

CARROLS RESTAURANT GROUP, INC.

Form 10-Q

November 05, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 28, 2008

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission File Number: 001-33174

CARROLS RESTAURANT GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-1287774
(I.R.S. Employer
Identification No.)

968 James Street
Syracuse, New York 13203
(Address of principal executive office) (Zip Code)
Registrant's telephone number, including area code: (315) 424-0513

Commission File Number: 001-06553

CARROLS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 16-0958146
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)

968 James Street
Syracuse, New York 13203
(Address of principal executive offices) (Zip Code)
Registrant's telephone number including area code: (315) 424-0513

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

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

Yes No

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

Carrols Restaurant Group, Inc.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Carrols Corporation

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Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller
reporting company)

Smaller reporting company

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

As of November 1, 2008, Carrols Restaurant Group, Inc. had 21,573,775 shares of its common stock, \$.01 par value, outstanding. As of November 1, 2008, all outstanding equity securities of Carrols Corporation, which consisted of 10 shares of its common stock, were owned by Carrols Restaurant Group, Inc.

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CARROLS RESTAURANT GROUP, INC. AND CARROLS CORPORATION

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS****(In thousands of dollars, except share and per share amounts)****(Unaudited)**

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,897	\$ 7,396
Trade and other receivables	5,811	4,734
Inventories	5,225	5,339
Prepaid rent	2,936	2,803
Prepaid expenses and other current assets	6,928	6,172
Deferred income taxes	4,922	4,802
Total current assets	28,719	31,246
Property and equipment, net	222,211	200,325
Franchise rights, net (Note 4)	77,670	80,052
Goodwill (Note 4)	124,934	124,934
Intangible assets, net	709	887
Franchise agreements, at cost less accumulated amortization of \$5,757 and \$5,646, respectively	5,824	5,548
Deferred income taxes	10,505	10,559
Other assets	11,533	12,007
Total assets	\$ 482,105	\$ 465,558
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt (Note 5)	\$ 7,614	\$ 3,129
Accounts payable	20,371	20,054
Accrued interest	3,902	8,148
Accrued payroll, related taxes and benefits	15,416	18,669
Accrued income taxes payable	3,681	933
Accrued real estate taxes	4,418	3,312
Other liabilities	12,808	10,113
Total current liabilities	68,210	64,358
Long-term debt, net of current portion (Note 5)	307,408	298,154
Lease financing obligations (Note 9)	46,495	52,689
Deferred income sale-leaseback of real estate	32,551	31,348
Accrued postretirement benefits (Note 8)	2,804	3,022
Other liabilities (Note 7)	21,620	22,822
Total liabilities	479,088	472,393
Commitments and contingencies (Note 12)		
Stockholders' equity (deficit):		

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Preferred stock, par value \$.01; authorized 20,000,000 shares, issued and outstanding - none		
Voting common stock, par value \$.01; authorized 100,000,000 shares, issued and outstanding - 21,573,775 and 21,571,565 shares, respectively	216	216
Additional paid-in capital	(130)	(1,591)
Retained earnings (accumulated deficit)	1,703	(6,680)
Accumulated other comprehensive income	1,369	1,361
Treasury stock, at cost	(141)	(141)
Total stockholders' equity (deficit)	3,017	(6,835)
Total liabilities and stockholders' equity (deficit)	\$ 482,105	\$ 465,558

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF OPERATIONS****THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007****(In thousands of dollars, except share and per share amounts)****(Unaudited)**

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenues:				
Restaurant sales	\$ 208,698	\$ 203,181	\$ 614,422	\$ 591,164
Franchise royalty revenues and fees	366	328	1,077	997
Total revenues	209,064	203,509	615,499	592,161
Costs and expenses:				
Cost of sales	63,558	58,595	185,130	168,264
Restaurant wages and related expenses (including stock-based compensation expense of \$57, \$45, \$171 and \$121, respectively)	59,786	59,519	179,090	174,029
Restaurant rent expense	11,714	11,101	34,765	32,687
Other restaurant operating expenses	32,433	30,547	93,326	87,028
Advertising expense	7,826	7,458	24,874	24,442
General and administrative (including stock-based compensation expense of \$438, \$314, \$1,290 and \$947, respectively)	12,893	12,327	39,605	38,778
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses (Note 3)	53	1,810	155	1,879
Other income (Note 10)		(303)	(119)	(650)
Total operating expenses	196,387	189,161	581,049	550,142
Income from operations	12,677	14,348	34,450	42,019
Interest expense	6,861	7,690	21,418	23,647
Loss (gain) on extinguishment of debt (Note 5)			(180)	1,485
Income before income taxes	5,816	6,658	13,212	16,887
Provision for income taxes (Note 6)	2,136	1,795	4,829	5,349
Net income	\$ 3,680	\$ 4,863	\$ 8,383	\$ 11,538
Basic and diluted net income per share (Note 13)	\$ 0.17	\$ 0.23	\$ 0.39	\$ 0.54
Basic weighted average common shares outstanding (Note 13)	21,573,485	21,550,827	21,572,241	21,550,827
Diluted weighted average common shares outstanding (Note 13)	21,576,176	21,555,020	21,575,280	21,559,524

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS****NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007****(In thousands of dollars)****(Unaudited)**

	2008	2007
Cash flows provided from operating activities:		
Net income	\$ 8,383	\$ 11,538
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss (gain) on disposals of property and equipment	102	(57)
Stock-based compensation expense	1,461	1,068
Depreciation and amortization	24,223	23,685
Amortization of deferred financing costs	890	940
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,582)	(1,460)
Impairment losses	155	1,879
Gain on settlements of lease financing obligations	(48)	(163)
Accretion of interest on lease financing obligations	180	397
Deferred income taxes	(58)	(319)
Accrued income taxes	2,748	331
Loss (gain) on extinguishment of debt	(180)	1,485
Changes in other operating assets and liabilities	(5,501)	3,656
Net cash provided from operating activities	29,157	41,364
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,464)	(26,241)
Restaurant remodeling	(9,622)	(5,850)
Other restaurant capital expenditures	(6,903)	(6,825)
Corporate and restaurant information systems	(5,835)	(1,840)
Total capital expenditures	(48,824)	(40,756)
Properties purchased for sale-leaseback		(2,461)
Proceeds from sale-leaseback transactions	6,788	7,036
Proceeds from sales of other properties	119	1,623
Net cash used for investing activities	(41,917)	(34,558)
Cash flows provided from (used for) financing activities:		
Repayment of term loans under prior credit facility		(118,400)
Borrowings on revolving credit facility	109,600	45,500
Repayments on revolving credit facility	(92,400)	(44,300)
Proceeds from new senior credit facility		120,000
Principal payments on term loans	(1,500)	
Principal payments on capital leases	(119)	(262)
Expenses from initial public offering		(21)
Financing costs associated with issuance of debt		(1,228)
Repurchase of senior subordinated notes	(1,820)	

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Settlement of lease financing obligations	(5,500)	(4,412)
Net cash provided from (used for) financing activities	8,261	(3,123)
Net increase (decrease) in cash and cash equivalents	(4,499)	3,683
Cash and cash equivalents, beginning of period	7,396	3,939
Cash and cash equivalents, end of period	\$ 2,897	\$ 7,622
Supplemental disclosures:		
Interest paid on long-term debt	\$ 20,984	\$ 22,932
Interest paid on lease financing obligations	\$ 3,578	\$ 3,700
Increase (decrease) in accruals for capital expenditures	\$ 68	\$ (348)
Income taxes paid	\$ 2,141	\$ 3,064
Non-cash reduction of assets under lease financing obligations due to lease amendments	\$ 298	\$
Non-cash reduction of lease financing obligations due to lease amendments	\$ 880	\$
Capital lease obligations incurred	\$ 158	\$ 88

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****(in thousands of dollars except share and per share amounts)****1. Basis of Presentation**

Basis of Consolidation. The unaudited consolidated financial statements presented herein include the accounts of Carrols Restaurant Group, Inc. (Carrols Restaurant Group or the Company) and its wholly-owned subsidiary Carrols Corporation (Carrols). Carrols Restaurant Group is a holding company and conducts all of its operations through Carrols and its wholly-owned subsidiaries. Unless the context otherwise requires, Carrols Restaurant Group, Carrols and the direct and indirect subsidiaries of Carrols are collectively referred to as the Company. All intercompany transactions have been eliminated in consolidation.

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

Business Description. At September 30, 2008 the Company operated, as franchisee, 317 quick-service restaurants under the trade name Burger King in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2008, the Company also owned and operated 89 Pollo Tropical restaurants, of which 86 were located in Florida and three were located in New Jersey, and franchised a total of 27 Pollo Tropical restaurants, 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2008, the Company owned and operated 153 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico, one in Texas and one in Georgia.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 30, 2007 and December 31, 2006 will be referred to as the fiscal years ended December 31, 2007 and 2006, respectively. Similarly, all references herein to the three and nine months ended September 28, 2008 and September 30, 2007 will be referred to as the three and nine months ended September 30, 2008 and September 30, 2007, respectively. The years ended December 31, 2007 and 2006 each contained 52 weeks and the three and nine months ended September 30, 2008 and 2007 contained thirteen and thirty-nine weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission and do not include certain of the information and the footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of such financial statements have been included. The results of operations for the three and nine months ended September 30, 2008 and 2007 are not necessarily indicative of the results to be expected for the full year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2007 contained in the Company's 2007 Annual Report on Form 10-K. The December 31, 2007 balance sheet data is derived from those audited financial statements.

Reclassification of previously issued interim financial statements. The Company has reclassified certain prior year amounts related to its Pollo Tropical restaurant expenses from cost of sales to other restaurant operating expenses in order to conform to the 2008 presentation in the Company's interim results of operations and the presentation in the Company's 2007 Annual Report on Form 10-K. The amount of increase (decrease) in previously reported interim amounts was as follows:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Cost of sales	\$ (271)	\$ (798)
Other restaurant operating expenses	271	798
Total	\$	\$

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Use of Estimates. The preparation of the 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 and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates include: accrued occupancy costs, insurance liabilities, legal obligations, income taxes, evaluation for impairment of goodwill, long-lived assets and Burger King franchise rights, lease accounting matters and stock-based compensation. Actual results could differ from those estimates.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars except share and per share amounts)

2. Stock-Based Compensation

The Company adopted an incentive stock plan in 2006 (the 2006 Plan) under which incentive stock options, non-qualified stock options and restricted shares may be granted to employees and non-employee directors.

On January 15, 2008, the Company granted options to purchase 517,820 shares of its common stock, consisting of 160,000 shares of non-qualified stock options and 357,820 shares of incentive stock options (ISOs), and issued 7,100 shares of restricted stock. The non-qualified stock options and ISOs granted are exercisable for up to one-fifth of the total number of option shares on or after the first anniversary of the grant date and as of the first day of each month thereafter are exercisable for an additional one-sixtieth of the total number of option shares until fully exercisable. The options expire seven years from the date of the grant and were issued with an exercise price equal to the fair market value of the stock price, or \$8.08 per share of common stock, on the date of grant. The restricted stock awards vest 100% on the third anniversary of the award date.

During the three months ended September 30, 2008 an aggregate of 60,500 ISO s were granted under the 2006 Plan. The options were issued with an exercise price equal to the fair market value of the stock price, or \$5.17 per share, on the date of grant and generally vest 20% per year. During the three months ended September 30, 2008 and 2007, there were an aggregate of 7,000 and 7,200 restricted shares granted to certain employees, respectively. The restricted shares granted to employees in 2008 vest 100% three years from the date of grant. The restricted shares granted in 2007 vest 33% per year.

The Company currently uses and will continue to use the simplified method to estimate the expected term for share option grants until it has enough historical experience to provide a reasonable estimate of expected term in accordance with Staff Accounting Bulletin No. 110 (SAB 110). The weighted average fair-value of options granted during the three months ended September 30, 2008 was \$2.02 which was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2008
Risk-free interest rate	3.20%
Annual dividend yield	0%
Expected term	5 years
Expected volatility	39%

Stock-based compensation expense for the three and nine months ended September 30, 2008 was \$0.5 million and \$1.5 million, respectively and for the three and nine months ended September 30, 2007 was \$0.4 million and \$1.1 million, respectively.

As of September 30, 2008, the total non-vested stock-based compensation expense relating to the options and restricted shares is approximately \$4.0 million and the Company expects to record an additional \$0.5 million as compensation expense in 2008. The remaining weighted average vesting period for the stock options is 3.7 years and restricted shares is approximately 2.03 years at September 30, 2008.

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(in thousands of dollars except share and per share amounts)

Stock Options

A summary of all option activity for the nine months ended September 30, 2008 was as follows:

		2006 Plan			
	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands) (1)	
Options outstanding at January 1, 2008	1,214,690	\$ 14.31	6.0	\$	
Granted	588,820	7.75			
Forfeited	(60,890)	12.51			
Options outstanding at September 30, 2008	1,742,620	\$ 12.16	5.6	\$	
Expected to vest at September 30, 2008	1,298,798	\$ 11.51	5.7	\$	
Options exercisable at September 30, 2008	408,135	\$ 14.31	5.2	\$	

- (1) The aggregate intrinsic value was calculated using the difference between the market price of the Company's common stock at September 30, 2008 and the grant price for only those awards that have a grant price that is less than the market price of the Company's common stock at September 30, 2008.

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2008 was as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	55,398	\$ 13.22
Shares granted	14,100	6.64
Shares vested	(2,210)	6.67
Shares forfeited	(4,124)	12.03
Nonvested at September 30, 2008	63,164	\$ 11.78

The value of restricted shares is determined based on the Company's closing price on the date of grant.

3. Impairment of Long-Lived Assets

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The Company reviews its long-lived assets, principally property and equipment, for impairment at the restaurant level. If an indicator of impairment exists for any of its assets, an estimate of undiscounted future cash flows from the related long-lived assets is compared to that long-lived asset's carrying value. If the carrying value is greater than the undiscounted cash flow, the Company then determines the fair value of the asset. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value.

