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MEXICAN RESTAURANTS INC
Form 10-Q
May 03, 2002

UNITED STATES

SECURITIES & EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the Quarterly period ended MARCH 31, 2002

OR

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

For the transition period from _____ to _____

Commission file number: 0-28234

MEXICAN RESTAURANTS, INC.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of
incorporation or organization)

76-0493269

(IRS Employer Identification Number)

1135 EDGEBROOK, HOUSTON, TEXAS

(Address of Principal Executive Offices)

77034-1899

(Zip Code)

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

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

Yes No

Number of shares outstanding of each of the issuer's classes of common stock, as of April 22, 2002: 3,504,105 SHARES OF COMMON STOCK, PAR VALUE \$.01.

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PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	(UNAUDITED) 3/31/20

Current assets:	
Cash and cash equivalents	\$ 304
Royalties receivable	113
Other receivables	695
Inventory	610
Taxes receivable	310
Prepaid expenses and other current assets	1,014

Total current assets	3,047

Property, plant and equipment	25,845
Less accumulated depreciation	(9,232)

Net property, plant and equipment	16,613
Deferred tax assets	911
Property held for resale	968
Other assets	8,519

	\$ 30,060
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Current installments of long-term debt	\$ 1,000
Accounts payable	2,539
Accrued sales and liquor taxes	487
Accrued payroll and taxes	745
Accrued expenses	666

Total current liabilities	5,439

Long-term debt, net of current portion	5,272
Other liabilities	810
Deferred gain	2,341
Stockholders' equity:	
Preferred stock, \$.01 par value, 1,000,000 shares authorized	
Capital stock, \$.01 par value, 20,000,000 shares	

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authorized, 4,732,705 shares issued	47
Additional paid-in capital	20,121
Retained earnings	7,371
Deferred compensation	(119)
Treasury stock, cost of 1,181,600 and 1,200,400 shares, respectively	(11,223)

Total stockholders' equity	16,196

	\$ 30,060
	=====

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MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	13-WEEK PERIOD ENDED 03/31/02	13-W PERIOD 04/01
	-----	-----
Revenues:		
Restaurant sales	\$ 14,984,897	\$ 15,4
Franchise fees and royalties	314,931	3
Other	6,426	
	-----	-----
	15,306,254	15,7
	-----	-----
Costs and expenses:		
Cost of sales	4,046,195	4,2
Labor	4,881,552	5,1
Restaurant operating expenses	3,657,718	3,7
General and administrative	1,347,757	1,2
Depreciation and amortization	542,417	5
Pre-opening costs	--	
	-----	-----
	14,475,639	15,0
	-----	-----
Operating income	830,615	7
	-----	-----
Other income (expense):		
Interest income	9,842	
Interest expense	(119,324)	(1
Other, net	21,971	
	-----	-----
	(87,511)	(1
	-----	-----
Income before income tax expense	743,104	5

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Income tax expense	245,224	2
	-----	-----
Net income	\$ 497,880	\$ 3
	=====	=====
Basic and diluted income per share	\$ 0.14	\$
	=====	=====
Weighted average number of shares (basic and diluted)	3,556,285	3,5
	=====	=====

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MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	13-WE
	3/31/20

Cash flows from operating activities:	
Net income	\$ 497
Adjustments to reconcile net income to net cash provided by operating activities:	
Deferred compensation	10
Depreciation and amortization	542
Deferred gain amortization	(52)
Deferred taxes	234
Loss (gain) on sale of property, plant & equipment	
Changes in assets and liabilities:	
Royalties receivable	
Other receivables	(118)
Income tax receivable/payable	23
Inventory	44
Prepaid and other current assets	(326)
Other assets	(50)
Accounts payable	591
Accrued expenses and other liabilities	(997)
Other liabilities	230

Total adjustments	130

Net cash provided by operating activities	628

Cash flows from investing activities:	
Purchase of property, plant and equipment	(386)
Proceeds from sale of property, plant and equipment	78
Payment received on note for sale of property	1

Net cash used in investing activities	(306)

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Cash flows from financing activities:	
Net borrowings (payments) under line of credit	(300)
Purchase of treasury stock	(29)
Net cash used in financing activities	(329)
Increase (decrease) in cash and cash equivalents	(6)
Cash and cash equivalents at beginning of period	311
Cash and cash equivalents at end of period	\$ 304
Supplemental disclosure of cash flow information: Cash paid during the period:	
Interest	\$ 85
Income Taxes	\$
Non-cash investing and financing activity:	
Sale of property for note receivable	\$ 398

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MEXICAN RESTAURANTS, INC. AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

In the opinion of Mexican Restaurants, Inc. (the "Company"), the accompanying consolidated financial statements contain all adjustments (consisting only of normal recurring accruals and adjustments) necessary for a fair presentation of the consolidated financial position as of March 31, 2002, and the consolidated statements of income and cash flows for the 13-week periods ended March 31, 2002 and April 1, 2001. The consolidated statements of income for the 13-week period ended March 31, 2002 is not necessarily indicative of the results to be expected for the full year.

