MEXICAN RESTAURANTS INC
Form 10-K
April 05, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [FEE REQUIRED]

FOR THE FISCAL YEAR ENDED JANUARY 2, 2005

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 0-28234

MEXICAN RESTAURANTS, INC.
(Exact name of registrant as specified in its charter)

TEXAS	76-0493269
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
1135 EDGEBROOK, HOUSTON, TEXAS	77034-1899
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: 713/943-7574

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

Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, $.01 PAR VALUE
(Title of class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] 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 Registrant's 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. [X]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes [ ] No [X]

The aggregate market value of the Registrant's Common Stock held by

non-affiliates of the Registrant, based on the sale trade price of the Common Stock as reported by the Nasdaq Small Cap Market on the last business day of the second quarter ended June 27, 2004 was $9,279,247. For purposes of this computation, all officers, directors and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors or 10% beneficial owners are, in fact, affiliates of the Registrant.

Number of shares outstanding of the Registrant's Common Stock, as of March 23, 2005: 3,414,805 shares of common stock, par value $.01.

DOCUMENTS INCORPORATED BY REFERENCE

Specified portions of the Company's definitive proxy statement in connection with the Annual Meeting of Shareholders to be held May 24, 2005, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, are incorporated by reference into Part III of this report.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Form 10-K under "Business", "Legal Proceedings". "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report constitute "forward-looking

statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other facts which may cause the actual results, performance or achievements of Mexican Restaurants, Inc. and its subsidiaries (the "Company"), its restaurants, area developers and franchisees to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions; competition; success of operating initiatives; development and operating costs; advertising and promotional efforts; brand awareness; adverse publicity; acceptance of new product offerings; availability, locations and terms of sites for store development; changes in business strategy or development plans; quality of management; availability, terms and development of capital; business abilities and judgment of personnel; availability of qualified personnel; food, labor and employee benefit costs; area developers' adherence to development schedules; changes in, or the failure to comply with government regulations; regional weather conditions; construction schedules; and other factors referenced in the Form 10-K. The use in this Form 10-K of such words as "believes", "anticipates", "expects", "intends" and similar expressions with respect to future activities or other future events or conditions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. The success of the Company is dependent on the efforts of the Company, its employees, its area developers, and franchisees and the manner in which they operate and develop stores in light of various factors, including those set forth above.

Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements included in this Form 10-K will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Company that its objectives or plans will be achieved.

PART I

ITEM 1. BUSINESS

GENERAL

Mexican Restaurants, Inc. (the "Company") operates and franchises Mexican-theme restaurants featuring various elements associated with the casual dining experience under the names Casa Ole, Monterey's Tex-Mex Cafe, Monterey's Little Mexico, Tortuga Coastal Cantina, La Senorita and Crazy Jose. The Casa Ole, Monterey, Tortuga, La Senorita and Crazy Jose concepts have been in business for 33, 50, 11, 26 and 18 years, respectively. Today the Company operates 60 restaurants, franchises 19 restaurants and licenses one restaurant in various communities across Texas, Louisiana, Oklahoma and Michigan. The Casa Ole, Monterey, La Senorita and Crazy Jose restaurants are designed to appeal to a broad range of customers, and are located primarily in small and in medium-sized communities and middle-income areas of larger markets. The Tortuga Coastal Cantina restaurants also are designed to appeal to a broad range of customers and are located primarily in Houston suburban markets. The restaurants offer fresh, quality food, affordable prices, friendly service and comfortable surroundings. Menus feature a variety of traditional Mexican and Tex-Mex selections, complemented by the Company's own original Mexican-based recipes, designed to have broad appeal. The Company believes that the established success of the Company in existing markets, its focus on middle-income customers, and

the skills of its management team provide significant opportunities to realize the value inherent in the Mexican restaurant market and increase revenues in existing markets.

On January 7, 2004, the Company completed its purchase of 13 restaurants and related assets from its Beaumont-based franchisee for a total consideration of approximately $13.75 million. The restaurants acquired include 8 Casa Ole restaurants located in Southeast Texas, 2 Casa Ole restaurants located in Southwest Louisiana, and 3 Crazy Jose's restaurants located in Southeast Texas. In the past year these restaurants had combined sales of over $20 million. On October 14, 2004, the Company completed its purchase of one Casa Ole franchise restaurant in Brenham, Texas for approximately $215,000. The restaurant was closed, remodeled and re-opened on November 22, 2004. The Company spent $329,489 remodeling the restaurant.

The Company was incorporated under the name "Casa Ole Restaurants, Inc." under the laws of the State of Texas in February 1996, and had its initial public offering in April 1996. On May 24, 1999, the Company changed its corporate name to Mexican Restaurants, Inc. The Company operates as a holding company and conducts substantially all of its operations through its subsidiaries. All references to the Company include the Company and its subsidiaries, unless otherwise stated.

STRATEGY AND CONCEPT

The Company's objective is to be perceived as a value leader in the Mexican theme segment of the full-service casual dining marketplace. To accomplish this objective, the Company has developed strategies designed to achieve and maintain high levels of customer loyalty, frequent patronage and profitability. The key strategic elements are:

- Offering consistent, high-quality, original recipe Mexican menu items that reflect both national and local taste preferences;

- Pricing its menu offerings at levels below many family and casual-dining restaurant concepts;

- Selecting, training and motivating its employees to enhance customer dining experiences and the friendly casual atmosphere of its restaurants;

- Providing customers with the friendly, attentive service typically associated with more expensive casual-dining experiences; and

- Reinforcing the perceived value of the dining experience with a comfortable and inviting Mexican decor.

MENU. The Company's restaurants offer high-quality products with a distinctive, yet mild taste profile with mainstream appeal. Fresh ingredients are a critical recipe component, and the majority of menu items are prepared daily in the kitchen of each restaurant from original recipes.

The menus feature a wide variety of entrees including enchiladas, combination platters, burritos, fajitas, coastal seafood and other house specialties. The menu also includes soup, salads, appetizers and desserts. From time to time the Company also introduces new dishes designed to keep the menus fresh. Alcoholic beverages are served as a complement to meals and represent a range of less than 5% of sales at its more family-oriented locations, and up to 20% in its more casual dining locations. At Company-owned restaurants the dinner menu entrees presently range in price from $4.99 to $15.95, with

most items priced between $5.95 and $9.95. Lunch prices at most Company-owned restaurants presently range from $4.99 to $8.95.

ATMOSPHERE AND LAYOUT. The Company emphasizes an attractive interior and exterior design for each of its restaurants. The typical restaurant has an inviting and interesting Mexican exterior. The interior decor is comfortable Mexican in appearance to reinforce the perceived value of the dining experience. Stucco, tile floors, carpets, plants and a variety of paint colors are integral features of each restaurant's decor. These decor features are incorporated in a floor plan designed to provide a comfortable atmosphere. The Company's restaurant designs are sufficiently flexible to accommodate a variety of available sites and development opportunities, such as malls, end-caps of strip shopping centers and free standing buildings, including conversions to the Company's restaurant design. The restaurant facility is also designed to serve a high volume of customers in a relatively limited period of time. The Company's restaurants typically range in size from approximately 4,000 to 5,600 square feet, with an average of approximately 4,500 square feet and a seating capacity of approximately 180.

GROWTH STRATEGY

The Company believes that the unit economics of the various restaurant concepts of the Company, as well as their value orientation and focus on middle income customers, provide significant potential opportunities for growth. The Company's long-standing strategy to capitalize on these growth opportunities has been comprised of two key elements:

IMPROVE SAME RESTAURANT SALES AND PROFITS. The Company's first growth opportunity is to improve the sales and controllable income of existing restaurants (controllable income consists of restaurant sales less food and beverage expenses, labor and controllable expenses, such as utilities and repair and maintenance expenses, but excludes advertising and occupancy expenses). This is accomplished through an emphasis on restaurant operations, coupled with improving marketing, purchasing and other organizational efficiencies (see "Restaurant Operations" below). During fiscal year 2005, the Company expects to focus on improving sales and profitability so that it can maximize free cash flow, which it will use to pay off debt, remodel existing restaurants, build new restaurants, acquire existing franchise restaurants and to make repurchases of its common stock when it determines such repurchases are a prudent use of its capital.

INCREASED PENETRATION OF EXISTING MARKETS. The Company's second growth opportunity is, when it believes market conditions warrant, to increase the number of restaurants in existing Designated Market Areas ("DMAs") and to expand into contiguous new markets. The DMA concept is a mapping tool developed by the A.C. Nielsen Co. that measures the size of a particular market by reference to communities included within a common television market. The Company's objective in increasing the density of Company-owned restaurants within existing markets is to improve operating efficiencies in such markets and to realize improved overhead absorption. In addition, the Company believes that increasing the density of restaurants in both Company-owned and franchised markets will assist it in achieving effective media penetration while maintaining or reducing advertising costs as a percentage of revenues in the relevant markets. The Company believes that careful and prudent site selection within existing markets will avoid cannibalization of the sales bases of existing restaurants.

In implementing its unit expansion strategy, the Company may use a combination of franchised and Company-owned restaurants. The number of such restaurants developed in any period will vary. The Company believes that a mix of franchised and Company-owned restaurants would enable it to realize

accelerated expansion opportunities, while maintaining majority or sole ownership of a significant number of restaurants. Generally the Company does not anticipate opening franchised and Company-owned restaurants within the same market. In seeking franchisees, the Company will continue to primarily target experienced multi-unit restaurant operators with knowledge of a particular geographic market and financial resources sufficient to execute the Company's development strategy.

The restaurant industry is a competitive and fragmented business. Moreover, the restaurant industry is characterized by a high initial capital investment. Our focus is not on new restaurant expansion just to generate additional sales, but a balanced approach that emphasizes same-restaurant sales growth and selective new restaurant development and acquisitions of existing franchise restaurants. Consequently, the Company did not build any new restaurants in fiscal year 2004, but did acquire 13 restaurants and related assets from its Beaumont-based franchisee on January 7, 2004 and one franchise restaurant in Brenham, Texas on October 14, 2004. On December 15, 2004, one new franchise restaurant was opened in Opelousas, Louisiana. The Company plans to build two new restaurants in fiscal year 2005, as well as significantly remodel one existing restaurant and moderately remodel five existing restaurants. Further, the Company anticipates it will continue to selectively acquire existing franchised restaurants from time to time when such opportunities arise. In addition, the Company will actively promote the development of new franchise restaurants (see "Franchising" below).

SITE SELECTION

When developing new restaurant sites, senior management of the Company devotes significant time and resources to analyzing prospective sites for the Company's restaurants. Senior management has also created and utilizes a site selection committee, which reviews and approves each site to be developed. In addition, the Company conducts customer surveys to define precisely the demographic profile of the customer base of each of the Company's restaurant concepts. The Company's site selection criteria focus on:

1) matching the customer profile of the respective restaurant concept to the profile of the population of the target local market;

2) easy site accessibility, adequate parking, and prominent visibility of each site under consideration;

3) the site's strategic location within the marketplace;

4) the site's proximity to the major concentration of shopping centers within the market;

5) the site's proximity to a large employment base to support the lunch segment; and

6) the impact of competition from other restaurants in the market.

The Company believes that a sufficient number of suitable sites are available for contemplated Company and franchise development in existing markets. Based on its current planning and market information, the Company plans to open two new restaurants in fiscal year 2005. The anticipated total investment for a 4,200 to 5,600 square foot restaurant, including land, building, equipment, signage, site work, furniture, fixtures and decor ranges

between $1.4 and $2.1 million (including capitalized lease value). Additionally, training and other pre-opening costs are anticipated to approximate $50,000 to $100,000 per location. The cost of developing and operating a Company restaurant can vary based upon fluctuations in land acquisition and site improvement costs, construction costs in various markets, the size of the particular restaurant and other factors. Although the Company anticipates that development costs associated with near-term restaurants will range between $1.4 and $2.1 million, there can be no assurance of this. Where possible, the Company uses build to suit, lease conversion or sale and leaseback transactions in an effort to limit its cash investment to approximately $550,000 per location.

RESTAURANT OPERATIONS

MANAGEMENT AND EMPLOYEES. The management staff of each restaurant is responsible for managing the restaurant's operations. Each Company-owned restaurant operates with a general manager, one or more assistant managers and a kitchen manager or a chef. Including managers, restaurants have an average of 50 full-time and part-time employees. The Company historically has spent considerable effort developing its employees, allowing it to promote from within. As an additional incentive to its restaurant management personnel, the Company has a bonus plan in which restaurant managers can receive monthly bonuses based on a percentage of their restaurants' controllable profits.

The Company's regional supervisors, who report directly to the Company's Directors of Operation, offer support to the store managers. Each supervisor is eligible for a monthly bonus based on a percentage of controllable profits of the stores under their control.

As of January 2, 2005, the Company employed approximately 2,711 people, of whom approximately 2,660 were restaurant personnel at the Company-owned restaurants and 51 were corporate personnel. The Company considers its employee relations to be good. Most employees, other than restaurant management and corporate personnel, are paid on an hourly basis. The Company's employees are not covered by a collective bargaining agreement.

TRAINING AND QUALITY CONTROL. The Company requires its hourly employees to participate in a formal training program carried out at the individual restaurants, with the on-the-job training program varying from three days to two weeks based upon the applicable position. Managers of both Company-owned and franchised restaurants are trained at one of the Company's specified training stores by that store's general manager and are then certified upon completion of a four to six week program that encompasses all aspects of restaurant operations as well as personnel management and policy and procedures, with special emphasis on quality control and customer relations. To evaluate ongoing employee service and provide rewards to employees, the Company employs a "mystery shopper" program that consists of two anonymous visits per month per restaurant. The Company's franchise agreement requires each franchised restaurant to employ a general manager who has completed the Company's training program at one of the Company's specified training stores. Compliance with the Company's operational standards is monitored for both Company-owned and franchised restaurants by random, on-site visits by corporate management, regular inspections by regional supervisors, the ongoing direction of a corporate quality control manager and the mystery shopper program.

MARKETING AND ADVERTISING. The Company believes that when media penetration is achieved in a particular market, investments in radio and television advertising can generate significant increases in revenues in a cost-effective manner. During fiscal 2004, the Company spent approximately 3.0% of restaurant revenues on various forms of advertising and plans to spend a comparable amount in fiscal 2005. Besides radio and television, the Company makes use of in-store promotions, involvement in community activities, and customer word-of-mouth to maintain their performance.

