CARROLS RESTAURANT GROUP, INC.
Form 10-Q
November 05, 2008
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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 September 28, 2008

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

Commission File Number: 001-06553

CARROLS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**16-0958146**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
968 James Street	
Syracuse, New York	**13203**
(Address of principal executive offices)	**(Zip Code)**

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

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

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 x No ¨

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

Carrols Restaurant Group, Inc.

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

Carrols Corporation

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

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

As of November 1, 2008, Carrols Restaurant Group, Inc. had 21,573,775 shares of its common stock, $.01 par value, outstanding. As of November 1, 2008, all outstanding equity securities of Carrols Corporation, which consisted of 10 shares of its common stock, were owned by Carrols Restaurant Group, Inc.

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CARROLS RESTAURANT GROUP, INC. AND CARROLS CORPORATION

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2008

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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, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,897	$ 7,396
Trade and other receivables	5,811	4,734
Inventories	5,225	5,339
Prepaid rent	2,936	2,803
Prepaid expenses and other current assets	6,928	6,172
Deferred income taxes	4,922	4,802
Total current assets	28,719	31,246
Property and equipment, net	222,211	200,325
Franchise rights, net (Note 4)	77,670	80,052
Goodwill (Note 4)	124,934	124,934
Intangible assets, net	709	887
Franchise agreements, at cost less accumulated amortization of $5,757 and $5,646, respectively	5,824	5,548
Deferred income taxes	10,505	10,559
Other assets	11,533	12,007
Total assets	$ 482,105	$ 465,558
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt (Note 5)	$ 7,614	$ 3,129
Accounts payable	20,371	20,054
Accrued interest	3,902	8,148
Accrued payroll, related taxes and benefits	15,416	18,669
Accrued income taxes payable	3,681	933
Accrued real estate taxes	4,418	3,312
Other liabilities	12,808	10,113
Total current liabilities	68,210	64,358
Long-term debt, net of current portion (Note 5)	307,408	298,154
Lease financing obligations (Note 9)	46,495	52,689
Deferred income sale-leaseback of real estate	32,551	31,348
Accrued postretirement benefits (Note 8)	2,804	3,022
Other liabilities (Note 7)	21,620	22,822
Total liabilities	479,088	472,393
Commitments and contingencies (Note 12)		
Stockholders equity (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 - 21,573,775 and 21,571,565 shares, respectively		216		216
Additional paid-in capital		(130)		(1,591)
Retained earnings (accumulated deficit)		1,703		(6,680)
Accumulated other comprehensive income		1,369		1,361
Treasury stock, at cost		(141)		(141)
Total stockholders equity (deficit)		3,017		(6,835)
Total liabilities and stockholders equity (deficit)	$	482,105	$	465,558

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

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(In thousands of dollars, except share and per share amounts)

(Unaudited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Revenues:				
Restaurant sales	$ 208,698	$ 203,181	$ 614,422	$ 591,164
Franchise royalty revenues and fees	366	328	1,077	997
Total revenues	209,064	203,509	615,499	592,161
Costs and expenses:				
Cost of sales	63,558	58,595	185,130	168,264
Restaurant wages and related expenses (including stock-based compensation expense of $57, $45, $171 and $121, respectively)	59,786	59,519	179,090	174,029
Restaurant rent expense	11,714	11,101	34,765	32,687
Other restaurant operating expenses	32,433	30,547	93,326	87,028
Advertising expense	7,826	7,458	24,874	24,442
General and administrative (including stock-based compensation expense of $438, $314, $1,290 and $947, respectively)	12,893	12,327	39,605	38,778
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses (Note 3)	53	1,810	155	1,879
Other income (Note 10)		(303)	(119)	(650)
Total operating expenses	196,387	189,161	581,049	550,142
Income from operations	12,677	14,348	34,450	42,019
Interest expense	6,861	7,690	21,418	23,647
Loss (gain) on extinguishment of debt (Note 5)			(180)	1,485
Income before income taxes	5,816	6,658	13,212	16,887
Provision for income taxes (Note 6)	2,136	1,795	4,829	5,349
Net income	$ 3,680	$ 4,863	$ 8,383	$ 11,538
Basic and diluted net income per share (Note 13)	$ 0.17	$ 0.23	$ 0.39	$ 0.54
Basic weighted average common shares outstanding (Note 13)	21,573,485	21,550,827	21,572,241	21,550,827
Diluted weighted average common shares outstanding (Note 13)	21,576,176	21,555,020	21,575,280	21,559,524

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, 2008 AND 2007

(In thousands of dollars)

(Unaudited)

	2008	2007
Cash flows provided from operating activities:		
Net income	$ 8,383	$ 11,538
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss (gain) on disposals of property and equipment	102	(57)
Stock-based compensation expense	1,461	1,068
Depreciation and amortization	24,223	23,685
Amortization of deferred financing costs	890	940
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,582)	(1,460)
Impairment losses	155	1,879
Gain on settlements of lease financing obligations	(48)	(163)
Accretion of interest on lease financing obligations	180	397
Deferred income taxes	(58)	(319)
Accrued income taxes	2,748	331
Loss (gain) on extinguishment of debt	(180)	1,485
Changes in other operating assets and liabilities	(5,501)	3,656
Net cash provided from operating activities	29,157	41,364
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,464)	(26,241)
Restaurant remodeling	(9,622)	(5,850)
Other restaurant capital expenditures	(6,903)	(6,825)
Corporate and restaurant information systems	(5,835)	(1,840)
Total capital expenditures	(48,824)	(40,756)
Properties purchased for sale-leaseback		(2,461)
Proceeds from sale-leaseback transactions	6,788	7,036
Proceeds from sales of other properties	119	1,623
Net cash used for investing activities	(41,917)	(34,558)
Cash flows provided from (used for) financing activities:		
Repayment of term loans under prior credit facility		(118,400)
Borrowings on revolving credit facility	109,600	45,500
Repayments on revolving credit facility	(92,400)	(44,300)
Proceeds from new senior credit facility		120,000
Principal payments on term loans	(1,500)	
Principal payments on capital leases	(119)	(262)
Expenses from initial public offering		(21)
Financing costs associated with issuance of debt		(1,228)
Repurchase of senior subordinated notes	(1,820)	

Settlement of lease financing obligations		(5,500)		(4,412)
Net cash provided from (used for) financing activities		8,261		(3,123)
Net increase (decrease) in cash and cash equivalents		(4,499)		3,683
Cash and cash equivalents, beginning of period		7,396		3,939
Cash and cash equivalents, end of period	$	2,897	$	7,622
Supplemental disclosures:				
Interest paid on long-term debt	$	20,984	$	22,932
Interest paid on lease financing obligations	$	3,578	$	3,700
Increase (decrease) in accruals for capital expenditures	$	68	$	(348)
Income taxes paid	$	2,141	$	3,064
Non-cash reduction of assets under lease financing obligations due to lease amendments	$	298	$	
Non-cash reduction of lease financing obligations due to lease amendments	$	880	$	
Capital lease obligations incurred	$	158	$	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-(Continued)

(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 equity (deficit).

