification provisions of the Separation and Distribution Agreement.

The maximum potential liability for future rental payments the Company could be required to make under these leases at July 1, 2012 was $62.1 million. The obligations under these leases will generally continue to decrease over time as these operating leases expire. No payments have been made to date and none are expected to be required to be made in the future. The Company has not recorded a liability for those guarantees in accordance with ASC 460 - Guarantees as Fiesta has indemnified the Company for all such obligations and the Company did not believe it was probable it would be required to perform under any of the guarantees or direct obligations.

Litigation. The Company is a party to various litigation matters incidental to the conduct of the Company's 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.

11. Transactions with Related Parties

As part of the acquisition, the Company issued to BKC 100 shares of Series A Convertible Preferred Stock which is convertible into 28.9% of the outstanding shares of common stock calculated on the date of the closing of the acquisition on a fully diluted basis, subject to issuance limitations. See Note 12—Preferred Stock for further information. BKC also, as a result of the acquisition, has two representatives on the Company's board of directors.

Each of our Burger King restaurants operates under a separate franchise agreement with BKC. These franchise agreements generally provide for an initial term of twenty years and currently have an initial franchise fee of $50. Any franchise agreement, including renewals, can be extended at our discretion for an additional 20 year term, with BKC's approval, provided that, among other things, the restaurant meets the current Burger King image standard and the Company is not in default under terms of the franchise agreement.

In addition to the initial franchise fee, the Company generally pays BKC a monthly royalty for both new restaurants and for successor franchise agreements at a rate of 4.5% of sales. Royalty expense was $5.1 million and $3.5 million in the three months ended July 1, 2012 and July 3, 2011, respectively, and $8.5 million and $6.8 million in the six months ended July 1, 2012 and July 3, 2011, respectively.

The Company is also generally required to contribute 4% of restaurant sales from our Burger King restaurants to an advertising fund utilized by BKC for its advertising, promotional programs and public relations activities. Advertising expense was $4.6 million and $3.5 million in the three months ended July 1, 2012 and July 3, 2011 and $7.3 million and $6.8 million in the six months ended July 1, 2012 and July 3, 2011, respectively.

As of July 1, 2012, the Company leased 298 of its restaurant locations from BKC, representing 51.8% of the total number of restaurants in operation. For 197 of the acquired restaurants, the terms and conditions of the lease with BKC are identical to those between BKC and the third-party lessor. Aggregate rent under these BKC leases for the three months ended July 1, 2012 and July 3, 2011 was $2.6 million and $0.4 million, respectively, and for the six months ended July 1, 2012 and July 3, 2011 was $3.1 million and $0.9 million, respectively. The Company believes the related party lease terms have not been significantly affected by the fact that the Company and BKC are deemed to be related parties.

As of July 1, 2012, the Company owed BKC $3.6 million associated with its purchase of the right of first refusal related to the acquisition of BKC restaurants and $4.9 million related to the payment of advertising and royalties, which is remitted on a monthly basis.

12. Preferred Stock

In connection with the acquisition of restaurants from BKC discussed in Note 2, the Company issued to BKC 100 shares of Series A Convertible Preferred Stock pursuant to a certificate of designation which is convertible into 28.9% of the outstanding shares of Carrols Restaurant Group Common Stock ("Carrols Common Stock") calculated on the

date of the closing of the acquisition on a fully diluted basis after giving effect to its issuance, or an aggregate of 9,414,580 shares of Carrols' Common Stock. The Preferred Stock is subject to certain restrictions limiting its conversion and limiting the issuance of the shares of Carrols Common Stock upon the conversion to not exceed 19.9% of the outstanding shares of Carrols Common Stock as of the date of issuance (the "issuance limitation"). Pursuant to the purchase agreement, the removal of the issuance limitation will be subject to obtaining the approval of Carrols Restaurant Group stockholders.