PURCHASING. The Company strives to obtain consistent quality products at competitive prices from reliable sources. The Company works with its distributors and other purveyors to ensure the integrity, quality, price and availability of the various raw ingredients. The Company researches and tests various products in an effort to maintain quality and to be responsive to changing customer tastes. The Company operates a centralized purchasing system that is utilized by all of the Company-owned restaurants and is available to the Company's franchisees. Under the Company's franchise agreement, if a franchisee wishes to purchase from a supplier other than a currently approved supplier, it must first submit the products and supplier to the Company for approval. Regardless of the purchase source, all purchases must comply with the Company's product specifications. The Company's ability to maintain consistent product quality throughout its operations depends upon acquiring specified food products and supplies from reliable sources. Management believes that all essential food and beverage products are available from other qualified sources at competitive prices.

FRANCHISING

The Company currently has 11 franchisees operating a total of 19 restaurants and one licensee operating one restaurant. Most franchisees operate one or two restaurants. In fiscal year 2004, one new franchise restaurant was opened, one was closed, and fourteen franchise restaurants were sold to the Company. The Company's largest franchisee, a Beaumont-based franchisee, sold its 10 Casa Ole restaurants (it also sold its 3 Crazy Jose restaurants to the Company) and related assets to the Company on January 7, 2004, and a Casa Ole franchisee sold its Brenham, Texas restaurant to the Company on October 14, 2004.

Franchising allows the Company to expand the number of stores and penetrate markets more quickly and with less capital than developing Company-owned stores. The Company has the first right of refusal when a franchisee decides to sell its restaurant(s). Historically, the Company has selectively acquired franchisee restaurants when reasonably available. At the same time, the Company plans to expand its base of franchise restaurants. Consequently, in 2004 the Company updated its Casa Ole and La Senorita Uniform Franchise Offering Circular ("UFOC") in order to pursue new franchisees.

Franchisees are selected on the basis of various factors, including business background, experience and financial resources. In seeking new franchisees, the Company targets experienced multi-unit restaurant operators with knowledge of a particular geographic market and financial resources sufficient to execute the Company's development schedule. Under the current franchise agreement, franchisees are required to operate their stores in compliance with the Company's policies, standards and specifications, including matters such as menu items, ingredients, materials, supplies, services, fixtures, furnishings, decor and signs. In addition, franchisees are required to purchase, directly from the Company or its authorized agent, spice packages for use in the preparation of certain menu items, and must purchase certain other items from approved suppliers unless written consent is received from the Company.

FRANCHISE AGREEMENTS. The Company enters into a franchise agreement with each franchisee that grants the franchisee the right to develop a single store within a specific territory at a site approved by the Company. The franchisee then has limited exclusive rights within the territory. Under the Company's current standard franchise agreement, the franchisee is required to pay a franchise fee of $25,000 per restaurant. The current standard franchise

agreement provides for an initial term of 15 years (with a limited renewal option) and payment of a royalty of 3% to 5% of gross sales. The termination dates of the Company's franchise agreements with its existing franchisees currently range from 2005 to 2015.

Franchise agreements are not assignable without the prior written consent of the Company. Also, the Company retains rights of first refusal with respect to any proposed sales by the franchisee. Franchisees are not permitted to compete with the Company during the term of the franchise agreement and for a limited time, and in a limited area, after the term of the franchise agreement. The enforceability and permitted scope of such noncompetition provisions varies from state to state. The Company has the right to terminate any franchise agreement for certain specific reasons, including a franchisee's failure to make payments when due or failure to adhere to the Company's policies and standards. Many state franchise laws, however, limit the ability of a franchisor to terminate or refuse to renew a franchise. See "Item 1. Business -- Government Regulation."

Prior forms of the Company's franchise agreements may contain terms that vary from those described above, including with respect to the payment or nonpayment of advertising fees and royalties, the term of the agreement, and assignability, noncompetition and termination provisions.

FRANCHISEE TRAINING AND SUPPORT. Under the current franchise agreement, each franchisee (or if the franchisee is a business organization, a manager designated by the franchisee) is required to personally participate in the operation of the franchise. Before opening the franchisee's business to the public, the Company provides training at its approved training facility for each franchisee's general manager, assistant manager and kitchen manager or chef. The Company recommends that the franchisee, if the franchisee is other than the general manager, or if a business organization, its chief operating officer, attend such training. The Company also provides a training team to assist the franchisee in opening its restaurant. The team, supervised by the Director of Training, will assist and advise the franchisee and/or its manager in all phases of the opening operation for a seven to fourteen day period. The formal training program required of hourly employees and management, along with continued oversight by the Company's quality control manager, is designed to promote consistency of operations.

AREA DEVELOPERS. The area development agreement is an extension of the standard franchise agreement. The area development agreement provides area developers with the right to execute more than one franchise agreement in accordance with a fixed development schedule. Restaurants established under these agreements must be located in a specific territory in which the area developer will have limited exclusive rights. Area developers pay an initial development fee generally equal to the total initial franchise fee for the first franchise agreement to be executed pursuant to the development schedule plus 10% of the initial franchise fee for each additional franchise agreement to be executed pursuant to the development schedule. Generally the initial development fee is not refundable, but will be applied in the proportions described above to the initial franchise fee payable for each franchise agreement executed pursuant to the development schedule. New area developers will pay monthly royalties for all restaurants established under such franchise agreements on a declining scale generally ranging from 5% of gross sales for the initial restaurant to 3% of gross sales for the fourth restaurant and thereafter as additional restaurants are developed. Area development agreements are not assignable without the prior written consent of the Company. The Company will retain rights of first refusal with respect to proposed sales of restaurants by the area developers. Area developers are not permitted to compete with the Company. As described above, the enforceability and permitted scope of such noncompetition provisions may vary from state to state. If an area developer fails to meet its development schedule obligations, the Company can, among other things, terminate the area

development agreement or

modify the territory in the agreement. These termination rights may be limited by applicable state franchise laws. The Company is currently seeking new area developers. One area developer, a Beaumont-based franchisee, sold its 10 Casa Ole franchise restaurants and related assets to the Company on January 7, 2004 (the Company also purchased three Crazy Jose restaurants in the same transaction). The Company currently has two area developers operating a total of four and three restaurants, respectively.

COMPETITION

The restaurant industry is intensely competitive. Competition is based upon a number of factors, including concept, price, location, quality and service. The Company competes against a broad range of other family dining concepts, including those focusing on various other types of ethnic food, as well as local restaurants in its various markets. The Company also competes against other quick service and casual dining concepts within the Mexican and Tex-Mex food segment. Many of the Company's competitors are well established and have substantially greater financial and other resources than the Company. Some of the Company's competitors may be better established in markets where the Company's restaurants are or may be located. Also, the Company competes for qualified franchisees with franchisors of other restaurants and various other concepts.

The success of a particular restaurant concept is also affected by many other factors, including national, regional or local economic and real estate conditions, changes in consumer tastes and eating habits, demographic trends, weather, traffic patterns, and the type, number and location of competing restaurants. In addition, factors such as inflation, increased food, labor and benefit costs, and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general and the Company's restaurants in particular.

GOVERNMENT REGULATION

Each restaurant is subject to regulation by federal agencies and to licensing and regulation by state and local health, sanitation, safety, fire and other departments relating to the development and operation of restaurants. These include regulations pertaining to the environmental, building and zoning requirements in the preparation and sale of food. The Company is also subject to laws governing the service of alcohol and its relationship with employees, including minimum wage requirements, overtime, working conditions and immigration requirements. Difficulties or failures in obtaining the required construction and operating licenses, permits or approvals could delay or prevent the opening of a specific new restaurant. The Company believes that it is operating in substantial compliance with applicable laws and regulations that govern its operations.

Alcoholic beverage control regulations require each of the Company's restaurants to apply to a state authority and, in certain locations, county or municipal authorities, for a license or permit to sell alcoholic beverages on the premises and to provide service for extended hours. Typically, licenses must be renewed annually and may be revoked or suspended for cause at any time. Alcoholic beverage control regulations relate to numerous aspects of the Company's restaurants, including minimum age of patrons drinking alcoholic beverages and of employees serving alcoholic beverages, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages. The Company is also subject to "dramshop"

statutes that generally provide a person injured by an intoxicated person may seek to recover damages from an establishment determined to have wrongfully served alcoholic beverages to the intoxicated person. The Company carries liquor liability coverage as part of its existing comprehensive general liability insurance. Additionally, within thirty days of employment by the Company, each Texas employee of the Company who serves alcoholic beverages is required to attend an alcoholic seller training program that has been approved by the Texas Alcoholic Beverage Commission and endorsed by the Texas Restaurant Association and that endeavors to educate the server to detect and prevent overservice, as well as underage service, of the Company's customers.

In connection with the sale of franchises, the Company is subject to the United States Federal Trade Commission rules and regulations and state laws that regulate the offer and sale of franchises and business opportunities. The Company is also subject to laws that regulate certain aspects of such relationships. The Company has had no claims with respect to its programs and, based on the nature of any potential compliance issues identified, does not believe that compliance issues associated with its historic franchising programs will have a material adverse effect on its results of operations or financial condition. The Company believes that it is operating in substantial compliance with applicable laws and regulations that govern franchising programs.

The federal Americans With Disabilities Act prohibits discrimination on the basis of disability in public accommodations and employment. The Company is required to comply with the Americans With Disabilities Act and regulations relating to accommodating the needs of the disabled in connection with the construction of new facilities and with significant renovations of existing facilities.

The Company is subject to various local, state and federal laws regulating the discharge of pollutants into the environment. The Company believes that it conducts its operations in substantial compliance with applicable environmental laws and regulations. The Company conducts environmental audits of each proposed restaurant site in order to determine whether there is any evidence of contamination prior to purchasing or entering into a lease with respect to such site. To date the Company's operations have not been materially adversely affected by the cost of compliance with applicable environmental laws.

TRADEMARKS, SERVICE MARKS AND TRADE DRESS

The Company believes its trademarks, service marks and trade dress have significant value and are important to its marketing efforts. It has registered the trademarks for "Casa Ole", "Casa Ole Mexican Restaurant", "Monterey's Tex-Mex Cafe", "Monterey's Little Mexico", "Tortuga Cantina", "La Senorita" and, as of January 7, 2004, "Crazy Jose" with the U.S. Patent Office.

RISK FACTORS

The Company cautions readers that its business is subject to a number of risks, any of which could cause the actual results of the Company to differ materially from those indicated by forward-looking statements made from time to time in releases, including this Form 10-K, and oral statements. Certain risk factors are presented throughout this document, including, among others, business strategy; site selection; attracting and retaining franchisees, managers and other employees; availability of food products; competition; and government regulation. Certain other risks to which the Company is subject include:

SEASONAL FLUCTUATIONS IN SALES AND EARNINGS AFFECT THE COMPANY'S QUARTERLY RESULTS. The Company's sales and earnings fluctuate seasonally. Historically the

Company's highest sales and earnings have occurred in the second and third calendar quarters, which the Company believes is typical of the restaurant industry and consumer spending patterns in general. In addition, quarterly results have been and, in the future are likely to be, substantially affected by the timing of new restaurant openings. Because of the seasonality of the Company's business and the impact of new restaurant openings, results for any calendar quarter are not necessarily indicative of the results that may be achieved for a full fiscal year and cannot be used to indicate financial performance for the entire year.

INFLATION MAY ADVERSELY IMPACT NET INCOME. The Company believes that inflation impacted net income during fiscal year 2004. Substantial increases in utility expenses and certain food costs items had a marked impact on the Company's operating results to the extent such increases could not be passed along to customers. There can be no assurance that the Company will not experience the same inflationary impact in the future. If operating expenses increase, management intends to attempt to recover increased costs by increasing prices to the extent deemed advisable in light of competitive conditions.

AN INCREASE IN INTEREST RATES MAY ADVERSELY IMPACT NET INCOME. Our exposure to interest rate fluctuations is limited to our outstanding bank debt with Bank of America. The interest rate is either the prime rate or LIBOR plus a stipulated percentage. Accordingly, the Company is impacted by changes in the prime rate and LIBOR. As of January 2, 2005, the Company had $4.0 million outstanding on the credit facility with Bank of America. The Company is in full compliance with all debt covenants as amended. The Company expects to be in compliance with all debt covenants in fiscal year 2005. As of January 2, 2005, the Company also had $3.0 million in notes which have a fixed interest rate of 7.0% (See Footnote 3 in the accompanying Consolidated Financial Statements).

THE COMPANY'S SMALL RESTAURANT BASE AND GEOGRAPHIC CONCENTRATION MAKES ITS OPERATIONS MORE SUSCEPTIBLE TO LOCAL ECONOMIC CONDITIONS. The results achieved to date by the Company's relatively small restaurant base may not be indicative of the results of a larger number of restaurants in a more geographically dispersed area. Because of the Company's relatively small restaurant base, an unsuccessful new restaurant could have a more significant effect on the Company's results of operations than would be the case in a company owning more restaurants. Additionally, given the Company's present geographic concentration (all Company-owned units are currently in Texas, Oklahoma, Louisiana and Michigan), results of operations may be adversely affected by economic or other conditions in the region and any adverse publicity in the region relating to the Company's restaurants could have a more pronounced adverse effect on the Company's overall sales than might be the case if the Company's restaurants were more broadly dispersed.

THE COMPANY'S FINANCIAL COVENANTS COULD ADVERSELY AFFECT THE COMPANY'S ABILITY TO BORROW. Under the Company's current credit agreement, it is subject to certain reporting requirements and financial covenants, including requirements that it maintain minimum levels of net worth and various financial ratios. Although it is currently in compliance with such financial covenants, an erosion of the Company's business could place the Company out of compliance in future periods. Potential remedies for the lender if the Company is not in compliance include declaring all outstanding amounts immediately payable, terminating commitments and enforcing any liens; however, in the event of any future noncompliance the Company may seek a waiver from such lender. See Note 3, Long-term Debt, of Notes to Consolidated Financial Statements.