Business Description. At September 30, 2008 the Company operated, as franchisee, 317 quick-service restaurants under the trade name Burger King in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2008, the Company also owned and operated 89 Pollo Tropical restaurants, of which 86 were located in Florida and three were located in New Jersey, and franchised a total of 27 Pollo Tropical restaurants, 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2008, the Company owned and operated 153 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico, one in Texas 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 30, 2007 and December 31, 2006 will be referred to as the fiscal years ended December 31, 2007 and 2006, respectively. Similarly, all references herein to the three and nine months ended September 28, 2008 and September 30, 2007 will be referred to as the three and nine months ended September 30, 2008 and September 30, 2007, respectively. The years ended December 31, 2007 and 2006 each contained 52 weeks and the three and nine months ended September 30, 2008 and 2007 contained thirteen and thirty-nine weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 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, 2008 and 2007 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, 2007 contained in the Company s 2007 Annual Report on Form 10-K. The December 31, 2007 balance sheet data is derived from those audited financial statements.

Reclassification of previously issued interim financial statements. The Company has reclassified certain prior year amounts related to its Pollo Tropical restaurant expenses from cost of sales to other restaurant operating expenses in order to conform to the 2008 presentation in the Company s interim results of operations and the presentation in the Company s 2007 Annual Report on Form 10-K. The amount of increase (decrease) in previously reported interim amounts was as follows:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Cost of sales	$ (271)	$ (798)
Other restaurant operating expenses	271	798
Total	$	$

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.

On January 15, 2008, the Company granted options to purchase 517,820 shares of its common stock, consisting of 160,000 shares of non-qualified stock options and 357,820 shares of incentive stock options (ISOs), and issued 7,100 shares of restricted stock. The non-qualified stock options and ISOs granted are exercisable for up to one-fifth of the total number of option shares on or after the first anniversary of the grant date and as of the first day of each month thereafter are exercisable for an additional one-sixtieth of the total number of option shares until fully exercisable. The options expire seven years from the date of the grant and were issued with an exercise price equal to the fair market value of the stock price, or $8.08 per share of common stock, on the date of grant. The restricted stock awards vest 100% on the third anniversary of the award date.

During the three months ended September 30, 2008 an aggregate of 60,500 ISO s were granted under the 2006 Plan. The options were issued with an exercise price equal to the fair market value of the stock price, or $5.17 per share, on the date of grant and generally vest 20% per year. During the three months ended September 30, 2008 and 2007, there were an aggregate of 7,000 and 7,200 restricted shares granted to certain employees, respectively. The restricted shares granted to employees in 2008 vest 100% three years from the date of grant. The restricted shares granted in 2007 vest 33% per year.

The Company currently uses and will continue to use the simplified method to estimate the expected term for share option grants until it has enough historical experience to provide a reasonable estimate of expected term in accordance with Staff Accounting Bulletin No. 110 (SAB 110). The weighted average fair-value of options granted during the three months ended September 30, 2008 was $2.02 which was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2008
Risk-free interest rate	3.20%
Annual dividend yield	0%
Expected term	5 years
Expected volatility	39%

Stock-based compensation expense for the three and nine months ended September 30, 2008 was $0.5 million and $1.5 million, respectively and for the three and nine months ended September 30, 2007 was $0.4 million and $1.1 million, respectively.

As of September 30, 2008, the total non-vested stock-based compensation expense relating to the options and restricted shares is approximately $4.0 million and the Company expects to record an additional $0.5 million as compensation expense in 2008. The remaining weighted average vesting period for the stock options is 3.7 years and restricted shares is approximately 2.03 years at September 30, 2008.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

Stock Options

A summary of all option activity for the nine months ended September 30, 2008 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, 2008	1,214,690	$ 14.31	6.0	$
Granted	588,820	7.75		
Forfeited	(60,890)	12.51		
Options outstanding at September 30, 2008	1,742,620	$ 12.16	5.6	$
Expected to vest at September 30, 2008	1,298,798	$ 11.51	5.7	$
Options exercisable at September 30, 2008	408,135	$ 14.31	5.2	$

(1) The aggregate intrinsic value was calculated using the difference between the market price of the Company s common stock at September 30, 2008 and the grant price for only those awards that have a grant price that is less than the market price of the Company s common stock at September 30, 2008.

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2008 was as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	55,398	$ 13.22
Shares granted	14,100	6.64
Shares vested	(2,210)	6.67
Shares forfeited	(4,124)	12.03
Nonvested at September 30, 2008	63,164	$ 11.78

The value of restricted shares is determined based on the Company s closing 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, NY for $1.7 million. The restaurant was subsequently closed in the fourth quarter of 2007.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

For the three and nine months ended September 30, 2008 and 2007, the Company recorded impairment losses on long-lived assets for its segments as follows:

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Burger King	$ 43	$ 54	$ 135	$ 68
Pollo Tropical	5	1,657	5	1,657
Taco Cabana	5	99	15	154
	$ 53	$ 1,810	$ 155	$ 1,879

4. Goodwill and Franchise Rights

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:

	Pollo Tropical	Taco Cabana	Burger King	Total
Balance, September 30, 2008	$ 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 recorded against franchise rights for the three and nine months ended September 30, 2008 and 2007.

Amortization expense related to Burger King franchise rights was $799 and $805 for the three months ended September 30, 2008 and 2007, respectively. Amortization expense related to Burger King franchise rights was $2,399 and $2,412 for the nine months ended September 30, 2008 and 2007. The Company estimates the amortization expense for the year ending December 31, 2008 to be $3,197 and for each of the five succeeding years to be $3,196.

5. Long-term Debt

Long-term debt at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007

Collateralized:		
Senior Credit Facility - Revolving credit facility	$ 17,200	$
Senior Credit Facility-Term loan A facility	118,500	120,000
Unsecured:		
9% Senior Subordinated Notes	178,000	180,000
Capital leases	1,322	1,283
	315,022	301,283
Less: current portion	(7,614)	(3,129)
	$ 307,408	$ 298,154

On March 9, 2007, Carrols terminated and replaced its prior senior credit facility with a new senior credit facility with a syndicate of lenders. Carrols 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 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

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

obligations under the 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.

The term loan and revolving credit borrowings under the 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. At September 30, 2008 the LIBOR margin percentage was 1.25%.

