

CARROLS CORP  
Form 10-K  
March 23, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

OR

“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

**CARROLS RESTAURANT GROUP, INC.**

(Exact name of Registrant as specified in its charter)

Commission File Number: 001-33174

<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>16-1287774</b> (I.R.S. Employer Identification No.)
<b>968 James Street</b> <b>Syracuse, New York</b> (Address of principal executive office)	<b>13203</b> (Zip Code)
<b>Registrant's telephone number, including area code: (315) 424-0513</b>	

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

<b>Title of each class:</b> Common Stock, Carrols Restaurant Group, Inc.,	<b>Name on each exchange on which registered:</b> The NASDAQ Global Market
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par value \$.01 per share

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

**CARROLS CORPORATION**

(Exact name of Registrant as specified in its charter)

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Commission File Number: 0-25629

<p><b>Delaware</b> (State or other jurisdiction of incorporation or organization) <b>968 James Street</b>  <b>Syracuse, New York</b> (Address of principal executive office)</p>	<p><b>16-0958146</b> (I.R.S. Employer Identification No.)  <b>13203</b> (Zip Code) <b>Registrant's telephone number, including area code: (315) 424-0513</b></p>
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Securities registered pursuant to Section 12(b) of the Act: None

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

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

Indicate by check mark if each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

Carrols Restaurant Group, Inc. Yes  No

Carrols Corporation Yes  No

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 was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of March 16, 2007, Carrols Restaurant Group, Inc. had 21,550,826 shares of its common stock, \$.01 par value, outstanding and the aggregate market value of the common stock held by non-affiliates of Carrols Restaurant Group, Inc. was \$155,955,954. As of March 16, 2007, all outstanding equity securities of Carrols Corporation, which consisted of 10 shares of its common stock, were owned by Carrols Restaurant Group, Inc.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of Carrols Restaurant Group, Inc.'s definitive Proxy Statement for Carrols Restaurant Group, Inc.'s 2007 Annual Meeting of Stockholders, which is expected to be filed pursuant to Regulation 14A no later than 120 days after conclusion of Carrols Restaurant Group, Inc.'s fiscal year ended December 31, 2006, are incorporated by reference into Part III of this report.



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**CARROLS RESTAURANT GROUP, INC.**

**FORM 10-K**

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**PART I**

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

We use a 52 or 53 week fiscal year ending on the Sunday closest to December 31. For convenience, all references herein to the fiscal years ended December 29, 2002, December 28, 2003, January 2, 2005, January 1, 2006 and December 31, 2006 will hereinafter be referred to as the fiscal years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively. Our fiscal years ended December 31, 2002, 2003, 2005 and 2006 each contained 52 weeks. Our fiscal year ended December 31, 2004 contained 53 weeks.

We use the terms Segment EBITDA and Segment EBITDA margin in our 2006 Annual Report on Form 10-K because they are financial indicators that are reported to the chief operating decision maker for purposes of allocating resources to our segments and assessing their performance. Segment EBITDA (earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense, bonus to employees and a director in connection with the December 2004 Transactions (as defined in Item 6. Selected Financial Data), other income and expense and loss on extinguishment of debt) may not be necessarily comparable to other similarly titled captions of other companies due to differences in methods of calculation. The calculation of Segment EBITDA for our Burger King restaurants includes general and administrative expenses related directly to our Burger King segment, as well as the expenses associated with administrative support for all three of our segments including executive management, information systems and certain accounting, legal and other administrative functions. Segment EBITDA margin means Segment EBITDA as a percentage of the total revenues of the applicable segment. We consider our Pollo Tropical restaurants, Taco Cabana restaurants and Burger King restaurants to each constitute a separate segment. See Note 13 to the accompanying consolidated financial statements.

In this Annual Report on Form 10-K, we refer to information, forecasts and statistics regarding the restaurant industry. Unless otherwise indicated, all restaurant industry data in this Annual Report on Form 10-K refers to the U.S. restaurant industry and is taken from or based upon the Technomic Information Services (Technomic) report entitled 2006 Technomic Top 500 Chain Restaurant Report. In addition, statements in this Annual Report on Form 10-K concerning the increasing disposable income of the Hispanic consumer base are based on an article appearing in the third quarter 2004 edition of Georgia Business and Economic Conditions, a publication of the Terry College of Business, The University of Georgia. In this Annual Report on Form 10-K we also refer to information, forecasts and statistics from the U.S. Census Bureau and the U.S. Bureau of Labor Statistics and regarding BKC, as defined below. Unless otherwise indicated, information regarding BKC in this Annual Report on Form 10-K has been made publicly available by BKC. Any reference to BKC in this Annual Report on Form 10-K refers to Burger King Holdings, Inc. (NYSE: BKC) and its wholly-owned subsidiaries, including Burger King Corporation. We believe that all of these sources are reliable, but we have not independently verified any of this information and cannot guarantee its accuracy or completeness. The information, forecasts and statistics we have used from Technomic may reflect rounding adjustments.

**Forward-Looking Statements**

This 2006 Annual Report on Form 10-K contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are predictive in nature or that depend upon or refer to future events or conditions are forward-looking statements. These statements are often identified by the words may, might, will, should, anticipate, believe, expect, intend, estimate, hope or similar expressions.

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In addition, expressions of our strategies, intentions or plans are also forward looking statements. These statements reflect management's current views with respect to future events and are subject to risks and uncertainties, both known and unknown. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their date. There are important factors that could cause actual results to differ materially from those in forward-looking statements, many of which are beyond our control. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements. We have identified significant factors that could cause actual results to differ materially from those stated or implied in the forward-looking statements. For more information, please see Item 1A Risk Factors. We believe important factors that could cause actual results to differ materially from our expectations include the following, in addition to other risks and uncertainties discussed herein:

Competitive conditions;

Regulatory factors;

Environmental conditions and regulations;

General economic conditions, particularly at the retail level;

Weather conditions;

Fuel prices;

Significant disruptions in service or supply by any of our suppliers or distributors;

Changes in consumer perception of dietary health and food safety;

Labor and employment benefit costs;

The outcome of pending or future legal proceedings;

Our ability to manage our growth and successfully implement our business strategy;

The risks associated with the expansion of our business;

General risks associated with the restaurant industry;

Our inability to integrate any businesses we acquire;

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Our borrowing costs and credit ratings, which may be influenced by the credit ratings of our competitors;

The availability and terms of necessary or desirable financing or refinancing and other related risks and uncertainties;

The risk of events similar to those of September 11, 2001 or an outbreak or escalation of any insurrection or armed conflict involving the United States or any other national or international calamity;

Factors that affect the restaurant industry generally, including recalls if products become adulterated or misbranded, liability if product consumption causes injury, ingredient disclosure and labeling laws and regulations, reports of cases of mad cow disease and avian flu, and the possibility that consumers could lose confidence in the safety and quality of certain food products, as well as recent publicity concerning the health implications of obesity and trans fatty acids; and

Other factors discussed under Item IA Risk Factors and elsewhere herein.

**Table of Contents****ITEM 1. BUSINESS****Overview***Our Company*

We are one of the largest restaurant companies in the United States operating three restaurant brands in the quick-casual and quick-service restaurant segments with 547 restaurants located in 16 states as of December 31, 2006. We own and operate two Hispanic restaurant brands, Pollo Tropical® and Taco Cabana® (together referred to by us as our Hispanic Brands), which we acquired in 1998 and 2000, respectively. We are also the largest Burger King franchisee, based on the number of restaurants, and have operated Burger King restaurants since 1976. As of December 31, 2006, our company-owned restaurants included 76 Pollo Tropical restaurants and 143 Taco Cabana restaurants, and we operated 328 Burger King restaurants under franchise agreements. We also franchise our Hispanic Brand restaurants with 30 franchised restaurants located in Puerto Rico, Ecuador and the United States as of December 31, 2006. We believe that the diversification and strength of our restaurant brands as well as the geographic dispersion of our restaurants provide us with stability and enhanced growth opportunities. Our primary growth strategy is to develop new company-owned Hispanic Brand restaurants. For the year ended December 31, 2006, we had total revenues of \$751.4 million and net income of \$13.4 million.

On December 20, 2006, we and certain selling stockholders completed an initial public offering (the IPO) of 5,666,666 and 5,333,334 shares of our common stock, respectively (including 1,000,000 shares sold by the selling stockholders upon the underwriters' exercise of its over-allotment option). In connection with the IPO, our common stock was approved for listing on The NASDAQ Global Market and began trading on December 15, 2006 under the symbol TAST.

**Hispanic Brands.** Our Hispanic Brands operate in the quick-casual restaurant segment, combining the convenience and value of quick-service restaurants with the menu variety, use of fresh ingredients and food quality more typical of casual dining restaurants. For the year ended December 31, 2006, our company-owned Pollo Tropical and Taco Cabana restaurants generated average annual sales per restaurant of \$2,135,000 and \$1,643,000, respectively, which we believe are among the highest in the quick-casual and quick-service segments. For the year ended December 31, 2006, aggregate revenues for our Hispanic Brands were \$382.5 million, which represented 50.9% of our total consolidated revenues.

**Pollo Tropical:** Our Pollo Tropical restaurants are known for their fresh grilled chicken marinated in our own blend of tropical fruit juices and spices. Our menu also features other items including roast pork, sandwiches, grilled ribs offered with a selection of sauces, Caribbean style made from scratch side dishes and salads. Most menu items are made fresh daily in each of our Pollo Tropical restaurants, which feature open display cooking that enables customers to observe the preparation of menu items, including chicken grilled on large, open-flame grills. Pollo Tropical opened its first restaurant in 1988 in Miami. As of December 31, 2006, we owned and operated a total of 76 Pollo Tropical restaurants, of which 74 were located in Florida, one located in the New York City metropolitan area in northern New Jersey and one in Brooklyn, New York. For the year ended December 31, 2006, the average sales transaction at our company-owned Pollo Tropical restaurants was \$9.05 reflecting, in part, strong dinner traffic, with dinner sales representing the largest sales day-part of Pollo Tropical restaurant sales. For the year ended December 31, 2006, our Pollo Tropical restaurants generated total revenues of \$154.2 million.

**Taco Cabana:** Our Taco Cabana restaurants serve fresh Tex-Mex and traditional Mexican style food, including sizzling fajitas, quesadillas, enchiladas, burritos, tacos, other Tex-Mex dishes, fresh-made flour tortillas, frozen margaritas and beer. Most menu items are made fresh daily in each of our Taco Cabana restaurants, which feature open display cooking that enables customers to observe the preparation of menu items, including fajitas cooking on a grill and a machine making fresh tortillas. A majority of our Taco Cabana restaurants are open 24 hours a day, generating customer traffic and restaurant sales across multiple day-parts by offering a convenient and quality experience to our customers. Taco Cabana pioneered the Mexican patio café concept with its first restaurant in San Antonio, Texas in 1978. As of December 31, 2006, we owned and operated 143 Taco Cabana restaurants located in Texas, Oklahoma and New Mexico,



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of which 137 were located in Texas. For the year ended December 31, 2006, the average sales transaction at our company-owned Taco Cabana restaurants was \$7.31 with dinner sales representing the largest sales day-part of Taco Cabana restaurant sales. For the year ended December 31, 2006, our Taco Cabana restaurants generated total revenues of \$228.3 million.

***Burger King:*** Burger King is the second largest hamburger restaurant chain in the world (as measured by the number of restaurants and system-wide sales) and we are the largest franchisee in the Burger King system, based on number of restaurants. Burger King restaurants are part of the quick-service restaurant segment which is the largest of the five major segments of the U.S. restaurant industry based on 2006 sales. Burger King restaurants feature the popular flame-broiled Whopper sandwich, as well as a variety of hamburgers and other sandwiches, fries, salads, breakfast items and other offerings. According to BKC, historically it has spent between 4% and 5% of its annual system sales on marketing, advertising and promotion to sustain and increase its high brand awareness. We benefit from BKC's marketing initiatives as well as its development and introduction of new menu items. As of December 31, 2006, we operated 328 Burger King restaurants located in 12 Northeastern, Midwestern and Southeastern states. For the year ended December 31, 2006, the average sales transaction at our Burger King restaurants was \$5.23. For the year ended December 31, 2006, our Burger King restaurants generated total revenues of \$368.9 million.

***Corporate Information:*** Carrols Restaurant Group is a Delaware Corporation, incorporated in 1986. Carrols Restaurant Group conducts all of its operations through its direct and indirect subsidiaries and has no assets other than the shares of Carrols, its direct wholly-owned subsidiary. Prior to November 21, 2006 Carrols Restaurant Group was known as Carrols Holdings Corporation. On November 21, 2006, we amended our certificate of incorporation to change our name to Carrols Restaurant Group, Inc.

## **Industry**

### ***The Restaurant Market***

According to Technomic, total restaurant industry revenues in the United States for 2005 were \$330.8 billion, an increase of 5.6% over 2004. Sales in the overall U.S. restaurant industry are projected by Technomic to increase at a compound annual growth rate of 5.3% from 2005 through 2010.

### ***Quick-Casual Restaurants***

Our Hispanic Brands operate in the quick-casual restaurant segment, combining the convenience of quick-service restaurants with the menu variety, use of fresh ingredients and food quality more typical of casual dining. We believe that the quick-casual restaurant segment is one of the fastest growing segments of the restaurant industry. According to Technomic, sales growth in 2005 of quick-casual chains in the Technomic Top 500 restaurant chains was 11.8% as compared to 7.0% for the overall Top 500 restaurant chains, which includes all five major segments.

Quick-casual restaurants are primarily distinguished by the following characteristics:

*Quick-service or self-service format.* Meals are purchased prior to receiving food. In some cases, payment may be made at a separate station from where the order was placed. Also, servers may bring orders to the customer's table.

*Check averages between \$7 and \$10.* Technomic reports that the average check at quick-casual restaurants in 2005 ranged between \$7 and \$10, which was higher than the average check at traditional quick-service restaurants.

*Food prepared to order.* We believe that in quick-casual concepts, customization of orders and open display cooking are common.

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*Fresh ingredients.* Many concepts use the word "fresh" in their concept positioning and feature descriptive menus highlighting these fresh ingredients.

*Broader range of menu offerings.* Typically quick-casual concepts provide greater variety and diversity in their menu offerings relative to traditional quick-service restaurants.

*Enhanced decor.* Wooden tables, upholstered seating and track lighting are some of the design features commonly found in quick-casual establishments.

We believe that our Hispanic Brands are positioned to benefit from growing consumer demand for quick-casual restaurants because of food quality, value and differentiation of flavors, as well as the increasing acceptance of ethnic foods. We also believe that our Hispanic Brands will benefit from two significant demographic factors: the expected population growth rates in regions in which our restaurants are currently located and the expected rate of growth of the Hispanic population in the United States, both as projected by the U.S. Census Bureau in its 2001 Statistical Abstract of the United States.

Our Burger King restaurants are part of the quick-service restaurant segment that Technomic indicates is the largest of the five major segments of the U.S. restaurant chain industry. Technomic identifies ten major types of restaurants comprising the quick-service segment: Hamburger; Pizza; Chicken; Other Sandwich; Mexican; Frozen Dessert; Donut; Beverage; Cafeteria/Buffer; and Family Steak. According to Technomic, the quick-service restaurants included in the Top 100 quick-service restaurant companies in 2005 were divided by menu category as follows (percentages are based on total sales for the quick-service segment):

According to Technomic, sales at all quick-service restaurants in the United States were \$168.8 billion in 2005, representing 51% of total U.S. restaurant industry sales. Sales in this segment are projected by Technomic to increase at a compound annual growth rate of 5.5% from 2005 through 2010.