THE COMPANY'S MANAGEMENT AND DIRECTORS HOLD A MAJORITY OF THE COMMON STOCK. Approximately 57.6% of the Common Stock and rights to acquire Common Stock of the Company are beneficially owned or held by Larry N. Forehand, David Nierenberg, Michael D. Domec and Louis P. Neeb, directors and/or executive officers of the Company. As a result, these individuals have substantial control

over matters requiring shareholder approval, including the election of directors.

COMPETITION MAY ADVERSELY AFFECT THE COMPANY'S OPERATIONS AND FINANCIAL RESULTS. The restaurant industry is highly competitive with respect to price, service, restaurant location and food quality, and is often affected by changes in consumer tastes, economic conditions, population and traffic patterns. The Company competes within each market against other family dining concepts, as well as quick service and casual dining concepts, for customers, employees and franchisees. Several of the Company's competitors operate more restaurants and have significantly greater financial resources and longer operating histories than the Company. The Company's inability to successfully compete with the other restaurants in its

markets could prevent it from increasing or sustaining its revenues and profitability and result in a material adverse effect on its business, financial condition, results of operations or cash flows.

CHANGES IN GENERAL ECONOMIC AND POLITICAL CONDITIONS AFFECT CONSUMER SPENDING AND MAY HARM THE COMPANY'S REVENUES AND OPERATING RESULTS. The United States experienced an economic expansion throughout most of 2004, especially in Texas where the majority of the Company's restaurants operate. Although the forecast for 2005 is generally favorable, there remain a few significant economic developments that could weaken economic conditions. Rising fuel and energy costs could reduce consumers' level of discretionary spending. A decrease in discretionary spending could impact the frequency with which the Company's customers choose to dine out or the amount they spend on meals while dining out, thereby decreasing the Company's revenues. Additionally, the continued responses to the terrorist attacks on the United States, possible future terrorist attacks and the conflict in Iraq and its aftermath may exacerbate current economic conditions and lead to a weakening in the economy. Adverse economic conditions and any related decrease in discretionary spending by the Company's customers could have an adverse effect on the Company's revenues and operating results.

RISING INSURANCE COSTS COULD NEGATIVELY IMPACT PROFITABILITY. The Company insures itself against a variety of uncertainties. While the cost of certain insurance coverages increased in 2004, the Company was able to negotiate lower premium costs for other insurance coverages, and in general, was able to minimize the overall increase and impact of all total insurance costs to the Company. Each year the Company renews its insurance coverages. While the Company is proactive in its efforts to control insurance costs, market forces beyond the Company's control may thwart the Company's ability to manage these costs. An increase in premiums could have a negative impact on the Company's profitability if it is not able to negate the effect of such increases by continuing to improve its operating efficiencies.

IMPLEMENTING THE COMPANY'S GROWTH STRATEGY MAY STRAIN ITS RESOURCES. The Company's ability to expand by adding Company-owned and franchised restaurants will depend on a number of factors, including the availability of suitable locations, the ability to hire, train and retain an adequate number of experienced management and hourly employees, the availability of acceptable lease terms and adequate financing, timely construction of restaurants, the ability to obtain various government permits and licenses and other factors, some of which are beyond the control of the Company and its franchisees. The opening of additional franchised restaurants will depend, in part, upon the ability of existing and future franchisees to obtain financing or investment capital adequate to meet their market development obligations. Based on the Company's experience in attempting to grow outside its existing markets, the Company has found there can be limited consumer acceptance and that the cost of such efforts can have a material adverse impact on the Company's financial

results.

SHARES ELIGIBLE FOR FUTURE SALE COULD ADVERSELY IMPACT THE STOCK PRICE. Sales of substantial amounts of shares in the public market could adversely affect the market price of the Common Stock. In connection with its 1996 initial public offering, the Company granted limited registration rights to holders of warrants granted by the Company and Larry N. Forehand to Louis P. Neeb, Tex-Mex Partners, L.C. and a former officer of the Company to register the 757,465 underlying shares of Common Stock subject to such warrants in connection with registrations otherwise undertaken by the Company. Such warrants have an exercise price of $10.90 per share. If the Company registers these shares and these shareholders sell a large portion of their holdings on the open market at one time, the market price of the Common Stock will likely decline. In any event, the market price of the Common Stock could be subject to significant fluctuations in response to the Company's operating results and other factors.

LITIGATION COULD HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY'S BUSINESS. The Company is from time to time the subject of complaints or litigation from guests alleging food-borne illness, injury or other food quality, health or operational concerns. The Company may be adversely affected by publicity resulting from such allegations, regardless of whether such allegations are valid or whether it is liable. The Company is also subject to complaints or allegations from former or prospective employees from time to time. A lawsuit or claim could result in an adverse decision against the Company that could have a materially adverse effect on its business.

The Company is subject to state "dramshop" laws and regulations, which generally provide that a person injured by an intoxicated person may seek to recover damages from an establishment that wrongfully served alcoholic beverages to such person. Although the Company carries liquor liability coverage as part of its existing comprehensive general liability insurance, it may still be subject to a judgment in excess of its insurance coverage and it may not be able to obtain or continue to maintain such insurance coverage at reasonable costs, or at all.

COMPLIANCE WITH CHANGING REGULATION OF CORPORATE GOVERNANCE AND PUBLIC DISCLOSURE MAY RESULT IN ADDITIONAL EXPENSES. Keeping up to date and in compliance with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq Stock Market rules, has required an increased amount of management attention and external resources. The Company remains committed to maintaining high standards of corporate governance and public disclosure. As a result, the Company intends to invest all reasonably necessary resources to comply with evolving standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

OTHER RISKS, UNKNOWN OR IMMATERIAL TODAY, MAY BECOME KNOWN OR MATERIAL IN THE FUTURE. The Company has attempted to identify certain material risks currently affecting it. However, additional risks that the Company does not yet know of, that are not described herein, or that it currently believes are immaterial, may occur or become material. These risks could impair the Company's business operations or adversely affect its results of operations.

ITEM 2. PROPERTIES

In fiscal year 2004, the Company's executive offices were located in approximately 10,015 square feet of office space in Houston, Texas. The offices are currently leased by the Company from Gillett Properties, Ltd., under a gross lease (where the landlord pays utilities and property taxes) expiring in

December 2009, with rental payments of $10,500 per month. See "Notes to Consolidated Financial Statements--Related Party Transactions." The Company believes that its properties are generally well maintained, in good condition and adequate for its operations. Further, the Company believes that suitable additional or replacement space will be available if required.

The Company owns the land and buildings of one restaurant location, and the building and improvements of two restaurant locations that are situated on ground leases with the balance of locations being on leased sites. In fiscal year 2004, the Company sold a previously closed restaurant in Plainview, Texas for $422,000 in cash. On December 30, 2001 the Company closed three under - performing leased restaurants and in fiscal year 2002 the Company subleased those restaurants to other local operators. Real estate leased for Company-owned restaurants is typically leased under triple net leases that require the Company to pay real estate taxes and utilities, to maintain insurance with respect to the premises and in certain cases to pay contingent rent based on sales in excess of specified amounts. Generally the non-mall locations for the Company-owned restaurants have initial terms of 10 to 20 years with renewal options.

RESTAURANT LOCATIONS

At January 2, 2005, the Company had 60 Company-operated restaurants, 19 franchise restaurants and one licensed restaurant. As of such date, the Company operated and franchised 41 Casa Ole restaurants in the State of Texas and 4 in the State of Louisiana; operated 4 Monterey's Tex-Mex Cafe restaurants in the State of Oklahoma; operated and licensed 16 Monterey's Little Mexico restaurants in the State of Texas; operated 5 Tortuga Coastal Cantina restaurants in the State of Texas; and also operated and franchised 7 La Senorita restaurants in the State of Michigan. The Company's portfolio of restaurants is summarized below:

CASA OLE

Company-operated	28 Leased
Franchisee-operated	17
CONCEPT TOTAL	45

MONTEREY'S TEX-MEX CAFE

Company-operated	4 Leased
CONCEPT TOTAL	4

MONTEREY'S LITTLE MEXICO

Company-operated	15 Leased
Licensee-operated	1
CONCEPT TOTAL	16

TORTUGA COASTAL CANTINA

Company-operated	5 Leased

		-
	CONCEPT TOTAL	5
		=
LA SENORITA		
	Company-operated	5 Leased
	Franchisee-operated	2
		-
	CONCEPT TOTAL	7
		=
CRAZY JOSE'S		
	Company-operated	3
		-
	CONCEPT TOTAL	3
		=
		--
	SYSTEM TOTAL	80
		==

ITEM 3. LEGAL PROCEEDINGS

The Company is involved from time to time in litigation relating to claims arising from its operations in the normal course of business. Management believes that the ultimate disposition of all uninsured matters resulting from existing litigation will not have a material adverse effect on the Company's business or financial position.

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

No matter was submitted to a vote of the shareholders of the Company during the fourth quarter of the fiscal year ended January 2, 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information. The Company's Common Stock trades on the Nasdaq Small Cap Market tier of The Nasdaq Stock Market under the symbol "CASA." The following table sets forth the range of quarterly high and low closing sale prices of the Company's Common Stock on the Nasdaq Small Cap Market during each of the Company's fiscal quarters since December 30, 2002.

	HIGH	LOW
FISCAL YEAR 2003:		
First Quarter (ended March 30, 2003)	3.68	3.01
Second Quarter (ended June 29, 2003)	3.53	3.01

Third Quarter (ended September 28, 2003)	3.71	3.00
Fourth Quarter (ended December 28, 2003)	4.08	3.32
FISCAL YEAR 2004:		
First Quarter (ended March 28, 2004)	4.88	3.65
Second Quarter (ended June 27, 2004)	7.00	5.05
Third Quarter (ended September 26, 2004)	9.25	6.49
Fourth Quarter (ended January 2, 2005)	9.42	7.87
FISCAL YEAR 2005:		
First Quarter (as of March 23, 2005)	10.14	8.54

Holders. As of March 23, 2005, the Company estimates that there were approximately 800 beneficial owners of the Company's Common Stock, represented by approximately 55 holders of record, and 3,414,805 shares of Common Stock outstanding.

Issuer Purchases. During its fiscal 2004 fourth quarter, the Company did not purchase any shares of its Common Stock or other equity securities registered under the Securities Exchange Act of 1934.

Dividends. Since its 1996 initial public offering, the Company has not paid cash dividends on its Common Stock. The Company intends to retain earnings of the Company to support operations, to finance expansion and pay down its debt and does not intend to pay cash dividends on the Common Stock for the foreseeable future. The payment of cash dividends in the future will be at the discretion of the Board of Directors and will depend upon such factors as earnings levels, capital requirements, the Company's financial condition and other factors deemed relevant by the Board of Directors. In addition, the Company's current credit agreement prohibits the payment of any cash dividends.

ITEM 6. SELECTED FINANCIAL DATA

Balance sheet data as of December 31, 2000, December 30, 2001, December 29, 2002, December 28, 2003 and January 2, 2005 and income statement data for the fiscal years then ended have been derived from consolidated financial statements audited by KPMG LLP, Independent Registered Public Accounting Firm. The selected financial data set forth below should be read in conjunction with and are qualified by reference to the Consolidated Financial Statements and the related Notes thereto included in Item 8. hereof and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7. hereof.

	FISCAL YEARS			
	2000	2001	2002	2003
	(In thousands, except per share amoun			
INCOME STATEMENT DATA:				
Revenues:				
Restaurant sales	$ 55,775	$ 56,466	$ 54,009	$ 53,813
Franchise fees, royalties and other	1,362	1,393	1,286	1,139
Total revenues	57,137	57,859	55,295	54,952

Costs and expenses:				
Cost of sales	15,627	15,549	14,636	14,878
Restaurant operating expenses	32,001	32,330	30,620	31,011
General and administrative	5,548	5,457	5,198	5,306
Depreciation and amortization	1,863	2,121	1,927	2,080
Impairment and restaurant closure costs	--	972	--	950
(Gain) loss on sale of assets	--	--	(28)	(292)
Total costs and expenses	55,039	56,429	52,353	53,933
Operating income (loss)	2,098	1,430	2,942	1,019
Other income (expense)	(885)	(302)	(85)	(97)
Income from continuing operations before tax..	$ 1,213	$ 1,128	$ 2,857	$ 922
Income tax expense (benefit)	427	200	939	314
Income (loss) from continuing operations	786	928	1,918	608
Income (loss) from discontinued operations, net of tax	81	(79)	(214)	(1,643)
Net income (loss)	$ 867	$ 849	$ 1,704	$ (1,035)
Basic income per share:				
Income from continuing operations	$ 0.22	$ 0.26	$ 0.56	$ 0.18
Loss from discontinued operations	0.02	(0.02)	(0.07)	(0.49)
Net income (loss)	$ 0.24	$ 0.24	$ 0.49	$ (0.31)
Diluted income per share:				
Income from continuing operations	$ 0.22	$ 0.26	$ 0.54	$ 0.18
Loss from discontinued operations	0.02	(0.02)	(0.06)	(0.49)
Net income (loss)	$ 0.24	$ 0.24	$ 0.48	$ (0.31)

In fiscal 2000 and 2001, the Company's consolidated statements of income and cash flows included goodwill amortization. With the adoption of SFAS No. 142, no goodwill amortization was recorded for fiscal 2002, 2003 and 2004. The following table provides a reconciliation of reported net income to adjusted net income excluding goodwill amortization.