The Preferred Stock and the shares of Carrols Common Stock to be issued upon conversion are subject to a three-year restriction on transfer or sale by BKC from the date of the issuance and rank senior to Carrols Common Stock with respect to rights on liquidation, winding-up and dissolution of Carrols Restaurant Group. The Preferred Stock is perpetual and will receive any dividends and amounts upon a liquidation event on an as converted basis, without regard to the issuance limitation, does not

pay interest and has no mandatory prepayment features.
BKC also has certain approval rights as set forth in the certificate of designation for the Preferred Stock so long as it owns greater than 10.0% of the outstanding shares of Carrols Common Stock (on an as-converted basis). The Preferred Stock will vote with the Company's common stock on an as converted basis (subject to the issuance limitation) and provides for the right of BKC to elect (a) two members to the Company's board of directors until the date on which the number of shares of common stock into which the outstanding shares of the Preferred Stock held by BKC are then convertible constitutes less than 14.5% of the total number of outstanding shares of common stock and (b) one member to the Company's board of directors until BKC owns Preferred Stock (on an as converted basis to common stock) which equals less than 10.0% of the total number of outstanding shares of common stock.

13. Net Income (Loss) per Share
Basic net income per share is computed on the basis of weighted average outstanding common shares. Diluted net income per share is computed on the basis of basic weighted average outstanding common shares adjusted for the dilutive effect of stock options, if dilutive. The numerator of the diluted net income per share calculation is increased by the allocation of net income and dividends declared to nonvested shares, if the net impact is dilutive.
The Company has determined that certain nonvested share awards (also referred to as restricted stock awards) and the Preferred Stock issued by the Company are participating securities because they have non-forfeitable rights to dividends. Accordingly, basic net income per share is calculated under the two-class method calculation. In determining the number of diluted shares outstanding, the Company is required to disclose the more dilutive earnings per share result between the treasury stock method calculation and the two-class method calculation.
The computation of basic and diluted net income per share for the three and six months ended July 1, 2012 and July 3, 2011 were as follows:

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Basic net income (loss) per share:				
Net income (loss) from continuing operations	$(918)	$300	$(3,821)	$(532)
Net income from discontinued operations	$668	$5,208	$44	$8,286
Weighted average common shares outstanding	22,742,257	21,663,181	22,413,285	21,652,950
Basic net income (loss) per share from continuing operations	$(0.04)	$0.01	$(0.17)	$(0.02)
Basic net income per share from discontinued operations	$0.03	$0.24	$0.00	$0.38
Diluted net income (loss) per share:				
Net income (loss) from continuing operations	$(918)	$300	$(3,821)	$(532)
Net income from discontinued operations	$668	$5,208	$44	$8,286
Shares used in computing basic net income (loss) per share	22,742,257	21,663,181	22,413,285	21,652,950
Dilutive effect of preferred stock, non-vested shares and stock options	—	497,333	—	—
Shares used in computing diluted net income (loss) per share	22,742,257	22,160,514	22,413,285	21,652,950
Diluted net income (loss) per share from continuing operations	$(0.04)	$0.01	$(0.17)	$(0.02)
Diluted net income per share from discontinued operations	$0.03	$0.24	$0.00	$0.38
Shares excluded from diluted net income (loss) per share computation (1)	9,849,490	1,031,344	9,849,490	1,478,196

(1) These shares subject to preferred stock, stock options and non-vested shares were not included in the computation of diluted net income (loss) per share because they would have been antidilutive for the periods presented.

14. Recent Accounting Developments

In September 2011, the Financial Accounting Standards Board ("FASB") issued guidance on testing goodwill for impairment. The guidance provides entities an option to perform a "qualitative" assessment to determine whether further impairment testing is necessary. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, provided that the entity has not yet performed its 2011 annual impairment

test or issued its financial statements. The Company is evaluating the impact of this guidance on its annual testing for goodwill impairment at December 30, 2012.

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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.

We use a 52-53 week fiscal year ending on the Sunday closest to December 31. The fiscal years ended January 1, 2012 and January 2, 2011 each contained 52 weeks and the three and six months ended July 1, 2012 and July 3, 2011 each contained thirteen and twenty-six weeks, respectively.

Introduction

We are a holding company and conduct all of our operations through our direct and indirect subsidiaries and have no assets other than the shares of capital stock of Carrols, our direct wholly-owned subsidiary. 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 our Consolidated Financial Statements and the accompanying financial statement notes appearing elsewhere in this report and our Annual Report on Form 10-K for the year ended January 1, 2012, as amended. 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.

