MEXICAN RESTAURANTS INC
Form 10-K
March 28, 2002

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UNITED STATES
SECURITIES & 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 DECEMBER 30, 2001

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. [ ]

The aggregate market value of Common Stock held by non-affiliates of the registrant, based on the sale trade price of the Common Stock as reported by the Nasdaq National Market on March 15, 2002 was $5,089,227. 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 each of the registrant's classes of common stock, as of March 20, 2002: 3,504,105 shares of common stock, par value $.01.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's definitive proxy statement in connection with the Annual Meeting of Shareholders to be held May 29, 2002, to be filed with the Commission pursuant to Regulation 14A, is incorporated by reference into Part III of this report.

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PART 1

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Form 10-K under "Item 1. Business", "Item 3. Legal Proceedings", "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere 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 area developers, franchisees and restaurants 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; area developers' adherence to development schedules; 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; 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 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.

ITEM 1. BUSINESS

GENERAL

Mexican Restaurants, Inc. (formerly Casa Ole Restaurants, Inc.) (the "Company") was incorporated under the laws of the State of Texas in February 1996, and had its initial public offering in April 1996. 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.

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. The Casa Ole, Monterey, Tortuga and La Senorita concepts have been in business for 30, 47, 8 and 23 years, respectively. Today the Company operates 50 restaurants, franchises 33 restaurants and licenses one restaurant in various communities across Texas, Louisiana, Oklahoma and Michigan. The Company previously operated three restaurants in Idaho but closed those restaurants on December 30, 2001. The Idaho restaurant leased premises have subsequently been subleased. The Casa Ole', Monterey and La Senorita restaurants are designed to appeal to a broad range of customers, and are located primarily in small and medium-sized communities and middle-income areas of larger markets. The Tortuga Coastal Cantina restaurants also appeal to a broad range of customers and are primarily located 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. The Company, however, has no plans in fiscal year 2002 to open new restaurants.

STRATEGY AND CONCEPT

The Company's objective is to be perceived as a value leader in the Mexican 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 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. 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 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. This is accomplished through an emphasis on restaurant operations, coupled with marketing, purchasing and other organizational efficiencies (see "Restaurant Operations" below). During fiscal year 2002, the Company expects to focus solely on improving operational results and paying down debt.

INCREASED PENETRATION OF EXISTING MARKETS. The Company's second growth opportunity is to increase the number of restaurants in existing Designated Market Areas ("DMAs") and 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 base of existing restaurants.

In implementing its new 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.

In adding to its Company-owned restaurants, the Company anticipates it will continue to selectively acquire existing franchised restaurants. During fiscal 2001, the Company acquired a franchise restaurant in Bellmead, Texas. During fiscal 1999, the Company acquired a franchise restaurant in San Marcos, Texas and converted that restaurant into a Tortuga Coastal Cantina. The Company does not currently anticipate building any new restaurants or acquiring existing franchised restaurants in fiscal year 2002.

SITE SELECTION

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 precisely define 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 Company and franchise development in existing markets. Based on its current planning and market information, the Company does not plan to open additional restaurants in fiscal year 2002, but believes that its franchisees may open one additional restaurant. 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 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 to limit its cash investment to approximately $500,000 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 December 30, 2001, the Company employed 2,191 people, of whom 2,150 were restaurant personnel at the Company-owned restaurants and 41 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 which 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 2001, the Company spent approximately 4.0% of restaurant revenues on various forms of advertising. 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 15 franchisees operating a total of 33 restaurants and one licensee operating one restaurant. No new franchise restaurants were opened, one Casa Ole' franchise restaurant was acquired by the Company, one La Senorita franchise location was closed and one Monterey's Little Mexico was licensed during fiscal year 2001. It is expected that one additional franchise La Senorita will close in fiscal 2002. Franchising allows the Company to expand the number of stores and penetrate markets more quickly and with less capital than developing Company-owned stores. 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 which 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 2002 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 corporation, 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 corporation, 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. 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. The Company is not currently seeking new area developers. The Company currently has three area developers operating a total of on ten, 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

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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 with franchisors of other restaurants and various other concepts for franchisees.

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 which generally provide a person injured by an intoxicated person with the right to recover damages from an establishment that 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 which endeavors to educate the server to detect and prevent overservice of the Company's customers. This program endeavors to educate the server to detect and prevent over-service, or underage- service, of alcoholic beverages to 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 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 trademark, 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" and "La Senorita" with the U.S. Patent Office.

ITEM 2. PROPERTIES

In fiscal year 2001, the Company's executive offices were located in approximately 7,200 square feet of office space in Houston, Texas. The offices are currently leased by the Company from CO Properties No. 3, a Texas partnership owned by Larry N. Forehand and Michael D. Domec, under a gross lease (where the landlord pays utilities and property taxes) expiring in December 2004, with rental payments of $7,863 per month. Beginning January 1, 2002, the Company increased its office space to 10,015 square feet to accommodate its new accounting department. Rental payments will increase to $10,215 per month in fiscal year 2002. See "Notes to Consolidated Financial Statements--Related Party Transactions." The Company believes that its properties are suitable and adequate for its operations.