	FISCAL YEARS			
	2000	2001	2002	2003
			(In thousands)	
Reported net income (loss)	$ 867	$ 849	$ 1,704	$ (1,035)
Add back: Goodwill amortization, (net of tax)	215	284	--	--

Adjusted net income	$ 1,082	$ 1,133	$ 1,704	$ (1,035)
BASIC EARNINGS PER SHARE:				
Reported net income (loss)	$ 0.24	$ 0.24	$ 0.49	$ (0.31)
Goodwill amortization	.06	.08	--	--
Adjusted net income	$ 0.30	$ 0.32	$ 0.49	$ (0.31)
DILUTED EARNINGS PER SHARE:				
Reported net income (loss)	$ 0.24	$ 0.24	$ 0.48	$ (0.31)
Goodwill amortization	.06	.08	--	--
Adjusted net income	$ 0.30	$ 0.32	$ 0.48	$ (0.31)

	AS OF THE END OF FISCAL YEARS			
	2000	2001	2002	2003
	(In thousands)			
BALANCE SHEET DATA:				
Working capital (deficit)	$ (1,920)	$ (3,154)	$ (2,736)	$ (2,669)
Total assets	$ 31,509	$ 30,067	$ 28,983	$ 25,861
Long-term debt, less Current portion	$ 8,300	$ 5,573	$ 3,400	$ 1,775
Total stockholders' equity	$ 14,889	$ 15,717	$ 16,948	$ 15,954

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements set forth below under this caption constitute "forward-looking statements" within the meaning of the Reform Act. See "Special Note Regarding Forward-Looking Statements" above for additional factors relating to such

statements. The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto appearing elsewhere in this Report. Additional information concerning factors that could cause results to differ materially from those in the forward-looking statements is contained under "Item 1. Business-Rick Factors."

GENERAL OVERVIEW

The Company was organized under the laws of the State of Texas on February 16, 1996. Pursuant to the reorganization of the Company in preparation for the initial public offering, the shareholders of the prior corporations contributed to the Company all outstanding shares of capital stock of each corporation, and the Company issued to such shareholders in exchange therefor an aggregate of 2,732,705 shares of its Common Stock. The exchange transaction was completed April 24, 1996, and, as a result, the corporations became wholly-owned subsidiaries of the Company, and each shareholder of the Company received a number of shares of Common Stock in the Company.

The Company operates and franchises Mexican-theme restaurants featuring various elements associated with the casual dining experience under the names Casa Ole, Monterey's Tex-Mex Cafe, Monterey's Little Mexico, Tortuga Coastal Cantina and La Senorita. At January 2, 2005 the Company operated 60 restaurants, franchised 19 restaurants and licensed one restaurant in various communities in Texas, Louisiana, Oklahoma and Michigan.

On January 7, 2004, the Company completed its purchase of 13 restaurants and related assets from its Beaumont-based franchisee for a total consideration of approximately $13.75 million. The restaurants acquired include 8 Casa Ole restaurants located in Southeast Texas, 2 Casa Ole restaurants located in Southwest Louisiana, and 3 Crazy Jose's restaurants located in Southeast Texas. In the past year these restaurants had combined sales of over $20 million. On October 14, 2004, the Company completed its purchase of one Casa Ole franchise restaurant in Brenham, Texas for approximately $215,000. The restaurant was closed, remodeled and re-opened on November 22, 2004. The Company spent $329,489 remodeling the restaurant.

The Company's primary source of revenues is the sale of food and beverages at Company-owned restaurants. The Company also derives revenues from franchise fees, royalties and other franchise-related activities. Franchise fee revenue from an individual franchise sale is recognized when all services relating to the sale have been performed and the restaurant has commenced operation. Initial franchise fees relating to area franchise sales are recognized ratably in proportion to services that are required to be performed pursuant to the area franchise or development agreements and proportionately as the restaurants within the area are opened.

The consolidated statements of income and cash flows for fiscal years 2004, 2003 and 2002 have been adjusted to remove the operations of closed restaurants, which have been reclassified as discontinued operations. Consequently, the consolidated statements of income and cash flows for fiscal years 2003 and 2002 shown in the accompanying consolidated financial statements have been reclassified to conform to the 2004 presentation. These reclassifications had no effect on total assets, total liabilities, stockholders' equity or net income.

FISCAL YEAR

The Company has a 52/53 week fiscal year ending on the Sunday nearest December 31. References in this Report to fiscal 2002 2003 and 2004 relate to the periods ended December 29, 2002, December 28, 2003 and January 2, 2005 respectively. Fiscal years 2002 and 2003 presented herein consisted of 52 weeks. Fiscal year 2004 presented herein consisted of 53 weeks.

RESULTS OF OPERATIONS

FISCAL 2004 COMPARED TO FISCAL 2003 AS ADJUSTED FOR DISCONTINUED OPERATIONS

REVENUES. The Company's revenues for the fiscal year ended January 2, 2005 were up $23.7 million or 43.1% to $78.6 million compared with fiscal year 2003. Restaurant sales for fiscal year 2004 increased $24.1 million or 44.7% to $77.9 million compared with fiscal year 2003. The increase reflects the January 2004 acquisition of 13 restaurants and related assets from the Company's Beaumont-based franchisee. The increase also reflects positive same-restaurant sales. Each quarter in fiscal 2004 had positive same-restaurant sales. For fiscal 2004, total system same-restaurant sales increased 3.1%, Company-owned same restaurant sales increased 3.3% and franchise-owned same-restaurant sales increased 2.6% from fiscal year 2003.

Franchise fees, royalties and other decreased $385,975 or 33.9% to $753,293, reflecting lost royalty income from the acquisition of the

Beaumont-based franchise restaurants, the acquisition of the Brenham, Texas franchise restaurant, and the closure of a Houston based franchise restaurant.

COSTS AND EXPENSES. Costs of sales, consisting of food, beverage, liquor, supplies and paper costs, increased as a percent of restaurant sales 50 basis points to 28.1% compared with 27.6% in fiscal 2003. The increase reflects higher cheese and protein commodity prices.

Labor and other related expenses decreased as a percentage of restaurant sales 20 basis points to 32.8% compared with 33.0% in fiscal 2003. The decrease in labor as a percentage of restaurant sales reflects labor efficiencies gained from positive same-restaurant sales.

Restaurant operating expenses, which primarily includes rent, property taxes, utilities, repair and maintenance, liquor taxes, property insurance, general liability insurance and advertising, decreased as a percentage of restaurant sales 170 basis points to 22.8% in fiscal year 2004 as compared with 24.5% in fiscal year 2003. Much of the improvement reflects the advertising efficiency gained with the acquisition of the Beaumont-based restaurants. Further, the Beaumont-based restaurants have lower occupancy costs and liquor taxes relative to their sales volumes, which when consolidated brought the overall percentage of these costs down. And finally, general liability and property insurance premiums decreased as a percentage of restaurant sales in fiscal 2004 compared with fiscal 2003.

General and administrative expenses consist of expenses associated with corporate and administrative functions that support restaurant operations. General and administrative expenses decreased as a percentage of total sales 130 basis points to 8.4% in fiscal year 2004 as compared with 9.7% in fiscal year 2003. The improvement reflects efficiencies gained with the acquisition of the Beaumont-based restaurants, offset in part by executive and non-executive bonus accruals and higher professional and legal expenses.

Depreciation and amortization expenses include the depreciation of fixed assets and the amortization of intangible assets. Depreciation and amortization expense decreased as a percentage of restaurant sales 100 basis points to 2.8% in fiscal year 2004 as compared with 3.8% in fiscal year 2003. Actual depreciation and amortization expense increased $158,161 in fiscal year 2004 compared with fiscal year 2003. The decrease as a percentage of total sales reflects the acquisition of the Beaumont-based restaurants, which had a smaller asset base relative to the restaurant sales added.

During fiscal year 2004, the Company incurred $74,099 in pre-opening expenses related to the remodel of one existing restaurant and the remodel of one acquired Casa Ole franchise restaurant. In fiscal year 2003, the Company spent $95,891 in pre-opening expenses related to the purchase of one franchise restaurant that the Company remodeled for a new grand opening.

(GAIN) LOSS ON SALE OF ASSETS. During fiscal year 2004, the Company recorded a loss of $181,693 on the disposition of assets, primarily related to the remodel of one existing restaurant and the sale of a leasehold interest of another existing restaurant. During fiscal year 2003, the Company recorded a gain of $291,777 for insurance proceeds received from fire damage at the Humble, Texas restaurant location.

OTHER INCOME (EXPENSE). Net expense increased $362,148 to $458,779 in fiscal year 2004 compared with a net expense of $96,631 in fiscal year 2003. Interest expense increased $311,082 to $553,371 in fiscal year 2004 compared with interest expense of $242,289 in fiscal year 2003, reflecting the increase

in outstanding debt incurred for the acquisition of the Beaumont-based restaurants.

INCOME TAX EXPENSE. The Company's effective tax rate from continuing operations for fiscal year 2004 was 31.8% as compared to fiscal year 2003 of 34.1%. In fiscal year 2004, the Company had a significantly higher pretax income compared to fiscal 2003. In both years, the permanent differences were approximately the same, resulting in a lower effective tax rate in fiscal 2004.

RESTAURANT CLOSURE COSTS AND DISCONTINUED OPERATIONS. In fiscal year 2004, the Company recorded asset impairment and restaurant closure costs of $868,580. Of this total, $167,565 of these costs are included in discontinued operations related to the 2004 closure of three restaurants and the 2003 closure of one restaurant, located in San Marcos, Texas. Impairment expense of $701,015 in continuing operations relates primarily to four Tortuga restaurants that will be re-concepted to one of the Company's other Mexican food concepts. In addition, two Monterey's restaurants, which were impaired in 2003, incurred a small impairment in 2004. These two restaurants will either be re-concepted or closed at the expiration of their operating leases. The circumstances and testing leading to the impairment in fiscal 2004 are determined in accordance with SFAS No. 144 which requires that property, plant and equipment be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During fiscal year 2003, the Company recorded $2,908,406 related to restaurant closure and asset impairment costs. Of this total, $1,958,279 of these costs are included in discontinued operations and $950,127 of these costs are included in continuing operations.

FISCAL 2003 COMPARED TO FISCAL 2002

REVENUES. The Company's revenues for the fiscal year ended December 28, 2003 were down $342,122 or 0.6% to $54,952,456 compared with fiscal year 2002. Restaurant sales for fiscal year 2003 decreased $195,759 or 0.4% to $53,813,188 compared with fiscal year 2002. The decrease in revenues reflects a decline in same-restaurant sales, especially in the Houston market, where approximately 51% of all restaurant sales are generated. For fiscal 2003, total system same-restaurant sales decreased 2.4%, Company-owned same restaurant sales decreased 3.6% and franchise-owned same-restaurant sales decreased 0.7%.

Franchise fees, royalties and other decreased 11.4% or $146,363 to $1,139,268. The decrease reflects the decline in franchise-owned same-restaurant sales and the sale of one franchise restaurant.

COSTS AND EXPENSES. Costs of sales, consisting of food, beverage, liquor, supplies and paper costs, increased as a percent of restaurant sales 50 basis points to 27.6% compared with 27.1% in fiscal 2002. The increase reflects higher cheese, produce, liquor and paper and supply expenses.

Labor and other related expenses increased as a percentage of restaurant sales 40 basis points to 33.0% compared with 32.6% in fiscal 2002. The increase in labor as a percentage of restaurant sales reflects the semi-fixed nature of management costs, worker's compensation and health insurance expenses relative to declining same-restaurant sales.

Restaurant operating expenses, which primarily includes rent, property taxes, utilities, repair and maintenance, liquor taxes, property insurance, general liability insurance and advertising, increased as a percentage of restaurant sales 40 basis points to 24.5% in fiscal year 2003 as compared with 24.1% in fiscal year 2002. The increase reflects higher utility expenses, higher insurance premiums, and fixed restaurant expenses relative to declining

same-restaurant sales.

General and administrative expenses consist of expenses associated with corporate and administrative functions that support restaurant operations. General and administrative expenses increased as a percentage of total sales 30 basis points to 9.7% in fiscal year 2003 as compared with 9.4% in fiscal year 2002. Actual general and administrative expenses increased $108,335 in fiscal year 2003 compared with fiscal year 2002. The increase in general and administrative expenses reflects higher legal, officers and directors insurance and research and development expenses.

Depreciation and amortization expenses include the depreciation of fixed assets and the amortization of intangible assets. Depreciation and amortization expense increased as a percentage of restaurant sales 30 basis points to 3.8% in fiscal year 2003 as compared with 3.5% in fiscal year 2002. Actual depreciation and amortization expense increased $153,807 in fiscal year 2003 compared with fiscal year 2002. The increase, in part, reflects declining same-restaurant sales. It also reflects the addition of new assets (routine replacements for kitchen equipment, HVAC, etc. and restaurant remodels).

During fiscal year 2003, the Company incurred $95,891 in pre-opening expenses related to the purchase of one franchise restaurant that the Company remodeled for a new grand opening. In fiscal year 2002, the Company spent $15,837 in pre-opening expenses to re-open a restaurant that had been closed for six months due to fire damage.

(GAIN) LOSS ON SALE OF ASSETS. During fiscal year 2003, the Company recorded a gain of $291,778 for insurance proceeds received from fire damage at the Humble, Texas restaurant location.

OTHER INCOME (EXPENSE). Other income (expensee), net increased $11,524 to $96,631 in fiscal year 2003 compared with a net expense of $85,107 in fiscal year 2002. For fiscal 2003, interest expense decreased $128,410 to $242,289 as debt decreased during fiscal year 2003 from a beginning balance of $4.4 million to an ending balance of $2.8 million.

INCOME TAX EXPENSE. The Company's effective tax rate from continuing operations for fiscal year 2003 was 34.1% as compared to fiscal year 2002 of 32.9%. In fiscal year 2003, the Company had a significantly lower pretax income compared to fiscal 2002. In both years, the permanent differences were approximately the same, resulting in a lower effective tax rate in fiscal 2002.

DISCONTINUED OPERATIONS AND RESTAURANT CLOSURE COSTS. During fiscal year 2003, the Company recorded $2,908,406 related to restaurant closure and asset impairment costs. Of this total, $1,958,279 of these costs are included in discontinued operations and $950,128 of these costs are included in continuing operations. The discontinued operations loss relates to one restaurant that was closed in fiscal 2003 and the reclassification of three restaurants that were closed in fiscal 2004. These costs were determined in accordance with SFAS No. 144 which requires that property, plant and equipment be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. There were no impairments recorded in fiscal year 2002.

LIQUIDITY AND CAPITAL RESOURCES

The Company met fiscal 2004 capital requirements with cash generated by operations, its credit facility and a seller note. In fiscal 2004, the Company's operations generated approximately $5.7 million in cash, as compared with $2.4 million in fiscal 2003 and $4.4 million in fiscal 2002. As of January 2, 2005, the Company had a working capital deficit of approximately $1.2 million, compared with a working capital deficit of approximately $2.7 million at

December 28, 2003. A working capital deficit is common in the restaurant industry, since restaurant companies do not typically require a significant investment in either accounts receivable or inventory.