During the third quarter of 2007, the Company impaired an underperforming Pollo Tropical restaurant located in Brooklyn, NY for \$1.7 million. The restaurant was subsequently closed in the fourth quarter of 2007.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars except share and per share amounts)

For the three and nine months ended September 30, 2008 and 2007, the Company recorded impairment losses on long-lived assets for its segments as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Burger King	\$ 43	\$ 54	\$ 135	\$ 68
Pollo Tropical	5	1,657	5	1,657
Taco Cabana	5	99	15	154
	\$ 53	\$ 1,810	\$ 155	\$ 1,879

4. Goodwill and Franchise Rights

Goodwill. Goodwill is reviewed for impairment annually, or more frequently when events and circumstances indicate that the carrying amounts may be impaired. The Company performs its annual impairment assessment as of December 31 and does not believe circumstances have changed since the last assessment date which would make it necessary to reassess their values. Goodwill balances are summarized below:

	Pollo Tropical	Taco Cabana	Burger King	Total
Balance, September 30, 2008	\$ 56,307	\$ 67,177	\$ 1,450	\$ 124,934

Burger King Franchise Rights. Amounts allocated to franchise rights for each Burger King acquisition are amortized using the straight-line method over the average remaining term of the acquired franchise agreements at January 1, 2002 plus one twenty-year renewal period. The Company assesses the potential impairment of franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If an indicator of impairment exists, an estimate of the aggregate undiscounted future cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each Burger King acquisition. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value. There were no impairment charges recorded against franchise rights for the three and nine months ended September 30, 2008 and 2007.

Amortization expense related to Burger King franchise rights was \$799 and \$805 for the three months ended September 30, 2008 and 2007, respectively. Amortization expense related to Burger King franchise rights was \$2,399 and \$2,412 for the nine months ended September 30, 2008 and 2007. The Company estimates the amortization expense for the year ending December 31, 2008 to be \$3,197 and for each of the five succeeding years to be \$3,196.

5. Long-term Debt

Long-term debt at September 30, 2008 and December 31, 2007 consisted of the following:

September 30, 2008	December 31, 2007
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Collateralized:		
Senior Credit Facility - Revolving credit facility	\$ 17,200	\$
Senior Credit Facility-Term loan A facility	118,500	120,000
Unsecured:		
9% Senior Subordinated Notes	178,000	180,000
Capital leases	1,322	1,283
	315,022	301,283
Less: current portion	(7,614)	(3,129)
	\$ 307,408	\$ 298,154

On March 9, 2007, Carrols terminated and replaced its prior senior credit facility with a new senior credit facility with a syndicate of lenders. Carrols credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the 9% Senior Subordinated Notes due 2013 are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all outstanding borrowings and other

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

obligations under the Carrols prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. The Company also recorded a \$1.5 million loss on extinguishment of debt in the nine months ended September 30, 2007 for the write-off of deferred financing costs related to the prior senior credit facility.

The term loan and revolving credit borrowings under the senior credit facility bear interest at a per annum rate, at Carrols option, of either:

1) the applicable margin ranging from 0% to 0.25% based on Carrols senior leverage ratio (as defined in the new senior credit facility) plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or

2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on Carrols senior leverage ratio. At September 30, 2008 the LIBOR margin percentage was 1.25%.

Term loan A borrowings are due and payable in quarterly installments. Remaining principal payments are as follows:

1) three quarterly installments of \$1.5 million beginning on September 30, 2008;

2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;

3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and

4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the senior credit facility, Carrols is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an initial amount equal to 50% of Excess Cash Flow depending upon Carrols Total Leverage Ratio (as such terms are defined in the senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by Carrols therefrom, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, Carrols obligations under the senior credit facility are guaranteed by the Company and all of Carrols material subsidiaries and are collateralized by a pledge of Carrols common stock and the stock of each of Carrols material subsidiaries. The senior credit facility contains certain covenants, including, without limitation, those limiting Carrols ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of its business, engage in transactions with related parties, make certain investments or pay dividends. In addition, Carrols is required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the senior credit facility). Carrols was in compliance with the covenants under its senior credit facility as of September 30, 2008.

At September 30, 2008, \$118.5 million principal amount of term loan borrowings were outstanding under the term loan A facility and \$17.2 million principal amount of borrowings were outstanding under the revolving credit facility. After reserving \$14.2 million for letters of credit guaranteed by the facility, \$33.6 million was available for borrowings under the revolving credit facility at September 30, 2008.

On December 15, 2004, Carrols issued \$180 million of 9% Senior Subordinated Notes due 2013, which are referred to herein as the senior subordinated notes. Restrictive covenants under the senior subordinated notes include limitations with respect to the Carrols ability to issue additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. On April 7, 2008, Carrols purchased and retired \$2.0 million of its senior subordinated notes in an open market transaction. This resulted in a gain on extinguishment of debt of \$0.2 million. At September 30, 2008 and December 31, 2007, \$178.0 million and \$180.0 million principal amount of the senior subordinated notes were outstanding, respectively.

6. Income Taxes

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The provision for income taxes for the three and nine months ended September 30, 2008 and 2007 was comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Current	\$ 2,443	\$ 1,904	\$ 4,887	\$ 5,668
Deferred	(307)	(109)	(58)	(319)
	\$ 2,136	\$ 1,795	\$ 4,829	\$ 5,349

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars except share and per share amounts)

The provision for income taxes for the three and nine months ended September 30, 2008 was derived using an estimated effective annual income tax rate for 2008 of 37.2%, which excludes any discrete tax adjustments. Discrete tax adjustments increased the provision for income taxes by \$15 for the three months ended September 30, 2008 and decreased the provision for income taxes by \$97 for the nine months ended September 30, 2008.

The provision for income taxes for the three and nine months ended September 30, 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5% as well as the effect of any discrete tax items occurring in those periods. In addition to the discrete tax adjustment discussed in the following paragraph, the Company also recorded in the three months ended September 30, 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards.

The Company adopted the provisions of Financial Standards Accounting Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes , (FIN 48), an interpretation of FASB Statement No. 109 (SFAS 109), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in its consolidated financial statements. As of the adoption date of January 1, 2007, the Company had \$0.6 million of unrecognized tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.5 million of unrecognized tax benefits and \$0.1 million of accrued interest expired. The Company recorded this tax benefit as a discrete tax item in the third quarter of 2007.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2008, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions.

The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject. It is not possible to reasonably estimate any possible change in the unrecognized tax benefits within the next twelve months.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007
Unearned purchase discounts	\$ 559	\$ 2,231
Accrued occupancy costs	10,439	9,667
Accrued workers' compensation costs	4,466	4,418
Other	6,156	6,506
	\$ 21,620	\$ 22,822

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At both September 30, 2008 and December 31, 2007, the Company had \$0.5 million in lease liability reserves for remaining locations that are included in accrued occupancy costs.

8. Postretirement Benefits

The Company provides postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management salaried employees. A December 31 measurement date is used for postretirement benefits. On November 1, 2007 the Company amended its postretirement medical and life insurance benefits to eliminate life insurance benefits for active employees who retire after

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December 31, 2007 and to increase retiree contributions for both current and future retirees effective January 1, 2008. These amendments reduced the Company's postretirement benefit obligations and reduced expense in the three and nine months ended September 30, 2008.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars except share and per share amounts)

The following summarizes the components of net periodic benefit cost:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Service cost	\$ 7	\$ 124	\$ 21	\$ 370
Interest cost	27	101	80	304
Amortization of gains and losses	22	24	65	72
Amortization of unrecognized prior service cost	(90)	1	(269)	4
Net periodic postretirement benefit cost (benefit)	\$ (34)	\$ 250	\$ (103)	\$ 750

During the three and nine months ended September 30, 2008, the Company made contributions of \$56 and \$136 to its postretirement plan.

9. Lease Financing Obligations

The Company entered into sale-leaseback transactions in various years involving certain restaurant properties that did not qualify for sale-leaseback accounting and as a result, have been classified as financing transactions under Statement of Financial Accounting Standards (SFAS) No. 98, Accounting for Leases (SFAS 98). Under the financing method, the assets remain on the consolidated balance sheet and proceeds received by the Company from these transactions are recorded as a financing liability. Payments under these leases are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

In the second quarter of 2008, the Company purchased from the lessor six restaurant properties for \$5.5 million that were previously accounted for as lease financing obligations. As a result, the Company reduced its lease financing obligations by \$5.5 million and recorded a loss of \$31 as an increase to interest expense which represented the amount by which the purchase price exceeded the lease financing obligations.

In the second quarter of 2007, the Company exercised its right of first refusal under the leases for five restaurant properties previously accounted for as lease financing obligations and purchased these properties from the lessor. As a result, the Company reduced its lease financing obligations by \$4.4 million. The Company also recorded a gain of \$0.2 million as a reduction of interest expense which represented the net amount by which the lease financing obligations exceeded the purchase price of the acquired restaurant properties.

Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2008 and 2007 was \$1.1 million and \$1.4 million, respectively, and for the nine months ended September 30, 2008 and 2007 was \$3.8 million and \$4.2 million, respectively.

10. Other Income

The Company recorded a gain of \$0.1 million in the nine months ended September 30, 2008 and a gain of \$0.3 million in the nine months ended September 30, 2007 each related to the sale of a Taco Cabana property. In the third quarter of 2007, the Company also recorded a gain of \$0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

11. Business Segment Information

The Company is engaged in the quick-service and quick-casual restaurant industry, with three restaurant concepts: Burger King operating as a franchisee and Pollo Tropical and Taco Cabana, both Company-owned concepts. The Company's Burger King restaurants are all located in the

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United States, primarily in the Northeast, Southeast and Midwest. Pollo Tropical is a quick-casual restaurant chain featuring grilled marinated chicken and Caribbean style made from scratch side dishes. Pollo Tropical's core markets are located in South and Central Florida. Taco Cabana is a quick-casual restaurant chain featuring fresh Mexican style food, including flame-grilled beef and chicken fajitas, quesadillas and other Tex-Mex dishes. Taco Cabana's core markets are primarily located in Texas.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies. The following table includes Segment EBITDA which is the measure of segment profit or loss reported to the chief operating decision maker for purposes of allocating resources to the segments and assessing their performance. Segment EBITDA is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense, other income and expense and gains and losses on extinguishment of debt.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars except share and per share amounts)

The Other column includes corporate related items not allocated to reportable segments, including stock-based compensation expense. Other identifiable assets consist primarily of cash, certain other assets, corporate property and equipment including restaurant information systems expenditures, goodwill and deferred income taxes.

Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2008:					
Total revenues	\$ 43,389	\$ 64,132	\$ 101,543	\$	\$ 209,064
Cost of sales	14,312	19,646	29,600		63,558
Restaurant wages and related expenses	10,662	18,357	30,710	57	59,786
General and administrative expenses (1)	2,996	3,036	6,423	438	12,893
Depreciation and amortization	2,032	2,261	3,492	339	8,124
Segment EBITDA	5,222	7,308	8,819		
Capital expenditures, including acquisitions	3,656	7,320	5,369	3,250	19,595
September 30, 2007:					
Total revenues	\$ 42,560	\$ 61,254	\$ 99,695	\$	\$ 203,509
Cost of sales	13,426	18,532	26,637		58,595
Restaurant wages and related expenses	10,495	17,652	31,327	45	59,519
General and administrative expenses (1)	2,190	2,655	7,168	314	12,327
Depreciation and amortization	1,763	2,163	3,827	354	8,107
Segment EBITDA	7,776	7,348	9,197		
Capital expenditures, including acquisitions	5,202	5,043	2,437	347	13,029
Nine Months Ended					
September 30, 2008:					
Total revenues	\$ 133,125	\$ 187,825	\$ 294,549	\$	\$ 615,499
Cost of sales	43,965	58,022	83,143		185,130
Restaurant wages and related expenses	32,861	54,601	91,457	171	179,090
General and administrative expenses (1)	8,324	9,048	20,943	1,290	39,605
Depreciation and amortization	5,948	6,423	10,741	1,111	24,223
Segment EBITDA	17,959	19,679	22,532		
Capital expenditures, including acquisitions	15,064	16,360	11,565	5,835	48,824
September 30, 2007:					
Total revenues	\$ 126,846	\$ 180,222	\$ 285,093	\$	\$ 592,161
Cost of sales	40,440	53,485	74,339		168,264
Restaurant wages and related expenses	31,460	51,526	90,922	121	174,029
General and administrative expenses (1)	7,226	8,256	22,349	947	38,778
Depreciation and amortization	4,927	6,337	11,428	993	23,685
Segment EBITDA	21,862	22,723	23,416		
Capital expenditures, including acquisitions	18,442	13,086	7,388	1,840	40,756
Identifiable Assets:					
At September 30, 2008	\$ 68,718	\$ 83,998	\$ 149,672	\$ 179,717	\$ 482,105
At December 31, 2007	59,609	79,370	148,467	178,112	465,558

(1) For the Pollo Tropical and Taco Cabana segments, such amounts include general and administrative expenses related directly to each segment. For the Burger King segment such amounts include general and administrative expenses related directly to the Burger King

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segment as well as expenses associated with administrative support to all three of the Company's segments including executive management, information systems and certain accounting, legal and other administrative functions.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****(in thousands of dollars except share and per share amounts)**

A reconciliation of segment EBITDA to consolidated net income is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Segment EBITDA:				
Pollo Tropical	\$ 5,222	\$ 7,776	\$ 17,959	\$ 21,862
Taco Cabana	7,308	7,348	19,679	22,723
Burger King	8,819	9,197	22,532	23,416
Subtotal	21,349	24,321	60,170	68,001
Less:				
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses	53	1,810	155	1,879
Interest expense	6,861	7,690	21,418	23,647
Provision for income taxes	2,136	1,795	4,829	5,349
Stock-based compensation expense	495	359	1,461	1,068
Loss (gain) on extinguishment of debt			(180)	1,485
Other income		(303)	(119)	(650)
Net income	\$ 3,680	\$ 4,863	\$ 8,383	\$ 11,538

12. Commitments and Contingencies

On November 16, 1998, the Equal Employment Opportunity Commission (EEOC) filed suit in the United States District Court for the Northern District of New York (the Court), under Title VII of the Civil Rights Act of 1964, as amended, against Carrols. The complaint alleged that Carrols engaged in a pattern and practice of unlawful discrimination, harassment and retaliation against former and current female employees. The EEOC identified approximately 450 individuals (which were subsequently increased to 511 individuals) that it believed represented the class of claimants and was seeking monetary and injunctive relief from Carrols. On April 20, 2005, the Court issued a decision and order granting Carrols Motion for Summary Judgment that Carrols filed in January 2004. Subject to possible appeal by the EEOC, the case is dismissed; however the Court noted that it was not ruling on the claims, if any, that individual employees might have against Carrols. On February 27, 2006, Carrols filed a motion for summary judgment to dismiss all but between four and 17 of the individual claims. On July 10, 2006, in its response to that motion, the EEOC asserted that, notwithstanding the Court s dismissal of the case as a class action, the EEOC may still maintain some kind of collective action on behalf of these claimants. Oral argument before the Court was held on October 4, 2006 and the Company is awaiting the Court s decision on Carrols summary judgment motion. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements. Although the Company believes that the EEOC s continued class litigation argument is without merit, it is not possible to predict the outcome of the pending motion.