The Company owns the land and buildings on three restaurant locations, and the building and improvements on two restaurant locations situated on ground leases with the balance of locations on leased sites. One of the owned restaurants was closed in a prior year, and was sold under an installment contract in fiscal 2002. Two of the owned restaurants were closed in previous years and have been leased in prior years to either franchisees or to third parties. Since the end of the fiscal year the Company has subleased four closed restaurants to other local operators. The Company also owns a pad site in Phoenix, Arizona that is under negotiation for sale. 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 December 30, 2001, the Company had 50 Company-operated restaurants, 33 franchise restaurants and one license restaurant. As of such date, the

Company operated and franchised Casa Ole restaurants in the States of Texas and Louisiana; operated Monterey's Tex-Mex Cafe restaurants in the State of Oklahoma and operated and franchised Monterey's Little Mexico restaurants in the States of Texas; operated Tortuga Coastal Cantina restaurants in the State of Texas; and also operated and franchised La Senorita restaurants in the State of Michigan. The Company's portfolio of restaurants is summarized below:

CASA OLE		
Company-operated	17	Leased
Franchise-operated	30	
CONCEPT TOTAL	47	
MONTEREY'S TEX-MEX CAFE		
Company-operated	4	Leased
CONCEPT TOTAL	4	
MONTEREY'S LITTLE MEXICO		
Company-operated	14	Leased
License-operated	1	
CONCEPT TOTAL	15	
TORTUGA COASTAL CANTINA		
Company-operated	10	Leased
CONCEPT TOTAL	10	
LA SENORITA		
Company-operated	5	Leased
Franchise-operated	3	
CONCEPT TOTAL	8	
SYSTEM TOTAL	84	

ITEM 3. LEGAL PROCEEDINGS

Special Note: 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.

From time to time the Company is party to certain legal proceedings incidental to and arising in the ordinary course of business. Although the amount of any liability that could arise with respect to these proceedings cannot be predicted accurately, in the opinion of the Company, any liability that might result from existing claims will not have a material adverse effect on the Company or its business. Nevertheless, a future lawsuit or claim could result in a material adverse effect on the Company or its business.

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 December 30, 2001.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock trades on the Nasdaq National 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 National Market during each of the Company's fiscal quarters since January 4, 1999.

	HIGH
FISCAL YEAR 1999:	
First Quarter (through April 4, 1999)	4.50
Second Quarter (ended July 4, 1999)	4.56
Third Quarter (ended October 3, 1999)	4.94
Fourth Quarter (ended January 2, 2000)	4.44
FISCAL YEAR 2000:	
First Quarter (ended April 2, 2000)	3.81
Second Quarter (ended July 2, 2000)	4.00
Third Quarter (ended October 1, 2000)	3.87
Fourth Quarter (ended December 31, 2000)	2.87
FISCAL YEAR 2001:	
First Quarter (ended April 1, 2001)	3.19
Second Quarter (ended July 1, 2001)	3.04
Third Quarter (ended September 30, 2001)	3.82
Fourth Quarter (ended December 30, 2001)	3.04
FISCAL YEAR 2002:	
First Quarter (as of March 14, 2002)	3.80

As of March 14, 2002, the Company estimates that there were approximately 800 beneficial owners of the Company's Common Stock, represented by approximately 66 holders of record.

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 and to finance expansion 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 28, 1997, January 3, 1999, January 2, 2000, December 31, 2000, and December 30, 2001 and income statement data for the fiscal years then ended have been derived from consolidated financial statements audited by KPMG LLP, independent public accountants. 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 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			
	1997	1998(1)	1999	2000
	(Dollars in thousands, except per share amo			
INCOME STATEMENT DATA:				
Revenues:				
Restaurant sales	$ 34,301	$ 47,000	$ 55,997	$ 61,834
Franchise fees, royalties and other	1,029	1,120	1,469	1,362
Total revenues	35,330	48,120	57,466	63,196
Costs and expenses:				
Cost of sales	8,954	12,899	15,774	17,402
Restaurant operating expenses	19,231	25,611	31,448	35,796
General and administrative	3,632	4,429	5,191	5,548
Depreciation and amortization	1,245	1,654	2,003	2,227
Restaurant closure costs	432	--	1,493	--
Total costs and expenses ...	33,494	44,593	55,909	60,973
Infrequently occurring income items, net	--	--	437	--
Operating income	1,836	3,527	1,994	2,223
Other income (expense)	(171)	(385)	(534)	(885)
Income before income tax expense	$ 1,665	$ 3,142	$ 1,460	$ 1,338

Extraordinary item	$ --	$ 40	$ --	$ --
Net income	$ 1,015	$ 1,973	$ 833	$ 867
Net income per share (diluted)	$ 0.28	$ 0.55	$ 0.23	$ 0.24

	FISCAL YEARS				
	1997	1998	1999	2000	
	(Dollars in thousands)				
BALANCE SHEET DATA:					
Working capital (deficit)	$ (2,023)	$ (1,047)	$ (1,484)	$ (1,920)	$
Total assets	$ 26,508	$ 23,421	$ 31,043	$ 31,509	$
Long-term debt, less current portion	$ 10,107	$ 2,870	$ 8,963	$ 8,300	$
Total stockholders' equity	$ 11,735	$ 13,559	$ 14,392	$ 14,889	$

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(1) The fiscal year 1998 consisted of 53 weeks. All other fiscal years presented consisted of 52 weeks.

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.

GENERAL

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'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.

FISCAL YEAR

The Company has a 52/53 week fiscal year ending on a Sunday nearest December 31. References in this Report to fiscal 1999, 2000 and 2001 relate to the periods ended January 2, 2000, December 31, 2000 and December 30, 2001 respectively. Fiscal years 1999, 2000 and 2001 presented herein consisted of 52 weeks. Fiscal year 1998 consisted of 53 weeks.