The Company's principal capital requirements are the funding of routine capital expenditures, new restaurant development or acquisitions and remodeling of older units. During fiscal 2004, total cash used for capital requirements was $9,757,350, of which $6,767,916 was used to acquire the Beaumont-based franchise restaurants and the Brenham, Texas franchise restaurant. Cash used for capital expenditures on property, plant and equipment and remodeling was approximately $3.0 million as compared to approximately $1.8 million for fiscal 2003. The capital expenditures were for necessary replacement of equipment and leasehold improvements in various older units. The Company extensively remodeled two restaurants in fiscal 2004. The Company also sold one previously closed restaurant property located in Plainview, Texas for a total purchase price of $442,000, and sold a leasehold interest located in Houston, Texas for a total purchase price of $250,000, less transaction cost, respectively.

On January 7, 2004, the Company completed its purchase of 13 restaurants and related assets from its Beaumont-based franchisee for a total consideration of approximately $13.75 million. The financing for the acquisition was provided by Bank of America (formerly Fleet National Bank), CNL Franchise Network, LP ("CNL") and the sellers of Beaumont-based franchise

restaurants. Bank of America provided $3.1 million of the acquisition by amending its credit facility with Mexican Restaurants, Inc. Six of the acquired restaurants were concurrently sold to CNL for $8.325 million in a sale-leaseback transaction. The sellers accepted $3.0 million in notes from Mexican Restaurants, Inc. for the balance of the purchase price. The seller notes pay interest only for five years, with $1.5 million in principal due on January 7, 2009 and $1.5 million in principal amortizing over an additional five years.

On October 14, 2004, the Company completed its purchase of one franchise restaurant in Brenham, Texas for approximately $215,000. The restaurant was closed, remodeled and re-opened on November 22, 2004. The Company spent $329,489 remodeling the restaurant.

For fiscal year 2005, the Company plans to develop two new restaurants, extensively remodel one restaurant and moderately remodel five other restaurants. The estimated capital needed for fiscal year 2005 for general corporate purposes, including remodeling and new restaurant expansion, is approximately $4.1 million.

Over the last several years, the Company's debt was incurred to carry out acquisitions, to develop new restaurants, and to remodel existing restaurants, as well as to accommodate other working capital needs. The Company anticipates that it will use excess cash flow during fiscal year 2005 to pay down debt approximately $1.0 million.

On January 7, 2004, Bank of America amended its $10.0 million credit facility to accommodate the acquisition of the Beaumont-based franchise restaurants. The amended credit facility consists of a $5.0 million term note that requires quarterly principal payments of $250,000 and matures on December 31, 2008. The credit facility also includes a $5.0 million revolving line of credit that matures on January 7, 2007. The interest rate is either the prime rate or LIBOR plus a stipulated percentage. Accordingly, the Company is impacted by changes in the prime rate and LIBOR. The Company is subject to a non-use fee of 0.75% on the unused portion of the revolver from the date of the credit agreement. On January 7, 2004, the Company drew $3.1 million on its facility to complete the Beaumont-based acquisition. Since January 7, 2004 the Company paid

down $1.85 million of its indebtedness to Bank of America during fiscal year 2004. As of January 2, 2005, the Company had $4.0 million outstanding on the credit facility and $3.0 million in notes for a total indebtedness of $7.0 million. The Company is in full compliance with all debt covenants as amended. The Company expects to be in compliance with all debt covenants in fiscal year 2005.

The Company's management believes that with its operating cash flow and the Company's revolving line of credit with Bank of America, funds will be sufficient to meet operating requirements and to finance routine capital expenditures and new restaurant growth through the end of the 2005 fiscal year. Unless the Company violates an important debt covenant, the Company's credit facility with Bank of America is not subject to triggering events that would cause the credit facility to become due sooner than the maturity dates described in the previous paragraphs.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS.

The following table summarizes the Company's total contractual cash obligations as of January 2, 2005 (in thousands);

CONTRACTUAL OBLIGATION	TOTAL	LESS THAN 1 YEAR	1 TO 3 YEARS	4 TO 5 YEARS
Long-Term Debt	$ 7,000,000	$ 1,000,000	$ 2,000,000	$ 2,775,000
Long-Term Debt fixed interest	1,106,875	210,000	420,000	305,375
Operating Leases	54,636,453	5,227,699	10,246,559	9,377,726
Total Contractual Cash Obligations	$ 62,743,328	$ 6,437,699	$12,666,559	$ 12,458,101

The contractual obligation table does not include interest payments on our long-term debt with Bank of America (formerly Fleet National Bank) due to the variable interest rates under our credit facility and the varying debt balance during the year. The contractual interest rate for our credit facility is either the prime rate or LIBOR base rate plus a stipulated margin. See Note 3 to our consolidated financial statements for balances and terms of our credit facility at January 2, 2005.

RELATED PARTIES. In May 1998 the Board of Directors of the Company adopted a program to assist executives and five key employees of the Company in their purchasing of shares of the Company. As adopted, the program provided for the Company to assist the executives and key employees in obtaining third party loans to finance such purchases. As of February 1, 2003, the maturity date of the employee third party loans, the Company no longer guarantees employee third party loans.

The Company provides accounting and administrative services for the Casa Ole Media and Production Funds. The Casa Ole Media and Production Funds are not-for-profit, unconsolidated entities used to collect money from company - owned and franchise-owned restaurants to pay for the marketing of Casa Ole restaurants. Each restaurant contributes an agreed upon percentage of its sales to the funds.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not have or participate in transactions involving derivative, financial and commodity instruments. The Company's long-term debt bears interest at floating market rates. Based on amounts outstanding at year-end, a 1% change in interest rates would change interest expense by approximately $40,000.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Financial Statements and Supplementary Data are set forth herein commencing on page F-1 of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

The Company maintains disclosure controls and procedures, which it has designed to ensure that material information related to the Company, including its consolidated subsidiaries, is made known to a group comprised of designated members of the Company's senior management and/or the certifying officer (i.e., Chief Executive Officer and Chief Financial Officer) (collectively, the "Disclosure Committee"), on a timely basis. In response to recent legislation and proposed regulations, the Company reviewed its internal control structure and its disclosure controls and procedures. Although the Company believes its pre-existing disclosure controls and procedures were adequate to enable the Company to comply with its disclosure obligations, as a result of such review, the Company implemented minor changes, primarily to formalize and document the procedures already in place. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act of 1934, as amended, Rule 13a-15 and 15d-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic filings with the Securities and Exchange Commission.

(b) Changes in internal controls

There were no significant changes in the Company's internal controls or in other factors, including any corrective actions with regard to significant deficiencies and material weaknesses, that could significantly affect these controls subsequent to the date of their evaluation.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information called for by this Item 10 is incorporated herein by reference to the Company's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by this Item 11 is incorporated herein by reference to the Company's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information called for by this Item 12 is incorporated herein by reference to the Company's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information called for by this Item 13 is incorporated herein by reference to the Company's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information called for by this Item 14 is incorporated herein by reference to the Company's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Report:

1. Financial Statements:

   The Financial Statements are listed in the index to Consolidated Financial Statements on page F-1 of this Report.

2. The following exhibits are filed as part of this report. The exhibits designated with a cross are management contracts and compensatory plans and arrangements required to be filed as exhibits to this report.

3. Exhibits:

   3.1 Articles of Incorporation of the Company (as amended and incorporated by reference to the corresponding Exhibit number of the Company's Form 8-K filed on May 25, 1999 with the Securities and Exchange Commission).

   ++3.2 Bylaws of the Company.

   ++4.1 Specimen of Certificate of Common Stock of the Company.

   ++4.2 Articles of Incorporation of the Company (see 3.1 above).

   ++4.3 Bylaws of the Company (see 3.2 above).

++10.1 Employment Agreement by and between the Company and Louis P. Neeb dated February 28, 1996.

10.2 Indemnity Agreement by and between the Company and Louis P. Neeb dated as of April 10, 1996 (incorporated by reference to Exhibit 10.4 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.3 Indemnity Agreement by and between the Company and Larry N. Forehand dated as of April 10, 1996 (incorporated by reference to Exhibit 10.5 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.4 Indemnity Agreement by and between the Company and John C. Textor dated as of April 10, 1996 (incorporated by reference to Exhibit 10.6 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.5 Indemnity Agreement by and between the Company and Michael D. Domec dated as of April 10, 1996 (incorporated by reference to Exhibit 10.8 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.6 Indemnity Agreement by and between the Company and J.J. Fitzsimmons dated as of April 10, 1996 (incorporated by reference to Exhibit 10.10 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.7 Indemnity Agreement by and between the Company and Richard E. Rivera dated as of April 10, 1996 (incorporated by reference to Exhibit 10.11 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.8 Corrected Warrant Agreement by and between the Company and Louis P. Neeb dated as of February 26, 1996 (incorporated by reference to Exhibit 10.12 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.9 Corrected Warrant Agreement by and between the Company and Tex-Mex Partners, L.C. dated as of February 26, 1996 (incorporated by reference to Exhibit 10.13 of the

Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.10 Form of the Company's Multi-Unit Development Agreement (incorporated by reference to Exhibit 10.14 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.11 Form of the Company's Franchise Agreement (incorporated by reference to Exhibit 10.15 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.12 1996 Long Term Incentive Plan (incorporated by reference to Exhibit 10.16 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.13 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.17 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.14 Corrected Warrant Agreement by and between Larry N. Forehand and Louis P. Neeb dated as of February 26, 1996 (incorporated by reference to Exhibit 10.31 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.15 Corrected Warrant Agreement by and between Larry N. Forehand and Tex-Mex Partners, L.C. dated as of February 26, 1996 (incorporated by reference to Exhibit 10.32 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.16 Corrected Warrant Agreement by and between Larry N. Forehand and Patrick A. Morris dated as of February 26, 1996 (incorporated by reference to Exhibit 10.33 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.17 Corrected Warrant Agreement by and between Larry N. Forehand and Stacy M. Riffe dated as of February 26, 1996 (incorporated by reference to Exhibit 10.34 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.18 Indemnification letter agreement by Larry N. Forehand dated April 10, 1996 (incorporated by reference to Exhibit 10.35 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.19 1996 Manager's Stock Option Plan (incorporated by reference to Exhibit 99.2 of the Company's Form S-8 Registration Statement Under the Securities Act of 1933, dated February 24, 1997, filed with the Securities and Exchange Commission).

+10.20 Employment Agreement by and between the Company and Curt Glowacki dated May 15, 1997 (incorporated by reference to Exhibit 10.44 of the Company's Form 10-K Annual Report filed on March 30, 1998 with the Securities and Exchange Commission).

+10.21 Employment Agreement by and between the Company and Andrew J. Dennard dated May 20, 1997 (incorporated by reference to Exhibit 10.45 of the Company's Form 10-K Annual Report filed on March 30, 1998 with the Securities and Exchange Commission).

*10.22 Fleet Revolving Credit and Term Loan Agreement between Mexican Restaurants, Inc., as the Borrower, and Fleet National Bank, as the Bank, for $10,000,000 dated June 29, 2001 and as amended on January 7, 2004.

21.1 List of subsidiaries of the Company (incorporated by reference to Exhibit 22.1 of the Company's Form S-1 Registration Statement Under the Securities Act of 1933, dated April 24,1996, filed by the Company with the Securities and Exchange Commission).

*23.1 Consent of KPMG LLP, Independent Registered Public Accounting Firm.

*24.1 Power of Attorney (included on the signature page to this Form 10-K).

*31.1 Certification filed pursuant to Rule 13a-14(a) or Rule 15d-14(a).

*31.2 Certification filed pursuant to Rule 13a-14(a) or Rule 15d-14(a).

#32.1 Certification of Chief Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#32.2 Certification of Chief Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* Filed herewith.

++ Incorporated by reference to corresponding Exhibit number of the Company's Form S-1 Registration Statement under the Securities Act of 1933, dated

April 24, 1996, with the Securities and Exchange Commission (Registration number 333-1678).

+ Management contract or compensatory plan or arrangement.

Furnished herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on April 5, 2005.

MEXICAN RESTAURANTS, INC.

By:/s/ Louis P. Neeb

Louis P. Neeb,
Chairman of the Board of Directors

POWER OF ATTORNEY

KNOW ALL MEN AND WOMEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Louis P. Neeb, Curt Glowacki and Andrew Dennard, and each of them, such individual's true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for such individual and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Form 10-K under the Securities Exchange Act of 1934, and to file the same, with all exhibits thereto, and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ Louis P. Neeb --- Louis P. Neeb	Chairman of the Board of Directors	April 5, 2
/s/ Larry N. Forehand --- Larry N. Forehand	Founder and Vice Chairman of the Board of Directors	April 5, 2
/s/ Curt Glowacki --- Curt Glowacki	President and Chief Executive Officer (Principal Executive Officer)	April 5, 2

/s/ Andrew J. Dennard --- Andrew J. Dennard	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	April 5, 2
/s/ David Nierenberg --- David Nierenberg	Director	April 5, 2
/s/ Michael D. Domec --- Michael D. Domec	Director	April 5, 2
/s/ J. J. Fitzsimmons --- J. J. Fitzsimmons	Director	April 5, 2
/s/ Thomas E. Martin --- Thomas E. Martin	Director	April 5, 2
/s/ J. Stuart Sargent --- J. Stuart Sargent	Director	April 5, 2

MEXICAN RESTAURANTS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm .....

Consolidated Balance Sheets as of December 28, 2003 and January 2, 2005.....

Consolidated Statements of Income for each of the years in the three fiscal-year period ended January 2, 2005.....

Consolidated Statements of Stockholders' Equity for each of the years in the three fiscal-year period ended January 2, 2005.....

Consolidated Statements of Cash Flows for each of the years in the three fiscal-year period ended January 2, 2005.....

Notes to Consolidated Financial Statements.....