Quick-service restaurants are distinguished by the following characteristics:

*High speed of service and efficiency.* Quick-service restaurants typically have order taking and cooking platforms designed specifically to order, prepare and serve menu items with speed and efficiency. Fast and consistent food service is a characteristic of quick-service restaurants.

*Convenience.* Quick-service restaurants are typically located in places that are easily accessed and convenient to customers' homes, places of work and commuter routes.

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*Limited menu choice and service.* The menus at most quick-service restaurants have a limited number of standardized items. Typically, customers order at a counter or drive thru and pick up food that then is taken to a seating area or consumed off the restaurant premises.

*Value prices.* At quick-service restaurants, average check amounts are generally lower than other major segments of the restaurant industry.

Our Burger King restaurants operate in the hamburger segment of the quick-service restaurant segment. The hamburger segment of the quick-service restaurant segment in the United States, which generated \$56.4 billion in sales in 2005, is the largest segment of the quick-service restaurant segment in the United States, according to Technomic.

We believe that the quick-service and quick-casual restaurant segments meet consumers' desire for a convenient, reasonably priced restaurant experience. In addition, we believe that the consumers' need for meals prepared outside of the home, including takeout, has increased significantly over historical levels as a result of the greater numbers of working women and single parent families. For example, according to the U.S. Bureau of Labor Statistics, the percentage of mothers with children under age six participating in the workforce has increased from 39% in 1975 to 64% in 2002. According to the U.S. Census Bureau, the number of children living in households with two parents has decreased from approximately 85% in 1970 to 70% in 2001.

### **Our Competitive Strengths**

We believe we have the following strengths:

***Strong Hispanic Brands.*** We believe that the following factors have contributed, and will continue to contribute, to the success of our Hispanic Brands:

freshly-prepared food at competitive prices with convenience and value;

a variety of menu items including signature dishes with Hispanic flavor profiles designed to appeal to consumers' desire for freshly-prepared food and menu variety;

successful dinner day-part representing the largest sales day-part at both of our Hispanic Brands, providing a higher average check size than other day-parts;

broad consumer appeal that attracts both the growing Hispanic consumer base, with increasing disposable income to spend on items such as traditional foods prepared at restaurants rather than at home, and non-Hispanic consumers in search of new flavor profiles, grilled rather than fried entree choices and varied product offerings at competitive prices in an appealing atmosphere;

ability to control the consistency and quality of the customer experience and the strategic growth of our restaurant operations through our system consisting of primarily company-owned restaurants compared to competing brands that focus on franchising;

high market penetration of company-owned restaurants in our core markets that provides operating and marketing efficiencies, convenience for our customers and the ability to effectively manage and enhance brand awareness;

well positioned to continue to benefit from the projected population growth in Florida and Texas;

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established infrastructure at our Hispanic Brands to manage operations and develop and introduce new menu offerings, positioning us to build customer frequency and broaden our customer base; and

well positioned to continue to capitalize on the home meal replacement trend.

For the year ended December 31, 2006, aggregate revenues for our Hispanic Brands were \$382.5 million which represented 50.9% of our total consolidated revenues.

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***Primarily Company-Owned Hispanic Brand Restaurants Enable us to Control our Hispanic Brands.*** As of December 31, 2006, our Hispanic Brands were comprised of 219 company-owned and 30 franchised restaurants, of which only five of these franchised restaurants were located in the United States. Our Hispanic Brand restaurants in the United States are primarily company-owned and we therefore exercise control over the day-to-day operations of our company-owned restaurants unlike many of our competitors that have multiple franchisees operating as a single brand. Consequently, our success does not depend on our control of our franchisees, or support by them of our marketing programs, new product offerings, strategic initiatives or new restaurant development strategies. In addition, because our Hispanic Brand restaurants are primarily company-owned, we believe we are less susceptible to third party franchisees adversely affecting the long-term development potential of our brands and we believe we are better able to provide customers a more consistent experience relative to competing brands that utilize franchisee-operated restaurants.

***Strong Restaurant Level Economics and Operating Metrics for our Hispanic Brands.*** We believe that we benefit from attractive restaurant level economics and operating profitability for our Hispanic Brands. We believe that the average annual sales at our company-owned Hispanic Brand restaurants for the year ended December 31, 2006 of \$2,135,000 for our Pollo Tropical restaurants and \$1,643,000 for our Taco Cabana restaurants, respectively, are among the highest in the quick-casual and quick-service segments. For the year ended December 31, 2006 our Pollo Tropical restaurants generated a Segment EBITDA margin of 18.4% which included general and administrative expenses of 5.8% of total Pollo Tropical revenues. For the year ended December 31, 2006, our Taco Cabana restaurants generated Segment EBITDA margins of 14.7%, which included general and administrative expenses of 5.1% of total Taco Cabana revenues. We believe that the average annual sales at our company-owned Hispanic Brand restaurants and the operating margins of our Hispanic Brands generate unit economics and returns on invested capital which will enable us to accelerate and sustain new unit growth.

***Well Positioned to Continue to Capitalize on Growing Population in Core Markets Served by Our Hispanic Brands.*** We expect sales from our Hispanic Brand restaurants in Florida and Texas to benefit from the projected continued overall population growth in these markets, which is projected by the U.S. Census Bureau to grow at a faster rate than the national average. According to the U.S. Census Bureau, the U.S. population is forecast to grow by 4.5% from 2005 to 2010 and the population in Florida and Texas is forecast to grow by 9.9% and 8.2%, respectively, during that same period.

***Well Positioned to Continue to Capitalize on the Growth of the Hispanic Population in the United States.*** We expect sales from our Hispanic Brand restaurants to benefit from the population growth of the U.S. Hispanic population which is projected by the U.S. Census Bureau to grow at a faster rate than the national average. The U.S. Census Bureau forecasts that the growth of the Hispanic population is expected to outpace overall population growth and increase from 11.8% of the total U.S. population in 2000 to 18.2% by 2025.

***Largest Burger King Franchisee.*** We are Burger King's largest franchisee and are well positioned to leverage the scale and marketing of one of the most recognized brands in the restaurant industry. The size of our Burger King business has contributed significantly to our large aggregate restaurant base, enabling us to enhance operating efficiencies and realize benefits across all three of our brands from economies of scale with respect to our management team and management information and operating systems. In addition, our Burger King business has significantly contributed, and is expected to continue to significantly contribute, to our consolidated operating cash flows. For the year ended December 31, 2006, revenues for our Burger King restaurants were \$368.9 million, which represented 49.1% of our total consolidated revenues.

***Infrastructure in Place for Growth.*** We believe that our operating disciplines, seasoned management, operational infrastructure and marketing and product development capabilities, supported by our corporate and restaurant management information systems and comprehensive training and development programs, will support significant expansion. We expect to leverage our significant investment in corporate infrastructure as we grow our business.

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***Experienced Management Team.*** We believe that our senior management team's extensive experience in the restaurant industry, knowledge of the demographic and other characteristics of our core markets and its long and successful history of developing, acquiring, integrating and operating quick-service and quick-casual restaurants, provide us with a competitive advantage.

### **Business Strategy**

Our primary business strategy is as follows:

***Develop New Hispanic Brand Restaurants in Core and Other Markets.*** We believe that we have significant opportunities to develop new Pollo Tropical and Taco Cabana restaurants in their respective core markets within Florida and Texas and expand into new markets both within Florida and Texas as well as other regions of the United States. Our Pollo Tropical restaurants are primarily concentrated in South and Central Florida and our Taco Cabana restaurants are primarily concentrated in larger cities in Texas. By increasing the number of restaurants we operate in a particular market, we believe that we can continue to increase brand awareness and effectively leverage our field supervision, corporate infrastructure and marketing expenditures. We also believe that the appeal of our Hispanic Brands and our high brand recognition in our core markets provide us with opportunities to expand into other markets in Florida and Texas. In addition, we believe that there are a number of geographic regions in the United States outside of Florida and Texas where the size of the Hispanic population and its influence on the non-Hispanic population provide significant opportunities for development of additional Hispanic Brand restaurants. In March 2006, we opened our first Pollo Tropical restaurant in the New York City metropolitan area, located in northern New Jersey. In December 2006, we opened a second Pollo Tropical restaurant in the New York City metropolitan area in Brooklyn, New York. In addition, we currently are exploring opportunities for expansion of the Taco Cabana concept in new markets. During the year ended December 31, 2006, we opened eight Pollo Tropical restaurants (including two restaurants in the Northeast as described above) and nine Taco Cabana restaurants in Texas. In 2007, we currently plan to open between seven and ten Pollo Tropical restaurants and between ten and twelve additional Taco Cabana restaurants.

Our staff of real estate and development professionals is responsible for new restaurant development. Before developing a new restaurant, we conduct an extensive site selection and evaluation process that includes in depth demographic, market and financial analyses. By selectively increasing the number of restaurants we operate in a particular market, we believe that we can continue to increase brand awareness and effectively leverage our field supervision, corporate infrastructure and marketing expenditures. Where possible, we intend to continue to utilize real estate leasing as a means of reducing the amount of cash invested in new restaurants. We believe that cash generated from operations, borrowings under our senior credit facility and leasing will enable us to continue to pursue our strategy of new restaurant development.

In addition to opportunities for expansion of our Hispanic Brands within our core markets, we believe there are significant growth opportunities in areas contiguous to our core markets and beyond such markets. We plan to open new restaurants in existing and new markets that may be either freestanding buildings or restaurants contained within strip shopping centers, which we sometimes refer to as in-line restaurants, to further leverage our existing brand awareness. Developing in-line restaurants allows us to selectively expand our brand penetration and visibility in certain of our existing markets, while doing so at a lower cost than developing a restaurant as a freestanding building. In addition, development of in-line restaurants permits us to further penetrate markets where freestanding opportunities may be limited.

***Increase Comparable Restaurant Sales.*** Our strategy is to grow sales in our existing restaurants by continuing to develop new menu offerings and enhance the effectiveness of our proprietary advertising and promotional programs for our Hispanic Brands, further capitalize on attractive industry and

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demographic trends and enhance the quality of the customer experience at our restaurants. We also believe that our Burger King restaurants are well positioned to benefit from BKC's initiatives with respect to the Burger King brand.

***Continue to Improve Income from Operations and Leverage Existing Infrastructure.*** We believe that our continuing development of new company-owned Hispanic Brand restaurants, combined with our strategy to increase sales at our existing Hispanic Brand restaurants, will increase revenues generated by our Hispanic Brands as a percentage of our consolidated revenues and position us to continue to improve our overall income from operations. We also believe that our large restaurant base, skilled management team, sophisticated management information and operating systems, and training and development programs support our strategy of enhancing operating efficiencies for our existing restaurants and profitably growing our restaurant base. Our operating systems allow us to effectively manage restaurant labor and food costs, effectively manage our restaurant operations and ensure consistent application of operating controls at each of our restaurants. In addition, our size and, in the case of Burger King, the size of the Burger King system, enable us to realize certain benefits from economies of scale, including leveraging our existing infrastructure as we grow.

***Utilize Financial Leverage to Maintain an Efficient Capital Structure to Support Growth.*** We intend to continue utilizing financial leverage in an effort to enhance returns to our stockholders. We believe our operating cash flows will allow us to allocate sufficient capital towards new store development and repayment of our outstanding indebtedness as part of our strategy to support earnings growth, while providing the flexibility to alter our capital allocation depending on changes in market conditions and available expansion opportunities.

### **Overview of Restaurant Concepts**

#### ***Pollo Tropical Restaurants***

Our Pollo Tropical quick-casual restaurants combine freshly-prepared, distinctive menu items and an inviting tropical setting with the convenience and value of quick-service restaurants. Pollo Tropical restaurants offer a unique selection of food items reflecting tropical and Caribbean influences and feature fresh grilled chicken marinated in our own blend of tropical fruit juices and spices. Chicken is grilled in view of customers on large, open-flame grills. Pollo Tropical also features additional menu items such as roast pork, a line of TropiChops® (a bowl containing rice, black beans and chicken or pork), sandwiches and grilled ribs that feature a selection of sauces. We also feature an array of Caribbean style made from scratch side dishes, including black beans and rice, yucatan fries and sweet plantains, as well as more traditional menu items such as french fries, corn and tossed and caesar salads. We also offer uniquely Hispanic desserts, such as flan and tres leches.

Our Pollo Tropical restaurants typically incorporate high ceilings, large windows, tropical plants, light colored woods, decorative tiles, a visually distinctive exterior entrance tower, lush landscaping and other signature architectural features, all designed to create an airy, inviting and tropical atmosphere. We design our restaurants to conveniently serve a high volume of customer traffic while retaining an inviting, casual atmosphere.

Our Pollo Tropical restaurants are generally open for lunch, dinner and late night orders seven days per week from 11:00 am to midnight and offer sit-down dining, counter take-out and drive-thru service to accommodate the varied schedules of families, business people and students. Our menu offers a variety of portion sizes to accommodate a single customer, family or large group. Pollo Tropical restaurants also offer an economical catering menu, with special prices and portions to serve parties in excess of 25 people.

Our Pollo Tropical restaurants typically provide seating for 80 to 100 customers and provide drive-thru service. As of December 31, 2006, all of our company-owned Pollo Tropical restaurants were freestanding buildings except for seven locations contained within strip shopping centers and two street-level storefront

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locations. Our typical freestanding Pollo Tropical restaurant ranges between 2,800 and 3,200 square feet. We anticipate that many of our new Pollo Tropical restaurants located in markets outside of Florida (including in the New York City metropolitan area) will be in-line restaurants located within strip-retail shopping centers or will be street-level storefront locations and will not offer drive-thru service. Consequently, such restaurants may be larger than our typical freestanding Pollo Tropical restaurants to provide more seating to accommodate increased sit-down dining.

***Taco Cabana Restaurants***

Our Taco Cabana quick-casual restaurants combine generous portions of freshly-prepared Tex-Mex and traditional Mexican style food with the convenience and value of quick-service restaurants. The restaurants typically provide interior, semi-enclosed and patio dining areas with a festive Mexican theme. Menu items include flame-grilled beef and chicken fajitas served on sizzling iron skillets, quesadillas, enchiladas, burritos, tacos and other traditional Mexican and American breakfasts, other Tex-Mex dishes and fresh flour tortillas. Our Taco Cabana restaurants also offer a variety of beverage choices, including frozen margaritas and beer. Most of the menu items offered at Taco Cabana are prepared at each restaurant from fresh meat, chicken and produce delivered by suppliers to the restaurant, usually three times each week. Taco Cabana utilizes fresh ingredients and prepares many items from scratch. In order to simplify operations and provide a more consistent product, Taco Cabana also uses a number of pre-prepared items.