RESULTS OF OPERATIONS

FISCAL 2001 COMPARED TO FISCAL 2000

REVENUES. Fiscal year 2001 revenues increased 0.01% to $63.2 million. Restaurant sales increased $17,846 to $61.9 million. Fiscal year 2001 consisted of 2,728 restaurant weeks compared to 2,849 restaurant weeks in the prior year. Fiscal year 2000 sales included three under performing restaurants that were closed at the end of that fiscal year, and one restaurant that was sold in the middle of that fiscal year. During fiscal year 2001, one restaurant was temporarily closed for six weeks due to flood damage, one new restaurant was acquired from a franchisee, and three under performing restaurants were closed on December 30, 2001. Total system same-restaurant sales were up 2.7%. Company-owned same restaurant sales were up 2.2% and franchise-owned same-restaurant sales were up 3.5%. Company-owned average weekly sales increased 4.5% in fiscal year 2001.

Franchise fees, royalties and other increased 2.3% or $31,248 to $1.4 million. The increase was due to the increase in franchise same-restaurant sales. The increase in franchise same restaurant sales was offset by the bankruptcy of two franchisees during the second quarter of fiscal year 2001 and the loss of corresponding royalty income.

COSTS AND EXPENSES. Costs of sales, consisting of food, beverage, liquor, supplies and paper costs, decreased as a percent of restaurant sales to 27.7% compared with 28.1% in fiscal 2000. The decrease was due, in part, to menu price increases, and due to menu design changes that removed low selling, high food cost items. Higher cheese prices offset some of this improvement.

Labor and other related expenses decreased as a percentage of restaurant sales 70 basis points to 32.9% compared with 33.6% in fiscal 2000. The decrease was primarily due to hourly and manager labor efficiency as a result of increasing same restaurant sales. The improvement was also due to last year's closure of under performing restaurants. Worker's compensation insurance premiums increased 56.0% during fiscal year 2001, offsetting some of these improvements.

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 to 25.4% in fiscal year 2001 as compared with 24.3% in fiscal year 2000. The increase was primarily due to higher utility, insurance and advertising costs.

General and administrative expenses decreased as a percentage of total sales from 8.8% of total sales in fiscal year 2000 to 8.6% in fiscal year 2001. The decrease was primarily due to a decrease in corporate staffing that was offset by higher legal expenses relating to a parking easement lawsuit that was successfully concluded and severance expenses relating to the corporate staff decreases.

Depreciation and amortization increased by 14.0% to $2.4 million. The increase was primarily due to the addition of two new restaurants in October 2000 and June 2001, four remodels during 2000 and six remodels during 2001, as well as other fixed asset additions during fiscal year 2001. The closed restaurants mentioned above had relatively low book values of fixed assets so their closure did not significantly reduce depreciation.

No new restaurants were opened during 2001. The franchise restaurant acquired during fiscal year 2001 was an existing, operating restaurant that required no pre-opening costs.

During the fourth quarter of fiscal year 2001, the Company expensed $971,885 related to restaurant closure and asset impairment costs. These costs were due to the closure and sublease of three restaurants in Boise, Idaho and due to the impairment of the carrying value of previously closed restaurants that were sold or subleased just after the end of fiscal year 2001. There were no impairments recorded in fiscal year 2000.

OTHER INCOME (EXPENSE). Interest expense decreased by $172,416 due to declining debt and declining interest rates during fiscal year 2001. Total debt as of December 30, 2001 was $6.6 million compared with $8.3 million as of December 31, 2000, a decrease of $1.7 million. The decrease was also due to a $285,779 gain primarily due to 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.

INCOME TAX EXPENSE. The Company's effective tax rate for fiscal year 2001 was 13.8% compared with 35.0% in fiscal year 2000. The lower rate is due to the effect of higher tax credits and favorable tax treatment on the closure of the Boise, Idaho restaurants.

FISCAL 2000 COMPARED TO FISCAL 1999

REVENUES. Fiscal 2000 revenues increased 10.0% to $63.2 million. Restaurant sales increased 10.4% to $61.8 million. La Senorita Restaurants, which was acquired on April 30, 1999, contributed $2.2 million of the $5.7 million increase in restaurant sales. One new restaurant was opened, one restaurant was reopened, and three restaurants were closed during the year. Total system same-store sales (including La Senorita) were up 2.7%. Company-owned same store sales were up 3.2% and franchise-owned same-store sales were up 2.1%. Due to new store development of higher volume Tortuga Coastal Cantina and La Senorita restaurants, company-owned average weekly sales increased 6.1%.

Franchise fees, royalties and other decreased 7.3% or $107,000 to $1.4 million. The decrease was due to other miscellaneous revenues decreasing as the Company stopped selling certain merchandise items in the RESTAURANTS.

COSTS AND EXPENSES. Costs of sales, consisting of food, beverage, liquor, supplies and paper costs, decreased slightly as a percent of sales to 28.1% compared with 28.2% in fiscal 1999. The decrease was due to efforts with suppliers to generate costs savings coupled with a decrease in cheese prices. These were offset by significant increases in the cost of beef, guacamole and tequila. Moderate price increases during the year also helped to keep costs down as a percent of sales.

Labor and other related expenses increased 10 basis points to 33.6% compared with 33.5% in fiscal 1999. The increase was primarily due to higher labor costs associated with new store development, as well as the tight labor markets. Also, workers' compensation and health insurance expenses increased on a comparable basis. Offsetting these increases were labor efficiencies within the restaurants that were opened during fiscal 1999.

