MEXICAN RESTAURANTS INC
Form 10-Q
November 09, 2001

UNITED STATES

SECURITIES & EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the Quarterly period ended SEPTEMBER 30, 2001

OR

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

For the transition period from ___________ to ______________

Commission file number: 0-28234

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

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

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

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

Number of shares outstanding of each of the issuer's classes of common stock, as of November 1, 2001: 3,513,505 SHARES OF COMMON STOCK, PAR VALUE $.01.

PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	9/30/01	12/31/
ASSETS		
Current assets:		
Cash and cash equivalents	$ 371,090	$ 636
Royalties receivable	65,072	66
Other receivables	563,537	611
Inventory	637,956	718
Taxes receivable	0	257
Prepaid expenses and other current assets	1,030,994	529
Total current assets	2,668,649	2,820
Property, plant and equipment	26,735,511	25,550
Less accumulated depreciation	(8,589,728)	(7,339
Net property, plant and equipment	18,145,783	18,211
Deferred tax assets	986,432	1,167
Property held for resale	1,100,000	1,100
Other assets	8,161,028	8,209
	$ 31,061,892	$ 31,508
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	$ 1,000,000	$
Accounts payable	2,204,296	2,953
Accrued sales and liquor taxes	468,147	452
Accrued payroll and taxes	1,354,873	1,006
Accrued expenses	804,402	327
Total current liabilities	5,831,718	4,740
Long-term debt, net of current portion	6,022,729	8,300
Other liabilities	648,147	537
Deferred gain	2,567,231	3,042
Stockholders' equity:		
Preferred stock, $.01 par value, 1,000,000 shares authorized	--	
Capital stock, $0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued	47,327	47
Additional paid-in capital	20,121,076	20,121
Retained earnings	7,158,977	6,025
Deferred compensation	(140,541)	(171
Treasury stock, cost of 1,181,600 and 1,200,400 shares, respectively	(11,194,772)	(11,133
Total stockholders' equity	15,992,067	14,888
	$ 31,061,892	$ 31,508

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	13-WEEK PERIOD ENDED 09/30/01	13-WEEK PERIOD ENDED 10/01/00	39-WEEK PERIOD ENDED 09/30/01
Revenues:			
Restaurant sales	$ 16,147,855	$ 15,787,434	$ 47,119,290
Franchise fees and royalties	353,661	314,974	960,147
Other	26,019	25,338	111,501
	16,527,535	16,127,746	48,190,938
Costs and expenses:			
Cost of sales	4,540,844	4,389,553	13,090,479
Labor	5,252,917	5,265,303	15,469,390
Restaurant operating expenses	4,067,795	3,818,364	11,834,513
General and administrative	1,425,416	1,385,869	4,084,011
Depreciation and amortization	632,675	526,984	1,782,685
Pre-opening costs	--	42,432	254
Asset impairments and restaurant closing costs	--	--	--
	15,919,647	15,428,505	46,261,332
Operating income (loss)	607,888	699,241	1,929,606
Other income (expense):			
Interest income	30,300	--	44,346
Interest expense	(156,856)	(223,588)	(567,724)
Other, net	83,357	5,969	338,165
	(43,199)	(217,619)	(185,213)
Income before income tax expense	564,689	481,622	1,744,393
Income tax expense	197,711	168,568	610,537
Net income	$ 366,978	$ 313,054	$ 1,133,856
Basic and diluted income per share	$ 0.10	$ 0.09	$ 0.32
Weighted average number of shares (basic and diluted)	3,532,427	3,542,380	3,533,971