Our typical Taco Cabana restaurants average approximately 3,200 square feet (exclusive of the exterior dining area) and provide seating for approximately 80 customers, with additional outside patio seating for approximately 50 customers. As of December 31, 2006, all of our company-owned Taco Cabana restaurants were freestanding buildings except for four locations contained within retail malls and two locations contained within strip shopping centers. Taco Cabana restaurants are typically distinctive in appearance, conveying a Mexican theme and permitting easy identification by passing motorists. Our Taco Cabana restaurants feature rounded fronts, as well as Southwest accents such as a clay tile roof, heavy wood beams and a trellis that shades the patio area, and the use of bright colors outside and inside. Corrugated metal wall panels, aged wood finishes and distressed stainless steel counter tops are featured inside.

Taco Cabana's interior restaurant design features open display cooking that enables customers to observe fajitas cooking on a grill, a machine making fresh flour tortillas and the preparation of other food items. Upon entry, the customer places an order selected from an overhead menu board, proceeds down a service line to where the order is picked up, and then passes a salsa bar en route to the dining area. The distinctive salsa bar offers Taco Cabana customers our own freshly-prepared Tex-Mex ingredients such as salsa de fuego (made with charred peppers and tomatoes), pico de gallo and salsa (all made from scratch throughout the day at each restaurant), as well as cilantro, pickled jalapeno slices, crisp chopped onions and fresh sliced limes. Depending on the season, time of day and personal preference, our customers can choose to dine in the restaurant's brightly colored and festive interior dining area or in either the semi-enclosed or outdoor patio areas.

Our Taco Cabana restaurants provide the convenience of drive-thru windows as well as the ability for customers to dine-in or take-out. A majority of our Taco Cabana restaurants are open 24 hours a day, although, hours of operation are continually evaluated for economic viability on a market and individual restaurant basis.

***Burger King Restaurants***

Burger King is the second largest hamburger restaurant chain in the world (as measured by the number of restaurants and system-wide sales). According to BKC, as of December 31, 2006, there were a total of 11,184 Burger King restaurants in 66 countries and U.S. territories, including 7,502 or 67% located in the United States and Canada. According to BKC, its total worldwide restaurant sales as of June 30, 2006 were approximately \$12.4 billion, of which approximately \$8.5 billion were in the United States and Canada.



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Have It Your Way<sup>®</sup> service, flame broiling, generous portions and competitive prices characterize the Burger King system marketing strategy. Our Burger King restaurants feature flame-broiled hamburgers and other sandwiches, the most popular of which is the WHOPPER<sup>®</sup> sandwich. The WHOPPER is a large, flame-broiled hamburger on a toasted bun garnished with mayonnaise, lettuce, onions, pickles and tomatoes. The basic menu of all Burger King restaurants consists of hamburgers, cheeseburgers, chicken and fish sandwiches, breakfast items, french fries, onion rings, salads, chili, shakes, desserts, soft drinks and other beverages. In addition, promotional menu items are introduced periodically for limited periods. We believe that BKC continually seeks to develop new products as it endeavors to enhance the menu and service of Burger King restaurants.

Our Burger King restaurants are typically open seven days per week and currently have minimum operating hours from 6:00 am to 11:00 pm. We anticipate that minimum operating hours will be extended in 2007 from 11:00 pm to midnight. Burger King restaurants are quick-service restaurants of distinctive design and are generally located in high-traffic areas throughout the United States. We believe that the primary competitive advantages of Burger King restaurants are:

brand recognition;

convenience of location;

speed of service;

quality; and

price.

Burger King restaurants are designed to appeal to a broad spectrum of consumers, with multiple day-part meal segments targeted to different groups of consumers.

Our Burger King restaurants consist of one of several building types with various seating capacities. BKC's traditional freestanding restaurant contains approximately 2,800 to 3,200 square feet with seating capacity for 90 to 100 customers, has drive-thru service windows, and has adjacent parking areas. As of December 31, 2006, 316 of our 328 Burger King restaurants were freestanding. We operate all of our Burger King restaurants under franchise agreements with BKC. See Operations Burger King Franchise Agreements and Franchise Fees, Royalties and Early Successor Program below.

**Table of Contents****Restaurant Economics**

Selected restaurant operating data for our three restaurant concepts is as follows:

	Year Ended December 31,		
	2004(1)	2005(1)	2006(1)
<b>Pollo Tropical:</b>			
Average annual sales per company-owned restaurant (in thousands)	\$ 2,018	\$ 2,092	\$ 2,135
Average sales transaction	\$ 8.25	\$ 8.72	\$ 9.05
Drive-through sales as a percentage of total sales	42.5%	41.7%	41.7%
Day-part sales percentages:			
Lunch	45.7%	45.8%	46.7%
Dinner and late night (2)	54.3%	54.2%	53.3%
<b>Taco Cabana:</b>			
Average annual sales per company-owned restaurant (in thousands)	\$ 1,604	\$ 1,614	\$ 1,643
Average sales transaction	\$ 6.88	\$ 7.08	\$ 7.31
Drive-through sales as a percentage of total sales	47.2%	47.6%	47.6%
Day-part sales percentages:			
Breakfast	16.0%	16.5%	16.8%
Lunch	23.1%	23.2%	23.4%
Dinner	25.4%	25.6%	25.1%
Late night (9 pm to midnight)	14.1%	13.7%	13.9%
Other (2 pm to 5 pm and midnight to 6 am)	21.4%	21.0%	20.8%
<b>Burger King:</b>			
Average annual sales per restaurant (in thousands)	\$ 1,034	\$ 1,048	\$ 1,114
Average sales transaction	\$ 4.74	\$ 5.03	\$ 5.23
Drive-through sales as a percentage of total sales	61.8%	62.3%	62.8%
Day-part sales percentages:			
Breakfast	14.4%	14.6%	14.2%
Lunch	33.6%	33.2%	33.0%
Dinner	26.9%	26.9%	27.1%
Afternoon and late night.	25.1%	25.3%	25.7%

- (1) 2005 and 2006 were each a 52-week fiscal year. 2004 was a 53-week fiscal year. Average annual sales for company owned or operated restaurants are derived by dividing restaurant sales for such year for the applicable segment by the average number of restaurants for the applicable segment for such year. For purposes of the calculation of average annual sales per company owned or operated restaurant in the table above, we have excluded restaurant sales data for the extra week in 2004.
- (2) Day part sales percentages for 2004, 2005 and 2006 include 2.8%, 2.9% and 2.8%, respectively, for late night.

**Restaurant Capital Costs**

The initial cost of equipment, seating, signage and other interior costs of a typical new free-standing Pollo Tropical restaurant currently is approximately \$400,000 (excluding the cost of the land, building and site improvements). Generally, in our core Florida market, the cost of land currently ranges from \$1,000,000 to \$1,250,000 and the cost of building and site improvements currently ranges from \$1,000,000 to \$1,250,000.

Costs in new markets may differ from and may be higher than these ranges. We believe that in the New York City metropolitan area, our new Pollo Tropical restaurants will not typically be free-standing and are more likely to be located as in-line units within strip retail shopping centers or as street-level storefront locations. We believe that these locations will typically be leased, that the cost to build-out the retail location to our specifications could range from \$500,000 to \$1,000,000 and that the initial cost of equipment will be approximately \$450,000.

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The initial cost of equipment, seating, signage and other interior costs of a typical new Taco Cabana restaurant currently is approximately \$440,000 (excluding the cost of the land, building and site improvements). Generally, in our core Texas market, the cost of land currently ranges from \$900,000 to \$1,000,000 and the cost of building and site improvements currently ranges from \$900,000 to \$1,000,000. Costs in new markets may differ from these ranges.

The initial cost of the franchise fee, equipment, seating, signage and other interior costs of a standard new Burger King restaurant currently is approximately \$385,000 (excluding the cost of the land, building and site improvements). In the markets in which we primarily operate, the cost of land generally ranges from \$400,000 to \$525,000 and the cost of building and site improvements generally ranges from \$550,000 to \$625,000.

We generally seek to acquire the land on which a new free-standing restaurant is to be situated, to fund construction of the restaurant building, and then at a later date enter into an arrangement to sell and leaseback the land and building under a long-term lease. Historically, we have been able to acquire and finance a large percentage of our locations under such leasing arrangements. Where we are unable to purchase the underlying land, we enter into a long-term lease for the land and fund the construction of the building from cash generated from our operations or with borrowings under our senior credit facility rather than through long-term leasing arrangements. We believe that in certain real estate markets, particularly Florida, an increasing number of our new restaurants likely may be situated on leased land.

The cost of developing and equipping new restaurants can vary significantly and depends on a number of factors, including the geographic location and site of those restaurants and national and local economic conditions. Accordingly, the cost of opening new restaurants in the future, including Pollo Tropical restaurants in the New York City metropolitan area, may differ substantially from, and may be significantly higher than, both the historical cost of restaurants previously opened and the estimated costs appearing above.

**Seasonality**

Our business is moderately seasonal due to regional weather conditions. Sales from our Pollo Tropical restaurants (primarily located in south and central Florida) are generally higher during the winter months than during the summer months. Sales from our Taco Cabana restaurants (located in Texas, Oklahoma and New Mexico) and our Burger King restaurants (primarily located in the northern United States) are generally higher during the summer months than during the winter months. We believe this seasonal impact is not material to our business as a whole because our multiple concepts operating in diverse geographic areas enable us to reduce our dependence on the economic performance of any one particular region.

**Restaurant Locations**

As of December 31, 2006, we owned and operated 76 Pollo Tropical restaurants, 74 of which were located in Florida and two in the New York City metropolitan area located in Northern New Jersey and in Brooklyn, New York. In addition, of 27 franchised Pollo Tropical restaurants as of December 31, 2006, 23 were in Puerto Rico; two were in Ecuador and two were on college campuses in Florida.

As of December 31, 2006, we owned and operated 143 Taco Cabana restaurants and franchised three Taco Cabana restaurants located in the following states:

	Owned	Franchised	Total
Texas	137		137
Oklahoma	5		5
New Mexico	1	2	3
Georgia		1	1
Total	143	3	146

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The following table details the locations of our 328 Burger King restaurants as of December 31, 2006:

State	Total Restaurants
Indiana	5
Kentucky	9
Maine	4
Massachusetts	1
Michigan	25
New Jersey	2
New York	129
North Carolina	37
Ohio	83
Pennsylvania	12
South Carolina	20
Vermont	1
<b>Total</b>	<b>328</b>

**Operations*****Management Structure***

We conduct substantially all of our executive management, finance, marketing and operations support functions from our corporate headquarters in Syracuse, New York, our Pollo Tropical division headquarters in Miami, Florida and our Taco Cabana division headquarters in San Antonio, Texas. The management structure for Pollo Tropical consists of an Executive Vice President, who has over 30 years of experience in the restaurant industry, and a Vice President of Operations and a Regional Director supported by nine district supervisors. The management structure of Taco Cabana consists of an Executive Vice President of Operations, who has over 30 years of restaurant experience, and a Regional Vice President and two Regional Directors supported by 18 district supervisors. Our Burger King operations are overseen by five Regional Directors, three of whom are Vice Presidents that have an average of 25 years of Burger King restaurant experience. Forty-four district supervisors that have an average of 22 years of restaurant management experience in the Burger King system support the Regional Directors.

For each of our concepts, a district supervisor is responsible for the direct oversight of the day-to-day operations of an average of approximately seven restaurants. Typically, district supervisors have previously served as restaurant managers at one of our restaurants. Regional directors, district supervisors and restaurant managers are compensated with a fixed salary plus an incentive bonus based upon the performance of the restaurants under their supervision. Typically, our restaurants are staffed with hourly employees who are supervised by a salaried manager and two or three salaried assistant managers.

***Training***

We maintain a comprehensive training and development program for all of our personnel and provide both classroom and in-restaurant training for our salaried and hourly personnel. The program emphasizes system-wide operating procedures, food preparation methods and customer service standards for each of the concepts. In addition, BKC's training and development programs are also available to us as a franchisee.

***Management Information Systems***

Our management information systems, which we believe are more sophisticated than systems typically utilized by many small quick-casual/quick-service restaurant operators and many other Burger King franchisees,

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provide us with the ability to efficiently and effectively manage our restaurants and to ensure consistent application of operating controls at our restaurants. Our size also affords us the ability to maintain an in-house staff of information and restaurant systems professionals dedicated to continuously enhancing our systems. In addition, these capabilities allow us to integrate newly developed or acquired restaurants and to leverage our investments in information technology over a larger base of restaurants.

Our restaurants generally employ touch-screen point-of-sale (POS) systems that are designed to facilitate accuracy and speed of order taking. These systems are user-friendly, require limited cashier training and improve speed-of-service through the use of conversational order-taking techniques. The POS systems are integrated with PC-based applications at the restaurant that are designed to facilitate financial and management control of our restaurant operations.

Our restaurant systems provide daily tracking and reporting of traffic counts, menu item sales, labor and food data, and other key operating information for each restaurant. We electronically communicate with our restaurants on a daily basis, which enables us to collect this information for use in our corporate management systems. Our corporate and divisional administrative headquarters house client/server-based systems that support all of our accounting, operating and reporting systems. We also operate a 24-hour, seven-day help desk at our corporate headquarters that enables us to provide systems and operational support to our restaurant operations as required. Among other things, our restaurant information systems provide us with the ability to:

- monitor labor utilization and sales trends on a real-time basis at each restaurant, enabling the restaurant manager to effectively manage to our established labor standards on a timely basis;

- reduce shrinkage using restaurant-level inventory management and centralized standard costing systems;

- analyze sales and product mix data to help restaurant management personnel forecast production levels;

- monitor day-part drive-thru speed of service at each of our restaurants;

- systematically communicate human resource and payroll data to our administrative offices for efficient centralized management of labor costing and payroll processing;

- employ centralized control over price, menu and inventory management activities at the restaurant utilizing the remote access capabilities of our systems;

- take advantage of electronic commerce including our ability to place orders with suppliers and to integrate detailed invoice, receiving and product data with our inventory and accounting systems; and

provide analyses, reporting and tools to enable all levels of management to review a wide-range of financial and operational data. Information from our systems is available daily to the restaurant manager, who is expected to react quickly to trends or situations in his or her restaurant. Our district supervisors also receive daily information for all restaurants under their control and have computer access to key operating data on a remote basis using our corporate intranet. Management personnel at all levels, from the restaurant manager through senior management, monitor key restaurant performance indicators.

### ***Site Selection***

We believe that the location of our restaurants is a critical component of each restaurant's success. We evaluate potential new sites on many critical criteria including accessibility, visibility, costs, surrounding traffic patterns, competition and demographic characteristics. Our senior

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management determines the acceptability of all acquisition prospects and new sites, based upon analyses prepared by our real estate and financial professionals and operations personnel.