Restaurant operating expenses increased to 24.3% of restaurant sales compared with 22.6% in fiscal 1999. The increase was due to a combination of higher utility costs, increased repairs and maintenance, increased property taxes and rent. Utility costs increased due to the higher energy costs. Older facilities contributed to the increased repairs. The addition of the Tortuga Coastal Cantina and La Senorita restaurants and their related capital additions resulted in an increase in rental expense and property taxes.

General and administrative expenses decreased from 9.0% of total sales in fiscal year 1999 to 8.8% in fiscal year 2000. The decrease was primarily due to the absorption of general and administrative expenses over a larger revenue base. Fiscal year 1999 also included $62,000 in write-offs of site development costs.

Depreciation and amortization increased by 23.6% to $2.1 million. This increase is primarily due to the La Senorita acquisition in May 1999 and capital additions during 1999 as five new restaurants were opened and nine restaurants were remodeled resulting in a full year's depreciation during fiscal year 2000. Also during the year, two additional restaurants were opened and four were remodeled.

Pre-opening costs decreased by 60.8% as the number of stores opened decreased from 6 to 2.

During fiscal year 1999, the Company expensed $1.5 million related to restaurant closure and asset impairment costs. There were no impairments recorded in fiscal year 2000.

Infrequently occurring (income) and expense in 1999 consisted of two items that increased operating income in the aggregate by $437,684. There were no such items in fiscal year 2000.

OTHER INCOME (EXPENSE). Interest expense increased by $373,861 due to a higher average debt balance and higher interest rates. The Company borrowed $4.2 million to finance the La Senorita acquisition in May 1999 and also borrowed to finance investments in new stores throughout 1999, increasing debt from $2,870,000 to $8,963,320 during the year. Debt was decreased by $663,320 during 2000, but the average balance remained higher than in 1999. Interest rates have increased by 2% over the beginning of 1999, further contributing to the increased expense.

Other income and expense items decreased from a net expense of $42,426 to a net expense of $19,242.

INCOME TAX EXPENSE. The Company's effective tax rate for fiscal 2000 was 35.0% compared with 42.9% in fiscal 1999. The lower rate is due to the effect of higher tax credits on lower income before taxes.

LIQUIDITY AND CAPITAL RESOURCES

The Company met fiscal 2001 capital requirements with cash generated by operations. In fiscal 2001, the Company's operations generated approximately $3.2 million in cash, as compared with $3.5 million in fiscal 2000 and $3.6 million in fiscal 1999. As of December 30, 2001, the Company had a working capital deficit of approximately $3.2 million, compared with a working capital deficit of approximately $1.9 million at December 31, 2000. The increase in fiscal year 2001 working capital deficit is primarily due to the reclassification of $1.0 million of long-term debt to short-term debt. 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 new restaurant development or acquisitions and remodeling of older units. During fiscal 2001, capital expenditures on property, plant and equipment were approximately $1.8 million as compared to approximately $2.8 million for fiscal 2000. Capital expenditures included the remodeling of six restaurants. The Company also exchanged a franchise note receivable for an existing, operating restaurant. Additionally, the Company had cash outlays for necessary replacement of equipment and leasehold improvements in various older units. There are no new restaurants planned for fiscal year 2002. The Company does plan to modestly remodel five restaurants in fiscal year 2002. The estimated capital needed for fiscal year 2002 for general corporate purposes, including remodeling, is approximately $1.6 million.

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 quarterly principal payments of $250,000 and matures on June 29, 2006. The credit facility also includes a $5.0 million revolving line of credit that matures on June 29, 2004. 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 December 30, 2001, the Company had $6.6 million outstanding on the credit facility and is in full compliance with all debt covenants except the maximum capital expenditures covenant, which the Company exceeded by $95,000. The Company obtained a waiver for the fourth quarter non-compliance and expects to be in compliance with the covenant in all quarters of fiscal year 2002. Over the last several years, the Company's debt was incurred to acquire Monterey's Acquisition Corp, which was acquired on July 1997, La Senorita Restaurants, which was acquired on April 30, 1999, to develop new restaurants, 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 2002 to pay down debt approximately $2.0 million. The Company's Board of Directors is considering a stock repurchase program. Such a program would be established in a manner permitted under the current bank financing agreement. However, there is no assurance that any shares will actually be repurchased during fiscal year 2002.

The Company's management believes that with its 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 and remodels through the end of the 2002 fiscal year. Unless the

Company violates an important debt covenant, the Company's credit facility with Fleet National Bank is not subject to triggering events that would cause the credit facility to become due sooner than the maturity dates described in the previous paragraph.

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 have been presented throughout this document, including, among others, expansion 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:

SEASONALITY. 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 with respect to the third quarter and is due to increased holiday traffic at the Company's mall restaurants for the fourth quarter. 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.

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IMPACT OF INFLATION & MARKET RISKS. The Company believes that inflation has impacted net income during fiscal year 2002. Substantial increases in utility expenses and insurance premiums 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 considering competitive conditions. The Company does not have or participate in transactions involving derivative, financial and commodity instruments.

ACCELERATING GROWTH STRATEGY. 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 materially adverse impact on the Company's financial results.

SMALL RESTAURANT BASE AND GEOGRAPHIC CONCENTRATION. 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 and Michigan), results of operations may be adversely affected by economic or other conditions in the region and adverse publicity 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.

CONTROL OF THE COMPANY BY MANAGEMENT AND DIRECTORS. Approximately 56.8% 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.