On November 30, 2002, four former hourly employees commenced a lawsuit against Carrols in the United States District Court for the Western District of New York (the Court) entitled Dawn Seever, et al. v. Carrols Corporation. The lawsuit alleged, in substance, that Carrols violated certain minimum wage laws under the Federal Fair Labor Standards Act and related state laws by requiring employees to work without recording their time and by retaliating against those who complained. The plaintiffs sought damages, costs and injunctive relief. They also sought to notify and certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for Carrols. On December 17, 2007, the Court issued a decision and order denying Plaintiffs motion for notice and class certification and granting the Company s motion to dismiss all of the claims of the plaintiffs, other than certain nominal claims relating to orientation and managers meetings. The Court instructed the parties to confer, in good faith, and settle those nominal claims. Subject to settlement of the amounts for orientation and managers

meetings and possible appeal by the Plaintiffs, the case is concluded. The Company does not believe that these settlement amounts will be material to its consolidated financial statements.

Table of Contents**CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****(in thousands of dollars except share and per share amounts)**

The Company is a party to various other litigation matters incidental to the conduct of business. The Company does not believe that the outcome of any of these other matters will have a material adverse effect on its consolidated financial statements.

13. Net Income Per Share

Basic net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding plus the dilutive effect of outstanding stock options using the treasury stock method.

The computation of diluted net income per share excludes options to purchase 1,104,505 and 1,226,450 shares of common stock in each of the three months ended September 30, 2008 and 2007, respectively, because the exercise price of these options was greater than the average market price of the common shares in the periods and therefore, they were antidilutive. In addition, options to purchase 1,155,603 and 1,232,950 shares of common stock are excluded from the computation of diluted net income per share in each of the three and nine months ended September 30, 2008 and 2007, respectively, as they were antidilutive under the treasury stock method.

The following table is a reconciliation of the income and share amounts used in the calculation of basic net income per share and diluted net income per share:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Basic net income per share:				
Net income	\$ 3,680	\$ 4,863	\$ 8,383	\$ 11,538
Weighted average common shares outstanding	21,573,485	21,550,827	21,572,241	21,550,827
Basic net income per share	\$ 0.17	\$ 0.23	\$ 0.39	\$ 0.54
Diluted net income per share:				
Net income for diluted net income per share	\$ 3,680	\$ 4,863	\$ 8,383	\$ 11,538
Shares used in computed basic net income per share	21,573,485	21,550,827	21,572,241	21,550,827
Dilutive effect of restricted shares and stock options	2,691	4,193	3,039	8,697
Shares used in computed diluted net income per share	21,576,176	21,555,020	21,575,280	21,559,524
Diluted net income per share	\$ 0.17	\$ 0.23	\$ 0.39	\$ 0.54

14. Comprehensive Income

SFAS No. 130, Reporting Comprehensive Income (SFAS 130), requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with U.S. generally accepted accounting principles. The items that currently impact the Company's other comprehensive income are changes in postretirement benefit obligations, net of tax.

Three months ended September 30,		Nine months ended September 30,	
2008	2007	2008	2007

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Net income	\$ 3,680	\$ 4,863	\$ 8,383	\$ 11,538
Change in postretirement benefit obligation, net of tax			8	
Comprehensive income	\$ 3,680	\$ 4,863	\$ 8,391	\$ 11,538

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CARROLS RESTAURANT GROUP, INC. AND SUBSIDIARY

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars except share and per share amounts)

15. Recent Accounting Developments

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS 157). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. In February 2007, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS 157 for financial assets and financial liabilities, effective for fiscal 2008, did not have a material impact on the Company's consolidated financial statements. The Company is currently evaluating the impact SFAS 157 may have for nonfinancial assets and liabilities in its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the Company's fiscal year beginning January 1, 2008. The Company did not elect to begin reporting any financial assets or liabilities at fair value upon adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financials Statements, an Amendment of ARB No. 51 (SFAS 160). SFAS 160 clarifies the accounting for non controlling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact SFAS 160 will have on its consolidated financial statements.

In April 2008, the FASB issued FSP SFAS No. 142-3 Determination of the Useful Life of Intangible Assets (SFAS 142-3). SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumption used to determine the useful life of a recognized intangible asset under SFAS No. 142. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will require the Company to adopt these provisions in the first quarter of 2009. The Company has reviewed this pronouncement and does not anticipate the adoption of SFAS No. 142-3 will materially impact its financial statements.

Table of Contents**ITEM 1 INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****CARROLS CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands of dollars except share and per share amounts)

(Unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,897	\$ 7,396
Trade and other receivables	5,811	4,734
Inventories	5,225	5,339
Prepaid rent	2,936	2,803
Prepaid expenses and other current assets	6,928	6,172
Deferred income taxes	4,922	4,802
Total current assets	28,719	31,246
Property and equipment, net	222,211	200,325
Franchise rights, net (Note 4)	77,670	80,052
Goodwill (Note 4)	124,934	124,934
Intangible assets, net	709	887
Franchise agreements, at cost less accumulated amortization of \$5,757 and \$5,646, respectively	5,824	5,548
Deferred income taxes	10,505	10,559
Other assets	11,533	12,007
Total assets	\$ 482,105	\$ 465,558
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)		
Current liabilities:		
Current portion of long-term debt (Note 5)	\$ 7,614	\$ 3,129
Accounts payable	20,371	20,054
Accrued interest	3,902	8,148
Accrued payroll, related taxes and benefits	15,416	18,669
Accrued income taxes payable	3,681	933
Accrued real estate taxes	4,418	3,312
Other liabilities	12,808	10,113
Total current liabilities	68,210	64,358
Long-term debt, net of current portion (Note 5)	307,408	298,154
Lease financing obligations (Note 9)	46,495	52,689
Deferred income sale-leaseback of real estate	32,551	31,348
Accrued postretirement benefits (Note 8)	2,804	3,022
Other liabilities (Note 7)	21,577	22,784
Total liabilities	479,045	472,355
Commitments and contingencies (Note 12)		
Stockholder s equity (deficit):		
Common stock, par value \$1; authorized 1,000 shares, issued and outstanding 10 shares at both dates		
Additional paid-in capital	(7,623)	(9,084)

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Retained earnings	9,314	926
Accumulated other comprehensive income	1,369	1,361
Total stockholder's equity (deficit)	3,060	(6,797)
Total liabilities and stockholder's equity (deficit)	\$ 482,105	\$ 465,558

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007****(In thousands of dollars)****(Unaudited)**

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenues:				
Restaurant sales	\$ 208,698	\$ 203,181	\$ 614,422	\$ 591,164
Franchise royalty revenues and fees	366	328	1,077	997
Total revenues	209,064	203,509	615,499	592,161
Costs and expenses:				
Cost of sales	63,558	58,595	185,130	168,264
Restaurant wages and related expenses (including stock-based compensation expense of \$57, \$45, \$171 and \$121, respectively)	59,786	59,519	179,090	174,029
Restaurant rent expense	11,714	11,101	34,765	32,687
Other restaurant operating expenses	32,433	30,547	93,326	87,028
Advertising expense	7,826	7,458	24,874	24,442
General and administrative (including stock-based compensation expense of \$438, \$314, \$1,290 and \$947, respectively)	12,891	12,325	39,600	38,773
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses (Note 3)	53	1,810	155	1,879
Other income (Note 10)		(303)	(119)	(650)
Total operating expenses	196,385	189,159	581,044	550,137
Income from operations	12,679	14,350	34,455	42,024
Interest expense	6,861	7,690	21,418	23,647
Loss (gain) on extinguishment of debt (Note 5)			(180)	1,485
Income before income taxes	5,818	6,660	13,217	16,892
Provision for income taxes (Note 6)	2,136	1,795	4,829	5,349
Net income	\$ 3,682	\$ 4,865	\$ 8,388	\$ 11,543

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007****(In thousands of dollars)****(Unaudited)**

	2008	2007
Cash flows provided from operating activities:		
Net income	\$ 8,388	\$ 11,543
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss (gain) on disposals of property and equipment	102	(57)
Stock-based compensation expense	1,461	1,068
Depreciation and amortization	24,223	23,685
Amortization of deferred financing costs	890	940
Amortization of unearned purchase discounts	(1,616)	(1,616)
Amortization of deferred gains from sale-leaseback transactions	(1,582)	(1,460)
Impairment losses	155	1,879
Accretion of interest on lease financing obligations	180	397
Deferred income taxes	(58)	(319)
Accrued income taxes	2,748	331
Loss (gain) on extinguishment of debt	(180)	1,485
Gain on settlements of lease financing obligations	(48)	(163)
Changes in other operating assets and liabilities	(5,506)	3,651
Net cash provided from operating activities	29,157	41,364
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(26,464)	(26,241)
Restaurant remodeling	(9,622)	(5,850)
Other restaurant capital expenditures	(6,903)	(6,825)
Corporate and restaurant information systems	(5,835)	(1,840)
Total capital expenditures	(48,824)	(40,756)
Properties purchased for sale-leaseback		(2,461)
Proceeds from sale-leaseback transactions	6,788	7,036
Proceeds from sales of other properties	119	1,623
Net cash used for investing activities	(41,917)	(34,558)
Cash flows provided from (used for) financing activities:		
Repayment of term loans under prior credit facility		(118,400)
Borrowings on revolving credit facility	109,600	45,500
Repayments on revolving credit facility	(92,400)	(44,300)
Proceeds from new senior credit facility		120,000
Settlement of lease financing obligations	(5,500)	(4,412)
Repurchase of senior subordinated notes	(1,820)	
Principal payments on term loans	(1,500)	
Principal payments on capital leases	(119)	(262)
Expenses from initial public offering		(21)

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Financing costs associated with issuance of debt		(1,228)
Net cash provided from (used for) financing activities	8,261	(3,123)
Net increase (decrease) in cash and cash equivalents	(4,499)	3,683
Cash and cash equivalents, beginning of period	7,396	3,939
Cash and cash equivalents, end of period	\$ 2,897	\$ 7,622
Supplemental disclosures:		
Interest paid on long-term debt	\$ 20,984	\$ 22,932
Interest paid on lease financing obligations	\$ 3,578	\$ 3,700
Increase (decrease) in accruals for capital expenditures	\$ 68	\$ (348)
Income taxes paid	\$ 2,141	\$ 3,064
Non-cash reduction of assets under lease financing obligations due to lease amendments	\$ 298	\$
Non-cash reduction of lease financing obligations due to lease amendments	\$ 880	\$
Capital lease obligations incurred	\$ 158	\$ 88

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

1. Basis of Presentation

Basis of Consolidation. The unaudited consolidated financial statements presented herein include the accounts of Carrols Corporation and its subsidiaries (the Company). The Company is a wholly-owned subsidiary of Carrols Restaurant Group, Inc. (Carrols Restaurant Group or the Parent Company). All intercompany transactions have been eliminated in consolidation.

The difference between the consolidated financial statements of Carrols Corporation and Carrols Restaurant Group is primarily due to additional rent expense of approximately \$6 per year for Carrols Restaurant Group and the composition of stockholder's equity (deficit).

Business Description. At September 30, 2008 the Company operated, as franchisee, 317 quick-service restaurants under the trade name Burger King in 12 Northeastern, Midwestern and Southeastern states. At September 30, 2008, the Company also owned and operated 89 Pollo Tropical restaurants of which 86 were located in Florida and three were located in New Jersey, and franchised a total of 27 Pollo Tropical restaurants, 23 in Puerto Rico, two in Ecuador and two on college campuses in Florida. At September 30, 2008, the Company owned and operated 153 Taco Cabana restaurants located primarily in Texas and franchised two Taco Cabana restaurants in New Mexico, one in Texas and one in Georgia.

Fiscal Year. The Company uses a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 30, 2007 and December 31, 2006 will be referred to as the fiscal years ended December 31, 2007 and 2006, respectively. Similarly, all references herein to the three and nine months ended September 28, 2008 and September 30, 2007 will be referred to as the three and nine months ended September 30, 2008 and September 30, 2007, respectively. The years ended December 31, 2007 and 2006 each contained 52 weeks and the three and nine months ended September 30, 2008 and 2007 contained thirteen and thirty-nine weeks, respectively.

Basis of Presentation. The accompanying unaudited consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 have been prepared without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission and do not include certain of the information and the footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation of such financial statements have been included. The results of operations for the three and nine months ended September 30, 2008 and 2007 are not necessarily indicative of the results to be expected for the full year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2007 contained in the Company's 2007 Annual Report on Form 10-K. The December 31, 2007 balance sheet data is derived from those audited financial statements.

Reclassification of previously issued interim financial statements. The Company has reclassified certain prior year amounts related to its Pollo Tropical restaurant expenses from cost of sales to other restaurant operating expenses in order to conform to the 2008 presentation in the Company's interim results of operations and the presentation in the Company's 2007 Annual Report on Form 10-K. The amount of increase (decrease) in previously reported interim amounts was as follows:

	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2007
Cost of sales	(271)	(798)
Other restaurant operating expenses	271	798
Total	\$	\$

Use of Estimates. The preparation of the 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 and disclosure of

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contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant items subject to such estimates include: accrued occupancy costs, insurance liabilities, legal obligations, income taxes, evaluation for impairment of goodwill, long-lived assets and Burger King franchise rights, lease accounting matters and stock-based compensation. Actual results could differ from those estimates.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****(in thousands of dollars, except share and per share amounts)**

Earnings Per Share Presentation. The guidance of Statement of Financial Accounting Standards (SFAS) No. 128, Earnings Per Share, requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market. The Company's common stock is not publicly traded and therefore, earnings per share amounts are not presented.