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Mexican Restaurants, Inc.:

We have audited the accompanying consolidated balance sheets of Mexican

Restaurants, Inc. and subsidiaries as of December 28, 2003 and January 2, 2005, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended January 2, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mexican Restaurants, Inc. and subsidiaries as of December 28, 2003, and January 2, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended January 2, 2005, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Houston, Texas
March 28, 2005

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 28, 2003 AND JANUARY 2, 2005

	FISCAL YEARS	
	2003	2
ASSETS		
Current assets:		
Cash and cash equivalents	$ 366,042	$ 1,
Royalties receivable	179,517	
Other receivables	423,670	
Inventory	555,064	
Taxes receivable	345,006	
Prepaid expenses and other current assets	717,899	1,
Total current assets	2,587,198	4,
Property, plant and equipment	24,484,571	28,
Less accumulated depreciation	(11,502,668)	(13,
Net property, plant and equipment	12,981,903	15,

Goodwill, net	7,196,265	10,
Deferred tax assets	1,272,173	
Property held for resale	884,118	
Other assets	939,579	
	$ 25,861,236	$ 32,
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	$ 1,000,000	$ 1,
Accounts payable	1,516,217	1,
Accrued sales and liquor taxes	469,817	
Accrued payroll and taxes	976,146	1,
Accrued expenses	1,294,486	1,
Total current liabilities	5,256,666	5,
Long-term debt	1,775,000	6,
Other liabilities	898,115	1,
Deferred gain	1,977,355	1,
Stockholders' equity:		
Preferred stock, $.01 par value, 1,000,000 shares authorized, none issued	--	
Capital stock, $0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued	47,327	
Additional paid-in capital	20,121,076	20,
Retained earnings	7,542,817	9,
Deferred Compensation	(47,607)	
Treasury stock, cost of 1,348,100 common shares in 2003 and 1,317,900 common shares in 2004	(11,709,513)	(11,
Total stockholders' equity	15,954,100	17,
	$ 25,861,236	$ 32,

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE FISCAL YEARS ENDED DECEMBER 29, 2002,
DECEMBER 28, 2003 AND JANUARY 2, 2005

	FISCAL YEARS	
	2002	2003
Revenues:		

Restaurant sales	$ 54,008,947	$ 53,813,188
Franchise fees, royalties and other	1,285,631	1,139,268
	55,294,578	54,952,456
Costs and expenses:		
Cost of sales	14,635,503	14,877,654
Labor	17,595,664	17,752,949
Restaurant operating expenses	13,008,752	13,162,033
General and administrative	5,197,876	5,306,211
Depreciation and amortization	1,926,711	2,080,518
Pre-opening costs	15,837	95,891
Impairments and restaurant closure costs	--	950,128
(Gain) loss on sale of assets	(27,727)	(291,778)
	52,352,616	53,933,606
Operating income	2,941,962	1,018,850
Other income (expense):		
Interest income	113,128	28,736
Interest expense	(370,699)	(242,289)
Other, net	172,464	116,922
	(85,107)	(96,631)
Income from continuing operations before income taxes	2,856,855	922,219
Income tax expense	939,177	314,195
Income from continuing operations	1,917,678	608,024
Discontinued Operations:		
Loss from discontinued operations	(356,730)	(638,328)
Impairments and restaurant closure costs	--	(1,958,279)
Loss on sale of assets	--	(27,882)
Loss from discontinued operations before income taxes	(356,730)	(2,624,489)
Income tax benefit	142,980	981,557
Net loss from discontinued operations	(213,750)	(1,642,932)
Net Income (loss)	$ 1,703,928	$ (1,034,908)
Basic income per share:		
Income from continuing operations	0.56	0.18
Loss from discontinued operations	(0.07)	(0.49)
Net income (loss)	$ 0.49	$ (0.31)
Diluted income per share:		
Income from continuing operations	0.54	0.18
Loss from discontinued operations	(0.06)	(0.49)
Net income (loss)	$ 0.48	$ (0.31)
Weighted average number of shares (basic)	3,447,957	3,384,605

Weighted average number of shares (diluted)	3,520,769	3,430,380

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE FISCAL YEARS ENDED
DECEMBER 29, 2002, DECEMBER 28, 2003
AND JANUARY, 2 2005

	CAPITAL STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK
Balances at December 30, 2001	$47,327	$20,121,076	$6,873,797	$(11,194,7
Net income	--	--	1,703,928	
Repurchase of shares	--	--	--	(514,7
Amortization of Deferred Compensation	--	--	--	
Balances at December 29, 2002	$47,327	$20,121,076	$8,577,725	$(11,709,5
Net income	--	--	(1,034,908)	
Repurchase of shares	--	--	--	
Amortization of Deferred Compensation	--	--	--	
Balances at December 28, 2003	$47,327	$20,121,076	$7,542,817	$(11,709,5
Net income	--	--	1,760,974	
Issuance of Treasury Stock	--	--	--	111,5
Amortization of Deferred Compensation	--	--	--	
Balances at January 2, 2005	$47,327	$20,121,076	$9,303,791	$(11,597,9

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE FISCAL YEARS ENDED DECEMBER 29, 2002,
DECEMBER 28, 2003, AND JANUARY 2, 2005

	FISCAL YE	
	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income from continuing operations	$ 1,917,678	$ 608,
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,926,711	2,080,
Deferred gain amortization	(208,141)	(208,
Asset impairments and restaurant closure costs	--	950,
Impairment of Notes Receivable	--	196,
Gain on sale of fixed assets	(27,727)	(9,
Deferred compensation expense	41,304	41,
Gain from insurance proceeds	--	(478,
Deferred income taxes	785,209	(136,
Changes in assets and liabilities, net of effects of acquisitions....		
Royalties receivable	(28,702)	(37,
Other receivables	(114,200)	223,
Taxes receivable/payable	(49,844)	37,
Inventory	100,766	10,
Prepaids and other current assets	21,203	(118,
Other assets	29,512	(373,
Accounts payable	(68,517)	(416,
Accrued expenses and other liabilities	(100,791)	12,
Deferred rent and other long-term liabilities	229,641	40,
Total Adjustments	2,536,424	1,814,
Net cash provided by continuing operations	4,454,102	2,422,
Net cash provided (used) in discontinued operations	(21,292)	(17,
Net cash provided by operating activities	4,432,810	2,404,
CASH FLOWS FROM INVESTING ACTIVITIES:		
Insurance proceeds from fire loss on building	255,844	488,
Purchase of property, plant and equipment	(2,137,518)	(1,788,
Proceeds from sale of property, plant and equipment	478,000	476,
Business Acquisitions, net of cash acquired	--	
Net cash used in continuing operations	(1,403,674)	(823,
Net cash used in discontinued operations	(126,553)	(117,
Net cash used in investing activities	(1,530,227)	(940,
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings (payment) under line of credit agreement	(2,172,729)	(1,625,
Issuance (purchase) of treasury stock	(514,741)	
Additions to Long term Notes Payable	--	
Net cash provided (used) in financing activities	(2,687,470)	(1,625,
Increase (decrease) in cash and cash equivalents	215,113	(160,
Cash and cash equivalents at beginning of year	311,423	526,

Cash and cash equivalents at end of year	$ 526,536	$ 366,
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year:		
Interest	$ 341,330	$ 265,
Income taxes	408,339	304,
Non-cash financing activities:		
CNL real estate transaction	--	

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 29, 2002, DECEMBER 28, 2003 AND JANUARY 2, 2005

(1) DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Description of Business

On February 16, 1996, Mexican Restaurants, Inc. (formerly Casa Ole Restaurants, Inc.) was incorporated in the State of Texas, and on April 24, 1996, its initial public offering of 2,000,000 shares of Common Stock became effective. Mexican Restaurants, Inc. is the holding company for Casa Ole Franchise Services, Inc. and several subsidiary restaurant operating corporations (collectively the "Company"). Casa Ole Franchise Services, Inc. was incorporated in 1977, and derives its revenues from the collection of franchise fees under a series of protected location franchise agreements and from the sale of restaurant accessories to the franchisees of those protected location franchise agreements. The restaurants feature moderately priced Mexican and Tex-Mex food served in a casual atmosphere. The first Casa Ole restaurant was opened in 1973.

On July 2, 1997, the Company purchased 100% of the outstanding stock of Monterey's Acquisition Corp. ("MAC"). The Company purchased the shares of common stock for $4.0 million, paid off outstanding debt and accrued interest totaling $7.1 million and funded various other agreed upon items approximating $500,000. Approximately $4.8 million of goodwill was recorded as a result of this purchase. At the time of the acquisition, MAC owned and operated 26 restaurants in Texas and Oklahoma under the names "Monterey's Tex-Mex Cafe," "Monterey's Little Mexico" and "Tortuga Coastal Cantina."

On April 30, 1999, the Company purchased 100% of the outstanding stock of La Senorita Restaurants, a Mexican restaurant chain operated in the State of Michigan. The Company purchased the shares of common stock of La Senorita for $4.0 million. The transaction was funded with the Company's revolving line of credit with Bank of America. La Senorita operated five company-owned restaurants, and has three franchise restaurants. One of the franchise restaurants is owned by a partnership in which the parent company has a 16.5% limited interest.

On January 7, 2004, the Company completed its purchase of 13 restaurants and related assets from its Beaumont-based franchisee, Thomas Harken, and Mr. Harken's operating partner, Victor Gonzalez, for a total consideration of approximately $13.75 million. The financing for the acquisition was provided by Fleet National Bank, CNL and the sellers. The restaurants acquired include 8

Casa Ole restaurants located in Southeast Texas, 2 Casa Ole restaurants located in Southwest Louisiana, and 3 Crazy Jose's restaurants located in Southeast Texas. In the past year these restaurants had combined sales of over $20 million.

On October 14, 2004, the Company completed its purchase of one franchise restaurant in Brenham, Texas for approximately $215,000. The restaurant was closed, remodeled and re-opened on November 22, 2004. The Company spent $329,489 remodeling the restaurant.

The consolidated statements of income and cash flows for fiscal years 2004, 2003, and 2002 have been adjusted to remove the operations of closed restaurants, which have been reclassified as discontinued operations. Consequently, the consolidated statements of income and cash flows for the fiscal years 2003 and 2002 shown in the accompanying consolidated financial statements have been reclassified to conform to the 2004 presentation. These reclassifications have no effect on total assets, total liabilities, stockholders equity or net income.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of Mexican Restaurants, Inc. and its wholly owned subsidiaries, after elimination of all significant inter-company transactions. The Company owns and operates various Mexican restaurant concepts principally in Texas, Oklahoma, Louisiana and Michigan. The Company's three Idaho restaurants were closed on December 30, 2001 and the restaurants are either subleased or leased to third parties. The Company also franchises the Casa Ole concept principally in Texas and Louisiana and the La Senorita concept principally in the State of Michigan.

(c) Fiscal Year

The Company maintains its accounting records on a 52/53 week fiscal year ending on the Sunday nearest December 31. Fiscal years 2002 and 2003 consisted of 52 weeks and fiscal year 2004 consisted of 53 weeks.

(d) Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

(e) Inventory

Inventory, which is comprised of food and beverages, is stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Miscellaneous restaurant supplies are included in inventory and valued on a specific identification basis.

(f) Pre-opening Costs

Pre-opening costs primarily consists of hiring and training employees associated with the opening of a new restaurant and are expensed upon the opening of the restaurant.

(g) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation on equipment and on buildings and improvements is calculated on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized straight-line over the shorter of the lease term plus options or estimated useful life of the assets.

Buildings and improvements	20-40 years
Vehicles	5 years
Equipment	3-15 years
Leasehold improvements	3-20 years

Significant expenditures that add materially to the utility or useful lives of property, plant and equipment are capitalized. All other maintenance and repair costs are charged to current operations. The cost and related accumulated depreciation of assets replaced, retired or otherwise disposed of are eliminated from the property accounts and any gain or loss is reflected as other income and expense. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount the carrying value exceeds the fair value of the asset.

In fiscal year 2004, the Company recorded asset impairment and restaurant closure costs of $868,580. Of this total, $167,565 of these costs are included in discontinued operations related to the 2004 closure of three restaurants and the 2003 closure of one restaurant, located in San Marcos, Texas, described below. Impairment expense of $701,015 in continuing operations relates primarily to four Tortuga restaurants that will be re-concepted to a different company Mexican food concept. In addition, two Monterey's restaurants, which were impaired in 2003, incurred a small impairment in 2004. These two restaurants will either be re-concepted or closed at the expiration of their operating leases. The circumstances and testing leading to the impairment in fiscal 2004 are the same as those described in the paragraph below.

In fiscal year 2003, the Company recorded asset impairment and restaurant closure costs of $2,908,406. These costs related to the closure of three restaurants, two located in the Houston, Texas and one located in San Marcos, Texas. In addition to the three restaurant closures, five under-performing restaurants incurred impairment costs based on current and projected operating cash flows and Company-owned land and building, currently leased to a Monterey's licensee, was written down to its appraised fair market value. Of the five under-performing restaurants, two were subsequently re-concepted to a different company Mexican food concept, one was closed at the expiration of its operating lease and the other two are still operating, but will either be re-concepted or closed at the expiration of their operating leases. The leased land and building were subsequently sold to the Monterey's licensee. The circumstances leading to the testing of these long-lived assets were declines in revenues, a current cash flow loss combined with a forecast demonstrating continuing cash flow losses, current market conditions and competitive intrusion. The fiscal 2003 impairments were based on management's estimates of future cash flows to determine the recoverability of each restaurant's long-lived assets. The service potential of the assets includes assessment of future cash-flow-generating capacity, the remaining lives of the assets, the remaining term of the operating lease and evaluation of future cash flows associated with potential capital expenditures. The method for determining the fair value of impaired assets to be sold is based on its appraised fair market value or the value that a third party buyer would be willing to pay. There were no such impairment costs in fiscal year 2002.

Management performed a detailed analysis of leasehold improvement amortization. The purpose of the analysis was to verify that leasehold improvements were amortized over the shorter of the lease term plus options or estimated useful life of the assets. The analysis resulted in differences that were immaterial to the financial statements for all periods presented, therefore restatement of the financial statements was determined by management to be unnecessary.

Property held for resale is separately aggregated in the consolidated balance sheet and is recorded at the estimated fair market value of $505,118 and $884,118 for fiscal years 2004 and 2003, respectively.