Term loan A borrowings are due and payable in quarterly installments. Remaining principal payments are as follows:

1) three quarterly installments of $1.5 million beginning on September 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 senior credit facility, Carrols is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an initial amount equal to 50% of Excess Cash Flow depending upon Carrols Total Leverage Ratio (as such terms are defined in the 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 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 senior credit facility contains certain covenants, including, without limitation, those limiting 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 senior credit facility). Carrols was in compliance with the covenants under its senior credit facility as of September 30, 2008.

At September 30, 2008, $118.5 million principal amount of term loan borrowings were outstanding under the term loan A facility and $17.2 million principal amount of borrowings were outstanding under the revolving credit facility. After reserving $14.2 million for letters of credit guaranteed by the facility, $33.6 million was available for borrowings under the revolving credit facility at September 30, 2008.

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. On April 7, 2008, Carrols purchased and retired $2.0 million of its senior subordinated notes in an open market transaction. This resulted in a gain on extinguishment of debt of $0.2 million. At September 30, 2008 and December 31, 2007, $178.0 million and $180.0 million principal amount of the senior subordinated notes were outstanding, respectively.

6. Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2008 and 2007 was comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Current	$ 2,443	$ 1,904	$ 4,887	$ 5,668
Deferred	(307)	(109)	(58)	(319)
	$ 2,136	$ 1,795	$ 4,829	$ 5,349

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

The provision for income taxes for the three and nine months ended September 30, 2008 was derived using an estimated effective annual income tax rate for 2008 of 37.2%, which excludes any discrete tax adjustments. Discrete tax adjustments increased the provision for income taxes by $15 for the three months ended September 30, 2008 and decreased the provision for income taxes by $97 for the nine months ended September 30, 2008.

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 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.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2008, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions.

The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject. It is not possible to reasonably estimate any possible change in the unrecognized tax benefits within the next twelve months.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007
Unearned purchase discounts	$ 559	$ 2,231
Accrued occupancy costs	10,439	9,667
Accrued workers compensation costs	4,466	4,418
Other	6,156	6,506
	$ 21,620	$ 22,822

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At both September 30, 2008 and December 31, 2007, the Company had $0.5 million in lease liability reserves 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. On November 1, 2007 the Company amended its postretirement medical and life insurance benefits to eliminate life insurance benefits for active employees who retire after

December 31, 2007 and to increase retiree contributions for both current and future retirees effective January 1, 2008. These amendments reduced the Company s postretirement benefit obligations and reduced expense in the three and nine months ended September 30, 2008.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

The following summarizes the components of net periodic benefit cost:

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Service cost	$ 7	$ 124	$ 21	$ 370
Interest cost	27	101	80	304
Amortization of gains and losses	22	24	65	72
Amortization of unrecognized prior service cost	(90)	1	(269)	4
Net periodic postretirement benefit cost (benefit)	$ (34)	$ 250	$ (103)	$ 750

During the three and nine months ended September 30, 2008, the Company made contributions of $56 and $136 to its postretirement plan.

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 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.

In the second quarter of 2008, the Company purchased from the lessor six restaurant properties for $5.5 million that were previously accounted for as lease financing obligations. As a result, the Company reduced its lease financing obligations by $5.5 million and recorded a loss of $31 as an increase to interest expense which represented the amount by which the purchase price exceeded the lease financing obligations.

In 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 acquired restaurant properties.

Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2008 and 2007 was $1.1 million and $1.4 million, respectively, and for the nine months ended September 30, 2008 and 2007 was $3.8 million and $4.2 million, respectively.

10. Other Income

The Company recorded a gain of $0.1 million in the nine months ended September 30, 2008 and a gain of $0.3 million in the nine months ended September 30, 2007 each related to the sale of a Taco Cabana property. In the third quarter of 2007, the Company also recorded a gain of $0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

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, other income and expense and gains and losses on extinguishment of debt.

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

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 including restaurant information systems expenditures, goodwill and deferred income taxes.

Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2008:					
Total revenues	$ 43,389	$ 64,132	$ 101,543	$	$ 209,064
Cost of sales	14,312	19,646	29,600		63,558
Restaurant wages and related expenses	10,662	18,357	30,710	57	59,786
General and administrative expenses (1)	2,996	3,036	6,423	438	12,893
Depreciation and amortization	2,032	2,261	3,492	339	8,124
Segment EBITDA	5,222	7,308	8,819		
Capital expenditures, including acquisitions	3,656	7,320	5,369	3,250	19,595
September 30, 2007:					
Total revenues	$ 42,560	$ 61,254	$ 99,695	$	$ 203,509
Cost of sales	13,426	18,532	26,637		58,595
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
Nine Months Ended					
September 30, 2008:					
Total revenues	$ 133,125	$ 187,825	$ 294,549	$	$ 615,499
Cost of sales	43,965	58,022	83,143		185,130
Restaurant wages and related expenses	32,861	54,601	91,457	171	179,090
General and administrative expenses (1)	8,324	9,048	20,943	1,290	39,605
Depreciation and amortization	5,948	6,423	10,741	1,111	24,223
Segment EBITDA	17,959	19,679	22,532		
Capital expenditures, including acquisitions	15,064	16,360	11,565	5,835	48,824
September 30, 2007:					
Total revenues	$ 126,846	$ 180,222	$ 285,093	$	$ 592,161
Cost of sales	40,440	53,485	74,339		168,264
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
Identifiable Assets:					
At September 30, 2008	$ 68,718	$ 83,998	$ 149,672	$ 179,717	$ 482,105
At December 31, 2007	59,609	79,370	148,467	178,112	465,558

(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 three 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,	
	2008	2007	2008	2007
Segment EBITDA:				
Pollo Tropical	$ 5,222	$ 7,776	$ 17,959	$ 21,862
Taco Cabana	7,308	7,348	19,679	22,723
Burger King	8,819	9,197	22,532	23,416
Subtotal	21,349	24,321	60,170	68,001
Less:				
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses	53	1,810	155	1,879
Interest expense	6,861	7,690	21,418	23,647
Provision for income taxes	2,136	1,795	4,829	5,349
Stock-based compensation expense	495	359	1,461	1,068
Loss (gain) on extinguishment of debt			(180)	1,485
Other income		(303)	(119)	(650)
Net income	$ 3,680	$ 4,863	$ 8,383	$ 11,538

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 were 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. 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 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. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements. 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 (the Court) entitled Dawn Seever, et al. v. Carrols Corporation. The lawsuit alleged, 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 sought damages, costs and injunctive relief. They also sought to notify and certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for Carrols. On December 17, 2007, the Court issued a decision and order denying Plaintiffs motion for notice and class certification and granting the Company s motion to dismiss all of the claims of the plaintiffs, other than certain nominal claims relating to orientation and managers meetings. The Court instructed the parties to confer, in good faith, and settle those nominal claims. Subject to settlement of the amounts for orientation and managers meetings and possible appeal by the Plaintiffs, the case is concluded. The Company does not believe that these settlement amounts will be material to its consolidated financial statements.