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Each of our Burger King restaurants operates under a separate franchise agreement with BKC. Our franchise agreements with BKC generally require, among other things, that all restaurants comply with specified design criteria and be operated in a prescribed manner, including utilization of the standard Burger King menu. In addition, our Burger King franchise agreements generally require that our restaurants conform to BKC's current image and provide for remodeling of our restaurants at the request of BKC during the tenth year of the agreements to conform to such current image, which may require the expenditure of considerable funds. These franchise agreements with BKC generally provide for an initial term of 20 years and currently have an initial franchise fee of \$50,000. In the event that we terminate any franchise agreement and close the related BKC restaurant prior to the expiration of its term, we may be required to pay BKC an amount calculated based on the net present value of the royalty stream that would have been realized by BKC had such franchise agreement not been terminated. Any franchise agreement, including renewals, can be extended at our discretion for an additional 20-year term, with BKC's approval, provided that, among other things, the restaurant meets the current Burger King operating and image standards and the franchisee is not in default under the terms of the franchise agreement. The franchise agreement fee for subsequent renewals is currently \$50,000. BKC may terminate any of the franchise agreements if an act of default is committed by us under these agreements. Defaults under the franchise agreements include, among other things, our failure to operate such Burger King restaurant in accordance with the operating standards and specifications established by BKC (including failure to use equipment, uniforms or decor approved by BKC), our failure to sell products approved or designated by BKC, our failure to pay royalties or advertising and sales promotion contributions as required, our unauthorized sale, transfer or assignment of such franchise agreement or the related restaurant, certain events of bankruptcy or insolvency with respect to us, conduct by us or our employees that has a harmful effect on the Burger King restaurant system, conviction of us or our executive officers for certain indictable offenses, our failure to maintain a responsible credit rating or the acquisition by us of an interest in any other hamburger restaurant business. We are not in default under any of the franchise agreements with BKC.

In order to obtain a successor franchise agreement with BKC, a franchisee is typically required to make capital improvements to the restaurant to bring it up to Burger King's current image standards. The required capital improvements will vary widely depending upon the magnitude of the required changes and the degree to which we have made interim improvements to the restaurant. We have 18 franchise agreements due to expire in 2007, 28 franchise agreements due to expire in 2008 and 17 franchise agreements due to expire in 2009. In recent years, the historical costs of improving our Burger King restaurants in connection with franchise renewals generally have ranged from \$200,000 to \$400,000 per restaurant. However, any future costs for improving Burger King restaurants in connection with franchise renewals may vary significantly and will depend on a number of factors, including the geographic location and the size of those restaurants. In addition, the cost of capital improvements made in connection with future franchise agreement renewals may differ substantially from past franchise renewals.

We believe that we will be able to satisfy BKC's normal franchise agreement renewal policies. Accordingly, we believe that renewal franchise agreements will be granted on a timely basis by BKC at the expiration of our existing franchise agreements. Historically, BKC has granted all of our requests for successor franchise agreements. However, there can be no assurances that BKC will grant these requests in the future.

We evaluate the performance of our Burger King restaurants on an ongoing basis. Such evaluation depends on many factors, including our assessment of the anticipated future operating results of the subject restaurants and the cost of required capital improvements that we would need to commit for such restaurants. If we determine that a Burger King restaurant is under-performing, we may elect to close such restaurant. We closed eight Burger King restaurants in 2006. We currently anticipate that we will likely elect to close approximately three to four Burger King restaurants in 2007. However, based on the current operating results of such restaurants, we believe that the impact on our results of operations as a result of such restaurant closures will not be material, although there can be no assurance in this regard. Our determination of whether to close such four restaurants is not final and is subject to further evaluation and may change. We may also elect to close additional Burger King restaurants in the future.

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In addition to the initial franchise fee, we generally pay to BKC a monthly royalty. For an explanation of the franchise fees and royalties see Franchise Fees, Royalties and Early Successor Program below. We also contribute 4% of restaurant sales from our Burger King restaurants to fund BKC's national and regional advertising. BKC engages in substantial national and regional advertising and promotional activities and other efforts to maintain and enhance the Burger King brand. We supplement from time to time BKC's marketing with our own local advertising and promotional campaigns. See Advertising and Promotion below.

Our franchise agreements with BKC do not give us exclusive rights to operate Burger King restaurants in any defined territory. Although we believe that BKC generally seeks to ensure that newly granted franchises do not materially adversely affect the operations of existing Burger King restaurants, we cannot assure you that franchises granted by BKC to third parties will not adversely affect any Burger King restaurants that we operate.

We are required to obtain BKC's consent before we acquire existing Burger King restaurants from other franchisees or develop new Burger King restaurants. BKC also has the right of first refusal to purchase any Burger King restaurant that is being offered for sale by a franchisee. To date, BKC has approved all of our acquisitions of Burger King restaurants from other franchisees; however, in two instances, BKC exercised its right of first refusal and purchased restaurants we sought to acquire.

### ***Franchise Fees, Royalties and Early Successor Program***

On July 1, 2000, BKC increased its royalty and franchise fees for most new restaurants. The franchise fee for new restaurants increased to \$50,000 for a 20-year agreement and the royalty rate generally increased from 3 1/2% of sales to 4 1/2% of sales. The royalty rates for existing franchise agreements are not affected by these changes until the time of renewal.

BKC offered a voluntary program to encourage franchisees to accelerate the renewal of their franchise agreements. Franchisees that elected to participate in the Early Successor Incentive Program were required to make capital improvements in their restaurants to bring them up to Burger King's then current design image. Franchise agreements entered into under this program contain special provisions regarding the royalty rates including a reduction in the royalty for a period of time.

For commitments made prior to July 1, 2000 to renew franchise agreements under BKC's Fiscal 2000 Early Successor Incentive Program, the renewal franchise fee remained at \$40,000. The royalty rate under this program remained at 3 1/2% of sales through March 31, 2002, at which time it was reduced to 2 3/4% of sales for the following five-year period. The royalty rate reverts back to 3 1/2% of sales effective April 1, 2007 for the remainder of any of the initial franchise term, and then increases to 4 1/2% of sales for the balance of the new agreement.

For commitments made between July 1, 2000 and June 30, 2001 to renew franchise agreements under BKC's Fiscal 2001 Early Successor Incentive Program, the renewal franchise fee increased to \$50,000. The royalty rate remained at 3 1/2% of sales through September 30, 2002, at which time it was reduced to 3% of sales for a three-year period. The royalty rate reverts back to 3 1/2% of sales effective October 1, 2005 for the remainder of any of the initial franchise term, and then increases to 4 1/2% of sales for the balance of the new franchise agreement.

After evaluating the applicable royalty reductions and the acceleration of the required capital improvements, in 2000 we elected to renew 48 franchise agreements under BKC's Early Successor Incentive Program. Burger King royalties, as a percentage of our Burger King restaurant sales, were 3.5% in 2006, 3.5% in 2005 and 3.4% in 2004. We anticipate our Burger King royalties, as a percentage of our Burger King restaurant sales, to increase to 3.7% in 2007 as a result of the above.



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### **Hispanic Brands Franchise Operations**

As of December 31, 2006, Pollo Tropical had three franchisees operating a total of 27 Pollo Tropical restaurants, 23 of which were located in Puerto Rico, two in Ecuador and two located on college campuses in Florida. As of December 31, 2006, Taco Cabana had two franchisees operating a total of three Taco Cabana restaurants. While our existing franchisees may open new restaurants from time to time, we are not actively expanding our franchise operations at the present time. However, we believe that there are significant opportunities to expand our Hispanic Brands outside of the United States and we may seek to franchise or license our Hispanic Brands in additional markets outside of the United States. Any such expansion into additional foreign markets ideally would take the form of a franchising or licensing arrangement with one or more experienced restaurant companies with operations in the target area. We believe that there are a number of geographic areas outside of the United States which have a significant component of the population with both adequate disposable income and a strong proclivity for foods similar to those offered by our Hispanic Brands. We currently have no understandings, commitments or agreements with respect to any such franchising or licensing arrangements of our Hispanic Brands outside of the United States other than for our franchised Pollo Tropical restaurants located in Puerto Rico and Ecuador.

All of our current franchisees are required to operate their restaurants in compliance with certain methods, standards and specifications developed by us regarding such matters as menu items, recipes, food preparation, materials, supplies, services, fixtures, furnishings, decor and signs. The franchisees have discretion to determine the prices to be charged to customers. In addition, all franchisees are required to purchase substantially all food, ingredients, supplies and materials from suppliers approved by us.

### **Advertising and Promotion**

We believe our Hispanic Brands are among the most highly recognized quick-casual restaurant brands in their core markets of south and central Florida and Texas. Pollo Tropical and Taco Cabana utilize an integrated, multi-level marketing approach that includes periodic chain-wide promotions, direct mail, in-store promotions, local store marketing and other strategies, including the use of radio and television advertising in their major markets. Combination value meals are also utilized as well as limited time offer menu item promotions. Pollo Tropical advertises in both English and Spanish media throughout the year. As a percentage of Pollo Tropical restaurant sales, Pollo Tropical's advertising expenditures were 1.6% in 2006, 1.9% in 2005 and 1.6% in 2004, due to lower television and radio advertising compared to prior years. As a percentage of our Taco Cabana restaurant sales, Taco Cabana's advertising expenditures were 4.1% in 2006, 4.2% in 2005 and 4.1% in 2004.

The efficiency and quality of advertising and promotional programs can significantly affect quick-casual/quick-service restaurant businesses. We believe that one of the major advantages of being a Burger King franchisee is the value of the extensive regional and national advertising and promotional programs conducted by BKC. In addition to the benefits derived from BKC's advertising spending, we supplement from time to time BKC's advertising and promotional activities with our own local advertising and promotions, including the purchase of additional television, radio and print advertising. The concentration of our Burger King restaurants in many of our markets permits us to leverage advertising in those markets. We also utilize promotional programs, such as combination value meals and discounted prices, targeted to our customers, in order to create a flexible and directed marketing program.

We are generally required to contribute 4% of restaurant sales from our Burger King restaurants to an advertising fund utilized by BKC for its advertising, promotional programs and public relations activities. BKC's advertising programs consist of national campaigns supplemented by local advertising. BKC's advertising campaigns are generally carried on television, radio and in circulated print media (national and regional newspapers and magazines).

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### **Product Development**

Each of Pollo Tropical and Taco Cabana has separate and complete product research and development functions, which we believe are comparable to other large multi-unit restaurant companies. These capabilities enable us to continually refine our menu offerings and develop new products for introduction in our Hispanic Brand restaurants. These functions include:

fully equipped test kitchens;

professional culinary and quality assurance team members;

consumer research protocol;

uniform and detailed product specification formats; and

product development committees that integrate marketing, operations, financial analysis and procurement.

Pollo Tropical's test kitchen is located in our Miami division headquarters. The facility includes cooking equipment that mirrors the capability of a Pollo Tropical restaurant and a tasting area. Permanent staff positions include a Senior Director of R&D, a Manager of R&D and a Corporate Chef.

Taco Cabana's test kitchen is located near our San Antonio division headquarters in leased commercial space. The facility includes a large test kitchen, with equipment that mirrors the capability of a Taco Cabana restaurant, office space for all R&D staff, and a large tasting and meeting room. Permanent staff positions include a Director of R&D, a Corporate Chef and a staff assistant.

### **Suppliers and Distributors**

For our Pollo Tropical and Taco Cabana restaurants, we have negotiated directly with local and national suppliers for the purchase of food and beverage products and supplies to ensure consistent quality and freshness and to obtain competitive prices. Pollo Tropical and Taco Cabana restaurants' food and supplies are ordered from approved suppliers and are shipped via distributors to the restaurants. Both brands are responsible for monitoring quality control and supervision of these suppliers and conduct inspections to observe the preparation and quality of products purchased. For our Pollo Tropical restaurants, Henry Lee, a division of Gordon Food Service, serves as our primary distributor of food and paper products under an agreement that expires on May 15, 2007. For our Taco Cabana restaurants, SYGMA Network, Inc. (SYGMA) serves as our primary distributor of food and beverage products and supplies. SYGMA purchases, warehouses and distributes products for these restaurants under a distribution service agreement that expires on June 1, 2009. We rely significantly on these suppliers but, in general, if any such suppliers are unable to service us, we believe that we have significant alternative sources available to us to avoid any material disruption in service. We also rely on Gold Kist under an agreement that expires on December 31, 2007 as our supplier and distributor of chicken for our Pollo Tropical restaurants and, although we believe that alternative sources of chicken are available to us, if such supplier is unable to service us, this could lead to a material disruption of service or supply until a new supplier is engaged, which could have a material adverse effect on our business. With respect to our distributors for our Pollo Tropical and Taco Cabana restaurants, although we believe that alternative distributors are available to us, if any of our distributors are unable to service us, this could lead to a material disruption of service or supply until a new distributor is engaged, which could have a material adverse effect on our business.

We are a member of a national purchasing cooperative, Restaurant Services, Inc., created for the Burger King system. Restaurant Services is a non-profit independent cooperative that acts as the purchasing agent for approved distributors to the Burger King system and serves to negotiate the lowest cost for the system. We use our purchasing power to negotiate directly with certain other vendors, to obtain favorable pricing and terms for supplying our Burger King restaurants. For our Burger King restaurants, we are required to purchase all of our foodstuffs, paper goods and packaging materials from BKC-approved suppliers. We currently utilize three distributors, Maines Paper & Food Service, Inc., Reinhart Food Service L.L.C. and MBM Food Service Inc., to



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supply our Burger King restaurants with the majority of their foodstuffs in various geographical areas and, as of December 31, 2006, such distributors supplied 63%, 32% and 5%, respectively, of our Burger King restaurants. We may purchase non-food items such as kitchen utensils, equipment maintenance tools and other supplies from any suitable source so long as such items meet BKC product uniformity standards. All BKC-approved distributors are required to purchase foodstuffs and supplies from BKC-approved manufacturers and purveyors. BKC is responsible for monitoring quality control and supervision of these manufacturers and conducts regular visits to observe the preparation of foodstuffs, and to run various tests to ensure that only quality foodstuffs are sold to BKC-approved suppliers. In addition, BKC coordinates and supervises audits of approved suppliers and distributors to determine continuing product specification compliance and to ensure that manufacturing plant and distribution center standards are met. Although we believe that we have alternative sources of supply available to our Burger King restaurants, in the event any distributors or suppliers for our Burger King restaurants are unable to service us, this could lead to a disruption of service or supply at our Burger King restaurants until a new distributor or supplier is engaged, which could have an adverse effect on our business.

### **Quality Assurance**

At each of our three concepts, our operational focus is closely monitored to achieve a high level of customer satisfaction via speed, order accuracy and quality of service. Our senior management and restaurant management staffs are principally responsible for ensuring compliance with our operating policies, and with respect to our Burger King restaurants, BKC's required operating procedures as well. We have uniform operating standards and specifications relating to the quality, preparation and selection of menu items, maintenance and cleanliness of the premises and employee conduct. In order to maintain compliance with these operating standards and specifications, we distribute to our restaurant operations management team detailed reports measuring compliance with various customer service standards and objectives, including the results of our mystery shopper program. These mystery shopper programs are conducted by an independent agency and consist of evaluations of speed, quality of service and other operational objectives including the cleanliness of our restaurants.

We also operate in accordance with quality assurance and health standards mandated by federal, state and local governmental laws and regulations. These standards include food preparation rules regarding, among other things, minimum cooking times and temperatures, maximum time standards for holding prepared food, food handling guidelines and cleanliness. To maintain these standards, we conduct unscheduled inspections of our restaurants. In addition, restaurant managers conduct internal inspections for taste, quality, cleanliness and food safety on a regular basis.