(h) Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

At January 2, 2005, the balance sheet included $10.6 million of goodwill primarily resulting from the MAC, La Senorita and Beaumont-based franchisee acquisitions. In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Statement required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. The Company was required to determine the fair value of each reporting unit and compare it to the carrying amount of the reporting unit within six months of January 1, 2002. To the extent the carrying amount of a reporting unit exceeded the fair value of the reporting unit, the Company would be required to perform the second step of the transitional impairment test, as this is an indication that the reporting unit goodwill may be impaired. Management evaluated goodwill as required by SFAS 142 upon its adoption and annually as of December 29, 2002, December 28, 2003 and January 2, 2005. Management performed its goodwill impairment testing of the 60 reporting units for fiscal year 2004 and has determined that the aggregate fair value exceeded the aggregate carrying amount of the reporting units and that no impairment of goodwill exists.

Prior to the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over the expected periods to be benefited (40 years for MAC and 15 years for La Senorita) and assessed for recoverability by determining whether the amortization of the goodwill balance over its remaining life could be recovered through undiscounted future operating cash flows of the acquired operation. The amount of goodwill and other intangible asset impairment, if any, was measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds.

(i) Impairment of Long-Lived Assets

SFAS No. 144 provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale; and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations. The Company adopted SFAS No. 144 on January 1, 2002. The adoption of SFAS No. 144 did not affect the Company's financial statements.

In accordance with SFAS No. 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets not subject to amortization are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

Prior to the adoption of SFAS No. 144, the Company accounted for long-lived assets in accordance with SFAS No. 121, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of.

(j) Income Taxes

Income taxes are provided based on the asset and liability method of accounting pursuant to Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes.

(k) Franchise Fees

Franchise fee revenue from an individual franchise sale is recognized when all services relating to the sale have been performed and the restaurant has commenced operation. Initial franchise fees relating to area franchise sales are recognized ratably in proportion to services that are required to be performed pursuant to the area franchise or development agreements and proportionately as the restaurants within the area are opened.

(l) Stock Options

In December 2004, the FASB issued SFAS 123 (Revised), "Share-Based Payment", a revision of SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123R required the fair value measurement of all stock-based payments to employees, including grants of employee stock options, and recognition of those

expenses in the statement of operations. SFAS 123R is effective for reporting periods beginning after June 15, 2005. We will continue to account for stock-based compensation using the intrinsic value method until adoption of SFAS 123R on July 1, 2005. Historically, the compensation expense recognized related to stock options under this method has been minimal. As a result, adoption of the provisions of SFAS 123R are expected to have an impact to reported net income and earnings per share. We have not yet determined the method of adoption or the effect of adopting SFAS 123R and have not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

The Company has adopted the disclosure-only provisions of the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123, which amends SFAS No. 123, "Accounting for Stock-Based Compensation," and has accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Accordingly, no compensation cost has been recognized for stock options or warrants. Had compensation cost for the Company's outstanding stock options and warrants been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below for fiscal years 2002, 2003 and 2004:

	2002	2003
Net income - as reported	$ 1,703,928	$ (1,034,908)
Proforma net income - pro forma for SFAS No. 123	1,696,458	(1,079,476)
Net income per share - as reported	0.49	(0.31)
Pro forma net income per share - pro forma for SFAS No. 123	0.49	(0.32)

(m) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Insurance proceeds

During the first half of fiscal year 2003, the Company recorded a gain of $478,032 for insurance proceeds received from fire damage at the Humble, Texas restaurant location. During the second half of fiscal year 2002, the Company received $105,000 of business interruption insurance proceeds and recorded a partial gain of $46,268 for insurance proceeds received from the previously mentioned fire damage at the Humble, Texas restaurant location. These amounts were recorded in other income (expense) during fiscal years 2003 and 2002. There were no insurance proceeds recorded in 2004.

(o) Recently Issued Accounting Standards

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, and interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This

Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and did not have a material effect on the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to these consolidated financial statements.

(2) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 28, 2003 and January 2, 2005 were as follows:

	2003	2004
Land	$ 6,000	$ 360,750
Buildings and improvements	465,141	1,001,747
Vehicles	50,953	20,874
Equipment and Smallwares	14,499,748	17,809,973
Leasehold Improvements	9,462,729	9,589,851
Construction in Progress	--	146,692
Total	$24,484,571	$28,929,887

(3) LONG-TERM DEBT

Long-term debt consists of the following at December 28, 2003 and January 2, 2005:

	FISCAL YEARS	
	2003	2004
Revolving Line of Credit	750,000	--
Term Note	2,025,000	4,000,000

Other long-term debt	--	3,000,000
Total long-term debt	2,775,000	7,000,000
Less current installments due in 2005	(1,000,000)	(1,000,000)
Long-term debt, excluding current installments....	$ 1,775,000	$ 6,000,000

On January 7, 2004, Bank of America (formerly Fleet National Bank) amended its $10.0 million credit facility to accommodate the acquisition of the Beaumont-based franchise restaurants. The amended credit facility consists of a $5.0 million term note that requires quarterly principal payments of $250,000 and matures on December 31, 2008. The credit facility also includes a $5.0 million revolving line of credit that matures on January 7, 2007. The interest rate is either the prime rate or LIBOR plus a stipulated percentage. Accordingly, the Company is impacted by changes in the prime rate and LIBOR. The Company is subject to a non-use fee of 0.75% on the unused portion of the revolver from the date of the credit agreement. On January 7, 2004, the Company drew up $3.1 million on its facility to complete the Beaumont-based acquisition. Since January 7, 2004 the Company paid down $1.85 million of its indebtedness to Bank of America during fiscal year 2004. As of January 2, 2005, the Company had $4.0 million outstanding on the credit facility and $3.0 million in notes for a total indebtedness of $7.0 million. The Company is in full compliance with all debt covenants as amended. The Company expects to be in compliance with all debt covenants in fiscal year 2005.

Maturities on long-term debt are as follows:

2005.....	1,000,000
2006.....	1,000,000
2007.....	1,000,000
2008.....	1,000,000
2009.....	1,775,000
Thereafter.....	1,225,000
	$ 7,000,000

(4) Income Taxes

The provision for income tax expense from continuing operations is summarized as follows for fiscal years 2002, 2003 and 2004:

	2002(1)	2003(1)	2004(1)
Current:			
Federal	$ 90,168	$ 300,187	$ 421,838
State and local.....	63,800	150,584	87,103

Deferred	785,209	(136,576)	499,025
	$939,177	$ 314,195	$1,007,966

(1) Excludes income tax benefits from discontinued operations of $142,980, $981,557, and $237,063 for 2002, 2003 and 2004, respectively.

The actual income tax expense differs from expected income tax expense calculated by applying the U.S. federal corporate tax rate to income before income tax expense as follows:

	2002	2003	2004
Expected tax expense	$ 971,329	$ 345,855	$ 1,076,271
State tax expense, net	85,313	112,655	94,757
Non-deductible amortization	3,391	3,391	3,391
Tax credits	(122,788)	(126,499)	(171,547)
Other	1,932	(21,207)	5,094
	$ 939,177	$ 314,195	$ 1,007,966

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 28, 2003 and January 2, 2005 are as follows:

	DECEMBER 28, 2003	JANUARY 2, 2005
Deferred tax assets:		
Sale-leaseback	$ 731,028	$ 654,212
Tax credit carryforwards.....	433,791	591,592
Asset impairments	999,013	747,699
Accrued expenses	155,133	40,397
	$ 2,318,965	$ 2,033,900
Deferred tax liabilities:		
Other	$ (5,556)	$ (8,219)
Depreciation differences	(1,041,236)	(1,406,594)
	$(1,046,792)	$(1,414,813)
Net deferred taxes	$ 1,272,173	$ 619,087

At January 2, 2005, the Company determined that it was more likely than not that the deferred tax assets would be realized based on the level of

historical taxable income and projections of future taxable income over the periods in which the deferred tax assets are deductible. At January 2, 2005, the Company has tax credit carryforwards of $591,592 which are available to reduce future Federal regular income taxes, if any, over an indefinite period.

(5) COMMON STOCK, OPTIONS AND WARRANTS

(a) 1996 Long Term Incentive Plan

The Board of Directors and shareholders of the Company have approved the Mexican Restaurants, Inc. 1996 Long Term Incentive Plan (the "Incentive Plan"). The Incentive Plan, as amended, authorizes the granting of up to 500,000 shares of Common Stock in the form of incentive stock options and non-qualified stock options to key executives and other key employees of the Company, including officers of the Company and its subsidiaries. The purpose of the Incentive Plan is to attract and retain key employees, to motivate key employees to achieve long-range goals and to further align the interests of

key employees with those of the other shareholders of the Company. Options granted under the Incentive Plan will generally vest and become exercisable at the rate of 10% on the first anniversary of the date of grant, 15% on the second anniversary of the date of grant, and 25% on each of the third through fifth anniversaries of the date of grant. All stock options granted pursuant to the 1996 Long Term Incentive Plan will be nonqualified stock options and will remain exercisable until the earlier of ten years from the date of grant or no more than 90 days after the optionee ceases to be an employee of the Company.

(b) Stock Option Plan for Non-Employee Directors

The Company has adopted the Mexican Restaurants, Inc. Stock Option Plan for Non-Employee Directors (the "Directors Plan") for its outside directors and has reserved 200,000 shares of Common Stock for issuance thereunder. The Directors Plan provides that each outside director will automatically be granted an option to purchase 10,000 shares of Common Stock at the time of becoming a director. These options will be exercisable in 20% increments and will vest equally over the five-year period from the date of grant. Such options are priced at the fair market value at the time an individual is elected as a director. Until the third quarter of fiscal year 2002, each outside director received options to purchase 1,500 shares of Common Stock quarterly, plus additional options for attendance at committee meetings, exercisable at the fair market value of the Common Stock at the close of business on the date immediately preceding the date of grant. Such annual options will vest at the conclusion of one year, so long as the individual remains a director of the Company. All stock options granted pursuant to the Directors Plan will be nonqualified stock options and will remain exercisable until the earlier of ten years from the date of grant or six months after the optionee ceases to be a director of the Company.

As of the third quarter of fiscal year 2002, compensation for each outside director was changed from quarterly options to cash payments of $2,000 per quarter and $1,000 per board meeting attended. The chairman of the audit committee receives compensation of $5,000 per quarter.

On November 15 and 18 of fiscal 2004, one director exercised 30,200 of his options in the open market. The Company received $111,591 in exchange for 30,200 shares of common stock that was previously held as Treasury stock.

(c) 1996 Manager's Stock Option Plan

The Company has adopted the 1996 Manager's Stock Option Plan (the "Manager's Plan") specifically for its store-level managers. The Manager's Plan authorizes the granting of up to 200,000 shares of Common Stock in the form of non-qualified stock options to store-level managers of the Company. The purpose of the Manager's Plan is to attract, retain and motivate restaurant managers to achieve long-range goals and to further align the interests of those employees with those of the other shareholders of the Company. Options granted under the Manager's Plan will generally vest and become exercisable at the rate of 10% on the first anniversary of the date of grant, 15% on the second anniversary of the date of grant, and 25% on each of the third through fifth anniversaries of the date of grant. All stock options granted pursuant to the 1996 Manager's Stock Option Plan will be nonqualified stock options and will remain exercisable until the earlier of ten years from the date of grant or no more than 90 days after the optionee ceases to be an employee of the Company.

(d) Warrants

In conjunction with the initial public offering, the Company entered into warrant agreements with Louis P. Neeb and Tex-Mex, a limited liability company in which a member of the Board of Directors prior to February 14, 2000 is a principal, pursuant to which Mr. Neeb and Tex-Mex acquired warrants to purchase shares of Common Stock at the initial public offering ($11.00 per share) price less the amount paid for the warrant ($.10 per share) for an aggregate amount of Common Stock equal to ten percent (10%) of the shares of Common Stock of the Company outstanding upon consummation of the initial public offering, such shares to be allocated 5%, or 179,885 shares, to Mr. Neeb and 5%, or 179,885 shares, to Tex-Mex. The Company's warrants to Mr. Neeb became exercisable on the second anniversary of the initial public offering, and the Company's warrants to Tex-Mex became exercisable on the first anniversary of the initial public offering. The warrants expire on April 24, 2006.

In late fiscal 1998 the Company exchanged a note valued in the amount of $148,534 (principal and accrued interest) for 98,301 warrants to purchase Common Stock previously held by a former officer of the Company. The warrants, which were granted by Larry N. Forehand with an exercise price of $10.90 per share, became exercisable in April 1998. Upon an exercise by Mr. Neeb or Tex-Mex of the warrants granted to them by the Company, the Company plans to exercise these newly acquired warrants simultaneously and use the warrant shares acquired from Mr. Forehand to satisfy a portion of its obligations under its warrant agreements with Mr. Neeb and Tex-Mex.

(e) Stock Transactions

During 1999 and 2000 the Company authorized the granting of 64,000 shares of restricted stock to key executives. The awards were valued at an average of $3.50 per share and will vest in 20% increments over a five year period from the date of the grant. Compensation expense of $41,304 was recognized in both fiscal years 2003 and 2004, respectively.

During fiscal year 2004 and 2003, the Company did not repurchase any of its common shares. During fiscal year 2002, the Company repurchased 119,500 shares of common stock for $485,601, and also purchased 12,425 vested options for $13,838 and 9,400 common shares for $29,140 from former employees and a former

director of the Company.

(f) Option and Warrant Summary Weighted Average

	Shares	Weighted Average Exercise Price
Balance at December 29, 2002		
Granted	76,800	$ 3.46
Exercised	--	--
Canceled	(77,300)	$ 5.61
	1,040,470	$ 6.90
Balance at December 28, 2003		
Granted	24,500	$ 3.31
Exercised	--	--
Canceled	(36,000)	$ 4.67
	1,028,970	$ 6.87
Balance at January 2, 2005		
Granted	--	$ --
Exercised	30,200	3.70
Canceled	22,500	$ 7.36
	976,270	6.96

The options (616,500) and warrants (359,770) outstanding at January 2, 2005 had exercise prices ranging between $2.50 to $11.00, of which 135,000 of the options had exercise prices ranging from $8.63 to $11.00, and 359,770 of the warrants had a exercise price of $10.90. As of January 2, 2005, 808,470 options and warrants were exercisable at an average price of $7.75.