Operating Results from Continuing Operations—an analysis of our results of continuing operations for the three and six months ended July 1, 2012 compared to the three and six months ended July 3, 2011, respectively, including a review of material items and known trends and uncertainties.

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.

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 projections.

Company Overview

We are one of the largest restaurant companies in the United States and have been operating restaurants for more than 50 years. We are the largest Burger King franchisee in the world and have operated Burger King restaurants since 1976. As of July 1, 2012, we operated 574 Burger King restaurants in 13 states. On May 30, 2012, we acquired 278 of Burger King Corporation, which we refer to as "BKC", company-owned Burger King® restaurants which we refer to as the "acquired restaurants". Our restaurants operated prior to the acquisition are referred to as our "legacy restaurants". Our former indirect wholly-owned subsidiary, Fiesta Restaurant Group, Inc., which we refer to as "Fiesta", was spun off by us to our stockholders on May 7, 2012, which we refer to as the "spin-off". The discussion in our MD & A is focused on our continuing Burger King restaurant operations.

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 restaurants. Restaurant sales are influenced by changes in comparable restaurant sales, menu price increases, new restaurant openings and closures of restaurants. Restaurants are included in comparable restaurant sales after they have been open for 12 months. For comparative purposes, the calculation of the changes in comparable restaurant sales is based on a 52-week year.
- 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.

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- Restaurant wages and related expenses include all restaurant management and hourly productive labor costs and related benefits, employer payroll taxes and restaurant-level bonuses. Payroll and related benefits are subject to inflation, including minimum wage increases and increased costs for health insurance, workers' compensation insurance and state unemployment insurance.
- Restaurant rent expense includes base rent and contingent rent on our leases characterized as operating leases, reduced by the amortization of deferred gains on sale-leaseback transactions.
- Other restaurant operating expenses include all other restaurant-level operating costs, the major components of which are royalty expenses paid to BKC, utilities, repairs and maintenance, real estate taxes and credit card fees.
- Advertising expense includes all promotional expenses including advertising payments based on a percentage of sales as required under our franchise agreements.
- 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, auditing and other professional fees and (3) stock-based compensation expense. Historical general and administrative expenses are shown net of allocations to Fiesta for periods prior to the spin-off. Amounts charged under a transition services agreement with Fiesta subsequent to the spin-off are recorded as an offset to general and administrative expenses and were $1.0 million in the second quarter of 2012.
- EBITDA and Adjusted EBITDA. EBITDA and Adjusted EBITDA are non-GAAP financial measures. EBITDA represents net income (loss) from continuing operations, before provision (benefit) for income taxes, interest expense and depreciation and amortization. Adjusted EBITDA represents EBITDA as adjusted to exclude impairment and other lease charges, acquisition related expenses, stock compensation expense and loss on extinguishment of debt. We exclude these items from EBITDA when evaluating our operating performance and believe that Adjusted EBITDA provides a more meaningful comparison than EBITDA of our core business operating results, as well as with those of other similar companies that may have different capital structures. Management believes that EBITDA and Adjusted EBITDA, when viewed with our results of operations calculated in accordance with GAAP and our reconciliation of Adjusted EBITDA to net income (loss) from continuing operations, provide useful information about our operating performance and period-over-period growth, and provide additional information that is useful for evaluating the operating performance of our core business without regard to potential distortions. Additionally, management believes that EBITDA and Adjusted EBITDA permit investors to gain an understanding of the factors and trends affecting our ongoing cash earnings, from which capital investments are made and debt is serviced. However, EBITDA and Adjusted EBITDA are not measures of financial performance or liquidity under GAAP and, accordingly, should not be considered as alternatives to net income (loss) from continuing operations or cash flow from operating activities as indicators of operating performance or liquidity. Also, these measures may not be comparable to similarly titled captions of other companies. For a reconciliation between net income (loss) from continuing operations and EBITDA and Adjusted EBITDA see page 24.