### **Trademarks**

We believe that our names and logos for our Hispanic Brands are important to our operations. We have registered our principal Pollo Tropical and Taco Cabana logos and designs with the U.S. Patent and Trademark Office on the Principal Register as a service mark for our restaurant services. We also have secured or have applied for state and federal registrations of several other advertising or promotional marks, including variations of our principal marks, and have applied for or been granted registrations in foreign countries of our principal marks and several other marks. We intend to protect both Pollo Tropical and Taco Cabana trademarks by appropriate legal action whenever necessary. In certain foreign countries, we have been involved in trademark opposition proceedings to defend our rights to register certain trademarks. In that regard, we have discovered that an individual unaffiliated with us has registered, without our knowledge, authorization or consent, a trademark in Spain and the European Community for a name and logo virtually identical to our Pollo Tropical name and logo. We intend to initiate a cancellation action to declare such unauthorized trademark registration null and void. Although we believe we will be successful in the action, there can be no assurance in this regard.

Other than the Pollo Tropical and Taco Cabana trademarks, we have no proprietary intellectual property other than the logo and trademark of Carrols. As a franchisee of Burger King, we also have contractual rights to use certain BKC-owned trademarks, service marks and other intellectual property relating to the Burger King concept.

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### **Government Regulation**

Various federal, state and local laws affect our business, including various health, sanitation, fire and safety standards. Restaurants to be constructed or remodeled are subject to state and local building code and zoning requirements. In connection with the development and remodeling of our restaurants, we may incur costs to meet certain federal, state and local regulations, including regulations promulgated under the Americans with Disabilities Act.

We are subject to the federal Fair Labor Standards Act and various state laws governing such matters as:

minimum wage requirements;

overtime; and

other working conditions and citizenship requirements.

A significant number of our food service personnel are paid at rates related to the federal, and where applicable, state minimum wage and, accordingly, increases in the minimum wage have increased and in the future will increase wage rates at our restaurants.

We are also subject to various federal, state and local environmental laws, rules and regulations. We believe that we conduct our operations in substantial compliance with applicable environmental laws and regulations. None of the applicable environmental laws or regulations has had a material adverse effect on our results of operations, cash flows or financial condition.

Taco Cabana is subject to alcoholic beverage control regulations that require state, county or municipal licenses or permits to sell alcoholic beverages at each location. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time. Licensing entities, authorized with law enforcement authority, may issue violations and conduct audits and investigations of the restaurant's records and procedures. Alcoholic beverage control regulations relate to numerous aspects of daily operations of Taco Cabana restaurants, including minimum age for consumption, certification requirements for employees, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages. These regulations also prescribe certain required banking and accounting practices related to alcohol sales and purchasing.

Taco Cabana is subject to state dram-shop laws in the states in which it operates. Dram-shop laws provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated or minor patron. We have specific insurance that covers claims arising under dram-shop laws. However, we cannot assure you that this insurance will be adequate to cover any claims that may be instituted against us.

With respect to the franchising of Pollo Tropical and Taco Cabana restaurants, we are subject to franchise and related regulations in the U.S. and certain foreign jurisdictions where we offer and sell franchises. These regulations include obligations to provide disclosure about our two concepts, the franchise agreements and the franchise system. The regulations also include obligations to register certain franchise documents in the U.S. and foreign jurisdictions, and obligations to disclose the substantive relationship between the parties to the agreements.

### **Competition**

The restaurant industry is highly competitive with respect to price, service, location and food quality. In each of our markets, our restaurants compete with a large number of national and regional restaurant chains, as well as locally owned restaurants, offering low and medium-priced fare. We also compete with convenience stores, delicatessens and prepared food counters in supermarkets, grocery stores, cafeterias and other purveyors of moderately priced and quickly prepared foods.

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We believe that:

product quality and taste;

brand recognition;

convenience of location;

speed of service;

menu variety;

price; and

ambiance

are the most important competitive factors in the quick-casual and quick-service restaurant segments and that our three concepts effectively compete in each category.

Pollo Tropical's competitors include national chicken-based concepts, such as Boston Market and KFC, and regional chicken-based concepts, as well as quick-service hamburger restaurant chains and other types of quick-casual restaurants.

Taco Cabana's restaurants, although part of the quick-casual segment of the restaurant industry, compete in Texas, Oklahoma and New Mexico with quick-service restaurants, including those in the quick-service Mexican segment such as Taco Bell, other quick-casual restaurants and traditional casual dining Mexican restaurants. We believe that Taco Cabana's combination of freshly prepared food, distinctive ambiance and superior service help to distinguish Taco Cabana restaurants from quick-service operators, while Taco Cabana's price-value relationship enables it to compete favorably with more expensive casual dining Mexican restaurants.

With respect to our Burger King restaurants, our largest competitors are McDonald's and Wendy's restaurants. According to Technomic, McDonald's restaurants had aggregate U.S. system-wide sales of \$25.6 billion for the year ended December 31, 2005 and operated 13,727 restaurants in the United States at that date, and Wendy's restaurants had aggregate system-wide sales of \$7.7 billion for the year ended December 31, 2005 and operated 6,018 restaurants in the United States at that date.

## **Employees**

As of December 31, 2006, we employed approximately 16,400 persons, of which approximately 300 were administrative personnel and approximately 16,000 were restaurant operations personnel. None of our employees is covered by collective bargaining agreements. We believe that our relations with our employees are good.

## **Availability of Information**

We file annual, quarterly and current reports and other information with the Securities and Exchange Commission (the "SEC"). The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

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We make available through our internet website ([www.carrols.com](http://www.carrols.com)) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after electronically filing such material with the SEC. The reference to our website address is a textual reference only, meaning that it does not constitute incorporation by reference of the information contained on the website and should not be considered part of this document.

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### **ITEM 1A. RISK FACTORS**

You should carefully consider the risks described below, as well as other information and data included in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, consolidated financial condition or results of operations.

**Intense competition in the restaurant industry could make it more difficult to expand our business and could also have a negative impact on our operating results if customers favor our competitors or we are forced to change our pricing and other marketing strategies.**

The restaurant industry is highly competitive. In each of our markets, our restaurants compete with a large number of national and regional restaurant chains, as well as locally owned restaurants, offering low and medium-priced fare. We also compete with convenience stores, delicatessens and prepared food counters in grocery stores, supermarkets, cafeterias and other purveyors of moderately priced and quickly prepared food.

Pollo Tropical's competitors include national chicken-based concepts, such as Boston Market and Kentucky Fried Chicken (KFC), and regional chicken-based concepts as well as quick-service hamburger restaurant chains and other types of quick-casual restaurants. Our Taco Cabana restaurants, although part of the quick-casual segment of the restaurant industry, compete with quick-service restaurants, including those in the quick-service Mexican segment such as Taco Bell, other quick-casual restaurants and traditional casual dining Mexican restaurants. With respect to our Burger King restaurants, our largest competitors are McDonald's and Wendy's restaurants.

To remain competitive, we, as well as certain of the other major quick-casual and quick-service restaurant chains, have increasingly offered selected food items and combination meals at discounted prices. These changes in pricing and other marketing strategies have had, and in the future may continue to have, a negative impact on our sales and earnings.

**Factors specific to the quick-casual and quick-service restaurant segments may adversely affect our results of operations, which may cause a decrease in earnings and revenues.**

The quick-casual and quick-service restaurant segments are highly competitive and can be materially adversely affected by many factors, including:

changes in local, regional or national economic conditions;

changes in demographic trends;

changes in consumer tastes;

changes in traffic patterns;

increases in fuel prices, including a continuation of the current relatively higher levels of gasoline prices;

consumer concerns about health and nutrition;

increases in the number of, and particular locations of, competing restaurants;

inflation;



increases in utility costs;

increases in the cost of food, such as beef and chicken, and packaging;

consumer dietary considerations;

increased labor costs, including healthcare and minimum wage requirements;

regional weather conditions; and

the availability of experienced management and hourly-paid employees.

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**Our continued growth depends on our ability to open and operate new restaurants profitably, which in turn depends on our continued access to capital, and newly acquired or developed restaurants may not perform as we expect and we cannot assure you that our growth and development plans will be achieved.**

Our continued growth depends on our ability to develop additional Pollo Tropical and Taco Cabana restaurants and to selectively acquire and develop additional Burger King restaurants. Development involves substantial risks, including the following:

the inability to fund development;

development costs that exceed budgeted amounts;

delays in completion of construction;

the inability to obtain all necessary zoning and construction permits;

the inability to identify, or the unavailability of, suitable sites on acceptable leasing or purchase terms;

developed restaurants that do not achieve desired revenue or cash flow levels once opened;

incurring substantial unrecoverable costs in the event a development project is abandoned prior to completion;

the inability to recruit, train and retain managers and other employees necessary to staff each new restaurant;

changes in governmental rules, regulations and interpretations; and

changes in general economic and business conditions.

We cannot assure you that our growth and development plans can be achieved. Our development plans will require additional management, operational and financial resources. For example, we will be required to recruit and train managers and other personnel for each new restaurant. We cannot assure you that we will be able to manage our expanding operations effectively and our failure to do so could adversely affect our results of operations. In addition, our ability to open new restaurants and to grow, as well as our ability to meet other anticipated capital needs, will depend on our continued access to external financing, including borrowings under our senior credit facility. We cannot assure you that we will have access to the capital we need on acceptable terms or at all, which could materially adversely affect our business.

Additionally, we may encounter difficulties growing beyond our presence in our existing core markets. We cannot assure you that we will be able to successfully grow our market presence beyond the current key regions within our existing markets, as we may encounter well-established competitors in new areas. In addition, we may be unable to find attractive locations or successfully market our products as we attempt to expand beyond our existing core markets, as the competitive circumstances and consumer characteristics in these new areas may differ substantially from those in areas in which we currently operate. As a result of the foregoing, we cannot assure you that we will be able to successfully integrate or profitably operate our new restaurants outside our core markets.

**Our expansion into new markets may present increased risks due to our unfamiliarity with the area.**

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Some of our new restaurants are and will be located in areas where we have little or no meaningful experience. Those markets may have different competitive conditions, consumer tastes and discretionary spending patterns than our existing markets, which may cause our new restaurants to be less successful than restaurants in our existing markets or to incur losses. An additional risk of expanding into new markets is the lack of market awareness of the Pollo Tropical or Taco Cabana brand. Restaurants opened in new markets may open at lower average weekly sales volumes than restaurants opened in existing markets, and may have higher restaurant-level operating expense ratios than in existing markets. Sales at restaurants opened in new markets may take longer to reach average unit volumes, if at all, thereby adversely affecting our operating results.

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Opening new restaurants in areas in which we have little or no operating experience and in which potential customers may not be familiar with our restaurants may include costs related to the opening, operation and promotion of those restaurants that are substantially greater than those incurred by our restaurants in other areas. Even though we may incur substantial additional costs with respect to these new restaurants, they may attract fewer customers than our more established restaurants in existing markets.

### **We could be adversely affected by additional instances of mad cow disease, avian flu or other food-borne illness, as well as widespread negative publicity regarding food quality, illness, injury or other health concerns.**

Negative publicity about food quality, illness, injury or other health concerns (including health implications of obesity and transfatty acids) or similar issues stemming from one restaurant or a number of restaurants could materially adversely affect us, regardless of whether they pertain to our own restaurants or to restaurants owned or operated by other companies. For example, health concerns about the consumption of beef or chicken or by specific events such as the outbreak of mad cow disease or avian flu could lead to changes in consumer preferences, reduce consumption of our products and adversely affect our financial performance. These events could reduce the available supply of beef or chicken or significantly raise the price of beef or chicken.

In addition, we cannot guarantee that our operational controls and employee training will be effective in preventing food-borne illnesses, food tampering and other food safety issues that may affect our restaurants. Food-borne illness or food tampering incidents could be caused by customers, employees or food suppliers and transporters and, therefore, could be outside of our control. Any publicity relating to health concerns or the perceived or specific outbreaks of food-borne illnesses, food tampering or other food safety issues attributed to one or more of our restaurants, could result in a significant decrease in guest traffic in all of our restaurants and could have a material adverse effect on our results of operations. In addition, similar publicity or occurrences with respect to other restaurants or restaurant chains could also decrease our guest traffic and have a similar material adverse effect on us.

### **Our substantial indebtedness could adversely affect our financial condition and our ability to operate our business.**

We have a substantial amount of indebtedness. As of December 31, 2006, we had \$358.5 million of outstanding indebtedness, including \$118.4 million of indebtedness under our prior senior credit facility, as defined in Item 6 Selected Financial Data, (excluding \$15.0 million of outstanding letters of credit and \$35.0 million of unused revolving credit borrowing availability under our prior senior credit facility), \$180 million of 9% Senior Subordinated Notes due 2013 (the Notes), \$58.6 million of lease financing obligations and \$1.5 million of capital leases. On March 9, 2007, Carrols terminated its prior senior credit facility and entered into a loan agreement providing for a new senior credit facility with a syndicate of lenders (which we refer to herein as new senior credit facility). Our new senior credit facility totals approximately \$185.0 million, consisting of \$120.0 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Notes are not refinanced by June 30, 2012) and a \$65.0 million revolving credit facility (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. As a result, we are a highly leveraged company. This level of indebtedness could have important consequences, including the following:

it will limit our ability to borrow money to fund our working capital, capital expenditures, acquisitions and debt service requirements and other financing needs;

a substantial portion of our operating cash flow will be dedicated to the repayment of our indebtedness and related interest, including indebtedness we may incur in the future;

our interest expense would increase if interest rates in general increase because a substantial portion of our indebtedness, including all of our indebtedness under our senior credit facility, bears interest at floating rates;

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it may limit our flexibility in planning for, or reacting to, changes in our business and future business opportunities;

we are more highly leveraged than some of our competitors, which may place us at a competitive disadvantage;

it may make us more vulnerable to a downturn in our business, industry or the economy in general; and

there would be a material adverse effect on our business and financial condition if we were unable to service our indebtedness or obtain additional financing as needed.

**Despite our substantial indebtedness, we may still incur significantly more debt, which could further exacerbate the risks described above.**

Although covenants under our new senior credit facility and the Indenture (the Indenture ) dated as of December 15, 2004 among Carrols, the Subsidiary Guarantors (as defined therein) and The Bank of New York, as trustee, governing the Notes limit our ability and the ability of our present and future restricted subsidiaries to incur additional indebtedness, the terms of our new senior credit facility and the Indenture governing the Notes permit us to incur significant additional indebtedness, including unused availability under our new revolving credit facility. As of December 31, 2006, we had \$35.0 million available for additional revolving credit borrowings under our prior senior credit facility (after reserving for \$15.0 million of letters of credit outstanding), subject to compliance with customary borrowing conditions. The new senior credit facility provides for a \$65.0 million revolving credit facility of which \$4.3 million was borrowed upon the close of the new senior credit facility on March 9, 2007 (excluding \$15.0 million reserved for outstanding letters of credit). In addition, neither the new senior credit facility nor the Indenture governing the Notes prevent us from incurring obligations that do not constitute indebtedness as defined in those documents. To the extent that we incur additional indebtedness or other obligations, the risks associated with our substantial leverage described above, including our possible inability to service our debt, would increase.

**We may not be able to generate sufficient cash flows to meet our debt service obligations.**

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash from our future operations and on our continued access to external sources of financing. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Our business may not generate sufficient cash flow from operations and future borrowings under the new senior credit facility or from other sources may not be available to us in an amount sufficient to enable us to repay our indebtedness or to fund our other liquidity needs, including capital expenditure requirements. If we complete an acquisition, our debt service requirements could increase. A substantial portion of our indebtedness, including all of our indebtedness under the new senior credit facility, bears interest at floating rates, and therefore if interest rates increase, our debt service requirements will increase. We may need to refinance or restructure all or a portion of our indebtedness on or before maturity. We may not be able to refinance or restructure any of our indebtedness, including the new senior credit facility and the Notes, on commercially reasonable terms, or at all. If we cannot service or refinance or restructure our indebtedness, we may have to take actions such as selling assets, seeking additional equity or reducing or delaying capital expenditures, strategic acquisitions, investments and alliances, any of which could have a material adverse effect on our operations. Additionally, we may not be able to effect such actions, if necessary, on commercially reasonable terms, or at all.