2. Stock-Based Compensation

Carrols Restaurant Group adopted an incentive stock plan in 2006 (the 2006 Plan) under which incentive stock options, non-qualified stock options and restricted shares may be granted to employees and non-employee directors.

On January 15, 2008, Carrols Restaurant Group granted options to purchase 517,820 shares of its common stock, consisting of 160,000 shares of non-qualified stock options and 357,820 shares of incentive stock options (ISOs), and issued 7,100 shares of restricted stock. The non-qualified stock options and ISOs granted are exercisable for up to one-fifth of the total number of option shares on or after the first anniversary of the grant date and as of the first day of each month thereafter are exercisable for an additional one-sixtieth of the total number of option shares until fully exercisable. The options expire seven years from the date of the grant and were issued with an exercise price equal to the fair market value of the stock price, or \$8.08 per share of common stock, on the date of grant. The restricted stock awards vest 100% on the third anniversary of the award date.

During the three months ended September 30, 2008 an aggregate of 60,500 ISO s were granted under the 2006 Plan. The options were issued with an exercise price equal to the fair market value of the stock price, or \$5.17 per share, on the date of grant and generally vest 20% per year. During the three months ended September 30, 2008 and 2007, there were an aggregate of 7,000 and 7,200 restricted shares granted to certain employees, respectively. The restricted shares granted to employees in 2008 vest 100% three years from the date of grant. The restricted shares granted in 2007 vest 33% per year.

The Company currently uses and will continue to use the simplified method to estimate the expected term for share option grants until it has enough historical experience to provide a reasonable estimate of expected term in accordance with Staff Accounting Bulletin No. 110 (SAB 110). The weighted average fair-value of options granted during the three months ended September 30, 2008 was \$2.02 which was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2008
Risk-free interest rate	3.20%
Annual dividend yield	0%
Expected term	5 years
Expected volatility	39%

Stock-based compensation expense for the three and nine months ended September 30, 2008 was \$0.5 million and \$1.5 million, respectively and for the three and nine months ended September 30, 2007 was \$0.4 million and \$1.1 million, respectively.

As of September 30, 2008, the total non-vested stock-based compensation expense relating to the options and restricted shares is approximately \$4.0 million and the Company expects to record an additional \$0.5 million as compensation expense in 2008. The remaining weighted average vesting period for the stock options is 3.7 years and restricted shares is approximately 2.03 years at September 30, 2008.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

Stock Options

A summary of all option activity for the nine months ended September 30, 2008 was as follows:

			2006 Plan		
	Number of	Weighted	Average	Aggregate	
	Options	Average	Remaining	Intrinsic	
		Exercise Price	Contractual	Value (in	
			Life	thousands) (1)	
Options outstanding at January 1, 2008	1,214,690	\$ 14.31	6.0	\$	
Granted	588,820	7.75			
Forfeited	(60,890)	12.51			
Options outstanding at September 30, 2008	1,742,620	\$ 12.16	5.6	\$	
Expected to vest at September 30, 2008	1,298,798	\$ 11.51	5.7	\$	
Options exercisable at September 30, 2008	408,135	\$ 14.31	5.2	\$	

- (1) The aggregate intrinsic value was calculated using the difference between the market price of Carrols Restaurant Group's common stock at September 30, 2008 and the grant price for only those awards that have a grant price that is less than the market price of Carrols Restaurant Group's common stock at September 30, 2008.

Restricted Shares

The restricted stock activity for the nine months ended September 30, 2008 was as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2008	55,398	\$ 13.22
Shares granted	14,100	6.64
Shares vested	(2,210)	6.67
Shares forfeited	(4,124)	12.03
Nonvested at September 30, 2008	63,164	\$ 11.78

The value of restricted shares is determined based on Carrols Restaurant Group's closing price on the date of grant.

3. Impairment of Long-Lived Assets

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The Company reviews its long-lived assets, principally property and equipment, for impairment at the restaurant level. If an indicator of impairment exists for any of its assets, an estimate of undiscounted future cash flows from the related long-lived assets is compared to that long-lived asset's carrying value. If the carrying value is greater than the undiscounted cash flow, the Company then determines the fair value of the asset. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value.

During the third quarter of 2007, the Company impaired an underperforming Pollo Tropical restaurant located in Brooklyn, NY for \$1.7 million. The restaurant was subsequently closed in the fourth quarter of 2007.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

For the three and nine months ended September 30, 2008, the Company recorded impairment losses on long-lived assets for its segments as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Burger King	\$ 43	\$ 54	\$ 135	\$ 68
Pollo Tropical	5	1,657	5	1,657
Taco Cabana	5	99	15	154
	\$ 53	\$ 1,810	\$ 155	\$ 1,879

4. Goodwill and Franchise Rights

Goodwill. Goodwill is reviewed for impairment annually, or more frequently when events and circumstances indicate that the carrying amounts may be impaired. The Company performs its annual impairment assessment as of December 31 and does not believe circumstances have changed since the last assessment date which would make it necessary to reassess their values. Goodwill balances are summarized below:

	Pollo Tropical	Taco Cabana	Burger King	Total
Balance, September 30, 2008	\$ 56,307	\$ 67,177	\$ 1,450	\$ 124,934

Burger King Franchise Rights. Amounts allocated to franchise rights for each Burger King acquisition are amortized using the straight-line method over the average remaining term of the acquired franchise agreements at January 1, 2002 plus one twenty-year renewal period. The Company assesses the potential impairment of franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If an indicator of impairment exists, an estimate of the aggregate undiscounted future cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each Burger King acquisition. If an asset is determined to be impaired, the loss is measured by the excess of the carrying amount of the asset over its fair value. There were no impairment charges recorded against franchise rights for the three and nine months ended September 30, 2008 and 2007.

Amortization expense related to Burger King franchise rights was \$799 and \$805 for the three months ended September 30, 2008 and 2007, respectively. Amortization expense related to Burger King franchise rights was \$2,399 and \$2,412 for the nine months ended September 30, 2008 and 2007. The estimated amortization expense for the year ending December 31, 2008 is \$3,197 and for each of the five succeeding years is \$3,196.

5. Long-term Debt

Long-term debt at September 30, 2008 and December 31, 2007 consisted of the following:

September 30, 2008	December 31, 2007
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Collateralized:		
Senior Credit Facility - Revolving credit facility	\$ 17,200	\$
Senior Credit Facility-Term loan A facility	118,500	120,000
Unsecured:		
9% Senior Subordinated Notes	178,000	180,000
Capital leases	1,322	1,283
	315,022	301,283
Less: current portion	(7,614)	(3,129)
	\$ 307,408	\$ 298,154

On March 9, 2007, the Company terminated and replaced its prior senior credit facility with a new senior credit facility with a syndicate of lenders. The Company's credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the 9% Senior Subordinated Notes due 2013 are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all

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CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars, except share and per share amounts)

outstanding borrowings and other obligations under the Company's prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. The Company also recorded a \$1.5 million loss on extinguishment of debt in the nine months ended September 30, 2007 for the write-off of deferred financing costs related to the prior senior credit facility.

The term loan and revolving credit borrowings under the senior credit facility bear interest at a per annum rate, at the Company's option, of either:

1) the applicable margin ranging from 0% to 0.25% based on the Company's senior leverage ratio (as defined in the new senior credit facility) plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or

2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on the Company's senior leverage ratio. At September 30, 2008 the LIBOR margin percentage was 1.25%.

Term loan A borrowings are due and payable in quarterly installments. Remaining principal payments are as follows:

1) three quarterly installments of \$1.5 million beginning on September 30, 2008;

2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;

3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and

4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the senior credit facility, the Company is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an initial amount equal to 50% of Excess Cash Flow depending upon the Company's Total Leverage Ratio (as such terms are defined in the senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by the Company therefrom, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, the Company's obligations under the senior credit facility are guaranteed by Carrols Restaurant Group and all of the Company's material subsidiaries and are collateralized by a pledge of the Company's common stock and the stock of each of the Company's material subsidiaries. The senior credit facility contains certain covenants, including, without limitation, those limiting the Company's ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of its business, engage in transactions with related parties, make certain investments or pay dividends. In addition, the Company is required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the senior credit facility). The Company was in compliance with the covenants under its new senior credit facility as of September 30, 2008.

At September 30, 2008, \$118.5 million principal amount of term loan borrowings were outstanding under the term loan A facility and \$17.2 million principal amount of borrowings were outstanding under the revolving credit facility. After reserving \$14.2 million for letters of credit guaranteed by the facility, \$33.6 million was available for borrowings under the revolving credit facility at September 30, 2008.

On December 15, 2004, the Company issued \$180 million of 9% Senior Subordinated Notes due 2013, which are referred to herein as the senior subordinated notes. Restrictive covenants under the senior subordinated notes include limitations with respect to the Company's ability to issue additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. On April 7, 2008, the Company purchased and retired \$2.0 million of the senior subordinated notes in an open market transaction. This resulted in a gain on extinguishment of debt of \$0.2 million. At September 30, 2008 and December 31, 2007, \$178.0 million and \$180.0 million principal amount of the senior subordinated notes were outstanding, respectively.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

6. Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2008 and 2007 was comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Current	\$ 2,443	\$ 1,904	\$ 4,887	\$ 5,668
Deferred	(307)	(109)	(58)	(319)
	\$ 2,136	\$ 1,795	\$ 4,829	\$ 5,349

The provision for income taxes for the three and nine months ended September 30, 2008 was derived using an estimated effective annual income tax rate for 2008 of 37.2%, which excludes any discrete tax adjustments. Discrete tax adjustments increased the provision for income taxes by \$15 for the three months ended September 30, 2008 and decreased the provision for income taxes by \$97 for the nine months ended September 30, 2008.

The provision for income taxes for the three and nine months ended September 30, 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5% as well as the effect of any discrete tax items occurring in those periods. In addition to the discrete tax adjustment discussed in the following paragraph, the Company also recorded in the three months ended September 30, 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards.

The Company adopted the provisions of Financial Standards Accounting Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes , (FIN 48), an interpretation of FASB Statement No. 109 (SFAS 109), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in its consolidated financial statements. As of the adoption date of January 1, 2007, the Company had \$0.6 million of unrecognized tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.5 million of unrecognized tax benefits and \$0.1 million of accrued interest expired. The Company recorded this tax benefit as a discrete tax item in the third quarter of 2007.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2008, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions.

The tax years 2004-2007 remain open to examination by the major taxing jurisdictions to which the Company is subject. It is not possible to reasonably estimate any possible change in the unrecognized tax benefits within the next twelve months.

7. Other Liabilities, Long-Term

Other liabilities, long-term, at September 30, 2008 and December 31, 2007 consisted of the following:

	September 30, 2008	December 31, 2007
Unearned purchase discounts	\$ 559	\$ 2,231

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Accrued occupancy costs	10,439	9,667
Accrued workers compensation costs	4,466	4,418
Other	6,113	6,468
	\$ 21,577	\$ 22,784

In 2001, management decided to close seven Taco Cabana restaurants in the Phoenix, Arizona market and discontinue restaurant development underway in that market. At both September 30, 2008 and December 31, 2007, the Company had \$0.5 million in lease liability reserves for the remaining locations that are included in accrued occupancy costs.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

8. Postretirement Benefits

The Company provides postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management salaried employees. A December 31 measurement date is used for postretirement benefits. On November 1, 2007 the Company amended its postretirement medical and life insurance benefits to eliminate life insurance benefits for active employees who retire after December 31, 2007 and to increase retiree contributions for both current and future retirees effective January 1, 2008. These amendments reduced the Company's postretirement benefit obligations and reduced expense in the three and nine months ended September 30, 2008.

The following summarizes the components of net periodic benefit cost:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Service cost	\$ 7	\$ 124	\$ 21	\$ 370
Interest cost	27	101	80	304
Amortization of gains and losses	22	24	65	72
Amortization of unrecognized prior service cost	(90)	1	(269)	4
Net periodic postretirement benefit cost (benefit)	\$ (34)	\$ 250	\$ (103)	\$ 750

During the three and nine months ended September 30, 2008, the Company made contributions of \$56 and \$136 to its postretirement plan.

9. Lease Financing Obligations

The Company entered into sale-leaseback transactions in various years involving certain restaurant properties that did not qualify for sale-leaseback accounting and as a result, have been classified as financing transactions under SFAS No. 98, Accounting for Leases (SFAS 98). Under the financing method, the assets remain on the consolidated balance sheet and proceeds received by the Company from these transactions are recorded as a financing liability. Payments under these leases are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

In the second quarter of 2008, the Company purchased from the lessor six restaurant properties for \$5.5 million that were previously accounted for as lease financing obligations. As a result, the Company reduced its lease financing obligations by \$5.5 million and recorded a loss of \$31 as an increase to interest expense which represented the amount by which the purchase price exceeded the lease financing obligations.

In the second quarter of 2007, the Company exercised its right of first refusal under the leases for five restaurant properties previously accounted for as lease financing obligations and purchased these properties from the lessor. As a result, the Company reduced its lease financing obligations by \$4.4 million. The Company also recorded a gain of \$0.2 million as a reduction of interest expense which represented the net amount by which the lease financing obligations exceeded the purchase price of the acquired restaurant properties.

Interest expense associated with lease financing obligations, including settlement gains and losses, for the three months ended September 30, 2008 and 2007 was \$1.1 million and \$1.4 million, respectively and for the nine months ended September 30, 2008 and 2007 was \$3.8 million and \$4.2 million, respectively.

10. Other Income

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The Company recorded a gain of \$0.1 million in the nine months ended September 30, 2008 and a gain of \$0.3 million in the nine months ended September 30, 2007 each related to the sale of a Taco Cabana property. In the third quarter of 2007, the Company also recorded a gain of \$0.3 million related to the sale of one of its non-operating Burger King restaurant properties.

11. Business Segment Information

The Company is engaged in the quick-service and quick-casual restaurant industry, with three restaurant concepts: Burger King operating as a franchisee and Pollo Tropical and Taco Cabana, both Company-owned concepts. The Company's Burger King restaurants are all located in the United States, primarily in the Northeast, Southeast and Midwest. Pollo Tropical is a quick-casual restaurant chain featuring grilled marinated chicken and Caribbean style made from scratch side

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CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars, except share and per share amounts)

dishes. Pollo Tropical's core markets are located in South and Central Florida. Taco Cabana is a quick-casual restaurant chain featuring fresh Mexican style food, including flame-grilled beef and chicken fajitas, quesadillas and other Tex-Mex dishes. Taco Cabana's core markets are primarily located in Texas.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies. The following table includes Segment EBITDA which is the measure of segment profit or loss reported to the chief operating decision maker for purposes of allocating resources to the segments and assessing their performance. Segment EBITDA is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense, other income and expense and gains and losses on extinguishment of debt.