The weighted average fair value of the options and warrants granted during 2002, 2003 and 2004 is estimated at $1.41, $1.40 and $0.00 per share (no options or warrants were granted in 2004), respectively, on the date of grant using the Black-Scholes option-pricing model with the following assumptions: volatility of 40% for 2002, 44% for 2003 and 35% for 2004, risk-free interest rate of 3.8% for 2002, 3.0% for 2003 and 3.0% for 2004, an expected life of 5 years for options and 4 years for warrants and 0% dividend yield.

(g) Income Per Share

Basic income per share is based on the weighted average shares outstanding without any dilutive effects considered. Diluted income per share reflects dilution from all contingently issuable shares, including options and warrants. For fiscal years 2002, 2003 and 2004, the effect of dilutive stock options increase the weighted average shares outstanding by approximately 72,855, 45,775 and 246,360 shares respectively. For fiscal year 2003, the effect of dilutive stock options did not affect the determination of diluted income per share. For fiscal years 2002 and 2004, such stock options and warrants did affect the determination of diluted income approximately $0.01 and $0.04 per share, respectively. Approximately 659,470, 731,370 and 454,570 options and warrants were considered antidilutive for fiscal years 2002, 2003 and 2004 respectively.

(6) LEASES

The Company leases restaurant operating space and equipment under non-cancelable operating leases which expire at various dates through January 31, 2024.

The restaurant operating space base agreements typically provide for a minimum lease rent plus common area maintenance, insurance, and real estate taxes, plus additional percentage rent based upon revenues of the restaurant (generally 2% to 7%) and may be renewed for periods ranging from five to twenty-five years.

On June 25, 1998, the Company completed a sale-leaseback transaction involving the sale and leaseback of land, building and improvements of 13 company-owned restaurants. The properties were sold for $11.5 million and resulted in a gain of approximately $3.5 million that was deferred and is amortized over the terms of the leases, which are 15 years each. The leases are classified as operating leases in accordance with SFAS No. 13 "Accounting for Leases". Subsequent to the original transaction one lease was sold. The remaining 12 leases have a total future minimum lease obligation of approximately $10,568,978 and are included in the future minimum lease payment schedule below.

Future minimum lease payments (which includes the three closed restaurants scheduled below) under non-cancelable operating leases with initial or remaining lease terms in excess of one year as of January 2, 2005 are approximately:

2005	5,227,699
2006	5,205,510
2007	5,041,049
2008	4,808,761
2009	4,568,965
Thereafter	29,784,469
	$ 54,636,453

The three Idaho restaurants (which are included in the table above) have been subleased to third party restaurant operators for five year terms. Two of the subtenants have two five year options to extend their leases, and one of the subtenants has one five year option to extend its lease. Future minimum lease receipts under non-cancelable operating leases with initial or remaining lease terms in excess of one year as of January 2, 2005 are approximately:

2005	285,500
2006	303,500
2007	233,500
2008	145,221
Thereafter	--
	$967,721

Rent expense for restaurant operating space and equipment amounted to approximately $4,424,641, $4,478,663 and $5,964,086 for the fiscal years 2002, 2003 and 2004, respectively.

(7) ACQUISITION

On January 7, 2004, the Company completed its purchase of 13 restaurants and related assets from its Beaumont-based franchisee for a total consideration of approximately $13.75 million. The financing for the acquisition was provided by Bank of America (formerly Fleet National Bank), CNL Franchise Network, LP ("CNL") and the sellers of the Beaumont-based franchise restaurants. Bank of America (formerly Fleet National Bank) provided $3.1 million of the acquisition financing by amending its existing credit facility with Mexican Restaurants, Inc. Six of the acquired restaurants were concurrently sold to CNL for $8.325 million in a sale-leaseback transaction. The sellers accepted $3.0 million in notes from Mexican Restaurants, Inc. for the balance of the purchase price. The seller notes require the payments of interest only for five years, with $1.5 million in principal due on January 7, 2009 and $1.5 million in principal amortizing over an additional five years.

The table below presents pro forma income statement information as if the Company had purchased the Beaumont-based restaurants at the beginning of fiscal year 2003. Pro forma adjustments are to remove royalty income and expense, reflect net interest expense on the debt resulting from the acquisition and record additional income tax at an effective rate of 16.9% and 31.8% for the fourth quarter and year to date, respectively, of fiscal 2004 and 29.8% and 34.1% for the fourth quarter and year to date, respectively, of fiscal 2003. The pro forma information does not purport to be indicative of results of operations which would have occurred had the acquisition been consummated on the date indicated or future results of operations.

	Fiscal Fourth Quarter Ended	
	1/2/05	12/28/03
Revenues from continuing operations	$20,226,240	$18,255,640
Net income	24,136	(1,872,971)
Diluted income per share	0.01	(0.54)

	Fiscal Year Ended	
	1/2/05	12/28/03
Revenues from continuing operations	$78,640,135	$74,764,481
Net income	1,760,974	(869,971)
Diluted income per share	0.48	(0.25)

The acquisition was accounted for under SFAS 141 and results of operations are included in the accompanying financial statements from the date of acquisition. The assets acquired and liabilities assumed of the acquisition were recorded at estimated fair values using comparables, appraisals, and records. Some of the acquisition amounts recorded are estimates and are subject to

change.

A summary of the assets acquired and liabilities assumed in the acquisition follow:

Estimated fair value of assets acquired:	
Current assets	$ 184,601
Property and Equipment	2,946,365
Other assets	175,000
Goodwill	3,283,916
Total assets	$6,589,882
Less: Cash acquired	(35,150)
Net assets acquired	$6,554,732

On October 14, 2004, the Company completed its purchase of one franchise restaurant in Brenham, Texas for approximately $215,000, which included $164,509 classified as goodwill. The restaurant was closed, remodeled and re-opened on November 22, 2004.

(8) 401(k) PLAN

Beginning in fiscal year 1998, the Company established a defined contribution 401(k) plan that covers substantially all full-time employees meeting certain age and service requirements. Participating employees may elect to defer a percentage of their qualifying compensation as voluntary employee contributions. The Company may contribute additional amounts at the discretion of management. The Company did not make any contributions to the plan in fiscal years 2003 and 2004.

(9) RELATED PARTY TRANSACTIONS

The Company leased its executive offices from a company owned by two shareholders of Mexican Restaurants, Inc. Net lease expense related to these facilities in fiscal 2002, 2003 and 2004 was $122,584, $125,188 and $10,416 respectively. The building was sold to a non-related party on February 20, 2004.

In May 1998 the Board of Directors of the Company adopted a program to assist executives and five key employees of the Company in their purchasing of shares of the Company. As adopted, the program provided for the Company to assist the executives and key employees in obtaining third party loans to finance such purchases. As of February 1, 2003, the maturity date of the employee third party loans, the Company no longer guarantees employee third party loans.

The Company provides accounting and administrative services for the Casa Ole Media and Production Funds. The Casa Ole Media and Production Funds are not-for-profit, unconsolidated entities used to collect money from company - owned and franchise-owned restaurants to pay for the marketing of Casa Ole restaurants. Each restaurant contributes an agreed upon percentage of its sales to the funds.

(10) CONTINGENCIES

The Company has litigation, claims and assessments that arise in the normal course of business. Management believes that the Company's financial

position or results of operations will not be materially affected by such matters.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(CONTINUED)

(11) SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The unaudited quarterly results for the fiscal year ended January 2, 2005 were as follows (in thousands, except per share data):

	FISCAL YEAR 2003 QUARTER ENDED			
	DECEMBER 28	SEPTEMBER 28	JUNE 29	M
Revenues	13,325	14,219	13,755	
Income from continuing operations	(594)	344	312	
Income from discontinued operations	(1,321)	(147)	(99)	
Net income (loss)	(1,915)	197	214	
Basic income per share				
Income from continuing operations	($ 0.18)	$ 0.10	$ 0.09	$
Loss from discontinued operations	($ 0.39)	($ 0.04)	($ 0.03)	($
Net income (loss)	($ 0.57)	$ 0.06	$ 0.06	$
Diluted income per share				
Income from continuing operations	($ 0.18)	$ 0.10	$ 0.09	$
Loss from discontinued operations	($ 0.39)	($ 0.04)	($ 0.03)	($
Net income (loss)	($ 0.57)	$ 0.06	$ 0.06	$

	FISCAL YEAR 2004 QUARTER ENDED		
	JANUARY 02	SEPTEMBER 26	JUNE 27
Revenues	20,226	19,819	19,727
Income from continuing operations	175	614	691
Income from discontinued operations	(151)	(31)	(68)
Net income (loss)	24	583	623
Basic income per share			
Income from continuing operations	$ 0.05	$ 0.18	$ 0.20
Loss from discontinued operations	($ 0.04)	($ 0.01)	($ 0.02)
Net income (loss)	$ 0.01	$ 0.17	$ 0.18
Diluted income per share			
Income from continuing operations	$ 0.05	$ 0.17	$ 0.19
Loss from discontinued operations	($ 0.04)	($ 0.01)	($ 0.02)
Net income (loss)	$ 0.01	$ 0.16	$ 0.17

In the 4th quarter of fiscal 2003 and 2004, the Company recognized asset impairment and restaurant closure costs of $950,128 and $701,015. Excluding these infrequently occurring costs, income from continuing operations would be $1,872,347 and $3,866,519, respectively.

INDEX TO EXHIBITS

Exhibits:

3.1	Articles of Incorporation of the Company (as amended and incorporated by reference to the corresponding Exhibit number of the Company's Form 8-K filed on May 25, 1999 with the Securities and Exchange Commission).
++3.2	Bylaws of the Company.
++4.1	Specimen of Certificate of Common Stock of the Company.
++4.2	Articles of Incorporation of the Company (see 3.1 above).
++4.3	Bylaws of the Company (see 3.2 above).
++10.1	Employment Agreement by and between the Company and Louis P. Neeb dated February 28, 1996.
10.2	Indemnity Agreement by and between the Company and Louis P. Neeb dated as of April 10, 1996 (incorporated by reference to Exhibit 10.4 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).
10.3	Indemnity Agreement by and between the Company and Larry N. Forehand dated as of April 10, 1996 (incorporated by reference to Exhibit 10.5 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).
10.4	Indemnity Agreement by and between the Company and John C. Textor dated as of April 10, 1996 (incorporated by reference to Exhibit 10.6 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).
10.5	Indemnity Agreement by and between the Company and Michael D. Domec dated as of April 10, 1996 (incorporated by reference to Exhibit 10.8 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).
10.6	Indemnity Agreement by and between the Company and J.J. Fitzsimmons dated as of April 10, 1996 (incorporated by reference to Exhibit 10.10 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).
10.7	Indemnity Agreement by and between the Company and

Richard E. Rivera dated as of April 10, 1996 (incorporated by reference to Exhibit 10.11 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.8 Corrected Warrant Agreement by and between the Company and Louis P. Neeb dated as of February 26, 1996 (incorporated by reference to Exhibit 10.12 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.9 Corrected Warrant Agreement by and between the Company and Tex-Mex Partners, L.C. dated as of February 26, 1996 (incorporated by reference to Exhibit 10.13 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.10 Form of the Company's Multi-Unit Development Agreement (incorporated by reference to Exhibit 10.14 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.11 Form of the Company's Franchise Agreement (incorporated by reference to Exhibit 10.15 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.12 1996 Long Term Incentive Plan (incorporated by reference to Exhibit 10.16 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.13 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10.17 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.14 Corrected Warrant Agreement by and between Larry N. Forehand and Louis P. Neeb dated as of February 26, 1996 (incorporated by reference to Exhibit 10.31 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.15 Corrected Warrant Agreement by and between Larry N. Forehand and Tex-Mex Partners, L.C. dated as of February 26, 1996 (incorporated by reference to Exhibit 10.32 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996,

with the Securities and Exchange Commission (Registration Number 333-1678)).

10.16 Corrected Warrant Agreement by and between Larry N. Forehand and Patrick A. Morris dated as of February 26, 1996 (incorporated by reference to Exhibit 10.33 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.17 Corrected Warrant Agreement by and between Larry N. Forehand and Stacy M. Riffe dated as of February 26, 1996 (incorporated by reference to Exhibit 10.34 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

10.18 Indemnification letter agreement by Larry N. Forehand dated April 10, 1996 (incorporated by reference to Exhibit 10.35 of the Company's Form S-1 Registration Statement filed under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration Number 333-1678)).

+10.19 1996 Manager's Stock Option Plan (incorporated by reference to Exhibit 99.2 of the Company's Form S-8 Registration Statement Under the Securities Act of 1933, dated February 24, 1997, filed with the Securities and Exchange Commission).

+10.20 Employment Agreement by and between the Company and Curt Glowacki dated May 15, 1997 (incorporated by reference to Exhibit 10.44 of the Company's Form 10-K Annual Report filed on March 30, 1998 with the Securities and Exchange Commission).

+10.21 Employment Agreement by and between the Company and Andrew J. Dennard dated May 20, 1997 (incorporated by reference to Exhibit 10.45 of the Company's Form 10-K Annual Report filed on March 30, 1998 with the Securities and Exchange Commission).

*10.22 Fleet Revolving Credit and Term Loan Agreement between Mexican Restaurants, Inc., as the Borrower, and Fleet National Bank, as the Bank, for $10,000,000 dated June 29, 2001 and as amended on January 7, 2004.

21.1 List of subsidiaries of the Company (incorporated by reference to Exhibit 22.1 of the Company's Form S-1 Registration Statement Under the Securities Act of 1933, dated April 24,1996, filed by the Company with the Securities and Exchange Commission).

*23.1 Consent of KPMG LLP, Independent Registered Public Accounting Firm.

*24.1 Power of Attorney (included on the signature page to this Form 10-K).

*31.1 Certification filed pursuant to Rule 13a-14(a) or Rule 15d-14(a).

*31.2 Certification filed pursuant to Rule 13a-14(a) or Rule 15d-14(a).

#32.1 Certification of Chief Executive Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#32.2 Certification of Chief Financial Officer furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* Filed herewith.

++ Incorporated by reference to corresponding Exhibit number of the Company's Form S-1 Registration Statement under the Securities Act of 1933, dated April 24, 1996, with the Securities and Exchange Commission (Registration number 333-1678).

\+ Management contract or compensatory plan or arrangement.

\# Furnished herewith.