3

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	39-WEEK PE 9/30/01
Cash flows from operating activities:	
Net income	$ 1,133,856
Adjustments to reconcile net income to net cash provided by operating activities:	
Deferred compensation	30,978
Depreciation and amortization	1,782,685
Deferred gain amortization	(172,179)
Deferred taxes	181,229
Loss (gain) on sale of property, plant & equipment	(284,302)
Changes in assets and liabilities:	
Royalties receivable	1,726
Other receivables	(108,781)
Income tax receivable/payable	575,393
Inventory	80,673
Prepaid and other current assets	(554,704)
Other assets	(176,214)
Accounts payable	(749,353)
Accrued expenses and other liabilites	522,645
Other liabilities	140,597
Total adjustments	1,270,393
Net cash provided by operating activities	2,404,249
Cash flows from investing activities:	
Payment for purchase of acquisition, net of cash acquired	--
Purchase of property, plant and equipment	(1,439,531)
Proceeds from sale of property, plant and equipment	108,738
Net cash used in investing activities	(1,330,793)
Cash flows from financing activities:	
Net borrowings under line of credit	(1,277,271)
Purchase of treasury stock	(61,429)
Net cash provided by (used in) financing activities	(1,338,700)
Increase (decrease) in cash and cash equivalents	(265,244)
Cash and cash equivalents at beginning of period	636,334
Cash and cash equivalents at end of period	$ 371,090
Supplemental disclosure of cash flow information:	
Cash paid during the period:	
Interest	$ 550,708
Income Taxes	$ 152,597
Non-cash investing and financing activity:	
Sale of property for note receivable	$ 244,109
Issuance of restricted stock	$ --
Purchase of property for note receivable	$ 207,800

4

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

In the opinion of Mexican Restaurants, Inc. and subsidiaries (the "Company"), the accompanying consolidated financial statements contain all adjustments (consisting only of normal recurring accruals and adjustments) necessary for a fair presentation of the consolidated financial position as of September 30, 2001, and the consolidated statements of income and cash flows for the 39-week and 13-week periods ended September 30, 2001 and October 1, 2000. The consolidated statements of income for the 39-week and 13-week period ended September 30, 2001 is not necessarily indicative of the results to be expected for the full year.

RECENT ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"), was issued by the Financial Accounting Standards Board in June 1998. SFAS 133 standardizes the accounting for derivative instruments, including certain derivative instruments embedded in other contracts. Under the standard, entities are required to carry all derivative instruments in the statement of financial position at fair value. The Company adopted SFAS 133 beginning in fiscal year 2001. The adoption of SFAS 133 did not have a material effect on the Company's financial condition or results of operation because the Company does not enter into derivative or other financial instruments for trading or speculative purposes nor does the Company use or intend to use derivative financial instruments or derivative commodity instruments.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the FASB issued Statement on Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets," (SFAS 142) which will be effective for our Company as of the beginning of fiscal 2002. SFAS 142 requires goodwill and other intangible assets with indefinite lives no longer be amortized. SFAS 142 further requires the fair value of goodwill and other intangible assets with indefinite lives be tested for impairment upon adoption of this statement, annually and upon the occurrence of certain events, and be written down to fair value if considered impaired. Our management estimates the adoption of SFAS 142 will result in the elimination of annual amortization expense related to goodwill and other intangible assets, including trademarks, in the amount of approximately $329,468, of $214,154 net of tax; however, due to the extensive effort required to comply with SFAS 142, the impact of related impairment, if any, on our financial position or results of operations has not yet been determined.

In August, 2001, the FASB issued Statement on Financial

Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144) which will be effective for our Company as of the beginning of fiscal 2002. SFAS 144 requires that long-lived assets to be disposed of by sale be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS 144 broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The impact, if any, of SFAS 144, on our financial position or results of operations has not yet been determined.

2. ACCOUNTING POLICIES

During the interim periods the Company follows the accounting policies set forth in its consolidated financial statements in its Annual Report and Form 10-K (file number 0-28234). Reference should be made to such financial statements for information on such accounting policies and further financial details.

3. NET INCOME (LOSS) PER COMMON 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. Stock options and warrants outstanding at September 30, 2001 and October 1, 2000 of 902,270 and 889,695 shares, respectively, were not considered in the computation of net income per common share because the effect of their inclusion would have been antidilutive.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company 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: accelerating growth strategy; dependence on executive officers; geographic concentration; increasing susceptibility to adverse conditions in the region; changes in consumer tastes and eating habits; national, regional or local economic and real estate conditions; demographic trends; inclement weather; traffic patterns; the type, number and location of competing restaurants; inflation; increased food, labor and benefit costs; the availability of experienced management and hourly employees; seasonality and the timing of new restaurant openings; changes in governmental regulations; dram shop exposure; and other factors not yet experienced by the Company. The use of words such as "believes", "anticipates", "expects", "intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Readers are urged to carefully review and consider the various disclosures made by the Company in this report and in the Company's Annual Report and Form 10-K for the fiscal year ended December 31, 2000, that attempt to advise interested parties of the risks and factors that may affect the Company's business.