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

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 1,104,505 and 1,226,450 shares of common stock in each of the three months ended September 30, 2008 and 2007, respectively, because the exercise price of these options was greater than the average market price of the common shares in the periods and therefore, they were antidilutive. In addition, options to purchase 1,155,603 and 1,232,950 shares of common stock are excluded from the computation of diluted net income per share in each of the three and nine months ended September 30, 2008 and 2007, respectively, as they were antidilutive under the treasury stock method.

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:

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Basic net income per share:				
Net income	$ 3,680	$ 4,863	$ 8,383	$ 11,538
Weighted average common shares outstanding	21,573,485	21,550,827	21,572,241	21,550,827
Basic net income per share	$ 0.17	$ 0.23	$ 0.39	$ 0.54
Diluted net income per share:				
Net income for diluted net income per share	$ 3,680	$ 4,863	$ 8,383	$ 11,538
Shares used in computed basic net income per share	21,573,485	21,550,827	21,572,241	21,550,827
Dilutive effect of restricted shares and stock options	2,691	4,193	3,039	8,697
Shares used in computed diluted net income per share	21,576,176	21,555,020	21,575,280	21,559,524
Diluted net income per share	$ 0.17	$ 0.23	$ 0.39	$ 0.54

14. Comprehensive Income

SFAS No. 130, Reporting Comprehensive Income (SFAS 130), requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with U.S. generally accepted accounting principles. The items that currently impact the Company s other comprehensive income are changes in postretirement benefit obligations, net of tax.

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007

Net income	$ 3,680	$ 4,863	$ 8,383	$ 11,538
Change in postretirement benefit obligation, net of tax			8	
Comprehensive income	$ 3,680	$ 4,863	$ 8,391	$ 11,538

CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

15. Recent Accounting Developments

In September 2006, the Financial Accounting Standards Board (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. In February 2007, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS 157 for financial assets and financial liabilities, effective for fiscal 2008, did not have a material impact on the Company s consolidated financial statements. The Company is currently evaluating the impact SFAS 157 may have for nonfinancial assets and liabilities in its 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 did not elect to begin reporting any financial assets or liabilities at fair value upon adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financials Statements, an Amendment of ARB No. 51 (SFAS 160). SFAS 160 clarifies the accounting for non controlling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact SFAS 160 will have on its consolidated financial statements.

In April 2008, the FASB issued FSP SFAS No. 142-3 Determination of the Useful Life of Intangible Assets (SFAS 142-3). SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumption used to determine the useful life of a recognized intangible asset under SFAS No. 142. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will require the Company to adopt these provisions in the first quarter of 2009. The Company has reviewed this pronouncement and does not anticipate the adoption of SFAS No. 142-3 will materially impact its financial statements.

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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, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,897	$ 7,396
Trade and other receivables	5,811	4,734
Inventories	5,225	5,339
Prepaid rent	2,936	2,803
Prepaid expenses and other current assets	6,928	6,172
Deferred income taxes	4,922	4,802
Total current assets	28,719	31,246
Property and equipment, net	222,211	200,325
Franchise rights, net (Note 4)	77,670	80,052
Goodwill (Note 4)	124,934	124,934
Intangible assets, net	709	887
Franchise agreements, at cost less accumulated amortization of $5,757 and $5,646, respectively	5,824	5,548
Deferred income taxes	10,505	10,559
Other assets	11,533	12,007
Total assets	$ 482,105	$ 465,558
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt (Note 5)	$ 7,614	$ 3,129
Accounts payable	20,371	20,054
Accrued interest	3,902	8,148
Accrued payroll, related taxes and benefits	15,416	18,669
Accrued income taxes payable	3,681	933
Accrued real estate taxes	4,418	3,312
Other liabilities	12,808	10,113
Total current liabilities	68,210	64,358
Long-term debt, net of current portion (Note 5)	307,408	298,154
Lease financing obligations (Note 9)	46,495	52,689
Deferred income sale-leaseback of real estate	32,551	31,348
Accrued postretirement benefits (Note 8)	2,804	3,022
Other liabilities (Note 7)	21,577	22,784
Total liabilities	479,045	472,355
Commitments and contingencies (Note 12)		
Stockholder s equity (deficit):		
Common stock, par value $1; authorized 1,000 shares, issued and outstanding 10 shares at both dates		
Additional paid-in capital	(7,623)	(9,084)

Retained earnings	9,314	926
Accumulated other comprehensive income	1,369	1,361
Total stockholder s equity (deficit)	3,060	(6,797)
Total liabilities and stockholder s equity (deficit)	$ 482,105	$ 465,558

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

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CARROLS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(In thousands of dollars)

(Unaudited)

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Revenues:				
Restaurant sales	$ 208,698	$ 203,181	$ 614,422	$ 591,164
Franchise royalty revenues and fees	366	328	1,077	997
Total revenues	209,064	203,509	615,499	592,161
Costs and expenses:				
Cost of sales	63,558	58,595	185,130	168,264
Restaurant wages and related expenses (including stock-based compensation expense of $57, $45, $171 and $121, respectively)	59,786	59,519	179,090	174,029
Restaurant rent expense	11,714	11,101	34,765	32,687
Other restaurant operating expenses	32,433	30,547	93,326	87,028
Advertising expense	7,826	7,458	24,874	24,442
General and administrative (including stock-based compensation expense of $438, $314, $1,290 and $947, respectively)	12,891	12,325	39,600	38,773
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses (Note 3)	53	1,810	155	1,879
Other income (Note 10)		(303)	(119)	(650)
Total operating expenses	196,385	189,159	581,044	550,137
Income from operations	12,679	14,350	34,455	42,024
Interest expense	6,861	7,690	21,418	23,647
Loss (gain) on extinguishment of debt (Note 5)			(180)	1,485
Income before income taxes	5,818	6,660	13,217	16,892
Provision for income taxes (Note 6)	2,136	1,795	4,829	5,349
Net income	$ 3,682	$ 4,865	$ 8,388	$ 11,543

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

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CARROLS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(In thousands of dollars)

(Unaudited)