The Other column includes corporate related items not allocated to reportable segments, including stock-based compensation expense. Other identifiable assets consist primarily of cash, certain other assets, corporate property and equipment including restaurant information systems expenditures, goodwill and deferred income taxes.

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(in thousands of dollars, except share and per share amounts)

Three Months Ended	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
September 30, 2008:					
Total revenues	\$ 43,389	\$ 64,132	\$ 101,543	\$	\$ 209,064
Cost of sales	14,312	19,646	29,600		63,558
Restaurant wages and related expenses	10,662	18,357	30,710	57	59,786
General and administrative expenses (1)	2,994	3,036	6,423	438	12,891
Depreciation and amortization	2,032	2,261	3,492	339	8,124
Segment EBITDA	5,224	7,308	8,819		
Capital expenditures, including acquisitions	3,656	7,320	5,369	3,250	19,595
September 30, 2007:					
Total revenues	\$ 42,560	\$ 61,254	\$ 99,695	\$	\$ 203,509
Cost of sales	13,426	18,532	26,637		58,595
Restaurant wages and related expenses	10,495	17,652	31,327	45	59,519
General and administrative expenses (1)	2,188	2,655	7,168	314	12,325
Depreciation and amortization	1,763	2,163	3,827	354	8,107
Segment EBITDA	7,778	7,348	9,197		
Capital expenditures, including acquisitions	5,202	5,043	2,437	347	13,029
Nine Months Ended					
September 30, 2008:					
Total revenues	\$ 133,125	\$ 187,825	\$ 294,549	\$	\$ 615,499
Cost of sales	43,965	58,022	83,143		185,130
Restaurant wages and related expenses	32,861	54,601	91,457	171	179,090
General and administrative expenses (1)	8,319	9,048	20,943	1,290	39,600
Depreciation and amortization	5,948	6,423	10,741	1,111	24,223
Segment EBITDA	17,964	19,679	22,532		
Capital expenditures, including acquisitions	15,064	16,360	11,565	5,835	48,824
September 30, 2007:					
Total revenues	\$ 126,846	\$ 180,222	\$ 285,093	\$	\$ 592,161
Cost of sales	40,440	53,485	74,339		168,264
Restaurant wages and related expenses	31,460	51,526	90,922	121	174,029
General and administrative expenses (1)	7,221	8,256	22,349	947	38,773
Depreciation and amortization	4,927	6,337	11,428	993	23,685
Segment EBITDA	21,867	22,723	23,416		
Capital expenditures, including acquisitions	18,442	13,086	7,388	1,840	40,756
Identifiable Assets:					
At September 30, 2008	\$ 68,718	\$ 83,998	\$ 149,672	\$ 179,717	\$ 482,105
At December 31, 2007	59,609	79,370	148,467	178,112	465,558

- (1) For the Pollo Tropical and Taco Cabana segments, such amounts include general and administrative expenses related directly to each segment. For the Burger King segment such amounts include general and administrative expenses related directly to the Burger King segment as well as expenses associated with administrative support to all of the Company's segments including executive management, information systems and certain accounting, legal and other administrative functions.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)**

(in thousands of dollars, except share and per share amounts)

A reconciliation of segment EBITDA to consolidated net income is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Segment EBITDA:				
Pollo Tropical	\$ 5,224	\$ 7,778	\$ 17,964	\$ 21,867
Taco Cabana	7,308	7,348	19,679	22,723
Burger King	8,819	9,197	22,532	23,416
Subtotal	21,351	24,323	60,175	68,006
Less:				
Depreciation and amortization	8,124	8,107	24,223	23,685
Impairment losses	53	1,810	155	1,879
Interest expense	6,861	7,690	21,418	23,647
Provision for income taxes	2,136	1,795	4,829	5,349
Stock-based compensation expense	495	359	1,461	1,068
Loss (gain) on extinguishment of debt			(180)	1,485
Other income		(303)	(119)	(650)
Net income	\$ 3,682	\$ 4,865	\$ 8,388	\$ 11,543

12. Commitments and Contingencies

On November 16, 1998, the Equal Employment Opportunity Commission (EEOC) filed suit in the United States District Court for the Northern District of New York (the Court), under Title VII of the Civil Rights Act of 1964, as amended, against the Company. The complaint alleged that the Company engaged in a pattern and practice of unlawful discrimination, harassment and retaliation against former and current female employees. The EEOC identified approximately 450 individuals (which were subsequently increased to 511 individuals) that it believed represented the class of claimants and was seeking monetary and injunctive relief from the Company. On April 20, 2005, the Court issued a decision and order granting the Company's Motion for Summary Judgment that the Company filed in January 2004. Subject to possible appeal by the EEOC, the case is dismissed; however the Court noted that it was not ruling on the claims, if any, that individual employees might have against the Company. On February 27, 2006, the Company filed a motion for summary judgment to dismiss all but between four and 17 of the individual claims. On July 10, 2006, in its response to that motion, the EEOC asserted that, notwithstanding the Court's dismissal of the case as a class action, the EEOC may still maintain some kind of collective action on behalf of these claimants. Oral argument before the Court was held on October 4, 2006 and the Company is awaiting the Court's decision on the Company's summary judgment motion. The Company does not believe that any individual claim, if any, would have a material adverse impact on its consolidated financial statements. Although the Company believes that the EEOC's continued class litigation argument is without merit, it is not possible to predict the outcome of the pending motion.

On November 30, 2002, four former hourly employees commenced a lawsuit against the Company in the United States District Court for the Western District of New York (the Court) entitled Dawn Seever, et al. v. the Company. The lawsuit alleged, in substance, that the Company violated certain minimum wage laws under the Federal Fair Labor Standards Act and related state laws by requiring employees to work without recording their time and by retaliating against those who complained. The plaintiffs sought damages, costs and injunctive relief. They also sought to notify and certify, a class consisting of current and former employees who, since 1998, have worked, or are working, for the Company. On December 17, 2007, the Court issued a decision and order denying Plaintiffs' motion for notice and class certification and granting the Company's motion to dismiss all of the claims of the plaintiffs, other than certain nominal claims relating to orientation and managers meetings. The Court instructed the parties to confer, in good faith, and settle those nominal claims. Subject to settlement of the amounts for

orientation and managers meetings and possible appeal by the Plaintiffs, the case is concluded. The Company does not believe that these settlement amounts will be material to its consolidated financial statements.

Table of Contents**CARROLS CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)****(in thousands of dollars, except share and per share amounts)**

The Company is a party to various other litigation matters incidental to the conduct of business. The Company does not believe that the outcome of any of these other matters will have a material adverse effect on its consolidated financial statements.

13. Comprehensive income

SFAS No. 130, Reporting Comprehensive Income (SFAS 130), requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with U.S. generally accepted accounting principles. The items that currently impact the Company's other comprehensive income are changes in the postretirement benefit obligations, net of tax.

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net income	\$ 3,682	\$ 4,865	\$ 8,388	\$ 11,543
Change in postretirement benefit obligation, net of tax			8	
Comprehensive income	\$ 3,682	\$ 4,865	\$ 8,396	\$ 11,543

14. Recent Accounting Developments

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS 157). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. In February 2007, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS 157 for financial assets and financial liabilities, effective for fiscal 2008, did not have a material impact on the Company's consolidated financial statements. The Company is currently evaluating the impact SFAS 157 may have for nonfinancial assets and liabilities in its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the Company's fiscal year beginning January 1, 2008. The Company did not elect to begin reporting any financial assets or liabilities at fair value upon adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financials Statements, an Amendment of ARB No. 51 (SFAS 160). SFAS 160 clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact SFAS 160 will have on its consolidated financial statements.

In April 2008, the FASB issued FSP SFAS No. 142-3 Determination of the Useful Life of Intangible Assets (SFAS 142-3). SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumption used to determine the useful life of a recognized intangible asset under SFAS No. 142. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will require the Company to adopt these provisions in the first quarter of 2009. The Company has reviewed this pronouncement and does not anticipate the adoption of SFAS No. 142-3 will materially impact its financial statements.

15. Guarantor Financial Statements

The Company's obligations under the senior subordinated notes are jointly and severally guaranteed in full on an unsecured senior subordinated basis by certain of the Company's subsidiaries ("Guarantor Subsidiaries"), all of which are directly or indirectly wholly-owned by the Company. These subsidiaries are:

Cabana Beverages, Inc.

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CARROLS CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS-(Continued)

(in thousands of dollars, except share and per share amounts)

Cabana Bevco LLC

Carrols LLC

Carrols Realty Holdings Corp.

Carrols Realty I Corp.

Carrols Realty II Corp.

Carrols J.G. Corp.

Quanta Advertising Corp.

Pollo Franchise, Inc.

Pollo Operations, Inc.

Taco Cabana, Inc.

TP Acquisition Corp.

TC Bevco LLC

T.C. Management, Inc.

TC Lease Holdings III, V and VI, Inc.

Get Real, Inc.

Texas Taco Cabana, L.P.

TPAQ Holding Corporation

The following supplemental financial information sets forth on a consolidating basis, balance sheets as of September 30, 2008 and December 31, 2007 for the Parent Company only, Guarantor Subsidiaries and for the Company and the related statements of operations for the three and nine months ended September 30, 2008 and 2007, and statements of cash flows for the nine months ended September 30, 2008 and 2007.

At the beginning of the third quarter in 2008 assets and liabilities related to the Company's Burger King restaurant operations were transferred to Carrols LLC, a 100% owned subsidiary of the Company. Carrols LLC became a Guarantor Subsidiary at that time and its results of operations and cash flows are included with the Company's other Guarantor Subsidiaries for all periods presented.

For certain of the Company's sale-leaseback transactions, the Parent Company has guaranteed on an unsecured basis the rental payments of its subsidiaries. In accordance with Emerging Issues Task Force Issue No. 90-14, Unsecured Guarantee by Parent of Subsidiary's Lease Payments in a Sale-Leaseback Transaction, the Company has included in the following guarantor financial statements amounts pertaining to these leases as if

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they were accounted for as financing transactions of the Guarantor Subsidiaries. These adjustments are eliminated in consolidation.

For purposes of the guarantor financial statements, the Company and its subsidiaries determine the applicable tax provision for each entity generally using the separate return method. Under this method, current and deferred taxes are allocated to each reporting entity as if it were to file a separate tax return. The rules followed by the reporting entity in computing its tax obligation or refund, including the effects of the alternative minimum tax, would be the same as those followed in filing a separate return with the Internal Revenue Service. However, for purposes of evaluating an entity's ability to realize its tax attributes, the Company assesses whether it is more likely than not that those assets will be realized at the consolidated level. Any differences in the total of the income tax provision for the Parent Company only and the Guarantor Subsidiaries, as calculated on the separate return method and the consolidated income tax provision are eliminated in consolidation.

The Company provides some administrative support to its subsidiaries related to executive management, information systems and certain accounting, legal and other administrative functions. For purposes of the guarantor financial statements, the Company allocates such corporate costs on a specific identification basis, where applicable, or based on revenues or the number of restaurants for each subsidiary. Management believes that these allocations are reasonable based on the nature of costs incurred.

Table of Contents**CONSOLIDATING BALANCE SHEET**

September 30, 2008

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 4	\$ 2,893	\$	\$ 2,897
Trade and other receivables	53	5,758		5,811
Inventories		5,225		5,225
Prepaid rent		2,936		2,936
Prepaid expenses and other current assets	962	5,966		6,928
Deferred income taxes	93	4,829		4,922
Total current assets	1,112	27,607		28,719
Property and equipment, net	10,675	267,997	(56,461)	222,211
Franchise rights, net		77,670		77,670
Goodwill		124,934		124,934
Intangible assets, net		709		709
Franchise agreements, net		5,824		5,824
Intercompany receivable (payable)	176,801	(177,288)	487	
Investment in subsidiaries	131,701		(131,701)	
Deferred income taxes	6,142	6,267	(1,904)	10,505
Other assets	6,015	7,330	(1,812)	11,533
Total assets	\$ 332,446	\$ 341,050	\$ (191,391)	\$ 482,105
LIABILITIES AND STOCKHOLDER S EQUITY				
Current liabilities:				
Current portion of long-term debt	\$ 7,500	\$ 114	\$	\$ 7,614
Accounts payable	3,680	16,691		20,371
Accrued interest	3,902			3,902
Accrued payroll, related taxes and benefits	(439)	15,855		15,416
Accrued income taxes payable	3,681			3,681
Accrued real estate taxes	392	4,026		4,418
Other liabilities	(71)	12,879		12,808
Total current liabilities	18,645	49,565		68,210
Long-term debt, net of current portion	306,200	1,208		307,408
Lease financing obligations		119,525	(73,030)	46,495
Deferred income sale-leaseback of real estate		23,983	8,568	32,551
Accrued postretirement benefits	2,804			2,804
Other liabilities	1,737	19,217	623	21,577
Total liabilities	329,386	213,498	(63,839)	479,045
Commitments and contingencies				
Stockholder s equity	3,060	127,552	(127,552)	3,060

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Total liabilities and stockholder's equity	\$ 332,446	\$ 341,050	\$ (191,391)	\$ 482,105
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Table of Contents**CONSOLIDATING BALANCE SHEET**