6

RESULTS OF OPERATIONS

Revenues. The Company's revenues for the third quarter of fiscal 2001 were up $399,789 or 2.5% to $16.5 million compared with the same quarter a year ago. Restaurant sales for the third quarter of 2001 were up $360,421 compared with the same quarter a year ago, to $16.1 million. The increase was due to increasing same-restaurant sales that offset the impact of 26 fewer restaurant week sales than the same quarter a year ago. Company-owned same-store sales for the quarter increased 4.3%. Franchise-owned same-store sales for the quarter increased 4.2%.

On a year-to-date basis, the Company's revenues were up $100,795 or 0.2% to $48.2 million compared with the same 39-week period a year ago. Restaurant sales were up $52,703 or 0.1% compared with the same 39-week period a year ago. The increase was due to increasing same-store sales that off set the impact of 97 fewer restaurant week sales. Year-to-date company-owned same-store sales increased 3.1%. Year-to-date franchise-owned same-store sales increased 3.0%.

Costs and Expenses. Cost of sales, consisting primarily of food and beverage costs, but also including paper and supplies, increased as a percentage of restaurant sales in the third quarter of 2001 to 28.1% as compared with 27.8% in the same quarter in fiscal 2000. Cost of sales worsened by 30 basis points primarily due to higher cheese costs and due to promotions (discounting).

On a year-to-date basis, cost of sales decreased as a percentage of restaurant sales to 27.8% as compared with 28.1% in the same 39-week period a year ago. The higher cost of cheese and promotion discounting were a factor in the third quarter, but on a year-to-date basis, the improvement was primarily due to menu price increases that were initiated in the first quarter.

Labor and other related expenses decreased as a percentage of restaurant sales to 32.5% in the third quarter of 2001 as compared with 33.4% in the same quarter in fiscal year 2000. The decrease was primarily due to hourly labor efficiencies. The improvement was also due to last year's closure of under performing restaurants. Offsetting these improvements were workers' compensation insurance increases of 40.0%.

On a year-to-date basis, labor and other related expenses decreased as a percentage of restaurant sales 60 basis points to 32.8% as compared with 33.4% in the same 39-week period a year ago. The decrease was primarily due to the same factors discussed above.

Restaurant operating expenses, which primarily includes rent, property taxes, utilities, repair and maintenance, liquor taxes and advertising, increased as a percentage of restaurant sales to 25.2% in the third quarter of 2001 as compared with 24.2% in the same quarter in fiscal 2000. The increase was primarily due to higher utility and advertising costs.

On a year-to-date basis, restaurant operating expenses increased as a percentage of restaurant sales 160 basis points to 25.1% compared with 23.5% for the same 39-week period a year ago. The increase was primarily due to the same factors discussed above.

General and administrative expenses increased by 2.9%, or $39,547 from the same quarter in fiscal 2000. The Company accrued $100,000 in legal expenses during the third quarter. The lawsuit that gave rise to the legal expenses was settled just after the third quarter ended. General and administrative expenses were 8.6% of total revenues for the third quarter and the same quarter a year ago.

On a year-to-date basis, general and administrative expenses decreased as a percentage of total revenue by 20 basis points to 8.5% compared with 8.7% the same 39-week period a year ago. The improvement was primarily due to a reduction in corporate staffing, resulting in a decrease in compensation costs.

Depreciation and amortization expense increased by $105,691 compared to the same quarter a year ago. This was due to the addition of a new store in October 2000, four remodels during fiscal 2000

7

and six remodels during fiscal 2001, as well as other fixed asset additions in the last four quarters. The closed restaurants mentioned above had relatively low book values of fixed assets so their closure did not significantly reduce depreciation.

On a year-to-date basis, depreciation and amortization increased by $237,244 compared to the same 39-week period a year ago. The increase was primarily due to the same factors discussed above.