SHARES ELIGIBLE FOR FUTURE SALE AND STOCK PRICE. Sales of substantial amounts of shares in the public market could adversely affect the market price of the Common Stock. The Company has 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 880,766 underlying shares of Common Stock covered by such warrants in connection with registrations otherwise undertaken by the Company. 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.

COMPETITION. The restaurant industry is intensely competitive. The Company competes against other family dining concepts, as well as quick service and casual dining concepts, for customers, employees, and franchisees. See "Item 1. Business--Competition."

CONTRACTUAL OBLIGATIONS AND COMMITMENTS. The Company leases restaurant operating space and equipment under non-cancelable operating leases that expire at various dates through April 30, 2019. 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". The 13 leases have a total future minimum lease obligation of approximately $13,932,038.

Future minimum lease payments under non-cancelable operating leases with initial or remaining lease terms in excess of one year as of December 30, 2001 are approximately:

2002	4,007,792
2003	3,749,068
2004	3,402,971
2005	3,081,155
2006	3,053,816
Thereafter	21,091,266
	$ 38,386,068

Long-term debt consists of the following at December 31, 2000 and December 30, 2001:

	FISCAL YEARS 2000	2001
Revolving Line of Credit	8,300,000	2,072,729
Term Note	--	4,500,000
Long-term debt	8,300,000	6,572,729
Less current installments due in 2002	--	(1,000,000)
Long-term debt, excluding current installments	$ 8,300,000	$ 5,572,729

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 December 30, 2001, the Company had $6.6 million outstanding on the credit facility and is in full compliance with all debt covenants, except for the maximum capital expenditures covenant (the Company exceeded by 5.0%). The Company obtained a waiver for the fourth quarter non-compliance. The Company expects to be in compliance with the covenant in all quarters of fiscal year 2002.

Maturities on long-term debt are as follows:

2002..	1,000,000
2003..	1,000,000
2004..	3,072,729
2005..	1,000,000
2006..	500,000
	$6,572,729

RELATED PARTIES. Bay Area Management, Inc., owned entirely by the brother of a Company shareholder and director, provided accounting and administrative services on a fee basis, to all of the Company-owned Casa Ole restaurants and some franchise entities. The Company paid a termination fee of

$82,000 and cancelled the contract during 1999. Total amounts paid to Bay Area Management, Inc. in fiscal 1999 was $216,369.

The Company leases its executive offices from a company owned by two shareholders of Mexican Restaurants, Inc. Net lease expense related to these facilities in fiscal 1999, 2000 and 2001 was $60,000, $89,592 and $94,416, respectively.

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. The program provides for the Company to assist the executives and key employees in obtaining third party loans to finance such purchases. It also provides for annual cash bonuses to such executives to provide for payment of interest expense and principal amounts to amortize these loans in not more than five years. The bonus payments are based on attainment of earnings per share targets established by the Company's Board of Directors.

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 $66,000.

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.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required in response to this Item is incorporated herein by reference to the Company's 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 required in response to this Item is incorporated herein by reference to the Company's 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

The information required in response to this Item is incorporated herein by reference to the Company's 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 required in response to this Item is incorporated herein by reference to the Company's 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 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of Report.

1. Financial Statements:

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

2. Exhibits:

+/-2.1	Stock Purchase Agreement with Purchase of Designated Assets, dated as of January 12, 1999, by and among the Company, La Senorita Restaurants Acquisition Corp., a Delaware corporation and wholly owned subsidiary of the Company, La Senorita Traverse City, Inc., Kleinrichert Bros., Inc., La Senorita Mt. Pleasant, Inc., KMANCO, Inc., La Senorita Lansing, Inc., Kenneth Kleinrichert, Donald Kleinrichert, Joseph Kleinrichert, The Joseph Kleinrichert Trust and Steve Arnot.
*3.1	Articles of Incorporation of the Company (as amended).
++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	Employment Agreement by and between the Company and Patrick A. Morris dated February 28, 1996.
++10.3	Employment Agreement by and between the Company and Stacy M. Riffe dated February 28, 1996.
++10.4	Indemnity Agreement by and between the Company and Louis P. Neeb dated as of April 10, 1996.

++10.5	Indemnity Agreement by and between the Company and Larry N. Forehand dated as of April 10, 1996.
++10.6	Indemnity Agreement by and between the Company and John C. Textor dated as of April 10, 1996.

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++10.7	Indemnity Agreement by and between the Company and Patrick A. Morris dated as of April 10, 1996.
++10.8	Indemnity Agreement by and between the Company and Michael D. Domec dated as of April 10, 1996.
++10.9	Indemnity Agreement by and between the Company and Stacy M. Riffe dated as of April 10, 1996.
++10.10	Indemnity Agreement by and between the Company and J.J. Fitzsimmons dated as of April 10, 1996.
++10.11	Indemnity Agreement by and between the Company and Richard E. Rivera dated as of April 10, 1996.
++10.12	Corrected Warrant Agreement by and between the Company and Louis P. Neeb dated as of February 26, 1996.
++10.13	Corrected Warrant Agreement by and between the Company and Tex-Mex Partners, L.C. dated as of February 26, 1996.
++10.14	Form of the Company's Multi-Unit Development Agreement.
++10.15	Form of the Company's Franchise Agreement.
+++10.16	1996 Long Term Incentive Plan.
+++10.17	Stock Option Plan for Non-Employee Directors.
++10.18	Lease Agreement, dated July 15, 1977, between Weingarten Realty, Inc. and Fiesta Restaurants, Inc., for property located at 1020 Federal Road, Houston, Texas (Casa Ole No. 4).
++10.19	Lease Agreement, dated July 12, 1978, between W & W Investments, a Texas partnership, and Fiesta Restaurants, Inc., for property located at 2727 John Ben Shepperd Pkwy, Odessa, Texas (Casa Ole No. 8).
++10.20	Lease Agreement, dated August 11, 1986, between Hartford-Lubbock Limited Partnership, a Texas limited partnership, and Casa Ole No. 10, Inc., for property located at 4413 South Loop 289, Lubbock, Texas (Casa Ole No. 10).
++10.21	Lease Agreement, dated July 29, 1983, between Phil R. Kensinger, Trustee, and Quality Mexican Restaurants, Inc., for property located at 12203 Murphy Rd., Stafford, Texas (Casa Ole No. 13).