EBITDA and Adjusted EBITDA, have important limitations as analytical tools. These limitations include the following:

- EBITDA and Adjusted EBITDA do not reflect our capital expenditures, future requirements for capital expenditures or contractual commitments to purchase capital equipment;
- EBITDA and Adjusted EBITDA do not reflect the interest expense or the cash requirements necessary to service principal or interest payments on our debt;
- Although depreciation and amortization are non-cash charges, the assets that we currently depreciate and amortize will likely have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect the cash required to fund such replacements; and
- EBITDA and Adjusted EBITDA do not reflect the effect of earnings or charges resulting from matters that our management does not consider to be indicative of our ongoing operations. However, some of these charges (such as impairment expense) have recurred and may reoccur.
- Depreciation and amortization primarily includes the depreciation of fixed assets, including equipment, owned buildings and leasehold improvements utilized in our restaurants and the amortization of franchise rights and franchise fees.

- Impairment and other lease charges are determined through our assessment of the recoverability of property and equipment and intangible assets by determining whether the carrying value of these assets can be recovered over their respective

remaining lives through undiscounted future operating cash flows. A potential impairment charge is evaluated whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable. Lease charges are recorded for our obligations under the related leases for closed locations net of estimated sublease recoveries.

- Interest expense consists primarily of interest expense associated with our 11.25% Senior Secured Second Lien Notes due 2018 (the "Notes"), borrowings under our prior Carrols LLC senior secured credit facility and the amortization of deferred financing costs.

Recent and Future Events Affecting our Results of Operations

Acquisition of Burger King Restaurants

On May 30, 2012, we completed the acquisition of 278 of BKC company-owned Burger King restaurants, which we refer to as the "acquisition", for a purchase price consisting of (i) a 28.9% equity ownership interest (subject to the issuance limitation described below), (ii) $3.8 million for cash on hand and inventory at the acquired restaurants and (iii) $9.4 million of franchise fees and $3.8 million for BKC’s assignment of its right of first refusal on franchisee restaurant transfers in 20 states ("ROFR") pursuant to an Operating Agreement, which we refer to as the "operating agreement", dated as of May 30, 2012 with BKC. The amount for the ROFR is payable in quarterly payments over five years and the first quarterly payment of $0.2 million was made at closing. We also entered into new franchise agreements pursuant to the purchase and operating agreements and entered into leases with BKC for all of the acquired restaurants, including leases for 81 restaurants owned in fee by BKC and subleases for 197 restaurants under terms substantially the same as BKC’s underlying leases for those properties. Pursuant to the operating agreement, we also agreed to remodel 455 Burger King restaurants to BKC’s 20/20 restaurant image, including 57 restaurants in 2012, 154 restaurants in 2013, 154 restaurants in 2014 and 90 restaurants in 2015. The Series A Convertible Preferred Stock, which we refer to as the "Series A Preferred Stock", issued to BKC is subject to restrictions limiting the conversion of the Series A Preferred Stock to an amount of shares not to exceed 19.9% of the outstanding shares of our common stock as of the date of issuance (the “issuance limitation”). Pursuant to the purchase agreement, the removal of the issuance limitation is subject to obtaining the approval of our stockholders at our 2012 annual meeting or at subsequent meetings, if necessary, until stockholder approval is obtained.

The results of operations of the acquired restaurants have been included in our operating results from May 31, 2012, the day following the closing of the acquisition.

Refinancing of Outstanding Indebtedness

On May 30, 2012, we issued $150.0 million of 11.25% Senior Secured Second Lien Notes due 2018 and entered into a new senior credit facility that provides for up to $20.0 million of revolving credit borrowings (which was undrawn at closing). The net proceeds from the issuance of the Notes were used to (i) repay all outstanding borrowings under the Carrols LLC senior credit facility of $64.8 million (ii) pay $12.0 million related to the acquisition of the acquired restaurants from BKC and (iii) fees and expenses related to the offering of the Notes. The remainder of the net proceeds will be used together with anticipated operating cash flow to fund the restaurant remodeling obligations committed to in connection with the acquisition, and to fund future payments to BKC for the ROFR. Interest expense associated with this indebtedness, including the amortization of deferred financing costs, will be approximately $8.9 million in the second half of 2012.

Spin-off of Fiesta Restaurant Group, Inc.