	2008	2007
Cash flows provided from operating activities:		
Net income	$ 8,388	$ 11,543
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss (gain) on disposals of property and equipment	102	(57)
Stock-based compensation expense	1,461	1,068
Depreciation and amortization	24,223	23,685
Amortization of deferred financing costs	890	940
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,582)	(1,460)
Impairment losses	155	1,879
Accretion of interest on lease financing obligations	180	397
Deferred income taxes	(58)	(319)
Accrued income taxes	2,748	331
Loss (gain) on extinguishment of debt	(180)	1,485
Gain on settlements of lease financing obligations	(48)	(163)
Changes in other operating assets and liabilities	(5,506)	3,651
Net cash provided from operating activities	29,157	41,364
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,464)	(26,241)
Restaurant remodeling	(9,622)	(5,850)
Other restaurant capital expenditures	(6,903)	(6,825)
Corporate and restaurant information systems	(5,835)	(1,840)
Total capital expenditures	(48,824)	(40,756)
Properties purchased for sale-leaseback		(2,461)
Proceeds from sale-leaseback transactions	6,788	7,036
Proceeds from sales of other properties	119	1,623
Net cash used for investing activities	(41,917)	(34,558)
Cash flows provided from (used for) financing activities:		
Repayment of term loans under prior credit facility		(118,400)
Borrowings on revolving credit facility	109,600	45,500
Repayments on revolving credit facility	(92,400)	(44,300)
Proceeds from new senior credit facility		120,000
Settlement of lease financing obligations	(5,500)	(4,412)
Repurchase of senior subordinated notes	(1,820)	
Principal payments on term loans	(1,500)	
Principal payments on capital leases	(119)	(262)
Expenses from initial public offering		(21)

Financing costs associated with issuance of debt				(1,228)
Net cash provided from (used for) financing activities		8,261		(3,123)
Net increase (decrease) in cash and cash equivalents		(4,499)		3,683
Cash and cash equivalents, beginning of period		7,396		3,939
Cash and cash equivalents, end of period	$	2,897	$	7,622
Supplemental disclosures:				
Interest paid on long-term debt	$	20,984	$	22,932
Interest paid on lease financing obligations	$	3,578	$	3,700
Increase (decrease) in accruals for capital expenditures	$	68	$	(348)
Income taxes paid	$	2,141	$	3,064
Non-cash reduction of assets under lease financing obligations due to lease amendments	$	298	$	
Non-cash reduction of lease financing obligations due to lease amendments	$	880	$	
Capital lease obligations incurred	$	158	$	88

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

CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(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 Corporation and its subsidiaries (the Company). The Company is a wholly-owned subsidiary of Carrols Restaurant Group, Inc. (Carrols Restaurant Group or the Parent Company). 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 equity (deficit).

Business Description. At September 30, 2008 the Company operated, as franchisee, 317 quick-service restaurants under the trade name Burger King in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2008, the Company also owned and operated 89 Pollo Tropical restaurants of which 86 were located in Florida and three were located in New Jersey, and franchised a total of 27 Pollo Tropical restaurants, 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2008, the Company owned and operated 153 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico, one in Texas 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 30, 2007 and December 31, 2006 will be referred to as the fiscal years ended December 31, 2007 and 2006, respectively. Similarly, all references herein to the three and nine months ended September 28, 2008 and September 30, 2007 will be referred to as the three and nine months ended September 30, 2008 and September 30, 2007, respectively. The years ended December 31, 2007 and 2006 each contained 52 weeks and the three and nine months ended September 30, 2008 and 2007 contained thirteen and thirty-nine weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 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, 2008 and 2007 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, 2007 contained in the Company s 2007 Annual Report on Form 10-K. The December 31, 2007 balance sheet data is derived from those audited financial statements.

Reclassification of previously issued interim financial statements. The Company has reclassified certain prior year amounts related to its Pollo Tropical restaurant expenses from cost of sales to other restaurant operating expenses in order to conform to the 2008 presentation in the Company s interim results of operations and the presentation in the Company s 2007 Annual Report on Form 10-K. The amount of increase (decrease) in previously reported interim amounts was as follows:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Cost of sales	(271)	(798)
Other restaurant operating expenses	271	798
Total	$	$

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.

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(in thousands of dollars, except share and per share amounts)

Earnings Per Share Presentation. The guidance of Statement of Financial Accounting Standards (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.

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.

On January 15, 2008, Carrols Restaurant Group granted options to purchase 517,820 shares of its common stock, consisting of 160,000 shares of non-qualified stock options and 357,820 shares of incentive stock options (ISOs), and issued 7,100 shares of restricted stock. The non-qualified stock options and ISOs granted are exercisable for up to one-fifth of the total number of option shares on or after the first anniversary of the grant date and as of the first day of each month thereafter are exercisable for an additional one-sixtieth of the total number of option shares until fully exercisable. The options expire seven years from the date of the grant and were issued with an exercise price equal to the fair market value of the stock price, or $8.08 per share of common stock, on the date of grant. The restricted stock awards vest 100% on the third anniversary of the award date.

During the three months ended September 30, 2008 an aggregate of 60,500 ISO s were granted under the 2006 Plan. The options were issued with an exercise price equal to the fair market value of the stock price, or $5.17 per share, on the date of grant and generally vest 20% per year. During the three months ended September 30, 2008 and 2007, there were an aggregate of 7,000 and 7,200 restricted shares granted to certain employees, respectively. The restricted shares granted to employees in 2008 vest 100% three years from the date of grant. The restricted shares granted in 2007 vest 33% per year.

The Company currently uses and will continue to use the simplified method to estimate the expected term for share option grants until it has enough historical experience to provide a reasonable estimate of expected term in accordance with Staff Accounting Bulletin No. 110 (SAB 110). The weighted average fair-value of options granted during the three months ended September 30, 2008 was $2.02 which was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2008
Risk-free interest rate	3.20%
Annual dividend yield	0%
Expected term	5 years
Expected volatility	39%

Stock-based compensation expense for the three and nine months ended September 30, 2008 was $0.5 million and $1.5 million, respectively and for the three and nine months ended September 30, 2007 was $0.4 million and $1.1 million, respectively.

As of September 30, 2008, the total non-vested stock-based compensation expense relating to the options and restricted shares is approximately $4.0 million and the Company expects to record an additional $0.5 million as compensation expense in 2008. The remaining weighted average vesting period for the stock options is 3.7 years and restricted shares is approximately 2.03 years at September 30, 2008.

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Stock Options

A summary of all option activity for the nine months ended September 30, 2008 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, 2008	1,214,690	$ 14.31	6.0	$
Granted	588,820	7.75		
Forfeited	(60,890)	12.51		
Options outstanding at September 30, 2008	1,742,620	$ 12.16	5.6	$
Expected to vest at September 30, 2008	1,298,798	$ 11.51	5.7	$
Options exercisable at September 30, 2008	408,135	$ 14.31	5.2	$

(1) The aggregate intrinsic value was calculated using the difference between the market price of Carrols Restaurant Group s common stock at September 30, 2008 and the grant price for only those awards that have a grant price that is less than the market price of Carrols Restaurant Group s common stock at September 30, 2008.