++10.22	Lease Agreement, dated July 17, 1987, between Leroy Melcher and Fiesta Restaurants, Inc., for property located at 3121 Palmer Hwy, Texas City, Texas (Casa Ole No. 14).
++10.23	Lease Agreement, dated February 17, 1981, between Eldred Doty, wife Joyce C. Doty and Fiesta Restaurants, Inc., for property located at 3121 Palmer Hwy, Texas City, Texas (Casa Ole No. 14).
++10.24	Lease Agreement, dated May 16, 1983, between CBL Management, Inc., a Tennessee corporation, and Fiesta Restaurants, Inc., d/b/a Casa Ole, for property located at Post Oak Mall #3026, College Station, Texas (Casa Ole No. 22).
++10.25	Lease Agreement, dated June 5, 1985, between David Z. Mafrige Interests and Fiesta Restaurants, Inc., for property located at 12350 Gulf Freeway, Houston, Texas (Casa Ole No. 28).
++10.26	Lease Agreement, dated March 13, 1985, between Plantation Village Plaza Joint Venture and Fiesta Restaurants, Inc., for property located at 415 This Way, Lake Jackson, Texas (Casa Ole No. 29).
++10.27	Lease Agreement, dated August 6, 1985, between Dalsan Properties--Waco II, Service Life and Casualty Insurance Co. and Casa Ole No 34, Inc., for property located at 414 N. Valley Mills Dr., Waco, Texas (Casa Ole No. 34).
++10.28	Lease Agreement, dated May 6, 1976, between Federated Store Realty, Inc., Prudential Insurance Company of America and Fiesta Restaurants, Inc., for property located at 263 Greenspoint Mall, Houston, Texas (Casa Ole No. 35).
++10.29	Lease Agreement, dated May 30, 1989, between Temple Mall Company, a Texas General Partnership, and Casa Ole Franchise Services, Inc., for property located at 3049 S. 31st Street, Temple, Texas (Casa Ole No. 37).

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++10.30	Lease Agreement, dated May 3, 1995, between CO Properties No. 3, a Texas general partnership, and Casa Ole Franchise Services, Inc., for property located at 1135 Edgebrook, Houston, Texas.
++10.31	Corrected Warrant Agreement by and between Larry N. Forehand and Louis P. Neeb dated as of February 26, 1996.
++10.32	Corrected Warrant Agreement by and between Larry N. Forehand and Tex-Mex Partners, L.C. dated as of February 26, 1996.
++10.33	Corrected Warrant Agreement by and between Larry N. Forehand and Patrick A. Morris dated as of February

	26, 1996.
++10.34	Corrected Warrant Agreement by and between Larry N. Forehand and Stacy M. Riffe dated as of February 26, 1996.
++10.35	Indemnification letter agreement by Larry N. Forehand dated April 10, 1996.
+10.36	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 by the Company with the Securities and Exchange Commission).
**10.37	Lease Agreement, dated June 21, 1996, between Sam Jack McGlasson and Casa Ole Restaurants, Inc., for property located at 725 North Loop 340, Bellmead, Texas (Casa Ole No. 51).
**10.38	Amended Lease Agreement, dated November 7,1996, between The Prudential Insurance Company of America, by and through its Agent, Terranomics Retail Services, Inc. and Casa Ole Restaurants, Inc., for property located at 263 Greenspoint Mall, Houston, Texas (Casa Ole No. 35).
**10.39	Assignment of Lease and Consent to Assign, dated October 11, 1996, between Roy M. Smith and W.M. Bevly d/b/a Padre Staples Mall (landlord) and Pepe, Inc. d/b/a Casa Ole Restaurant and Cantina (tenant/assignor) and Jack Goodwin (guarantor) and Casa Ole No. 29, Inc., for property located at 1184 Padre Staples Mall, Corpus Christi, Texas (Casa Ole No. 36).
**10.40	Option Contract and Agreement dated January 11, 1997, between Casa Ole of Beaumont, Inc., a Texas corporation, and Casa Ole Restaurants, Inc.
**10.41	$750,000 Promissory Note, dated December 30, 1996, between Casa Ole No. 29, Inc. and Rainbolt, Inc. for the purchase of Victoria, Texas restaurant (Casa Ole No. 15).
10.42	Credit Agreement Between Casa Ole Restaurants, Inc., as the Borrower, and NationsBank of Texas, N.A., as the Bank, for $10,000,000, dated July 10, 1996 (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q Quarterly Report Under the Securities Exchange Act of 1934, dated August 22, 1996, filed by the Company with the Securities and Exchange Commission).
**10.43	Amendment No. 1, dated January 13, 1997, to the Credit Agreement Between Casa Ole Restaurants, Inc., as the Borrower, and NationsBank of Texas, N.A., as the Bank, for $10,000,000, dated July 10, 1996.
**10.44	Employment Agreement by and between the Company and Curt Glowacki dated May 15, 1997.