On April 16, 2012, our board of directors approved the spin-off of Fiesta, which through its subsidiaries, owns and operates the Pollo Tropical and Taco Cabana restaurant brands. In connection with the spin-off, on April 24, 2012, we and Carrols entered into several agreements that govern our post spin-off relationship with Fiesta, including a Separation and Distribution Agreement, Tax Matters Agreement, Employee Matters Agreement and Transition Services Agreement. Amounts earned by us under the Transition Services Agreement were $1.0 million in the second quarter of 2012 and are expected to be approximately $4.4 million for all of 2012.

Fiesta filed with the Securities and Exchange Commission (the "SEC") a Form 10 registration statement, File No. 001-35373, as amended, which included as an exhibit an information statement which describes the spin-off. The Form 10 registration statement, which registered the common stock of Fiesta under the Securities Exchange Act of 1934, as amended, was declared effective by the SEC on April 25, 2012.

On May 7, 2012, we completed the spin-off of Fiesta in the form of a pro rata dividend of all of the issued and outstanding common stock of Fiesta to Carrols Restaurant Group's stockholders whereby each stockholder of Carrols Restaurant Group's common stock of record on April 26, 2012 received one share of Fiesta common stock for every one share of Carrols Restaurant Group common stock held. As a result of the spin-off, Fiesta is now an independent company whose common stock is traded on

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The NASDAQ Global Select Market under the symbol "FRGI." Carrols Restaurant Group's common stock continues to trade on The NASDAQ Global Market under the symbol "TAST."
The historical operating results of Fiesta prior to the spin-off are included in our operating results as income or loss from discontinued operations for all periods presented.

Operating Results from Continuing Operations
Three Months Ended July 1, 2012 Compared to Three Months Ended July 3, 2011
The following table sets forth, for the three months ended July 1, 2012 and July 3, 2011, selected operating results from continuing operations as a percentage of restaurant sales for all of our restaurants, our legacy restaurants and the acquired restaurants:

	2012		2011	
Costs and expenses (all restaurants):				
Cost of sales	31.8	%	29.9	%
Restaurant wages and related expenses	30.7	%	31.0	%
Restaurant rent expense	6.5	%	6.4	%
Other restaurant operating expenses	14.9	%	15.0	%
Advertising expense	3.8	%	4.2	%
General and administrative	6.6	%	5.5	%

	2012		2011	
Costs and expenses (legacy restaurants):				
Cost of sales	31.1	%	29.9	%
Restaurant wages and related expenses	30.2	%	31.0	%
Restaurant rent expense	6.1	%	6.4	%
Other restaurant operating expenses	14.5	%	15.0	%
Advertising expense	3.7	%	4.2	%

	2012	
Costs and expenses (acquired restaurants):		
Cost of sales	34.4	%
Restaurant wages and related expenses	32.4	%
Restaurant rent expense	8.0	%
Other restaurant operating expenses	16.5	%
Advertising expense	3.9	%

Since the beginning of the second quarter of 2011 through the end of the second quarter of 2012, we have opened one restaurant and closed nine restaurants. On May 30, 2012 we acquired 278 restaurants from BKC.
Restaurant Sales. Total restaurant sales in the second quarter of 2012 increased 37.8%, to $122.1 million from $88.6 million in the second quarter of 2011. Restaurant sales in the second quarter of 2012 for the acquired restaurants were $27.5 million. Comparable restaurant sales for our legacy restaurants increased 8.8% resulting from an increase in customer traffic of 4.9% and a 3.9% increase in average check, which resulted from a shift in sales mix and the effect of menu price increases of 2.3% compared to the prior year. This was partially offset by the closure of nine restaurants since the beginning of the second quarter of 2011.
Operating Costs and Expenses (percentages stated as a percentage of total restaurant sales): Cost of sales increased to 31.8% in the second quarter of 2012 from 29.9% in the second quarter of 2011 due primarily to higher commodity prices (1.3%), including higher beef and pork prices (0.8%), and higher promotional sales discounts (0.5%) offset in part by a favorable sales mix and the effect of menu price increases taken in the last twelve months of approximately 2.3%.
Restaurant wages and related expenses decreased to 30.7% in the second quarter of 2012 from 31.0% in the second quarter of 2011 due to lower medical claim costs and lower restaurant level bonus accruals.