In addition, upon the incurrence of specific kinds of change of control events, we must offer to purchase the Notes at 101% of the principal amount thereof plus accrued and unpaid interest to the purchase date. We may not have sufficient funds available to make any required repurchases of the Notes, and restrictions under our new senior credit facility may not allow that repurchase. If we fail to repurchase the Notes in that circumstance, we

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will be in default under the Indenture governing the Notes and, under cross-default clauses; we will also be in default under the new senior credit facility. In addition, certain change of control events will constitute an event of default under the new senior credit facility. A default under the new senior credit facility could result in an event of default under the Indenture if the administrative agent or the lenders accelerate the debt under the new senior credit facility. In the event of a default under our new senior credit facility or the Indenture, the holders of the applicable indebtedness generally would be able to declare all of that indebtedness to be due and payable as described in the following risk factor. Upon the occurrence of a change of control we could seek to refinance the indebtedness under the new senior credit facility and the Notes or obtain a waiver from the lenders or the noteholders. We cannot assure you, however, that we would be able to obtain a waiver or refinance our indebtedness on commercially reasonable terms, if at all, in which case we might be required to sell assets to satisfy our repayment obligations. Any future debt that we incur may also contain provisions requiring the repayments of that debt upon the occurrence of similar change of control events or restrictions on repayment of the Notes or borrowings under our new senior credit facility upon a change of control.

**Restrictive covenants in the new senior credit facility and the Indenture governing the Notes may restrict our ability to operate our business and to pursue our business strategies; and defaults under our debt instruments may allow the lenders to declare borrowings due and payable.**

The new senior credit facility and the Indenture governing the Notes limit our ability, among other things, to:

incur additional indebtedness or issue preferred stock;

pay dividends or make distributions in respect of our capital stock or make certain other restricted payments or investments;

sell assets, including capital stock of restricted subsidiaries;

agree to limitations on our ability and the ability of our restricted subsidiaries to make distributions;

enter into transactions with our subsidiaries and affiliates;

incur liens;

enter into new lines of business; and

engage in consolidations, mergers or sales of substantially all of our assets.

In addition, the new senior credit facility requires us to comply with various operational and other covenants and restricts our ability to prepay our subordinated indebtedness. Also, the prior senior credit facility required and the new senior credit facility requires, us to maintain compliance with specified financial ratios, including fixed charge coverage, senior leverage and total leverage ratios (as such terms are defined in the new senior credit facility). At December 31, 2006, we were in compliance with such covenants under the prior senior credit facility. At December 31, 2006, under the prior senior credit facility, our fixed charge coverage ratio was 1.41 to 1.00 which was in excess of the required minimum fixed charge coverage ratio under the prior senior credit facility at December 31, 2006 of 1.25 to 1.00, our senior leverage ratio was 1.33 to 1.00 which was lower than the maximum allowable senior leverage ratio under the prior senior credit facility at December 31, 2006 of 2.50 to 1.00 and our total leverage ratio was 3.32 to 1.00 which was lower than the maximum allowable total leverage ratio under the prior senior credit facility at December 31, 2006 of 5.00 to 1.00. However, our ability to comply with these ratios under the new senior credit facility may be affected by events beyond our control. Any other debt instruments we enter into in the future may also have provisions similar to those described above.

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The restrictions contained in the Indenture governing the Notes and the new senior credit facility and in any other debt instruments we may enter into in the future could:

limit our ability to plan for or react to market conditions or meet capital needs or otherwise restrict our activities or business plans; and

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adversely affect our ability to finance our operations, strategic acquisitions, investments or alliances or other capital needs or to engage in other business activities that would be in our interest.

As noted above, our ability to remain in compliance with agreements and covenants in our debt instruments depends upon our results of operations and may be affected by events beyond our control, including economic, financial and industry conditions. Accordingly, there can be no assurance that we will remain in compliance with those agreements and covenants.

In the event of a default under our new senior credit facility or the Indenture and in any other debt instruments we may enter into in the future, the holders of the applicable indebtedness generally would be able to declare all of that indebtedness, together with accrued interest, to be due and payable. In addition, borrowings under the new senior credit facility are secured by a pledge of all of the outstanding capital stock of Carrols and its material subsidiaries and, in the event of a default under that facility, the lenders generally would be entitled to seize the collateral. In addition, default under one debt instrument could in turn permit lenders under other debt instruments to declare borrowings outstanding under those other instruments to be due and payable pursuant to cross default clauses. Moreover, upon the occurrence of an event of default under the new senior credit facility, the commitment of the lenders to make any further loans to us would be terminated. Any such actions or events could force us into bankruptcy and liquidation and we cannot provide any assurance that we could repay our obligations under the new senior credit facility or the Notes or any other indebtedness we may incur in the future. Moreover, our assets and cash flow may not be sufficient to fully repay borrowings under our debt instruments, either upon maturity or if accelerated following a default. Accordingly, the occurrence of a default under any debt instrument, unless cured or waived, would likely have a material adverse effect on our business.

**We are highly dependent on the Burger King system and our ability to renew our franchise agreements with Burger King Corporation. The failure to renew our franchise agreements or Burger King's failure to compete effectively could materially adversely affect our results of operations.**

Due to the nature of franchising and our agreements with BKC, our success is, to a large extent, directly related to the success of the nationwide Burger King system. In turn, the ability of the nationwide Burger King system to compete effectively depends upon the success of the management of the Burger King system and the success of its advertising programs and new products. We cannot assure you that Burger King will be able to compete effectively with other quick-service restaurants. As a result, any failure of Burger King to compete effectively would likely have a material adverse effect on our operating results.

Under each of our franchise agreements with BKC, we are required to comply with operational programs established by BKC. For example, our franchise agreements with BKC require that our restaurants comply with specified design criteria. In addition, BKC generally has the right to require us during the tenth year of a franchise agreement to remodel our restaurants to conform to the then-current image of Burger King, which may require the expenditure of considerable funds. In addition, although not required by the franchise agreements, we may not be able to avoid adopting menu price discount promotions instituted by BKC that may be unprofitable.

Our franchise agreements typically have a 20-year term after which BKC's consent is required to receive a successor franchise agreement. Our franchise agreements with BKC that are set to expire over the next three years are as follows:

18 of our franchise agreements with BKC are due to expire in 2007;

28 of our franchise agreements with BKC are due to expire in 2008; and

17 of our franchise agreements with BKC are due to expire in 2009.

We cannot assure you that BKC will grant each of our future requests for successor franchise agreements, and any failure of BKC to renew our franchise agreements could adversely affect our operating results. In addition, as a condition of approval of a successor franchise agreement, BKC may require us to make capital improvements to particular restaurants to bring them up to Burger King current image standards, which may require us to incur substantial costs.



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In addition, our franchise agreements with BKC do not give us exclusive rights to operate Burger King restaurants in any defined territory. Although we believe that BKC generally seeks to ensure that newly granted franchises do not materially adversely affect the operations of existing Burger King restaurants, we cannot assure you that franchises granted by BKC to third parties will not adversely affect any Burger King restaurants that we operate.

### **If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results.**

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In the past, we have identified and reported material weaknesses in our internal control over financial reporting and concluded that our disclosure controls and procedures were ineffective. In addition, we may in the future discover areas of our internal controls that need improvement or that constitute material weaknesses. A material weakness is a control deficiency (within the meaning of Public Company Accounting Oversight Board Auditing Standard No. 2), or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of annual or interim financial statements will not be prevented or detected. We are continuing to work to improve our internal controls. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to remediate material weaknesses in our internal control over financial reporting or to implement and maintain effective internal controls, or difficulties encountered in their implementation, could cause us to fail to timely meet our reporting obligations, result in material misstatements in our financial statements or could result in defaults under our new senior credit facility, the Indenture governing the Notes or under any other debt instruments we may enter into in the future. Deficiencies in our internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

### **There can be no assurance that we will not have to restate our financial statements in the future.**

We have undergone several restatements of our financial statements. In response to this situation, we have taken what we believe to be the necessary measures to ensure that restatements will not occur in the future. However, there can be no assurance that future restatements will not be necessary due to evolving policies, revised or new accounting pronouncements or other factors. Any future restatements of our financial statements could cause us to fail to timely meet our reporting obligations or could result in defaults under our new senior credit facility, the Indenture governing the Notes or under any other debt instruments we may enter into in the future. Future restatements of our financial statements could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

### **We may incur significant liability or reputational harm if claims are brought against us or against our franchisees.**

We or our franchisees may be subject to complaints, regulatory proceedings or litigation from guests or other persons alleging food-related illness, injuries suffered in our premises or other food quality, health or operational concerns, including environmental claims. In addition, in recent years a number of restaurant companies have been subject to lawsuits, including class action lawsuits, alleging, among other things, violations of federal and state law regarding workplace and employment matters, discrimination, harassment, wrongful termination and wage, rest break, meal break and overtime compensation issues and, in the case of quick service restaurants, alleging that they have failed to disclose the health risks associated with high-fat foods and that their marketing practices have encouraged obesity. We may also be subject to litigation or other actions initiated by governmental authorities, our employees and our franchisees, among others, based upon these and other matters. For example, in November 1998, the Equal Employment Opportunity Commission (the EEOC ) filed suit in the

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United States District Court for the Northern District of New York against Carrols, alleging that Carrols engaged in a pattern and practice of unlawful discrimination, harassment and retaliation against former and current female employees. Although the case was dismissed by the court, subject to possible appeal by the EEOC, the court noted that it was not ruling on the claims, if any, that individual employees might have against Carrols. A significant judgment against us could have a material adverse effect on our financial performance or liquidity. Adverse publicity resulting from such allegations or occurrences or alleged discrimination or other operating issues stemming from one of our locations, a number of our locations or our franchisees could adversely affect our business, regardless of whether the allegations are true, or whether we are ultimately held liable. Any cases filed against us could materially adversely affect us if we lose such cases and have to pay substantial damages or if we settle such cases. In addition, any such cases may materially and adversely affect our operations by increasing our litigation costs and diverting our attention and resources to address such actions. In addition, if a claim is successful, our insurance coverage may not cover or be adequate to cover all liabilities or losses and we may not be able to continue to maintain such insurance, or to obtain comparable insurance at a reasonable cost, if at all. If we suffer losses, liabilities or loss of income in excess of our insurance coverage or if our insurance does not cover such loss, liability or loss of income, there could be a material adverse effect on our results of operations. See Item 3. Legal Proceedings.

**Our franchisees could take actions that harm our reputation and reduce our franchise revenues.**

As of December 31, 2006, a total of 30 Pollo Tropical and Taco Cabana restaurants were owned and operated by our franchisees. We do not exercise control of the day-to-day operations of our franchisees. While we attempt to ensure that franchisee-owned restaurants maintain the same high operating standards as our company-owned restaurants, one or more of these franchisees may fail to meet these standards. Any shortcomings at our franchisee-owned restaurants are likely to be attributed to our company as a whole and could adversely affect our reputation and damage our brands, as well as have a direct negative impact on franchise revenues we receive from these franchisees

**If the sale/leaseback market requires significantly higher yields, we may not enter into sale/leaseback transactions and as a result would not receive the related net proceeds.**

From time to time, we sell our restaurant properties in sale-leaseback transactions. We historically have used, and intend to use, the net proceeds from such transactions to reduce outstanding debt and fund future capital expenditures for new restaurant development. However, the sale-leaseback market may cease to be a reliable source of additional cash flows for us in the future if capitalization rates become less attractive or other unfavorable market conditions develop. For example, should the sale-leaseback market require significantly higher yields (which may occur as interest rates rise), we may not enter into sale-leaseback transactions, which could adversely affect our ability to reduce outstanding debt and fund new capital expenditures for future restaurant development.

**Changes in consumer taste could negatively impact our business.**

We obtain a significant portion of our revenues from the sale of hamburgers, chicken, various types of sandwiches, and Mexican and other ethnic foods. The quick-casual and quick-service restaurant segments are characterized by the frequent introduction of new products, often accompanied by substantial promotional campaigns and are subject to changing consumer preferences, tastes, and eating and purchasing habits. Our success depends on our ability to anticipate and respond to changing consumer preferences, tastes and eating and purchasing habits, as well other factors affecting the restaurant industry, including new market entrants and demographic changes. We may be forced to make changes in our menu items in order to respond to changes in consumer tastes or dining patterns, and we may lose customers who do not prefer the new menu items. In recent years, numerous companies in the quick-casual and quick-service restaurant segments have introduced products positioned to capitalize on the growing consumer preference for food products that are, or are perceived to be, healthy, nutritious, low in calories and low in fat content. If we do not or, in the case of our Burger King

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restaurants, if BKC does not, continually develop and successfully introduce new menu offerings that appeal to changing consumer preferences or if we do not timely capitalize on new products, our operating results will suffer. In addition, any significant event that adversely affects consumption of our products, such as cost, changing tastes or health concerns, could adversely affect our financial performance.

**If a significant disruption in service or supply by any of our suppliers or distributors were to occur, it could create disruptions in the operations of our restaurants, which could have a material adverse effect on our business.**

Our financial performance is dependent on our continuing ability to offer fresh, quality food at competitive prices. If a significant disruption in service or supply by certain of our suppliers or distributors were to occur, it could create disruptions in the operations of our restaurants, which could have a material adverse effect on us.

For our Pollo Tropical and Taco Cabana restaurants, we have negotiated directly with local and national suppliers for the purchase of food and beverage products and supplies. Pollo Tropical and Taco Cabana restaurants' food and supplies are ordered from approved suppliers and are shipped via distributors to the restaurants. For our Pollo Tropical restaurants, Henry Lee, a division of Gordon Food Service, serves as our primary distributor of food and paper products under an agreement that expires on May 15, 2007. For our Taco Cabana restaurants, SYGMA Network, Inc. serves as our primary distributor of food and beverage products and supplies under a distribution services agreement that expires on June 1, 2009. We also rely on Gold Kist under an agreement that expires on December 31, 2007 as our supplier and distributor of chicken for our Pollo Tropical restaurants and if Gold Kist is unable to service us, this could lead to a material disruption of service or supply until a new supplier is engaged which could have a material adverse effect on our business. With respect to our distributors for our Pollo Tropical and Taco Cabana restaurants, if any of our distributors is unable to service us, this could lead to a material disruption of service or supply until a new distributor is engaged, which could have a material adverse effect on our business. For our Burger King restaurants, we are a member of a national purchasing cooperative, Restaurant Services, Inc., which serves as the purchasing agent for approved distributors to the Burger King system. We are required to purchase all of our foodstuffs, paper goods and packaging materials from BKC-approved suppliers for our Burger King restaurants. We currently utilize three distributors, Maines Paper & Food Service, Inc., Reinhart Food Service L.L.C. and MBM Food Service Inc., to supply our Burger King restaurants with the majority of their foodstuffs in various geographical areas and, as of December 31, 2006, such distributors supplied 63%, 32% and 5%, respectively of our Burger King restaurants. Although we believe that we have alternative sources of supply available to our Burger King restaurants, in the event any distributors or suppliers for our Burger King restaurants are unable to service us, this could lead to a disruption of service or supply at our Burger King restaurants until a new distributor or supplier is engaged, which could have an adverse effect on our business.