**10.45	Employment Agreement by and between the Company and Andrew J. Dennard dated May 20, 1997.
+10.46	Form of Executive Officer Stock Purchase Letters.
++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.
*24.1	Power of Attorney (included on the signature page to this Form 10-K).

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* Filed herewith.

** Incorporated by reference to corresponding Exhibit number of the Company's (then known as Casa Ole Restaurants, Inc.) Form 10-K Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, dated March 24, 1997, filed by the Company with the Securities and Exchange Commission.

+/- Incorporated by reference to corresponding Exhibit 2.1 of the Company's (then known as Casa Ole Restaurants, Inc.) Form 8-K filed by the Company on May 14, 1999 with the Securities and Exchange Commission.

* Incorporated by reference to corresponding Exhibit number of the Company's Form 8-K filed by the Company on May 25, 1999 with the Securities and Exchange Commission.

++ Incorporated by reference to corresponding Exhibit number of the Company's (then known as Casa Ole Restaurants, Inc.) FormS-1 Registration Statement Under the Securities Act of 1933, dated April 24, 1996, filed by the Company with the Securities and Exchange Commission (Registration number 333-1678).

\+ Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K

There were two reports on Form 8-K during the last quarter of the period covered by this report. On October 3, 2001, the Company reported that it was continuing to evaluate interest expressed by several parties with regard to a potential acquisition of all or a part of the Company. On November 7, 2001, the Company announced that its board of directors accepted the recommendation of its financial advisors to reject as inadequate all indications of interest received by the Company.

MEXICAN RESTAURANTS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Mexican Restaurants, Inc.:

We have audited the accompanying consolidated balance sheets of Mexican Restaurants, Inc. and subsidiaries (the Company) as of December 31, 2000 and December 30, 2001, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 30, 2001. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 31, 2000 and December 30, 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 30, 2001, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Houston, Texas
March 15, 2002

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2000 AND DECEMBER 30, 2001

	FISCAL YEARS	
	2000	200
ASSETS		
Current assets:		
Cash and cash equivalents	$ 636,334	$ 31
Royalties receivable	66,798	11
Other receivables	611,603	55
Inventory	718,629	65
Taxes receivable	257,080	33
Prepaid expenses and other current assets	529,830	68
Total current assets	2,820,274	2,64
Property, plant and equipment	25,550,871	25,50
Less accumulated depreciation	(7,339,223)	(8,74
Net property, plant and equipment	18,211,648	16,75
Deferred tax assets	1,167,661	1,14
Property held for resale	1,100,000	1,39
Other assets	8,209,243	8,12
	$ 31,508,826	$ 30,06
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt	$ --	$ 1,00
Accounts payable	2,953,649	1,94
Accrued sales and liquor taxes	452,617	46
Accrued payroll and taxes	1,006,457	1,12
Accrued expenses	327,390	1,26
Total current liabilities	4,740,113	5,80

Long-term debt	8,300,000	5,57
Other liabilities	537,219	58
Deferred gain	3,042,832	2,39
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	4
Additional paid-in capital	20,121,076	20,12
Retained earnings	6,025,121	6,87
Deferred Compensation	(171,519)	(13
Treasury stock, cost of 1,200,400 common shares in 2000 and 1,219,200 common shares in 2001	(11,133,343)	(11,19
Total stockholders' equity	14,888,662	15,71
	$ 31,508,826	$ 30,06

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE FISCAL YEARS ENDED JANUARY 2, 2000, DECEMBER 31, 2000 AND DECEMBER 30, 2001

	FISCAL YEARS		
	1999	2000	
Revenues:			
Restaurant sales	$ 55,997,170	$ 61,833,623	$ 61
Franchise fees, royalties and other	1,468,596	1,393,157	1
	57,465,766	63,195,532	63
Costs and expenses:			
Cost of sales	15,773,922	17,401,417	17
Labor	18,785,669	20,768,127	20
Restaurant operating expenses	12,662,395	15,028,247	15
General and administrative	5,191,043	5,547,784	5
Depreciation and amortization	1,708,965	2,111,839	2
Pre-opening costs	293,931	115,331	
Asset impairments and restaurant closure costs	1,493,449	--	
	55,909,374	60,972,745	61

Infrequently occurring income items, net	437,684	--	
Operating income	1,994,076	2,222,787	1
Other income (expense):			
Interest income	21,304	18,141	
Interest expense	(491,494)	(865,355)	
Other, net	(63,730)	(37,383)	
	(533,920)	(884,597)	
Income before income tax expense	1,460,156	1,338,190	
Income tax expense	627,032	471,000	
Net income	$ 833,124	$ 867,190	$
Basic income per share	$ .23	$ .24	$
Diluted income per share	$ .23	$ .24	$
Weighted average number of shares (basic and diluted)	3,603,712	3,580,380	3

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE FISCAL YEARS ENDED
JANUARY 3, 1999, JANUARY 2, 2000
AND DECEMBER 31, 2000

	CAPITAL STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK
Balances at January 3, 1999	$ 47,327	$ 20,537,076	$ 4,324,807	$(11,350,000
Net income	--	--	833,124	--

Balances at January 2, 2000	$ 47,327	$ 20,537,076	$ 5,157,931	$(11,350,000
Net income	--	--	867,190	--
Issuance of Restricted Stock	--	(416,000)	--	622,500
Repurchase of shares	--	--	--	(405,843
Amortization of Deferred Compensation	--	--	--	--
Balances at December 31, 2000	$ 47,327	$ 20,121,076	$ 6,025,121	$(11,133,343
Net income	--	--	848,676	--
Repurchase of shares	--	--	--	(61,429
Amortization of Deferred Compensation	--	--	--	--
Balances at December 30, 2001	$ 47,327	$ 20,121,076	$ 6,873,797	$(11,194,772