Pre-opening costs decreased $42,432 as no new restaurants were opened during the third quarter. One new restaurant was opened just after the third quarter ended the same period a year ago.

On a year-to-date basis, pre-opening costs decreased $93,210 as no new restaurants were opened in the first three quarters of 2001. One new restaurant was opened in the first quarter of fiscal 2000 and another restaurant was opened just after the third quarter closed.

Other Income (Expense). Net other income (expense) decreased by $174,420 compared to the same quarter in the last fiscal year. The decrease was due, in part, to lower interest rates and due to lower outstanding debt. Long-term debt as of September 30, 2001 was $7.0 million compared with $9.0 million the same quarter a year ago. The decrease was also due to a $48,000 gain from an insurance settlement and $13,170 interest income from a tax refund.

On a year-to-date basis, net other income (expense) decreased in expense by $436,285 compare to the same 39-week period a year ago. The decrease was due primarily to a $226,000 gain on the sale of one restaurant. The restaurant, which in 1998 had been sold and leased back from Franchise Finance of America ("FFCA), was purchased back from FFCA and then sold to a third party. The restaurant was purchased with insurance proceeds after it was destroyed by fire. The gain was primarily the realization of a deferred gain from the 1998 sale-lease back transaction. The decrease is also due to the same factors discussed above.

Income Tax Expense. The Company's effective tax rate was 35.0% in both the third quarter of 2001 and the comparable quarter last year. The effective tax rate is the same on a year-to-date basis.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was $2,404,249 for the 39-week period ended September 30, 2001, compared to $2,164,590 for the same period last year. As of September 30, 2001, the Company had a working capital deficit of $3.2 million, which is common in the restaurant industry, since restaurant companies do not typically require a significant investment in either accounts receivable or inventory.

During the first 39 weeks of 2001, capital expenditures on property, plant and equipment were approximately $1.4 million as compared to $2.4 million for the same period in 2000. Capital expenditures included the remodeling of six restaurants. Additionally, the Company had cash outlays for necessary replacement of equipment and leasehold improvements in various older units. The Company estimates its capital expenditures for the remainder of the fiscal year will be approximately $250,000.

On June 29, 2001, the Company re-financed $7.8 million of its debt with Fleet National Bank. The new credit facility is for $10.0 million. The credit facility consists of a $5.0 million term note that requires principal payments quarterly and matures in five years from the closing date of June 29, 2001 and a $5.0 million revolving line of credit that matures in three years from the closing date of June 29, 2001. 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 0.5% on the unused portion of the revolver from the date of the credit agreement. As of September 30, 2001, the Company had $7.0 million outstanding on the credit facility and is in full compliance with all debt covenants. The Company incurred the debt to acquire La Senorita Restaurants, which closed on April 30, 1999 ($4.2 million), to develop new restaurants, to remodel existing restaurants, as well as to accommodate other working capital needs. Excluding two properties

listed for sale, the Company anticipates that it will use excess cash flow to pay down approximately $400,000 of outstanding indebtedness during the last quarter of the fiscal year.

The Company also has a $9.8 million forward commitment agreement with Franchise Finance Corporation of America ("FFCA"). At July 1, 2001, the Company had approximately $9.8 million available under the FFCA forward commitments.

The Company's management believes that with its forward commitments with Franchise Finance Corporation of America, along with operating cash flow and the Company's revolving line of credit with Fleet National Bank, funds will be sufficient to meet operating requirements and to finance routine capital expenditures through the end of the 2001 fiscal year.

ITEM 3. 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 amount outstanding at September 30, 2001, a 100 basis point change in interest rates would change interest expense by $70,000 per annum.

PART II - OTHER INFORMATION

Not Applicable

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MEXICAN RESTAURANTS, INC.

Dated: November 8, 2001 By: /s/ Curt Glowacki
Curt Glowacki
Chief Executive Officer
(Principal Executive Officer)

Dated: November 8, 2001 By: /s/ Andrew J. Dennard
Andrew J. Dennard
Vice President, Chief Financial Officer & Treasurer
(Principal Financial Officer and
Principal Accounting Officer)