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2008 was as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	55,398	$ 13.22
Shares granted	14,100	6.64
Shares vested	(2,210)	6.67
Shares forfeited	(4,124)	12.03
Nonvested at September 30, 2008	63,164	$ 11.78

The value of restricted shares is determined based on Carrols Restaurant Group s closing 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, NY for $1.7 million. The restaurant was subsequently closed in the fourth quarter of 2007.

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For the three and nine months ended September 30, 2008, the Company recorded impairment losses on long-lived assets for its segments as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Burger King	$ 43	$ 54	$ 135	$ 68
Pollo Tropical	5	1,657	5	1,657
Taco Cabana	5	99	15	154
	$ 53	$ 1,810	$ 155	$ 1,879

4. Goodwill and Franchise Rights

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:

	Pollo Tropical	Taco Cabana	Burger King	Total
Balance, September 30, 2008	$ 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 recorded against franchise rights for the three and nine months ended September 30, 2008 and 2007.

Amortization expense related to Burger King franchise rights was $799 and $805 for the three months ended September 30, 2008 and 2007, respectively. Amortization expense related to Burger King franchise rights was $2,399 and $2,412 for the nine months ended September 30, 2008 and 2007. The estimated amortization expense for the year ending December 31, 2008 is $3,197 and for each of the five succeeding years is $3,196.

5. Long-term Debt

Long-term debt at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007

Collateralized:		
Senior Credit Facility - Revolving credit facility	$ 17,200	$
Senior Credit Facility-Term loan A facility	118,500	120,000
Unsecured:		
9% Senior Subordinated Notes	178,000	180,000
Capital leases	1,322	1,283
	315,022	301,283
Less: current portion	(7,614)	(3,129)
	$ 307,408	$ 298,154

On March 9, 2007, the Company terminated and replaced its prior senior credit facility with a new senior credit facility with a syndicate of lenders. The Company s 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 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

CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

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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.

The term loan and revolving credit borrowings under the 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

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. At September 30, 2008 the LIBOR margin percentage was 1.25%.

Term loan A borrowings are due and payable in quarterly installments. Remaining principal payments are as follows:

1) three quarterly installments of $1.5 million beginning on September 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 senior credit facility, the Company is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an initial amount equal to 50% of Excess Cash Flow depending upon the Company s Total Leverage Ratio (as such terms are defined in the 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 therefrom, 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 senior credit facility are guaranteed by Carrols Restaurant Group 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 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 senior credit facility). The Company was in compliance with the covenants under its new senior credit facility as of September 30, 2008.

At September 30, 2008, $118.5 million principal amount of term loan borrowings were outstanding under the term loan A facility and $17.2 million principal amount of borrowings were outstanding under the revolving credit facility. After reserving $14.2 million for letters of credit guaranteed by the facility, $33.6 million was available for borrowings under the revolving credit facility at September 30, 2008.

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 Company s ability to issue additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. On April 7, 2008, the Company purchased and retired $2.0 million of the senior subordinated notes in an open market transaction. This resulted in a gain on extinguishment of debt of $0.2 million. At September 30, 2008 and December 31, 2007, $178.0 million and $180.0 million principal amount of the senior subordinated notes were outstanding, respectively.

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6. Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2008 and 2007 was comprised of the following:

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Current	$ 2,443	$ 1,904	$ 4,887	$ 5,668
Deferred	(307)	(109)	(58)	(319)
	$ 2,136	$ 1,795	$ 4,829	$ 5,349

The provision for income taxes for the three and nine months ended September 30, 2008 was derived using an estimated effective annual income tax rate for 2008 of 37.2%, which excludes any discrete tax adjustments. Discrete tax adjustments increased the provision for income taxes by $15 for the three months ended September 30, 2008 and decreased the provision for income taxes by $97 for the nine months ended September 30, 2008.

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 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.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2008, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions.

The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject. It is not possible to reasonably estimate any possible change in the unrecognized tax benefits within the next twelve months.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007
Unearned purchase discounts	$ 559	$ 2,231

Accrued occupancy costs		10,439		9,667
Accrued workers compensation costs		4,466		4,418
Other		6,113		6,468
	$	21,577	$	22,784

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At both September 30, 2008 and December 31, 2007, the Company had $0.5 million in lease liability reserves for the remaining locations that are included in accrued occupancy costs.

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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. On November 1, 2007 the Company amended its postretirement medical and life insurance benefits to eliminate life insurance benefits for active employees who retire after December 31, 2007 and to increase retiree contributions for both current and future retirees effective January 1, 2008. These amendments reduced the Company s postretirement benefit obligations and reduced expense in the three and nine months ended September 30, 2008.

The following summarizes the components of net periodic benefit cost:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Service cost	$ 7	$ 124	$ 21	$ 370
Interest cost	27	101	80	304
Amortization of gains and losses	22	24	65	72
Amortization of unrecognized prior service cost	(90)	1	(269)	4
Net periodic postretirement benefit cost (benefit)	$ (34)	$ 250	$ (103)	$ 750

During the three and nine months ended September 30, 2008, the Company made contributions of $56 and $136 to its postretirement plan.

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 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.

In the second quarter of 2008, the Company purchased from the lessor six restaurant properties for $5.5 million that were previously accounted for as lease financing obligations. As a result, the Company reduced its lease financing obligations by $5.5 million and recorded a loss of $31 as an increase to interest expense which represented the amount by which the purchase price exceeded the lease financing obligations.

In 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 acquired restaurant properties.

Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2008 and 2007 was $1.1 million and $1.4 million, respectively and for the nine months ended September 30, 2008 and 2007 was $3.8 million and $4.2 million, respectively.

10. Other Income

The Company recorded a gain of $0.1 million in the nine months ended September 30, 2008 and a gain of $0.3 million in the nine months ended September 30, 2007 each related to the sale of a Taco Cabana property. In the third quarter of 2007, the Company also recorded a gain of $0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

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

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(in thousands of dollars, except share and per share amounts)

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, other income and expense and gains and losses on extinguishment of debt.

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 including restaurant information systems expenditures, goodwill and deferred income taxes.