December 31, 2007

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 3,243	\$ 4,153	\$	\$ 7,396
Trade and other receivables	219	4,515		4,734
Inventories		5,339		5,339
Prepaid rent		2,803		2,803
Prepaid expenses and other current assets	943	5,229		6,172
Deferred income taxes	(144)	4,946		4,802
Total current assets	4,261	26,985		31,246
Property and equipment, net	8,320	246,190	(54,185)	200,325
Franchise rights, net		80,052		80,052
Goodwill		124,934		124,934
Intangible assets, net		887		887
Franchise agreements, net		5,548		5,548
Intercompany receivable (payable)	169,636	(170,193)	557	
Investment in subsidiaries	117,681		(117,681)	
Deferred income taxes	3,458	8,348	(1,247)	10,559
Other assets	6,609	7,109	(1,711)	12,007
Total assets	\$ 309,965	\$ 329,860	\$ (174,267)	\$ 465,558
LIABILITIES AND STOCKHOLDER S EQUITY (DEFICIT)				
Current liabilities:				
Current portion of long-term debt	\$ 3,000	\$ 129	\$	\$ 3,129
Accounts payable	110	19,944		20,054
Accrued interest	8,148			8,148
Accrued payroll, related taxes and benefits	2,257	16,412		18,669
Accrued income taxes payable	933			933
Accrued real estate taxes		3,312		3,312
Other liabilities	269	9,844		10,113
Total current liabilities	14,717	49,641		64,358
Long-term debt, net of current portion	297,000	1,154		298,154
Lease financing obligations		121,154	(68,465)	52,689
Deferred income sale-leaseback of real estate		23,363	7,985	31,348
Accrued postretirement benefits	3,022			3,022
Other liabilities	2,023	20,297	464	22,784
Total liabilities	316,762	215,609	(60,016)	472,355
Commitments and contingencies				
Stockholder s equity (deficit)	(6,797)	114,251	(114,251)	(6,797)

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Total liabilities and stockholder's equity (deficit)	\$ 309,965	\$ 329,860	\$ (174,267)	\$ 465,558
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Table of Contents**CONSOLIDATING STATEMENT OF OPERATIONS****Three Months Ended September 30, 2008****(In thousands of dollars)****(Unaudited)**

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	\$	\$ 208,698	\$	\$ 208,698
Franchise royalty revenues and fees		366		366
Total revenues		209,064		209,064
Costs and expenses:				
Cost of sales		63,558		63,558
Restaurant wages and related expenses (including stock-based compensation expense of \$57)		59,786		59,786
Restaurant rent expense		10,300	1,414	11,714
Other restaurant operating expenses		32,433		32,433
Advertising expense		7,826		7,826
General and administrative (including stock-based compensation expense of \$438)	1,367	11,524		12,891
Depreciation and amortization		8,457	(333)	8,124
Impairment losses		53		53
Other income				
Total operating expenses	1,367	193,937	1,081	196,385
Income (loss) from operations	(1,367)	15,127	(1,081)	12,679
Interest expense	5,681	2,758	(1,578)	6,861
Gain on extinguishment of debt				
Intercompany interest allocations	(4,556)	4,556		
Income (loss) before income taxes	(2,492)	7,813	497	5,818
Provision (benefit) for income taxes	(796)	2,672	260	2,136
Equity income from subsidiaries	5,378		(5,378)	
Net income	\$ 3,682	\$ 5,141	\$ (5,141)	\$ 3,682

Table of Contents**CONSOLIDATING STATEMENT OF OPERATIONS****Three Months Ended September 30, 2007****(In thousands of dollars)****(Unaudited)**

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	\$	\$ 203,181	\$	\$ 203,181
Franchise royalty revenues and fees		328		328
Total revenues		203,509		203,509
Costs and expenses:				
Cost of sales		58,595		58,595
Restaurant wages and related expenses (including stock-based compensation expense of \$45)		59,519		59,519
Restaurant rent expense		9,792	1,309	11,101
Other restaurant operating expenses		30,547		30,547
Advertising expense		7,458		7,458
General and administrative (including stock-based compensation expense of \$314)	1,203	11,122		12,325
Depreciation and amortization		8,416	(309)	8,107
Impairment losses		1,810		1,810
Other income		(303)		(303)
Total operating expenses	1,203	186,956	1,000	189,159
Income (loss) from operations	(1,203)	16,553	(1,000)	14,350
Interest expense	6,267	2,880	(1,457)	7,690
Intercompany interest allocations	(4,557)	4,557		
Income (loss) before income taxes	(2,913)	9,116	457	6,660
Provision (benefit) for income taxes	(1,568)	3,137	226	1,795
Equity income from subsidiaries	6,210		(6,210)	
Net income	\$ 4,865	\$ 5,979	\$ (5,979)	\$ 4,865

Table of Contents**CONSOLIDATING STATEMENT OF OPERATIONS**

Nine Months Ended September 30, 2008

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	\$	\$ 614,422	\$	\$ 614,422
Franchise royalty revenues and fees		1,077		1,077
Total revenues		615,499		615,499
Costs and expenses:				
Cost of sales		185,130		185,130
Restaurant wages and related expenses (including stock-based compensation expense of \$171)		179,090		179,090
Restaurant rent expense		30,615	4,150	34,765
Other restaurant operating expenses		93,326		93,326
Advertising expense		24,874		24,874
General and administrative (including stock-based compensation expense of \$1,290)	4,328	35,272		39,600
Depreciation and amortization		25,198	(975)	24,223
Impairment loss		155		155
Other income		(119)		(119)
Total operating expenses	4,328	573,541	3,175	581,044
Income (loss) from operations	(4,328)	41,958	(3,175)	34,455
Interest expense	17,447	8,589	(4,618)	21,418
Gain on extinguishment of debt	(180)			(180)
Intercompany interest allocations	(13,669)	13,669		
Income (loss) before income taxes	(7,926)	19,700	1,443	13,217
Provision (benefit) for income taxes	(2,895)	7,002	722	4,829
Equity income from subsidiaries	13,419		(13,419)	
Net income	\$ 8,388	\$ 12,698	\$ (12,698)	\$ 8,388

Table of Contents**CONSOLIDATING STATEMENT OF OPERATIONS**

Nine Months Ended September 30, 2007

(In thousands of dollars)

(Unaudited)

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Revenues:				
Restaurant sales	\$	\$ 591,164	\$	\$ 591,164
Franchise royalty revenues and fees		997		997
Total revenues		592,161		592,161
Costs and expenses:				
Cost of sales		168,264		168,264
Restaurant wages and related expenses (including stock-based compensation expense of \$121)		174,029		174,029
Restaurant rent expense		28,782	3,905	32,687
Other restaurant operating expenses		87,028		87,028
Advertising expense		24,442		24,442
General and administrative (including stock-based compensation expense of \$947)	4,158	34,615		38,773
Depreciation and amortization		24,607	(922)	23,685
Impairment losses		1,879		1,879
Other income		(650)		(650)
Total operating expenses	4,158	542,996	2,983	550,137
Income (loss) from operations	(4,158)	49,165	(2,983)	42,024
Interest expense	19,329	8,662	(4,344)	23,647
Loss on extinguishment of debt	1,485			1,485
Intercompany interest allocations	(13,669)	13,669		
Income (loss) before income taxes	(11,303)	26,834	1,361	16,892
Provision (benefit) for income taxes	(4,600)	9,436	513	5,349
Equity income from subsidiaries	18,246		(18,246)	
Net income	\$ 11,543	\$ 17,398	\$ (17,398)	\$ 11,543

Table of Contents**CONSOLIDATING STATEMENT OF CASH FLOWS****Nine Months Ended September 30, 2008****(In thousands of dollars)****(Unaudited)**

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Cash flows provided from (used for) operating activities:				
Net income	\$ 8,388	\$ 12,698	\$ (12,698)	\$ 8,388
Adjustments to reconcile net income to net cash provided from (used for) operating activities:				
Loss on disposals of property and equipment		102		102
Stock-based compensation expense	1,007	454		1,461
Depreciation and amortization		25,198	(975)	24,223
Amortization of deferred financing costs	832	178	(120)	890
Amortization of unearned purchase discounts		(1,616)		(1,616)
Amortization of deferred gains from sale-leaseback transactions		(1,186)	(396)	(1,582)
Impairment losses		155		155
Gain on settlements of lease financing obligations		(48)		(48)
Accretion of interest on lease financing obligations		180		180
Accrued income taxes	2,748			2,748
Deferred income taxes	407	(1,123)	658	(58)
Gain on extinguishment of debt	(180)			(180)
Changes in other operating assets and liabilities	(29,928)	10,891	13,531	(5,506)
Net cash provided from (used for) operating activities	(16,726)	45,883		29,157
Cash flows used for investing activities:				
Capital expenditures:				
New restaurant development		(26,464)		(26,464)
Restaurant remodeling		(9,622)		(9,622)
Other restaurant capital expenditures		(6,903)		(6,903)
Corporate and restaurant information systems	(2,062)	(3,773)		(5,835)
Total capital expenditures	(2,062)	(46,762)		(48,824)
Proceeds from sale-leaseback transactions		2,557	4,231	6,788
Proceeds from sales of other properties		119		119
Net cash used for investing activities	(2,062)	(44,086)	4,231	(41,917)
Cash flows provided from (used for) financing activities:				
Borrowings on revolving credit facility	109,600			109,600
Repayments on revolving credit facility	(92,400)			(92,400)
Principal payments on capital leases		(119)		(119)
Repurchase of senior subordinated notes	(1,820)			(1,820)
Principal payments on term loans	(1,500)			(1,500)
Financing costs associated with issuance of debt		(219)	219	
Proceeds from lease financing obligations		4,450	(4,450)	
Settlement of lease financing obligations		(5,500)		(5,500)

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Net cash provided from (used for) financing activities	13,880	(1,388)	(4,231)	8,261
Net increase (decrease) in cash and cash equivalents	(4,908)	409		(4,499)
Cash and cash equivalents, beginning of period	4,912	2,484		7,396
Cash and cash equivalents, end of period	\$ 4	\$ 2,893	\$	\$ 2,897

Table of Contents**CONSOLIDATING STATEMENT OF CASH FLOWS****Nine Months Ended September 30, 2007****(In thousands of dollars)****(Unaudited)**

	Parent Company Only	Guarantor Subsidiaries	Eliminations	Consolidated Total
Cash flows provided from operating activities:				
Net income	\$ 11,543	\$ 17,398	\$ (17,398)	\$ 11,543
Adjustments to reconcile net income to net cash provided from operating activities:				
Gain on disposals of property and equipment		(57)		(57)
Stock-based compensation expense	721	347		1,068
Depreciation and amortization		24,607	(922)	23,685
Amortization of deferred financing costs	873	133	(66)	940
Amortization of unearned purchase discounts		(1,616)		(1,616)
Amortization of deferred gains from sale-leaseback transactions		(1,156)	(304)	(1,460)
Impairment losses		1,879		1,879
Gain on settlements of lease financing obligations		(163)		(163)
Accretion of interest on lease financing obligations		397		397
Deferred income taxes	(208)	(234)	123	(319)
Accrued income taxes	331			331
Loss on extinguishment of debt	1,485			1,485
Changes in other operating assets and liabilities	(12,390)	(2,526)	18,567	3,651
Net cash provided from operating activities	2,355	39,009		41,364
Cash flows used for investing activities:				
Capital expenditures:				
New restaurant development		(26,241)		(26,241)
Restaurant remodeling		(5,850)		(5,850)
Other restaurant capital expenditures		(6,825)		(6,825)
Corporate and restaurant information systems	(1,707)	(133)		(1,840)
Total capital expenditures	(1,707)	(39,049)		(40,756)
Properties purchased for sale-leaseback		(2,461)		(2,461)
Proceeds from sale-leaseback transactions		2,755	4,281	7,036
Proceeds from sales of other properties		1,623		1,623
Net cash used for investing activities	(1,707)	(37,132)	4,281	(34,558)
Cash flows provided from (used for) financing activities:				
Repayment of term loans under prior credit facility	(118,400)			(118,400)
Borrowings on revolving credit facility	45,500			45,500
Repayments on revolving credit facility	(44,300)			(44,300)
Proceeds from new senior credit facility	120,000			120,000
Principal payments on capital leases		(262)		(262)
Expenses from initial public offering	(21)			(21)
Financing costs associated with issuance of debt	(1,228)	(137)	137	(1,228)
Proceeds from lease financing obligations		4,418	(4,418)	

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Settlement of lease financing obligations		(4,412)		(4,412)
Net cash provided from (used for) financing activities	1,551	(393)	(4,281)	(3,123)
Net increase in cash and cash equivalents	2,199	1,484		3,683
Cash and cash equivalents, beginning of period	1,182	2,757		3,939
Cash and cash equivalents, end of period	\$ 3,381	\$ 4,241	\$	\$ 7,622

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

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

We use a 52-53 week fiscal year ending on the Sunday closest to December 31. All references herein to the fiscal years ended December 30, 2007 and December 31, 2006 will be referred to as the fiscal years ended December 31, 2007 and 2006, respectively. Similarly, all references herein to the three and nine months ended September 28, 2008 and September 30, 2007 will be referred to as the three and nine months ended September 30, 2008 and September 30, 2007, respectively. The years ended December 31, 2007 and 2006 each contained 52 weeks and the three and nine months ended September 30, 2008 and 2007 each contained thirteen and thirty-nine weeks, respectively.

Introduction

Carrols Restaurant Group is a holding company and conducts all of its operations through its direct and indirect subsidiaries and has no assets other than the shares of capital stock of Carrols, its direct wholly-owned subsidiary. The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) relates to the consolidated financial statements of Carrols Restaurant Group and the consolidated financial statements for Carrols presented in Item 1.

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

The following MD&A is written to help the reader understand our company. The MD&A is provided as a supplement to, and should be read in conjunction with, the Consolidated Financial Statements and the accompanying financial statement notes of each of Carrols Restaurant Group and Carrols appearing elsewhere in this report and our Annual Report on Form 10-K for the year ended December 31, 2007. The overview provides our perspective on the individual sections of MD&A, which include the following:

Company Overview a general description of our business and our key financial measures.

Recent and Future Events Affecting Our Results of Operations a description of recent events that affect, and future events that may affect, our results of operations.

Executive Summary an executive review of our performance for the three months ended September 30, 2008.

Liquidity and Capital Resources an analysis of historical information regarding our sources of cash and capital expenditures, the existence and timing of commitments and contingencies, changes in capital resources and a discussion of cash flow items affecting liquidity.

Results of Operations an analysis of our results of operations for the three and nine months ended September 30, 2008 compared to the three and nine months ended September 30, 2007.

Application of Critical Accounting Policies an overview of accounting policies requiring critical judgments and estimates.

Effects of New Accounting Standards a discussion of new accounting standards and any implications related to our financial statements.

Forward Looking Statements cautionary information about forward-looking statements and a description of certain risks and uncertainties that could cause our actual results to differ materially from our historical results or our current expectations or projections.