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2001, the FASB issued Statement on Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," (SFAS 142) which became effective for the Company at 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. The adoption of SFAS 142 resulted in the elimination of annual amortization expense related to goodwill in the amount of approximately \$329,468. If SFAS had been adopted the first quarter one year ago, adjusted net income would have been \$438,182 or \$0.12 per share. Our management has begun the process of evaluating goodwill as required by SFAS 142. Although preliminary indications are that no impairment of goodwill exists, further

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evaluation will be conducted over the balance of the second quarter of fiscal year 2002.

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 became effective for the Company at 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. There has been no impact on our financial position or results of operations due to the adoption of SFAS 144.

2. ACCOUNTING POLICIES

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

3. NET INCOME (LOSS) PER COMMON SHARE

Basic income per share is based on the weighted average shares outstanding without any dilutive effects considered. Diluted income per share reflects dilution from all contingently issuable shares, including options and warrants. As of March 31, 2002 and April 1, 2001, the Company had 1,066,770 and 949,570 options and warrants outstanding, respectively. Such stock options and warrants have the effect of increasing basic weighted average shares outstanding by 51,457 and 4,611 for the 13-weeks ended March 31, 2002 and April 1, 2001, respectively.

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: change in growth strategy; dependence on executive officers; geographic concentration; increasing susceptibility to adverse conditions in the region; changes in consumer tastes and eating habits; national, regional or local economic and real estate conditions; demographic trends; inclement weather; traffic patterns; the type, number and location of competing restaurants; inflation;

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increased food, labor and benefit costs; the availability of experienced management and hourly employees; seasonality and the timing of new restaurant openings; changes in governmental regulations; dram shop exposure; and other factors not yet experienced by the Company. The use of words such as "believes", "anticipates", "expects", "intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Readers are urged to carefully review and consider the various disclosures made by the Company in this report and in the Company's Annual Report and Form 10-K for the fiscal year ended December 30, 2001, that attempt to advise interested parties of the risks and factors that may affect the Company's business.

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RESULTS OF OPERATIONS

Revenues. The Company's revenues for the first quarter of fiscal 2002 were down \$471,747 or 3.0% to \$15.3 million compared with the same quarter one year ago. Restaurant sales for the first quarter of fiscal 2002 were down \$466,124 to \$15.0 million compared with the same quarter in fiscal 2001. The decline was primarily due to the December 30, 2001 closure of three under-performing restaurants in Boise, Idaho. In the fiscal quarter ended April 1, 2001, the three restaurants located in Boise, Idaho accounted for \$430,216 in restaurant sales. After the end of the first quarter of fiscal year 2001, in addition to the three restaurants that were closed, one restaurant was acquired from a franchisee. Total system sales at restaurants operating in both fiscal quarters ("same-stores") increased 1.4%. Company-owned same-store sales for the quarter decreased 1.4%. The decrease was due to the timing of Easter weekend, which typically features soft sales, and bad weather in our northern restaurants. Easter occurred in the second quarter one year ago but fell in the first quarter in fiscal 2002. Franchise-owned same-store sales for the quarter increased 5.0%.

Costs and Expenses. Cost of sales, consisting primarily of food and beverage costs, but also including paper and supplies, decreased as a percentage of restaurant sales in the first quarter of fiscal 2002 to 27.0% as compared with 27.5% in the same quarter in fiscal 2001. The improvement was due in part to the closure of under-performing restaurants and also due to improved buying efficiencies.

Labor and other related expenses decreased as a percentage of restaurant sales to 32.6% in the first quarter of fiscal 2002 as compared with 33.1% in the same quarter in fiscal 2001. The improvement was partly due to the closure of under-performing restaurants. The improvement was also due to labor efficiencies gained through increased same-store sales at Casa Ole and La Seniorita.