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Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2008:					
Total revenues	$ 43,389	$ 64,132	$ 101,543	$	$ 209,064
Cost of sales	14,312	19,646	29,600		63,558
Restaurant wages and related expenses	10,662	18,357	30,710	57	59,786
General and administrative expenses (1)	2,994	3,036	6,423	438	12,891
Depreciation and amortization	2,032	2,261	3,492	339	8,124
Segment EBITDA	5,224	7,308	8,819		
Capital expenditures, including acquisitions	3,656	7,320	5,369	3,250	19,595
September 30, 2007:					
Total revenues	$ 42,560	$ 61,254	$ 99,695	$	$ 203,509
Cost of sales	13,426	18,532	26,637		58,595
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
Nine Months Ended					
September 30, 2008:					
Total revenues	$ 133,125	$ 187,825	$ 294,549	$	$ 615,499
Cost of sales	43,965	58,022	83,143		185,130
Restaurant wages and related expenses	32,861	54,601	91,457	171	179,090
General and administrative expenses (1)	8,319	9,048	20,943	1,290	39,600
Depreciation and amortization	5,948	6,423	10,741	1,111	24,223
Segment EBITDA	17,964	19,679	22,532		
Capital expenditures, including acquisitions	15,064	16,360	11,565	5,835	48,824
September 30, 2007:					
Total revenues	$ 126,846	$ 180,222	$ 285,093	$	$ 592,161
Cost of sales	40,440	53,485	74,339		168,264
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
Identifiable Assets:					
At September 30, 2008	$ 68,718	$ 83,998	$ 149,672	$ 179,717	$ 482,105
At December 31, 2007	59,609	79,370	148,467	178,112	465,558

(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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Segment EBITDA:				
Pollo Tropical	$ 5,224	$ 7,778	$ 17,964	$ 21,867
Taco Cabana	7,308	7,348	19,679	22,723
Burger King	8,819	9,197	22,532	23,416
Subtotal	21,351	24,323	60,175	68,006
Less:				
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses	53	1,810	155	1,879
Interest expense	6,861	7,690	21,418	23,647
Provision for income taxes	2,136	1,795	4,829	5,349
Stock-based compensation expense	495	359	1,461	1,068
Loss (gain) on extinguishment of debt			(180)	1,485
Other income		(303)	(119)	(650)
Net income	$ 3,682	$ 4,865	$ 8,388	$ 11,543

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. 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 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 summary judgment motion. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements. 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 (the Court) entitled Dawn Seever, et al. v. the Company. The lawsuit alleged, 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 sought damages, costs and injunctive relief. They also sought to notify and certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for the Company. On December 17, 2007, the Court issued a decision and order denying Plaintiffs motion for notice and class certification and granting the Company s motion to dismiss all of the claims of the plaintiffs, other than certain nominal claims relating to orientation and managers meetings. The Court instructed the parties to confer, in good faith, and settle those nominal claims. Subject to settlement of the amounts for orientation and managers meetings and possible appeal by the Plaintiffs, the case is concluded. The Company does not believe that these settlement amounts will be material to its consolidated financial statements.

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(in thousands of dollars, except share and per share amounts)

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. Comprehensive income

SFAS No. 130, Reporting Comprehensive Income (SFAS 130), requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with U.S. generally accepted accounting principles. The items that currently impact the Company s other comprehensive income are changes in the postretirement benefit obligations, net of tax.

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net income	$ 3,682	$ 4,865	$ 8,388	$ 11,543
Change in postretirement benefit obligation, net of tax			8	
Comprehensive income	$ 3,682	$ 4,865	$ 8,396	$ 11,543

14. Recent Accounting Developments

In September 2006, the Financial Accounting Standards Board (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. In February 2007, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS 157 for financial assets and financial liabilities, effective for fiscal 2008, did not have a material impact on the Company s consolidated financial statements. The Company is currently evaluating the impact SFAS 157 may have for nonfinancial assets and liabilities in its 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 did not elect to begin reporting any financial assets or liabilities at fair value upon adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financials Statements, an Amendment of ARB No. 51 (SFAS 160). SFAS 160 clarifies the accounting for non controlling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact SFAS 160 will have on its consolidated financial statements.

In April 2008, the FASB issued FSP SFAS No. 142-3 Determination of the Useful Life of Intangible Assets (SFAS 142-3). SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumption used to determine the useful life of a recognized intangible asset under SFAS No. 142. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will require the Company to adopt these provisions in the first quarter of 2009. The Company has reviewed this pronouncement and does not anticipate the adoption of SFAS No. 142-3 will materially impact its financial statements.

15. 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.

CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars, except share and per share amounts)

Cabana Bevco LLC

Carrols 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, 2008 and December 31, 2007 for the Parent Company only, Guarantor Subsidiaries and for the Company and the related statements of operations for the three and nine months ended September 30, 2008 and 2007, and statements of cash flows for the nine months ended September 30, 2008 and 2007.

At the beginning of the third quarter in 2008 assets and liabilities related to the Company s Burger King restaurant operations were transferred to Carrols LLC, a 100% owned subsidiary of the Company. Carrols LLC became a Guarantor Subsidiary at that time and its results of operations and cash flows are included with the Company s other Guarantor Subsidiaries for all periods presented.

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 for the Parent Company only and the Guarantor Subsidiaries, as calculated on the separate return method and the consolidated income tax provision 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.

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CONSOLIDATING BALANCE SHEET

September 30, 2008

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	$ 4	$ 2,893	$	$ 2,897
Trade and other receivables	53	5,758		5,811
Inventories		5,225		5,225
Prepaid rent		2,936		2,936
Prepaid expenses and other current assets	962	5,966		6,928
Deferred income taxes	93	4,829		4,922
Total current assets	1,112	27,607		28,719
Property and equipment, net	10,675	267,997	(56,461)	222,211
Franchise rights, net		77,670		77,670
Goodwill		124,934		124,934
Intangible assets, net		709		709
Franchise agreements, net		5,824		5,824
Intercompany receivable (payable)	176,801	(177,288)	487	
Investment in subsidiaries	131,701		(131,701)	
Deferred income taxes	6,142	6,267	(1,904)	10,505
Other assets	6,015	7,330	(1,812)	11,533
Total assets	$ 332,446	$ 341,050	$ (191,391)	$ 482,105
LIABILITIES AND STOCKHOLDER S EQUITY				
Current liabilities:				
Current portion of long-term debt	$ 7,500	$ 114	$	$ 7,614
Accounts payable	3,680	16,691		20,371
Accrued interest	3,902			3,902
Accrued payroll, related taxes and benefits	(439)	15,855		15,416
Accrued income taxes payable	3,681			3,681
Accrued real estate taxes	392	4,026		4,418
Other liabilities	(71)	12,879		12,808
Total current liabilities	18,645	49,565		68,210
Long-term debt, net of current portion	306,200	1,208		307,408
Lease financing obligations		119,525	(73,030)	46,495
Deferred income sale-leaseback of real estate		23,983	8,568	32,551
Accrued postretirement benefits	2,804			2,804
Other liabilities	1,737	19,217	623	21,577
Total liabilities	329,386	213,498	(63,839)	479,045
Commitments and contingencies				
Stockholder s equity	3,060	127,552	(127,552)	3,060

Total liabilities and stockholder s equity	$ 332,446	$ 341,050	$ (191,391)	$ 482,105