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Company Overview

We are one of the largest restaurant companies in the United States operating three restaurant brands in the quick-casual and quick-service restaurant segments with 559 restaurants located in 16 states as of September 30, 2008. We have been operating restaurants for more than 45 years. We own and operate two Hispanic restaurant brands, Pollo Tropical and Taco Cabana (together referred to by us as our Hispanic Brands), which we acquired in 1998 and 2000, respectively. We are also the largest Burger King franchisee, based on the number of restaurants, and have operated Burger King restaurants since 1976. As of September 30, 2008, our company-owned restaurants included 89 Pollo Tropical restaurants and 153 Taco Cabana restaurants and 317 Burger King restaurants operated under franchise agreements. We also franchise our Hispanic Brand restaurants with 31 franchised restaurants located in Puerto Rico, Ecuador and the United States as of September 30, 2008. We believe that the diversification and strength of our restaurant brands as well as the geographic dispersion of our restaurants provide us with stability and enhanced growth opportunities. Our primary growth strategy is to develop new company-owned Hispanic Brand restaurants. For the nine months ended September 30, 2008 and September 30, 2007, we had total revenues of \$615.5 million and \$592.2 million, respectively, and net income of \$8.4 million and \$11.5 million, respectively.

The following is an overview of the key financial measures discussed in our results of operations:

Restaurant sales consist of food and beverage sales, net of discounts, at our company-owned Hispanic Brand restaurants and the Burger King restaurants we operate under franchise agreements. Restaurant sales are influenced by menu price increases, new restaurant openings, closures of underperforming restaurants, and changes in comparable restaurant sales. The changes in comparable restaurant sales noted below are calculated using only those restaurants open since the beginning of the earliest period being compared and for the entirety of both periods being compared. Restaurants are included in comparable restaurant sales after they have been open for 12 months for our Burger King restaurants and 18 months for our Pollo Tropical and Taco Cabana restaurants.

Cost of sales consists of food, paper and beverage costs, including packaging costs, less purchase discounts. Cost of sales is generally influenced by changes in commodity costs, the sales mix of items sold and the effectiveness of our restaurant-level controls to manage food and paper costs. For our Pollo Tropical and Taco Cabana restaurants, we have negotiated directly with local and national suppliers for the purchase of food, paper and beverage products and related supplies. Our Pollo Tropical and Taco Cabana restaurants' commodities are ordered from approved suppliers and are shipped via distributors directly to our restaurants. Key commodities, including chicken and beef, for our Pollo Tropical and Taco Cabana restaurants are generally purchased under annual contracts. For our Burger King restaurants we are a member of a national purchasing cooperative, Restaurant Services, Inc., a non-profit independent cooperative that serves as the purchasing agent for most of the commodities for the Burger King franchise system and also contracts with various distributors to fulfill orders to our restaurants.

Restaurant wages and related expenses include all restaurant management and hourly productive labor costs, employer payroll taxes, restaurant-level bonuses and related benefits. Payroll and related benefits are subject to inflation, including minimum wage rate increases and any increases in costs for health insurance and workers' compensation insurance. A significant number of our hourly staff is paid at rates consistent with the applicable Federal or state minimum wage and, accordingly, increases in minimum wage rates will increase our labor costs. We are insured for workers' compensation, general liability and medical insurance claims under policies where we pay all claims, subject to annual stop-loss limitations both for individual claims and claims in the aggregate.

Restaurant rent expense includes base rent, contingent rent and common area maintenance on our leases characterized as operating leases, reduced by the amortization of gains on sale-leaseback transactions.

Other restaurant operating expenses include all other restaurant-level operating costs, the major components of which are royalty expenses for our Burger King restaurants, utilities, repairs and maintenance, real estate taxes and credit card fees.

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Advertising expense includes all promotional expenses including television, radio, billboards and other media. Pollo Tropical and Taco Cabana utilize an integrated, multi-level marketing approach that includes periodic chain-wide promotions, direct mail, in-store promotions, local store marketing and other strategies, including the use of radio and television advertising in their major markets. For our Burger King restaurants we are generally required to contribute 4% of restaurant sales to an advertising fund utilized by the Burger King franchise system for its advertising, promotional programs and public relations activities. We also supplement from time to time, on a discretionary basis, BKC's advertising and promotional activities with our own local advertising and promotions which may include the purchase of additional media or other forms of advertising.

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General and administrative expenses are comprised primarily of (1) salaries and expenses associated with corporate and administrative functions that support the development and operations of our restaurants, (2) legal and professional fees, including external auditing and related costs, (3) costs associated with being a publicly-held company and (4) stock-based compensation expense.

Segment EBITDA, which is the measure of segment profit or loss used by our chief operating decision maker for purposes of allocating resources to our segments and assessing their performance, is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment losses, stock-based compensation expense, other income and expense and any gains or losses on extinguishment of debt. Segment EBITDA may not be necessarily comparable to other similarly titled captions of other companies due to differences in methods of calculation. Segment EBITDA for our Burger King restaurants includes general and administrative expenses related directly to the Burger King segment as well as the expenses associated with administrative support to all three of our segments including executive management, information systems and certain accounting, legal and other administrative functions.

Depreciation and amortization primarily includes the depreciation of fixed assets, including equipment, owned buildings and leasehold improvements, depreciation of assets under lease financing obligations and the amortization of Burger King franchise rights and franchise fees.

Interest expense consists primarily of interest expense associated with our 9% Senior Subordinated Notes due 2013 (the Notes), borrowings under our senior credit facility, amortization of deferred financing costs and imputed interest expense on certain leases entered into in connection with sale-leaseback transactions which are accounted for as lease financing obligations. Interest expense also includes any gains and losses from the settlement of lease financing obligations. Interest on borrowings under our senior credit facility is generally based on LIBOR with a current margin of 1.25% or prime as we designate. Consequently, changes in LIBOR rates or prime will impact our interest expense.

Recent and Future Events Affecting our Results of Operations

Initial Public Offering

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

New Senior Credit Facility

On March 9, 2007, Carrols terminated its prior senior credit facility and entered into a loan agreement governing our new senior credit facility with a syndicate of lenders. Carrols' new senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Notes are not refinanced by June 30, 2012) and a \$65.0 million revolving credit facility maturing on March 8, 2012. The term loan A borrowings and an additional \$4.3 million of revolver borrowings from this facility were used to repay all outstanding borrowings and other obligations under Carrols' prior senior credit facility and to pay certain fees and expenses incurred in connection with the new senior credit facility. In addition, we recorded a pretax charge of \$1.5 million in the first quarter of 2007 related to the write off of unamortized deferred financing costs associated with the prior senior credit facility. For a more detailed discussion of the new senior credit facility, see Liquidity and Capital Resources.

Issuance of Stock Options and Restricted Shares

In connection with the IPO, we granted options to purchase 1,241,750 shares of our common stock and issued 75,800 shares of restricted stock under our 2006 Stock Incentive Plan to certain of our employees and directors in December 2006. Total stock-based compensation expense of approximately \$5.4 million will be recognized over the vesting period of these grants. In January 2008 we also granted options to purchase 517,820 shares of our common stock and issued 7,100 shares of restricted stock under our 2006 Stock Incentive Plan to certain of our employees. In the third quarter of 2008 we also granted

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options to purchase 60,500 shares of our common stock and issued 7,000 shares of restricted stock under our 2006 Stock Incentive Plan to certain of our employees. Stock-based compensation expense will be recognized over the vesting period of these grants. For the nine months ended September 30, 2008 and 2007, stock-based compensation expense was \$1.5 million and \$1.1 million, respectively. We currently anticipate we will record total stock-based compensation expense of approximately \$2.0 million in 2008. In addition, we will incur additional stock-based compensation expense in future periods for any additional stock option and restricted share grants we make.

Burger King Restaurants

We evaluate the performance of our Burger King restaurants on an ongoing basis. Such evaluation depends on many factors, including our assessment of the anticipated future operating results of the restaurant, the cost of required capital improvements that we would need to commit for such restaurants and the location of the restaurant in its current market. If we determine that a Burger King restaurant is underperforming, we may elect to close such restaurant. Excluding Burger King restaurants which were relocated and opened in the same market area under a new franchise agreement, we closed five Burger King restaurants in 2007 and six Burger King restaurants in the first nine months of 2008. Excluding one Burger King restaurant which we may relocate in the same market area under a new franchise agreement, we currently anticipate that we will likely elect to close two additional Burger King restaurants in 2008. Based on the current operating results of such closed restaurants, we believe that the future impact on our consolidated results of operations as a result of such restaurant closures will not be material, although there can be no assurance in this regard. Our determination of whether to close such restaurants is subject to further evaluation and may change. We may also elect to close additional Burger King restaurants in the future.

We are also considering other strategic alternatives with respect to our Burger King restaurants, including the possible future sale of some or all of such restaurants. Such determination is subject to ongoing evaluation. To date, we have no current understandings, commitments or agreements with respect to the foregoing and there can be no assurance that we will enter into any such arrangements in the future.

Postretirement Benefits

On November 1, 2007, we amended our postretirement medical and life insurance benefits covering substantially all Burger King administrative and restaurant management personnel. The amendment included an elimination of life insurance benefits for active employees who retire after December 31, 2007 and increases in retiree contributions for both current and future retirees effective January 1, 2008. These amendments reduced our postretirement benefit obligations and will reduce expense in 2008 and subsequent years.

Executive Summary - Operating Performance for the Three Months Ended September 30, 2008

In the first nine months of 2008, we have opened five new Pollo Tropical restaurants, seven new Taco Cabana restaurants, and two new Burger King restaurants, which were relocated within their market areas, and closed six Burger King restaurants and one Taco Cabana restaurant.

Total revenues in the third quarter of 2008 increased 2.7% to \$209.1 million from \$203.5 million in the third quarter of 2007. Revenues from our Hispanic Brand restaurants increased 3.6% to \$107.5 million in the third quarter of 2008 from \$103.8 million in the third quarter of 2007 and revenues from our Burger King restaurants increased 1.9% to \$101.5 million in the third quarter of 2008 from \$99.7 million in the third quarter of 2007.

Pollo Tropical revenues increased 1.9% to \$43.4 million during the third quarter of 2008 compared to \$42.6 million in the third quarter of 2007 due primarily to the opening of ten new Pollo Tropical restaurants since the beginning of the third quarter of 2007, including one new Pollo Tropical restaurant in New Jersey. We also closed one Pollo Tropical restaurant during the same time period. Comparable restaurant sales at Pollo Tropical decreased 1.9% in the third quarter of 2008 due to lower customer traffic resulting from deteriorating economic conditions in Florida. The average check increase resulting primarily from menu price increases was 4.2% in the third quarter of 2008.

Taco Cabana revenues increased 4.7% to \$64.1 million during the third quarter of 2008 compared to \$61.3 million in the third quarter of 2007 due primarily to the opening of thirteen new Taco Cabana restaurants since the beginning of the third quarter of 2007. We also closed two Taco Cabana restaurants during the same time period. Comparable restaurant sales at Taco Cabana decreased 0.9% in the third quarter of 2008 as a result of lower customer traffic and the impact of losing approximately 150 total restaurant operating days due to Hurricane Ike. The average check increase resulting primarily from menu price increases was 4.0% in the third quarter of 2008.

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Comparable restaurant sales at our Burger King restaurants increased 3.5% in the third quarter of 2008 as a result of an average check increase, primarily from menu price increases, of 4.7% offset partially from a slight decline in customer traffic. These sales increases were also partially offset by the closure, excluding relocated restaurants, of eleven Burger King restaurants since the beginning of the third quarter of 2007.

Restaurant operating margins in 2008 continue to be negatively impacted from higher commodity costs at all three of our restaurant concepts. As a percentage of total restaurant sales, food and paper costs increased 1.7% to 30.5% in the third quarter of 2008 compared to 28.8% in the third quarter of 2007 as a result of higher prices for beef, chicken, cheese, shortening, wheat-based products and fuel surcharges from our distributors.

Higher energy costs also continue to adversely impact operating margins as utility costs, as a percentage of total restaurant sales, increased to 4.9% in the third quarter of 2008 from 4.4% in the third quarter of 2007.

General and administrative expenses were \$12.9 million in the third quarter of 2008 compared to \$12.3 million in the third quarter of 2007. As a percentage of total restaurant sales, general and administrative expenses decreased to 6.2% in the third quarter of 2008 from 6.5% in the second quarter of 2008 due primarily to lower administrative bonus accruals.

Interest expense decreased to \$6.9 million in the third quarter of 2008 from \$7.7 million in the third quarter of 2007 due to lower effective interest rates on our LIBOR based borrowings under our senior credit facility.

Impairment losses were \$0.1 million in the third quarter of 2008 compared to \$1.8 million in the third quarter of 2007. During the third quarter of 2007 we incurred an impairment charge of \$1.7 million associated with an underperforming Pollo Tropical restaurant located in Brooklyn, New York which was subsequently closed in the fourth quarter of 2007.

Our effective income tax rate, including discrete tax items, was 36.7% in the third quarter of 2008 compared to 27.0% in the third quarter of 2007. We recorded discrete tax items in the third quarter of 2007 which reduced income tax expense by \$0.8 million.

Net income was \$3.7 million in the third quarter of 2008 compared to \$4.9 million in the third quarter of 2007 as a result of the above.

Liquidity and Capital Resources

We do not have significant receivables or inventory and receive trade credit based upon negotiated terms in purchasing food products and other supplies. We are able to operate with a substantial working capital deficit because:

restaurant operations are primarily conducted on a cash basis;

rapid turnover results in a limited investment in inventories; and

cash from sales is usually received before related liabilities for food, supplies and payroll become due.

Interest payments under our debt obligations, capital expenditures and payments related to our lease obligations represent significant liquidity requirements for us. We believe cash generated from our operations, availability of borrowing under our revolving credit facility and proceeds from anticipated sale-leaseback transactions will provide sufficient cash availability to cover our anticipated working capital needs, capital expenditures (which include new restaurant development and represent a major investment of cash for us) and debt service requirements for the next twelve months.

Operating activities. Net cash provided from operating activities for the nine months ended September 30, 2008 was \$29.2 million due primarily to net income of \$8.4 million and depreciation and amortization expense of \$24.2 million. Net cash provided from operating activities for the nine months ended September 30, 2007 was \$41.4 million due primarily to net income of \$11.5 million, depreciation and amortization expense of \$23.7 million, non-cash impairment losses of \$1.9 million and a non-cash write off of previously deferred financing costs related to our prior senior credit facility of \$1.5 million.