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE FISCAL YEARS ENDED JANUARY 2, 2000,
DECEMBER 31, 2000, AND DECEMBER 30, 2001

	FI
	1999
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income	$ 833,124
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	1,708,965
Deferred gain amortization	(253,234)
Asset impairments and restaurant closure costs	1,493,449
Gain on sale of fixed assets	(457,243)
Deferred compensation expense	--
Deferred income taxes	(452,272)
Changes in assets and liabilities, net of effects of acquisitions:	
Royalties receivable	28,051
Other receivables	(168,133)
Taxes receivable/payable	426,845

Inventory	(241,935)	
Prepaids and other current assets	(152,282)	
Other assets	(93,056)	
Accounts payable	967,709	
Accrued expenses and other liabilities	(156,303)	
Deferred franchise fees and other long-term liabilities	137,707	
Total adjustments	2,788,268	
Net cash provided by operating activities	3,621,392	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payment for purchase of acquisition, net of cash acquired	(4,132,945)	
Purchase of property, plant and equipment	(7,297,411)	
Proceeds from sale of property, plant and equipment	1,996,732	
Net cash provided by (used in) investing activities	(9,433,624)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings under line of credit agreement	6,093,320	
Purchase of treasury stock	--	
Net cash provided by (used in) financing activities	6,093,320	
Increase (decrease) in cash and cash equivalents	281,088	
Cash and cash equivalents at beginning of year	462,847	
Cash and cash equivalents at end of year	$ 743,935	$
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year:		
Interest	$ 493,845	$
Income taxes	807,882	
Non-cash financing activities:		
Sale of property for notes receivable	--	
Purchase of property for notes receivable	--	
Issuance of restricted stock	--	

See accompanying notes to consolidated financial statements.

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JANUARY 2, 2000, DECEMBER 31, 2000 AND DECEMBER 30, 2001

(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 17.5% limited interest.

(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, Michigan and Idaho. The three Idaho restaurants were closed on December 30, 2001. 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 1999, 2000 and 2001 consisted of 52 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 the fourth quarter of fiscal year 2001, the Company recorded asset impairment and restaurant closure costs of $971,885. These costs related to the closure of three restaurants located in Boise, Idaho and to the impairment of the carrying value of previously closed restaurants due to their sale or sublease. There was an impairment cost of $1,493,449 in fiscal year 1999 and no such impairment cost in fiscal year 2000. Property held for resale is separately aggregated in the consolidated balance sheet and is recorded at the estimated fair market value ($1,100,000 and $1,399,672 or fiscal years 2000 and 2001, repectively). Fiscal year 2001 also included a gain on sale of $285,779 primarily due to a restaurant sold. Fiscal year 1999 also included a gain on sale of $519,685 on a restaurant sold.

(h) Other Assets

At December 30, 2001, other assets included $7.6 million of goodwill, net of amortization primarily resulting from the MAC and La Senorita acquisitions. Goodwill is being amortized over 40 years for MAC and 15 years for La Senorita. Accumulated amortization was $1,216,757 and $874,000 for fiscal years 2001 and 2000, respectively. The Company assesses the recoverability of intangible assets by determining whether amortization of the asset balance over its remaining life can be recovered through undiscounted operating cash flows of the acquired operation. The Company believes that no impairment of goodwill exists.

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 in the amount of approximately $329,468. Our management has begun the preliminary process of evaluating goodwill as required by SFAS 142. Although preliminary indications are that no impairment of goodwill exists, further evaluation will be conducted over the next two quarters of fiscal year 2002. Therefore, management's preliminary evaluation that no impairment of goodwill exists is subject to change.

(i) 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.

(j) 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.

(k) Stock Options

The Company has adopted the disclosure-only provisions of 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, compensation expense is recorded on the date of the grant only if the current market price of the underlying stock exceeds the exercise price at the date of grant.

(l) 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.

(m) Reclassification

Certain reclassifications have been made to the 1999 amounts to conform to the 2000 and 2001 presentations.

(n) Recent Accounting Pronouncements

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 in the amount of approximately $329,468. Our management has begun the preliminary process of evaluating goodwill as required by SFAS 142. Although preliminary indications are that no impairment of goodwill exists, further evaluation will be conducted over the next two quarters of fiscal year 2002. Therefore, management's preliminary evaluation that no impairment of goodwill exists is subject to change.

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) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 2000 and December 30, 2001 were as follows:

	FISCAL YEARS 2000	FISCAL YEARS 2001
Land	$ 637,412	$ 129,591
Buildings and improvements	1,250,124	1,159,115
Vehicles	36,880	54,989
Equipment and smallwares	14,046,786	13,752,123
Leasehold improvements	9,480,865	10,404,665
Construction in progress	98,804	--
Total	$ 25,550,871	$ 25,500,483

(3) LONG-TERM DEBT

Long-term debt consists of the following at December 31, 2000 and December 30, 2001:

	FISCAL YEARS 2000	2001
Revolving Line of Credit	8,300,000	2,072,729
Term Note	--	4,500,000
Long-term debt	8,300,000	6,572,729
Less current installments due in 2002	--	(1,000,000)
Long-term debt, excluding current installments ...	$ 8,300,000	$ 5,572,729

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