**If labor costs increase, we may not be able to make a corresponding increase in our prices and our operating results may be adversely affected.**

Wage rates for a substantial number of our employees are at or slightly above the minimum wage. As federal and/or state minimum wage rates increase, we may need to increase not only the wage rates of our minimum wage employees but also the wages paid to the employees at wage rates which are above the minimum wage, which will increase our costs. To the extent that we are not able to raise our prices to compensate for increases in wage rates, this could have a material adverse effect on our operating results.

**The efficiency and quality of our competitors' advertising and promotional programs and the extent and cost of our advertising could have a material adverse effect on our results of operations and financial condition.**

Should our competitors increase spending on advertising and promotion, should the cost of television or radio advertising increase, should our advertising funds materially decrease for any reason, or should our advertising and promotion be less effective than our competitors', there could be a material adverse effect on our results of operations and financial condition. In that regard, the success of our Burger King restaurants also depends in part upon advertising campaigns and promotions by BKC.

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### **Newly acquired or developed restaurants may reduce sales at our neighboring restaurants.**

We intend to continue to open restaurants in our existing core markets, particularly the core markets served by our Pollo Tropical and Taco Cabana restaurants. To the extent that we open a new restaurant in the vicinity of one or more of our existing restaurants within the same chain, it is possible that some of the customers who previously patronized those existing restaurants may choose to patronize the new restaurant instead, reducing sales at those existing restaurants. Accordingly, to the extent we open new restaurants in our existing markets, sales at some of our existing restaurants in those markets may decline.

### **Our business is regional and we therefore face risks related to reliance on certain markets.**

As of December 31, 2006, excluding our franchised locations, all but two of our Pollo Tropical restaurants were located in Florida and approximately 96% of our Taco Cabana restaurants were located in Texas. Also, as of December 31, 2006, 65% of our Burger King restaurants were located in New York and Ohio. Therefore, the economic conditions, state and local government regulations, weather conditions or other conditions affecting Florida, Texas, New York and Ohio and the tourism industry affecting Florida may have a material impact on the success of our restaurants in those locations. For example, the events of September 11, 2001 had a significant negative impact on tourism in Florida, which adversely impacted the revenues and operating results at our Pollo Tropical restaurants.

Many of our restaurants are located in regions that may be susceptible to severe weather conditions. As a result, adverse weather conditions in any of these areas could damage these restaurants, result in fewer guest visits to these restaurants and otherwise have a material adverse impact on our business. For example, our business was adversely impacted in the fourth quarter of 2005 and in the future may be adversely affected by hurricanes and severe weather in Florida and Texas.

### **We cannot assure you that the current locations of our existing restaurants will continue to be economically viable or that additional locations will be acquired at reasonable costs.**

The location of our restaurants has significant influence on their success. We cannot assure you that current locations will continue to be economically viable or that additional locations can be acquired at reasonable costs. In addition, the economic environment where restaurants are located could decline in the future, which could result in reduced sales in those locations. We cannot assure you that new sites will be profitable or as profitable as existing sites.

### **The loss of the services of our senior executives could have a material adverse effect on our business, financial condition or results of operations.**

Our success depends to a large extent upon the continued services of our senior management, including Alan Vituli, Chairman of the Board and Chief Executive Officer, and Daniel T. Accordino, President and Chief Operating Officer, who have substantial experience in the restaurant industry. We believe that it would be extremely difficult to replace Messrs. Vituli and Accordino with individuals having comparable experience. Consequently, the loss of the services of Mr. Vituli or Mr. Accordino could have a material adverse effect on our business, financial condition or results of operations.

### **Government regulation could adversely affect our financial condition and results of operations.**

We are subject to extensive laws and regulations relating to the development and operation of restaurants, including regulations relating to the following:

zoning;

the preparation and sale of food;

liquor licenses which allow us to serve alcoholic beverages at our Taco Cabana restaurants;



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employer/employee relationships, including minimum wage requirements, overtime, working and safety conditions, and citizenship requirements;

federal and state laws that prohibit discrimination and laws regulating design and operation of facilities, such as the Americans With Disabilities Act of 1990; and

federal and state regulations governing the operations of franchises, including rules promulgated by the Federal Trade Commission. In the event that legislation having a negative impact on our business is adopted, you should be aware that it could have a material adverse impact on us. For example, substantial increases in the minimum wage could adversely affect our financial condition and results of operations. Local zoning or building codes or regulations and liquor license approvals can cause substantial delays in our ability to build and open new restaurants. Local authorities may revoke, suspend or deny renewal of our liquor licenses if they determine that our conduct violates applicable regulations. Any failure to obtain and maintain required licenses, permits and approvals could adversely affect our operating results.

**If one of our employees sells alcoholic beverages to an intoxicated or minor patron, we may be liable to third parties for the acts of the patron.**

We serve alcoholic beverages at our Taco Cabana restaurants and are subject to the dram-shop statutes of the jurisdictions in which we serve alcoholic beverages. Dram-shop statutes generally provide that serving alcohol to an intoxicated or minor patron is a violation of the law.

In most jurisdictions, if one of our employees sells alcoholic beverages to an intoxicated or minor patron we may be liable to third parties for the acts of the patron. We cannot guarantee that those patrons will not be served or that we will not be subject to liability for their acts. Our liquor liability insurance coverage may not be adequate to cover any potential liability and insurance may not continue to be available on commercially acceptable terms or at all, or we may face increased deductibles on such insurance. Any increase in the number or size of dram-shop claims could have a material adverse effect on us as a result of the costs of defending against such claims; paying deductibles and increased insurance premium amounts; implementing improved training and heightened control procedures for our employees; and paying any damages or settlements on such claims.

**Federal, state and local environmental regulations relating to the use, storage, discharge, emission and disposal of hazardous materials could expose us to liabilities, which could adversely affect our results of operations.**

We are subject to a variety of federal, state and local environmental regulations relating to the use, storage, discharge, emission and disposal of hazardous materials. We own and lease numerous parcels of real estate on which our restaurants are located.

Failure to comply with environmental laws could result in the imposition of severe penalties or restrictions on operations by governmental agencies or courts of law that could adversely affect our operations. Also, if contamination is discovered on properties owned or operated by us, including properties we owned or operated in the past, we can be held liable for severe penalties and costs of remediation. These penalties could adversely affect our results of operations.

**We are subject to all of the risks associated with leasing space subject to long-term non-cancelable leases.**

Our leases generally have initial terms of 20 years, and typically provide for renewal options in five year increments as well as for rent escalations. Generally, our leases are net leases, which require us to pay all of the costs of insurance, taxes, maintenance and utilities. We generally cannot cancel these leases. Additional sites that we lease are likely to be subject to similar long-term non-cancelable leases. If an existing or future restaurant is

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not profitable, and we decide to close it, we may nonetheless be committed to perform our monetary obligations under the applicable lease including, among other things, paying all amounts due for the balance of the lease term. In addition, as each of our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close restaurants in desirable locations.

**We may, in the future, seek to pursue acquisitions and we may not find restaurant companies that are suitable acquisition candidates or successfully operate or integrate any restaurant companies we may acquire.**

We may in the future seek to acquire other restaurant chains. Although we believe that opportunities for future acquisitions may be available from time to time, increased competition for acquisition candidates exists and may continue in the future. Consequently, there may be fewer acquisition opportunities available to us as well as higher acquisition prices. There can be no assurance that we will be able to identify, acquire, manage or successfully integrate acquired restaurant companies without substantial costs, delays or operational or financial problems. In the event we are able to acquire other restaurant companies, the integration and operation of the acquired restaurants may place significant demands on our management, which could adversely affect our ability to manage our existing restaurants. We also face the risk that our existing systems, procedures and financial controls will be inadequate to support any restaurant chains we may acquire and that we may be unable to successfully integrate the operations and financial systems of any chains we may acquire with our own systems. While we may evaluate and discuss potential acquisitions from time to time, we currently have no understandings, commitments or agreements with respect to any acquisitions. We may be required to obtain additional financing to fund future acquisitions. There can be no assurance that we will be able to obtain additional financing on acceptable terms or at all. Both the new senior credit facility and the Indenture governing the Notes contain restrictive covenants that may prevent us from incurring additional debt or acquiring additional restaurant chains. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

**Our failure or inability to enforce our trademarks or other proprietary rights could adversely affect our competitive position or the value of our brand.**

We own certain common law trademark rights and a number of federal and international trademark and service mark registrations, including the Pollo Tropical name and logo and Taco Cabana name and logo, and proprietary rights relating to certain of our core menu offerings. We believe that our trademarks and other proprietary rights are important to our success and our competitive position. We, therefore, devote appropriate resources to the protection of our trademarks and proprietary rights. The protective actions that we take, however, may not be enough to prevent unauthorized usage or imitation by others, which could harm our image, brand or competitive position and, if we commence litigation to enforce our rights, cause us to incur significant legal fees.

We are not aware of any assertions that our trademarks or menu offerings infringe upon the proprietary rights of third parties, but we cannot assure you that third parties will not claim infringement by us in the future. Any such claim, whether or not it has merit, could be time-consuming, result in costly litigation, cause delays in introducing new menu items in the future or require us to enter into royalty or licensing agreements. As a result, any such claim could have a material adverse effect on our business, results of operations and financial condition.

**The market price of our common stock may be highly volatile or may decline regardless of our operating performance.**

The trading price of our common stock may fluctuate substantially. The price of our common stock that will prevail in the market may be higher or lower than the price you pay, depending on many factors, some of which are beyond our control. Broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. The fluctuations could cause a loss of all or part of an

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investment in our common stock. Factors that could cause fluctuation in the trading price of our common stock may include, but are not limited to the following:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of companies generally or restaurant companies (including BKC) in particular;

actual or anticipated variations in the earnings or operating results of our company or our competitors;

actual or anticipated changes in financial estimates by us or by any securities analysts who might cover our stock or the stock of other companies in our industry;

market conditions or trends in our industry and the economy as a whole;

announcements by us or our competitors of significant acquisitions, strategic partnerships or divestitures;

announcements of investigations or regulatory scrutiny of our operations or lawsuits filed against us;

capital commitments;

changes in accounting principles;

additions or departures of key personnel; and

sales of our common stock, including sales of large blocks of our common stock or sales by our directors and officers.

In addition, if the market for restaurant company stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, results of operations or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry (including BKC) or related industries even if these events do not directly affect us.

In the past, following periods of volatility in the market price of a company's securities, class action securities litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business, and could also require us to make substantial payments to satisfy judgments or to settle litigation.

**The concentrated ownership of our capital stock by insiders will likely limit your ability to influence corporate matters.**

Our executive officers, directors and funds managed by entities affiliated with Madison Dearborn Partners, LLC ( Madison Dearborn ) and BIB Holdings (Bermuda) Ltd. ( BIB ) together own approximately 45.5% of our common stock outstanding. In particular, BIB and funds managed by affiliates of Madison Dearborn in the aggregate each owned approximately 17.2% of our outstanding common stock outstanding, based on



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shares outstanding as of March 16, 2007. In addition, our executive officers and directors (excluding directors affiliated with Madison Dearborn and BIB) together owned approximately 11.1% of our common stock outstanding, based on shares outstanding as of March 16, 2007. As a result, our executive officers and these directors, if they act as a group, and BIB and the funds managed by affiliates of Madison Dearborn will be able to significantly influence matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions such as mergers and acquisitions. The directors will have the authority to make decisions affecting our capital structure, including the issuance of additional debt and the declaration of dividends. BIB and the funds managed by Madison Dearborn may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. Corporate action might be taken even if

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other stockholders oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately depress the market price of our common stock.

**A substantial number of shares of our common stock will be eligible for sale in the near future, which could cause our common stock price to decline significantly.**

If our stockholders sell, or the market perceives that our stockholders intend to sell, substantial amounts of our common stock in the public market, the market price of our common stock could decline significantly. These sales may also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. As of March 16, 2007, we had 21,550,826 shares of our common stock outstanding. Of these shares, 9,925,286 shares sold in the IPO are freely tradable, 466,521 additional shares of common stock will be available for sale in the public market approximately 90 days after December 14, 2006, and 11,159,019 additional shares of common stock will be available for sale in the public markets 180 days after December 14, 2006 (subject to possible extension by up to an additional 34 days) following the expiration of the lock-up agreements entered into by our executive officers and directors and some of our stockholders in connection with the IPO. However, Wachovia Capital Markets, LLC and Banc of America Securities LLC, the lead underwriters in the IPO, may, in their sole discretion and at any time or from time to time, without notice, release all or any portion of the shares subject to the lock-up agreements.

In addition, holders of 9,561,382 shares of our common stock have the right to require us to register those shares under the Securities Act or to include those shares in subsequent registration statements we may file with the SEC, in each case to enable the holders to sell those shares in the public markets. In addition, an aggregate of 74,700 shares of restricted common stock and options to purchase an aggregate of 1,251,950 shares of our common stock were outstanding under our 2006 Stock Incentive Plan as of March 16, 2007, and we intend, in the near future, to register these shares of restricted stock and the shares issuable upon exercise of those options, as well as the other shares available for issuance under our 2006 Stock Incentive Plan.

**We do not expect to pay any cash dividends for the foreseeable future, and the Indenture governing the Notes and the new senior credit facility limit Carrols' ability to pay dividends to us and consequently our ability to pay dividends to our stockholders.**

We do not anticipate that we will pay any cash dividends to holders of our common stock in the foreseeable future. The absence of a dividend on our common stock may increase the volatility of the market price of our common stock or make it more likely that the market price of our common stock will decrease in the event of adverse economic conditions or adverse developments affecting our company. We are a holding company and conduct all of our operations through our direct and indirect subsidiaries. As a result, for us to pay dividends, we would need to rely on dividends or distributions to us from Carrols and indirectly from subsidiaries of Carrols. The Indenture governing the Notes and the new senior credit facility limit, and the debt instruments that we and our subsidiaries may enter into in the future may limit, the ability of Carrols and its subsidiaries to pay dividends to us and our ability to pay dividends to our stockholders.

**If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our stock could decline.**

The trading market for our common stock will rely in part on the research and reports that industry or financial analysts publish about us or our business. We cannot assure you that these analysts will publish research or reports about us or that any analysts that do so will not discontinue publishing research or reports about us in the future. If one or more analysts who cover us downgrade our stock, our stock price could decline rapidly. If analysts do not publish reports about us or if one or more analysts cease coverage of our stock, we could lose visibility in the market, which in turn could cause our stock price to decline.