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Other restaurant operating expenses decreased to 14.9% in the second quarter of 2012 from 15.0% in the second quarter of 2011 due primarily to lower utility costs (0.2%) and the effect of higher sales volumes for our legacy restaurants on fixed operating costs, partially offset by higher credit card fees (0.2%).
Advertising expense decreased to 3.8% in the second quarter of 2012 from 4.2% in the second quarter of 2011 due primarily to advertising credits received from BKC that were associated with 2012 menu enhancement initiatives. These advertising credits total $5,400 annually per restaurant for 2012 through 2015. In 2012, $2,700 per restaurant was received in the first quarter with $900 per quarter to be received in each of the remaining quarters. For 2013 through 2015 these credits will be received ratably over each year.
Restaurant rent expense increased to 6.5% in the second quarter of 2012 from 6.4% in the second quarter of 2011 due primarily to higher rent, as a percentage of restaurant sales, associated with the acquired restaurants which was 8.0% from May 31, 2012 to the end of second quarter. Rent expense, as a percentage of restaurant sales, for our legacy restaurants decreased to 6.1% from 6.4% due to the effect of higher sales volumes on fixed rental costs.
General and Administrative Expenses. General and administrative expenses increased $3.2 million in the second quarter of 2012 to $8.1 million and, as a percentage of total restaurant sales, increased to 6.6% compared to 5.5% in the second quarter of 2011. This increase was due primarily to higher administrative bonus accruals of $0.7 million, $0.8 million of legal and other costs related to the acquisition of the acquired restaurants, $0.5 million of incremental field and corporate overhead costs associated with the ongoing management and support of the acquired restaurants and $0.6 million of legal fees related to our outstanding litigation with the EEOC.
Adjusted EBITDA. As a result of the factors above Adjusted EBITDA increased 2.9% to $7.9 million in the second quarter of 2012 from $7.7 million in the second quarter of 2011.
Depreciation and Amortization Expense. Depreciation and amortization expense increased to $6.3 million in the second quarter of 2012 from $4.0 million in the second quarter of 2011 due primarily to the addition of the acquired restaurants and from point-of-sale systems installed at our legacy restaurants in 2012 and the second half of 2011.
Impairment and Other Lease Charges. Impairment and other lease charges were $0.1 million in both the second quarter of 2012 and 2011.
Interest Expense. Interest expense increased to $2.6 million in the second quarter of 2012 from $2.3 million in the second quarter of 2011 and included $0.3 million related to the settlement of an interest rate swap agreement in conjunction with the our refinancing discussed above. The weighted average interest rate on our long-term debt, excluding lease financing obligations, increased to 8.2% in the second quarter of 2012 due to the issuance of the Notes.
Provision (Benefit) for Income Taxes. The benefit for income taxes for the second quarter of 2012 was derived using an estimated effective annual income tax rate for 2012 of 42.9%, which excluded discrete tax adjustments which reduced the benefit for income taxes $0.3 million in the second quarter of 2012. The provision for income taxes for the second quarter of 2011 was derived using an estimated effective annual income tax rate for 2011 of 76.6%, which excluded discrete tax adjustments which reduced the provision for income taxes $0.1 million in the second quarter of 2011.
Net Income (Loss) from Continuing Operations. As a result of the above, net loss from continuing operations for the second quarter of 2012 was $0.9 million, or $0.04 per diluted share, compared to net income from continuing operations in the second quarter of 2011 of $0.3 million, or $0.01 per diluted share. The second quarter of 2012 included a charge of $1.5 million related to the early extinguishment of debt and $0.8 million in costs and related expenses pertaining to our acquisition of the acquired restaurants from BKC which, in the aggregate, reduced net earnings from continuing operations by $0.06 per diluted share. The second quarter of 2011 included insurance gains of $0.3 million which increased net earnings from continuing operations by $0.01 per diluted share.
Six Months Ended July 1, 2012 Compared to Six Months Ended July 3, 2011
The following table sets forth, for the six months ended July 1, 2012 and July 3, 2011, selected operating results as a percentage of total restaurant sales:

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	2012		2011	
Costs and expenses:				
Cost of sales	31.3	%	29.6	%
Restaurant wages and related expenses	31.5	%	32.0	%
Restaurant rent expense	6.6	%	6.7	%
Other restaurant operating expenses	15.4	%	15.6	%
Advertising expense	3.5	%	4.2	