Restaurant operating expenses, which primarily includes rent, property taxes, utilities, repair and maintenance, liquor taxes and advertising, decreased as a percentage of restaurant sales to 24.4% in the first quarter of fiscal 2002 as compared with 24.5% in the same quarter in fiscal 2001. The improvement was due to lower utility and rent expenses, offset by higher advertising expenses.

General and administrative expenses increased as a percentage

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of total sales to 8.8% in the first quarter of fiscal 2002 as compared with 8.2% in the same quarter in fiscal year 2001. The increase was due, in part, to a lower revenue base as the Company closed under-performing restaurants. The increase was also due to higher bonus and legal and professional expenses.

Depreciation and amortization expense decreased as a percentage of total sales to 3.5% in the first quarter of fiscal 2002 compared with 3.6% the same quarter in fiscal 2001. The decrease was due to the adoption of SFAS 142, "Goodwill and Other Intangible Assets," which requires goodwill and other intangible assets with indefinite lives no longer be amortized. During the first quarter of fiscal year 2001, amortization expense was \$82,367.

The Company did not open any new restaurants in the first quarter of 2002; consequently, there were no pre-opening costs.

Other Income (Expense). For the first quarter of fiscal 2002, interest expense decreased by \$72,428 compared with the first quarter in fiscal 2001. The decrease was due to a decline in debt outstanding and a decline in interest rates. Total debt as of March 31, 2002 was \$6.3 million compared with \$8.1 million as of April 1, 2001.

Income Tax Expense. For the first quarter of fiscal 2002, the Company's effective tax rate was 33.0% as compared with 35.0% in the same quarter in fiscal 2001. The decrease was due to the utilization of tax credit carryforwards and the reversal of timing differences associated with restaurant closures in fiscal year 2001.

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LIQUIDITY AND CAPITAL RESOURCES

The Company met its first quarter of fiscal 2002 capital requirements with cash generated by operations. As of March 31, 2002, the Company's operations generated approximately \$628,550 in cash, as compared with \$1,201,911 in the first quarter one year ago. Cash flow generated from operations in the first quarter one year ago was unusually high due to an insurance settlement from a restaurant destroyed by fire. As of March 31, 2002, the Company had a working capital deficit of approximately \$2.4 million. 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 developments or acquisitions and remodeling of older units. During the first quarter of fiscal 2002, capital expenditures on property, plant and equipment were approximately \$386,299 as compared to \$492,640 for the first quarter of fiscal 2001. Capital expenditures included the remodeling of two restaurants. The Company also sold a previously closed restaurant for \$78,000 in cash and a note for \$400,000, for a total of \$478,000. 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 three more restaurants during the balance of fiscal year 2002. The Company estimates its capital expenditures for the remainder of the fiscal year will be approximately \$1.2 million.

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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 March 31, 2002, the Company had \$6.3 million outstanding on the credit facility and is in full compliance with all debt covenants. Over the last several years, the Company's debt was incurred to acquire Monterey's Acquisition Corp, which was acquired in July 1997, La Senorita Restaurants, which was acquired in April 30, 1999, to develop new restaurants, to remodel existing restaurants, as well as to accommodate other working capital needs. The Company paid down debt \$300,000 during the first quarter of fiscal 2002, and presently anticipates that it will use excess cash flow during the remainder of fiscal 2002 to pay down debt approximately \$1.7 million more (for a total of \$2.0 million for 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.

At its April meeting, the Company's Board of Directors authorized management to implement a limited stock repurchase program in a manner permitted under its bank financing agreement. Initially, the Company may purchase from time to time up to a total of \$350,000 of its outstanding common stock. Any shares acquired would be held for general corporate purposes, especially to offset the dilution effect on shareholders from the exercise of stock options.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not have or participate in transactions involving derivative, financial and commodity instruments. The Company's long-term debt bears interest at floating market rates. Based on amount outstanding at March 31, 2002, a 1% change in interest rates would change interest expense by \$15,750.

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PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit Number	Document Description
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99.1

Press release dated April 29, 2002,
announced the Board of Directors
authorization of a limited stock repurchase
program.

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SIGNATURES

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

MEXICAN RESTAURANTS, INC.

Dated: May 3, 2002
Curt Glowacki
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Curt Glowacki

Dated: May 3, 2002
Andrew J. Dennard
Senior Vice President,
Chief Financial Officer & Treasurer
(Principal Financial Officer and
Principal Accounting Officer)

By: /s/ Andrew J. Dennard

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EXHIBIT INDEX

Exhibit Number -----	Document Description -----
99.1	Press release dated April 29, 2002, announced the Board of Directors authorization of a limited stock repurchase program.