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CONSOLIDATING BALANCE SHEET

December 31, 2007

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	$ 3,243	$ 4,153	$	$ 7,396
Trade and other receivables	219	4,515		4,734
Inventories		5,339		5,339
Prepaid rent		2,803		2,803
Prepaid expenses and other current assets	943	5,229		6,172
Deferred income taxes	(144)	4,946		4,802
Total current assets	4,261	26,985		31,246
Property and equipment, net	8,320	246,190	(54,185)	200,325
Franchise rights, net		80,052		80,052
Goodwill		124,934		124,934
Intangible assets, net		887		887
Franchise agreements, net		5,548		5,548
Intercompany receivable (payable)	169,636	(170,193)	557	
Investment in subsidiaries	117,681		(117,681)	
Deferred income taxes	3,458	8,348	(1,247)	10,559
Other assets	6,609	7,109	(1,711)	12,007
Total assets	$ 309,965	$ 329,860	$ (174,267)	$ 465,558
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)				
Current liabilities:				
Current portion of long-term debt	$ 3,000	$ 129	$	$ 3,129
Accounts payable	110	19,944		20,054
Accrued interest	8,148			8,148
Accrued payroll, related taxes and benefits	2,257	16,412		18,669
Accrued income taxes payable	933			933
Accrued real estate taxes		3,312		3,312
Other liabilities	269	9,844		10,113
Total current liabilities	14,717	49,641		64,358
Long-term debt, net of current portion	297,000	1,154		298,154
Lease financing obligations		121,154	(68,465)	52,689
Deferred income sale-leaseback of real estate		23,363	7,985	31,348
Accrued postretirement benefits	3,022			3,022
Other liabilities	2,023	20,297	464	22,784
Total liabilities	316,762	215,609	(60,016)	472,355
Commitments and contingencies				
Stockholder s equity (deficit)	(6,797)	114,251	(114,251)	(6,797)

Total liabilities and stockholder s equity (deficit)	$ 309,965	$ 329,860	$ (174,267)	$ 465,558

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CONSOLIDATING STATEMENT OF OPERATIONS

Three Months Ended September 30, 2008

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	$	$ 208,698	$	$ 208,698
Franchise royalty revenues and fees		366		366
Total revenues		209,064		209,064
Costs and expenses:				
Cost of sales		63,558		63,558
Restaurant wages and related expenses (including stock-based compensation expense of $57)		59,786		59,786
Restaurant rent expense		10,300	1,414	11,714
Other restaurant operating expenses		32,433		32,433
Advertising expense		7,826		7,826
General and administrative (including stock-based compensation expense of $438)	1,367	11,524		12,891
Depreciation and amortization		8,457	(333)	8,124
Impairment losses		53		53
Other income				
Total operating expenses	1,367	193,937	1,081	196,385
Income (loss) from operations	(1,367)	15,127	(1,081)	12,679
Interest expense	5,681	2,758	(1,578)	6,861
Gain on extinguishment of debt				
Intercompany interest allocations	(4,556)	4,556		
Income (loss) before income taxes	(2,492)	7,813	497	5,818
Provision (benefit) for income taxes	(796)	2,672	260	2,136
Equity income from subsidiaries	5,378		(5,378)	
Net income	$ 3,682	$ 5,141	$ (5,141)	$ 3,682

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CONSOLIDATING STATEMENT OF OPERATIONS

Three Months Ended September 30, 2007

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	$	$ 203,181	$	$ 203,181
Franchise royalty revenues and fees		328		328
Total revenues		203,509		203,509
Costs and expenses:				
Cost of sales		58,595		58,595
Restaurant wages and related expenses (including stock-based compensation expense of $45)		59,519		59,519
Restaurant rent expense		9,792	1,309	11,101
Other restaurant operating expenses		30,547		30,547
Advertising expense		7,458		7,458
General and administrative (including stock-based compensation expense of $314)	1,203	11,122		12,325
Depreciation and amortization		8,416	(309)	8,107
Impairment losses		1,810		1,810
Other income		(303)		(303)
Total operating expenses	1,203	186,956	1,000	189,159
Income (loss) from operations	(1,203)	16,553	(1,000)	14,350
Interest expense	6,267	2,880	(1,457)	7,690
Intercompany interest allocations	(4,557)	4,557		
Income (loss) before income taxes	(2,913)	9,116	457	6,660
Provision (benefit) for income taxes	(1,568)	3,137	226	1,795
Equity income from subsidiaries	6,210		(6,210)	
Net income	$ 4,865	$ 5,979	$ (5,979)	$ 4,865

CONSOLIDATING STATEMENT OF OPERATIONS

Nine Months Ended September 30, 2008

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	$	$ 614,422	$	$ 614,422
Franchise royalty revenues and fees		1,077		1,077
Total revenues		615,499		615,499
Costs and expenses:				
Cost of sales		185,130		185,130
Restaurant wages and related expenses (including stock-based compensation expense of $171)		179,090		179,090
Restaurant rent expense		30,615	4,150	34,765
Other restaurant operating expenses		93,326		93,326
Advertising expense		24,874		24,874
General and administrative (including stock-based compensation expense of $1,290)	4,328	35,272		39,600
Depreciation and amortization		25,198	(975)	24,223
Impairment loss		155		155
Other income		(119)		(119)
Total operating expenses	4,328	573,541	3,175	581,044
Income (loss) from operations	(4,328)	41,958	(3,175)	34,455
Interest expense	17,447	8,589	(4,618)	21,418
Gain on extinguishment of debt	(180)			(180)
Intercompany interest allocations	(13,669)	13,669		
Income (loss) before income taxes	(7,926)	19,700	1,443	13,217
Provision (benefit) for income taxes	(2,895)	7,002	722	4,829
Equity income from subsidiaries	13,419		(13,419)	
Net income	$ 8,388	$ 12,698	$ (12,698)	$ 8,388

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CONSOLIDATING STATEMENT OF OPERATIONS

Nine Months Ended September 30, 2007

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	$	$ 591,164	$	$ 591,164
Franchise royalty revenues and fees		997		997
Total revenues		592,161		592,161
Costs and expenses:				
Cost of sales		168,264		168,264
Restaurant wages and related expenses (including stock-based compensation expense of $121)		174,029		174,029
Restaurant rent expense		28,782	3,905	32,687
Other restaurant operating expenses		87,028		87,028
Advertising expense		24,442		24,442
General and administrative (including stock-based compensation expense of $947)	4,158	34,615		38,773
Depreciation and amortization		24,607	(922)	23,685
Impairment losses		1,879		1,879
Other income		(650)		(650)
Total operating expenses	4,158	542,996	2,983	550,137
Income (loss) from operations				