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**Provisions in our restated certificate of incorporation and amended and restated bylaws or Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.**

Delaware corporate law and our restated certificate of incorporation and amended and restated bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions:

require that special meetings of our stockholders be called only by our board of directors or certain of our officers, thus prohibiting our stockholders from calling special meetings;

deny holders of our common stock cumulative voting rights in the election of directors, meaning that stockholders owning a majority of our outstanding shares of common stock will be able to elect all of our directors;

authorize the issuance of blank check preferred stock that our board could issue to dilute the voting and economic rights of our common stock and to discourage a takeover attempt;

provide that approval of our board of directors or a supermajority of stockholders is necessary to make, alter or repeal our amended and restated bylaws and that approval of a supermajority of stockholders is necessary to amend, alter or change certain provisions of our restated certificate of incorporation;

establish advance notice requirements for stockholder nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings;

divide our board into three classes of directors, with each class serving a staggered 3-year term, which generally increases the difficulty of replacing a majority of the directors;

provide that directors only may be removed for cause by a majority of the board or by a supermajority of our stockholders; and

require that any action required or permitted to be taken by our stockholders must be effected at a duly called annual or special meeting of stockholders and may not be effected by any consent in writing.

### **We will incur increased costs as a result of being a public company.**

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company prior to completion of the IPO. The Sarbanes-Oxley Act of 2002 and related rules of the SEC, and The NASDAQ Stock Market regulate corporate governance practices of public companies. We expect that compliance with these public company requirements will increase our costs and make some activities more time-consuming. For example, we may be required to adopt additional internal controls and disclosure controls and procedures. In addition, we will incur additional expenses associated with our SEC reporting requirements. A number of those requirements will require us to carry out activities we have not done previously. For example, under Section 404 of the Sarbanes-Oxley Act, for our annual report on Form 10-K for the year ending December 31, 2007 we will need to document and test our internal control procedures, our management will need to assess and report on our internal control over financial reporting and our independent accountants will need to issue an opinion on that assessment and the effectiveness of those controls. Furthermore, if we identify any issues in complying with those requirements (for example, if we or our accountants identify a material weakness or significant deficiency in our internal control over financial reporting), we could incur additional costs rectifying those issues, and the existence of those issues could adversely affect us, our reputation or investor perceptions of us. We also expect that it will be difficult and expensive to obtain director and officer liability insurance, and we may be required to accept reduced

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policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as executive officers. Advocacy efforts by stockholders and third parties may also prompt even more changes in governance and reporting requirements. We cannot predict or estimate the amount of additional costs we may incur as a result of being a public company or the timing of such costs.

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Not Applicable.

**ITEM 2. PROPERTIES**

As of December 31, 2006, we owned or leased the following restaurant properties:

	<b>Owned Land; Owned Building</b>	<b>Leased Land; Owned Building</b>	<b>Leased Land; Leased Building(1)</b>	<b>Total(2)</b>
Restaurants:				
Pollo Tropical	2	25	49	76
Taco Cabana	6	28	109	143
Burger King	11	25	292	328
Total operating restaurants (1)(2)	19	78	450	547

(1) Includes 17 restaurants located in mall shopping centers, four in-line or storefront locations and six co-branded locations.

(2) Excludes restaurants operated by our franchisees. In addition, as of December 31, 2006, we had four restaurants under construction, thirteen properties leased to third parties and three properties available for sale or lease.

As of December 31, 2006, we leased 97% of our Pollo Tropical restaurants, 96% of our Taco Cabana restaurants and 97% of our Burger King restaurants. We typically enter into leases (including options to renew) ranging from 20 to 40 years. The average remaining term for all leases, including options, was approximately 25 years at December 31, 2006. Generally, we have been able to renew leases, upon or prior to their expiration, at the prevailing market rates, although there can be no assurance that this will continue to occur.

Most of our Burger King restaurant leases are coterminous with the related franchise agreements. We believe that we generally will be able to renew, at commercially reasonable rates, the leases whose terms expire prior to the expiration of that location's Burger King franchise agreement, although there can be no assurance that this will occur.

Most leases require us, as lessee, to pay utility and water charges and real estate taxes. Certain leases also require contingent rentals based upon a percentage of gross sales of the particular restaurant that exceed specified minimums. In some of our mall locations, we are also required to pay certain other charges such as a pro rata share of the mall's common area maintenance costs, insurance and security costs.

In addition to the restaurant locations set forth under Restaurant Locations, we own a building with approximately 25,300 square feet at 968 James Street, Syracuse, New York, which houses our executive offices and most of our administrative operations for our Burger King restaurants. We lease five small regional offices that support the management of our Burger King restaurants. We also lease approximately 13,500 square feet at 7300 North Kendall Drive, 8th Floor, Miami, Florida, which houses most of our administrative operations for our Pollo Tropical restaurants. In addition, we lease approximately 17,700 square feet of office space at 8918 Tesoro Drive, Suite 200, San Antonio, Texas, which houses most of our administrative operations for our Taco Cabana restaurants.

**ITEM 3. LEGAL PROCEEDINGS**

On November 16, 1998, the 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



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retaliation against former and current female employees. The EEOC identified approximately 450 individuals (which was subsequently increased to 511 individuals) that it believed represented the class of claimants and was seeking monetary and injunctive relief from Carrols.

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

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

On November 30, 2002, four former hourly employees commenced a lawsuit against Carrols in the United States District Court for the Western District of New York entitled Dawn Seever, et al. v. Carrols Corporation. The lawsuit alleges, in substance, that Carrols violated certain minimum wage laws under the federal Fair Labor Standards Act and related state laws by requiring employees to work without recording their time and by retaliating against those who complained. The plaintiffs seek damages, costs and injunctive relief. They also seek to notify, and eventually certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for Carrols. As a result of the July 21, 2005 Status Conference, the parties agreed to withdraw Plaintiff's Motions to Certify and for National Discovery, and Defendant's Motion to Disqualify Counsel and related motions, to allow both sides limited additional discovery. Carrols has since filed a Motion for Summary Judgment as to the existing Plaintiffs that the Court has under consideration. On January 19, 2007, plaintiffs refiled a Motion to certify and for National Discovery and Carrols intends to oppose such Motion. It is too early to evaluate the likelihood of an unfavorable outcome or estimate the amount or range of potential loss. Consequently, it is not possible to predict what adverse impact, if any, this case could have on our consolidated financial condition or results of operations and cash flows. We intend to continue to contest this case vigorously.

We are a party to various other litigation matters incidental to the conduct of our business. We do not believe that the outcome of any of these other matters will have a material adverse effect on our consolidated financial statements.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

In connection with our preparation for our IPO, a majority of our stockholders took action by written consent on one occasion during the quarter ended December 31, 2006.

On November 21, 2006, a majority of our stockholders acted by written consent to: (1) approve a Certificate of Amendment to our Certificate of Incorporation with respect to changing our name to Carrols Restaurant Group, Inc., (2) ratify, affirm, approve and adopt actions taken by certain of our officers in connection with the IPO, (3) approve and adopt the terms and provisions of our Restated Certificate of Incorporation, (4) approve and adopt the terms and provisions of our Amended and Restated Bylaws, (5) ratify, affirm, approve and adopt a forward stock split of 11.288 to one on our outstanding shares of common stock effective immediately prior to the effective date of the IPO, (6) elect Jack A. Smith and Joel M. Handel to fill vacancies on our Board of Directors effective immediately prior to the effective date of the IPO, (7) elect Alan Vituli and Daniel T. Accordino as Class I directors to our Board of Directors; Joel M. Handel and Clayton Wilhite as Class II directors to our Board of Directors; and Robin P. Selati, Jack A. Smith and Olaseni Adeyemi Sonuga as Class III directors to our Board of Directors, and (8) to approve and adopt the terms and provisions of our 2006 Stock Incentive Plan.

**Table of Contents****PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

In December 2006, we and certain selling stockholders completed the IPO in which Carrols Restaurant Group and those stockholders sold 5,666,666 and 5,333,334 shares of our common stock, respectively, (including 1,000,000 shares sold by the selling stockholders upon the underwriters' exercise of its over-allotment option) at an initial public offering price of \$13.00 per share. In connection with and prior to the IPO, we effected an 11.288 for one stock split on December 8, 2006. Our common stock commenced trading on The NASDAQ Global Market under the symbol TAST on December 15, 2006. The high and low closing prices of our common stock from December 15, 2006 through December 31, 2006 were \$15.20 and \$14.15, respectively. As of March 16, 2007, there were 21,550,826 shares of our common stock outstanding held by 702 holders of record. This excludes persons whose shares are held of record by a bank, brokerage house or clearing agency.

**Dividends**

We did not pay any cash dividends during the fiscal years 2006 or 2005. In December 2004, we made a one-time cash dividend of \$116.8 million to our stockholders and also distributed approximately \$20.3 million to employees and an outside director holding certain options to purchase our common stock from the net proceeds of the December 2004 Transactions. The special cash dividend was paid on December 28, 2004.

We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain all available funds to fund the development and growth of our business. In addition, we are a holding company and conduct all of our operations through our direct and indirect subsidiaries. As a result, for us to pay dividends, we need to rely on dividends or distributions to us from Carrols and indirectly from subsidiaries of Carrols. The Indenture governing the Notes and the new senior credit facility limit, and debt instruments that we and our subsidiaries may enter into in the future may limit the ability of Carrols and its subsidiaries to pay dividends to us and our ability to pay dividends to our stockholders.

**Equity Compensation Plans**

The following table summarizes the equity compensation plans under which our common stock may be issued as of December 31, 2006. Stockholders of the Company approved all plans.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	1,317,550	\$ 14.30	1,982,450
Equity compensation plans not approved by security holders			
<b>Total</b>	<b>1,317,550</b>	<b>\$ 14.30</b>	<b>1,982,450</b>

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

We did not repurchase any of our registered securities during the fourth quarter of 2006 and we do not have a formal or publicly announced stock repurchase program.

**Use of Proceeds**



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On December 14, 2006, our registration statement on Form S-1 (Registration No. 333-137524) was declared effective for our IPO, pursuant to which we and certain selling stockholders sold 5,666,666 and 5,333,334 shares of our common stock, respectively (including 1,000,000 shares sold by the selling stockholders upon the

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underwriters (exercise of its over-allotment option) at an initial public offering price of \$13.00 per share. The IPO closed on December 20, 2006 and, as a result, we received net proceeds of approximately \$65.4 million from the sale of shares of our common stock in the IPO after deducting underwriting discounts and commissions and offering expenses payable by us of approximately \$8.3 million. We contributed the net proceeds from the IPO to Carrols (before deducting offering expenses payable by us), which used such funds to repay approximately \$68.0 million principal amount of term loan borrowings under our prior senior credit facility. The joint book running managers of the IPO were Wachovia Capital Markets, LLC and Banc of America Securities LLC.

No payments for such expenses were made directly or indirectly to (i) any of our officers or directors or their associates, (ii) any persons owning 10% or more of any class of our equity securities, or (iii) any of our affiliates. We did not receive any proceeds from the sale of common stock in IPO by the selling stockholders. There has been no material change in the planned use of proceeds from our IPO from that described in the final prospectus filed with the SEC pursuant to Rule 424(b) of the Securities Act of 1933, as amended.

**Stock Performance Graph**

The following graph compares, from December 15, 2006 (the date on which our common stock began trading on The NASDAQ Global Market), the cumulative total stockholder return on our common stock with the cumulative total returns of The NASDAQ Composite Index and a peer group, The S&P Small Cap Restaurant Index. We have elected to use the S&P Small Cap Restaurant Index in compiling our stock performance graph because we believe the S&P Small Cap Restaurant Index represents a comparison to competitors with similar market capitalization as us.

The initial public offering price of our common stock in the IPO was \$13.00 and the closing price of our common stock on December 15, 2006 (the date on which our common stock began trading on The NASDAQ Global Market) was \$15.20. The following graph is based upon the closing price of our common stock from December 15, 2006 through December 31, 2006.

	12/15/06	12/31/06
Carrols Restaurant Group, Inc.	\$ 100.00	\$ 93.29
NASDAQ Composite	\$ 100.00	\$ 99.79
S & P SmallCap Restaurant Index	\$ 100.00	\$ 101.18

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA****December 2004 Transactions**

On December 15, 2004, Carrols completed the private placement of \$180.0 million of its 9% Senior Subordinated Notes due 2013, which we refer to as the Notes. Concurrently, Carrols repaid all outstanding borrowings under our then existing senior secured credit facility and amended and restated such senior credit facility with a new syndicate of lenders, which we refer to as the prior senior credit facility. Carrols received \$400.0 million in total proceeds that included the issuance of the Notes and term loan B borrowings of \$220.0 million under the prior senior credit facility. The proceeds were primarily utilized to repay borrowings outstanding under the then existing senior credit facility of \$74.4 million, to retire all of Carrols' 9 1/2% senior subordinated notes due 2008 (including redemption premiums) in the amount of \$175.9 million, to pay a dividend to Carrols Restaurant Group, the sole stockholder of Carrols, in the amount of \$116.8 million (and Carrols Restaurant Group concurrently paid a dividend to its stockholders in the aggregate amount of \$116.8 million), to pay fees and expenses related to the refinancing of \$8.8 million, and to pay a bonus to employees (including management) and an outside director, who owned options to purchase common stock of Carrols Restaurant Group, totaling \$20.9 million, which includes \$0.6 million of payroll taxes. We also recorded an \$8.9 million loss on early extinguishment of debt primarily from the write-off of previously deferred financing costs and premiums in conjunction with the retirement of the 9 1/2% Senior Subordinated Notes. In this Annual Report on Form 10-K we refer to the Notes offering, Carrols entering into the prior senior credit facility and the term loan borrowings thereunder, the repayment of all outstanding borrowings under the then existing senior credit facility, retirement of all of the outstanding 9 1/2% Senior Subordinated Notes, the payment of a dividend to our stockholders and the distribution to our employees (including management) and a director as the December 2004 Transactions.

**December 2006 IPO**

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

The following table sets forth our selected consolidated financial data derived from our audited consolidated financial statements for each of the fiscal years ended December 31, 2002, 2003, 2004, 2005 and 2006. The information in the following table should be read together with our consolidated financial statements and accompanying notes as of December 31, 2005 and 2006 and for the years ended December 31, 2004, 2005 and 2006, and Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this report. These historical results are not necessarily indicative of the results to be expected in the future. Our fiscal years ended December 31, 2002, 2003, 2005 and 2006 each contained 52 weeks. Our fiscal year ended December 31, 2004 contained 53 weeks. The amounts in the table below reflect rounding adjustments.

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

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	Year Ended December 31,				
	2002	2003	2004	2005	2006
(Dollar in thousands, except share and per share data)					
<b>Statements of operations data:</b>					
Revenues:					
Restaurant sales	\$ 655,545	\$ 643,579	\$ 696,343	\$ 705,422	\$ 750,069
Franchise royalty revenues and fees	1,482	1,406	1,536	1,488	1,357
<b>Total revenues</b>	<b>657,027</b>	<b>644,985</b>	<b>697,879</b>	<b>706,910</b>	<b>751,426</b>
Costs and expenses:					
Cost of sales	183,976	181,182	202,624	204,620	211,236
Restaurant wages and related expenses (1)	196,258	194,315	206,732	204,611	218,797
Restaurant rent expense	30,940	31,089	34,606	34,668	37,768
Other restaurant operating expenses	87,335	89,880	92,891	102,921	110,164
Advertising expense	28,041	27,351	24,711	25,523	27,692
General and administrative (1)	36,460	37,388	43,585	58,621	49,756
Depreciation and amortization	39,434	40,228	38,521	33,096	33,534
Impairment losses	1,285	4,151	1,544	1,468	1,019
Bonus to employees					