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Investing activities including capital expenditures and qualified sale-leaseback transactions. Net cash used for investing activities in the nine months ended September 30, 2008 and 2007 was \$41.9 million and \$34.6 million, respectively. Capital expenditures for the nine months ended September 30, 2008 and 2007 were \$48.8 million and \$40.8 million, respectively. Our capital expenditures included expenditures for development of new Pollo Tropical and Taco Cabana restaurants in the first nine months of 2008 and 2007 of \$23.9 million and \$25.4 million, respectively. Expenditures to relocate existing Burger King restaurants within

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their market areas under a new franchise agreement were \$2.6 million and \$0.9 million in the first nine months of 2008 and 2007, respectively. Expenditures to remodel our existing Pollo Tropical and Burger King restaurants in the first nine months of 2008 and 2007 were \$9.3 million and \$5.9 million, respectively.

In the first nine months of 2008 and 2007, we sold six and four restaurant properties, respectively, in sale-leaseback transactions for net proceeds of \$6.8 million and \$7.0 million, respectively. We also sold one Taco Cabana property during the first nine months of 2008 for net proceeds of \$0.1 million. In the first nine months of 2007 we also sold one Taco Cabana property and one non-operating Burger King property for net proceeds totaling \$1.6 million. The net proceeds from these sales were used to reduce outstanding borrowings under our senior credit facility. We also had expenditures related to the purchase of restaurant properties to be sold in sale-leaseback transactions of \$2.5 million during the nine months ended September 30, 2007.

Our capital expenditures are primarily for (1) new restaurant development, which includes the purchase of related real estate; (2) restaurant remodeling, which includes the renovation or rebuilding of the interior and exterior of our existing restaurants, including expenditures associated with Burger King franchise renewals; (3) other restaurant capital expenditures, which include capital restaurant maintenance expenditures for the ongoing reinvestment and enhancement of our restaurants; and (4) corporate and restaurant information systems.

The following table sets forth our capital expenditures for the periods presented (in thousands):

	Pollo Tropical	Taco Cabana	Burger King	Other	Consolidated
Nine months ended September 30, 2008:					
New restaurant development	\$ 9,908	\$ 13,946	\$ 2,610	\$	\$ 26,464
Restaurant remodeling	3,275	340	6,007		9,622
Other restaurant capital expenditures (1)	1,881	2,074	2,948		6,903
Corporate and restaurant information systems				5,835	5,835
Total capital expenditures	\$ 15,064	\$ 16,360	\$ 11,565	\$ 5,835	\$ 48,824
Number of new restaurant openings	5	7	2		14
Nine months ended September 30, 2007:					
New restaurant development	\$ 14,908	\$ 10,455	\$ 878	\$	\$ 26,241
Restaurant remodeling	2,235		3,615		5,850
Other restaurant capital expenditures (1)	1,299	2,631	2,895		6,825
Corporate and restaurant information systems				1,840	1,840
Total capital expenditures	\$ 18,442	\$ 13,086	\$ 7,388	\$ 1,840	\$ 40,756
Number of new restaurant openings	7	7			14

(1) Excludes restaurant repair and maintenance expenses included in other restaurant operating expenses in our consolidated financial statements. For the nine months ended September 30, 2008 and 2007, total restaurant repair and maintenance expenses were approximately \$14.6 million and \$13.5 million, respectively.

For all of 2008, we currently anticipate that total capital expenditures will range from \$65 million to \$70 million, although the actual amount of capital expenditures may differ from these estimates. These capital expenditures are expected to include approximately \$37 million to \$40 million for the development of new restaurants and purchase of related real estate. In 2008, we currently anticipate that we will open a total of eight new Pollo Tropical restaurants, ten or eleven new Taco Cabana restaurants and four new Burger King restaurants, three of which will be relocations of existing restaurants within their current market areas. We also currently anticipate closing one Taco Cabana restaurant and a total of eight Burger King restaurants in 2008 in addition to those Burger King restaurants being relocated. Capital expenditures in 2008 also are expected to include expenditures of approximately \$13 million to \$14 million for the ongoing reinvestment in our three restaurant concepts for remodeling costs, capital maintenance expenditures of approximately \$9 million and approximately \$6 million to \$7 million related to the replacement and upgrade of our point-of-sale systems and other corporate and information systems expenditures. In 2009 we currently anticipate total capital expenditures of \$20 million to \$30 million with new unit growth significantly reduced from 2008.

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Financing activities. Net cash provided from financing activities for the first nine months of 2008 was \$8.3 million. Net revolver borrowings during the first nine months of 2008 and 2007 were \$17.2 million and \$1.2 million, respectively. During the nine months ended September 30, 2008 and 2007, we acquired six and five properties, respectively, that were previously accounted for as

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lease financing obligations and settled lease financing obligations of \$5.5 million and \$4.4 million, respectively. We also purchased \$2.0 million principal amount of our outstanding Notes for \$1.8 million during the first nine months of 2008 in an open market transaction. On March 9, 2007, Carrols entered into a new senior credit facility and terminated its prior senior credit facility. Term loan A borrowings of \$120.0 million and an additional \$4.3 million of revolver borrowings were used to repay all outstanding borrowings under the prior senior credit facility and to also pay certain fees and expenses incurred in connection with the new senior credit facility. We incurred \$1.2 million of deferred financing costs related to the new senior credit facility in the first nine months of 2007. As a result, net cash used for financing activities was \$3.1 million in the first nine months of 2007.

Senior Credit Facility. Carrols' senior credit facility totals approximately \$185 million, consisting of \$120 million principal amount of term loan A borrowings maturing on March 8, 2013 (or earlier on September 30, 2012 if the Notes are not refinanced by June 30, 2012) and a \$65.0 million revolving facility (including a sub limit of up to \$25.0 million for letters of credit and up to \$5.0 million for swingline loans), maturing on March 8, 2012.

Both term loan and revolving credit borrowings under the new senior credit facility bear interest at a per annum rate, at our option, of either:

- 1) the applicable margin ranging from 0% to 0.25% based on our senior leverage ratio (as defined in the senior credit facility) plus the greater of (i) the prime rate or (ii) the federal funds rate for that day plus 0.5%; or
- 2) Adjusted LIBOR plus the applicable margin percentage in effect ranging from 1.0% to 1.5% based on our senior leverage ratio. At September 30, 2008 the LIBOR margin percentage was 1.25%.

Term loan A borrowings are due and payable in quarterly installments. Remaining principal payments are as follows:

- 1) three quarterly installments of \$1.5 million beginning on September 30, 2008;
- 2) eight quarterly installments of \$3.0 million beginning on June 30, 2009;
- 3) four quarterly installments of \$4.5 million beginning on June 30, 2011; and
- 4) four quarterly installments of \$18.0 million beginning on June 30, 2012.

Under the senior credit facility, Carrols is also required to make mandatory prepayments of principal on term loan A facility borrowings (a) annually in an amount up to 50% of Excess Cash Flow depending upon Carrols' Total Leverage Ratio (as such terms are defined in the new senior credit facility), (b) in the event of certain dispositions of assets (all subject to certain exceptions) and insurance proceeds, in an amount equal to 100% of the net proceeds received by Carrols therefrom, and (c) in an amount equal to 100% of the net proceeds from any subsequent issuance of debt.

In general, obligations under the senior credit facility are guaranteed by us and all of Carrols' material subsidiaries and are collateralized by a pledge of Carrols' common stock and the stock of each of Carrols' material subsidiaries. The senior credit facility contains certain covenants, including, without limitation, those limiting our ability to incur indebtedness, incur liens, sell or acquire assets or businesses, change the nature of our business, engage in transactions with related parties, make certain investments or pay dividends. In addition, we are required to meet certain financial ratios, including fixed charge coverage, senior leverage, and total leverage ratios (all as defined under the senior credit facility). Carrols was in compliance as of September 30, 2008 with the covenants in the senior credit facility.

Notes. On December 15, 2004 Carrols issued \$180.0 million of Notes. The Notes bear interest at a rate of 9% payable semi-annually on January 15 and July 15 and mature on January 15, 2013. The Notes are redeemable at the option of Carrols in whole or in part on or after January 15, 2009 at a price of 104.5% of the principal amount if redeemed before January 15, 2010, 102.25% of the principal amount if redeemed after January 15, 2010 but before January 15, 2011 and at 100% of the principal amount after January 15, 2011. On April 7, 2008, Carrols purchased and retired \$2.0 million of the Notes in an open market transaction. This resulted in a gain on extinguishment of debt of \$0.2 million.

The Notes are unsecured and guaranteed by Carrols' material subsidiaries. Restrictive covenants under the Notes include limitations with respect to, among other things, Carrols' and its material subsidiaries' ability to incur additional debt, incur liens, sell or acquire assets or businesses, pay dividends and make certain investments. Carrols was in compliance as of September 30, 2008 with the restrictive covenants in the indenture governing the Notes.

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Indebtedness. At September 30, 2008, we had total debt outstanding of \$361.5 million comprised of \$178.0 million of Notes, term loan borrowings of \$118.5 million under the senior credit facility, borrowings of \$17.2 million under the revolving credit facility, lease financing obligations of \$46.5 million and capital lease obligations of \$1.3 million. After reserving \$14.2 million for letters of credit guaranteed by our senior credit facility, \$33.6 million was available for borrowings under the revolving credit facility at September 30, 2008.

Table of Contents***Contractual Obligations***

A table of our contractual obligations as of December 31, 2007 was included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007. There have been no significant changes to our contractual obligations during the nine months ended September 30, 2008.

Results of Operations***Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007***

The following table sets forth, for the three months ended September 30, 2008 and 2007, selected operating results as a percentage of consolidated restaurant sales:

	2008	2007
Restaurant sales:		
Pollo Tropical	20.7%	20.8%
Taco Cabana	30.7%	30.1%
Burger King	48.6%	49.1%
Total restaurant sales	100.0%	100.0%
Costs and expenses:		
Cost of sales	30.5%	28.8%
Restaurant wages and related expenses	28.6%	29.3%
Restaurant rent expense	5.6%	5.5%
Other restaurant operating expenses	15.5%	15.0%
Advertising expense	3.7%	3.7%
General and administrative (including stock-based compensation expense)	6.2%	6.1%

Since October 1, 2007 through September 28, 2008 we have opened seven new Pollo Tropical restaurants, eight new Taco Cabana restaurants and two new Burger King restaurants which were relocations within their market areas. During the same period we closed an additional ten Burger King restaurants, one Pollo Tropical restaurant and two Taco Cabana restaurants.

Restaurant Sales. Total restaurant sales for the third quarter of 2008 increased \$5.5 million, or 2.7%, to \$208.7 million from \$203.2 million in the third quarter of 2007 due to sales increases at our Hispanic Brand restaurants of \$3.7 million, or 3.5%, and sales increases at our Burger King restaurants of \$1.8 million. Restaurant sales at our Hispanic Brand restaurants were \$107.2 million in the third quarter of 2008.

Pollo Tropical restaurant sales increased \$0.8 million, or 1.9%, to \$43.1 million in the third quarter of 2008 due primarily to the opening of ten new Pollo Tropical restaurants since the beginning of the third quarter of 2007, which contributed \$2.2 million in additional sales in the third quarter of 2008 compared to the third quarter of 2007. This increase was partially offset by a decrease in comparable restaurant sales at our Pollo Tropical restaurants of 1.9% in the third quarter of 2008 due to lower customer traffic resulting from deteriorating economic conditions in Florida, and to a lesser extent, the closure of one Pollo Tropical restaurant since the beginning of the third quarter of 2007. The average check at our Pollo Tropical restaurants increased 4.2% in the third quarter of 2008 primarily from menu price increases.

Taco Cabana restaurant sales increased \$2.9 million, or 4.7%, to \$64.0 million in the third quarter of 2008 due primarily to the opening of thirteen new Taco Cabana restaurants since the beginning of the third quarter of 2007 which contributed \$4.0 million of additional sales in the third quarter of 2008 compared to the third quarter of 2007. This increase was partially offset by a 0.9% decrease in comparable restaurant sales in the third quarter of 2008 as a result of lower customer traffic, the impact of losing approximately 150 total restaurant operating days due to Hurricane Ike and the closure of two Taco Cabana restaurants since the beginning of the third quarter of 2007. The average check at our Taco Cabana restaurants increased 4.0% in the third quarter of 2008 primarily from menu price increases.

Comparable restaurant sales at our Burger King restaurants increased 3.5% in the third quarter of 2008 as a result of an average check increase, primarily from menu price increases, of 4.7% offset partially from a slight decline in customer traffic. These sales increases were also partially offset by the closure, excluding relocated restaurants, of eleven Burger King restaurants since the beginning of the third quarter of 2007.

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Operating Costs and Expenses. Cost of sales (food and paper costs), as a percentage of total restaurant sales, increased to 30.5% in the third quarter of 2008 from 28.8% in the third quarter of 2007. Pollo Tropical cost of sales, as a percentage of Pollo Tropical restaurant sales, increased to 33.2% in the third quarter of 2008 from 31.7% in the third quarter of 2007 due primarily to higher chicken commodity prices (1.3% of Pollo Tropical sales in the third quarter of 2008) and higher prices of other commodities including wheat-based products, yucca and shortening (2.1% of Pollo Tropical sales) and fuel surcharges (0.3% of Pollo Tropical sales), all partially offset by the effect of menu price increases. Taco Cabana cost of sales, as a percentage of Taco Cabana restaurant sales, increased to 30.7% in the third quarter of 2008 from 30.3% in the third quarter of 2007 due to higher commodity prices for cheese, wheat-based products, produce and eggs (2.1% of Taco Cabana sales in the third quarter of 2008) partially offset by the effect of menu price increases and higher vendor rebates (0.2% of Taco Cabana sales). Burger King cost of sales, as a percentage of Burger King restaurant sales, increased to 29.2% in the third quarter of 2008 from 26.7% in the third quarter of 2007 due to higher commodity prices including beef, cheese, shortening and wheat-based products (2.8% of Burger King sales in the third quarter of 2008) offset in part by the effect of menu price increases. In the third quarter of 2008 ground beef prices increased 24.7% compared to the third quarter of 2007 (1.2% of Burger King sales).

Restaurant wages and related expenses, as a percentage of total restaurant sales, decreased to 28.6% in the third quarter of 2008 from 29.3% in the third quarter of 2007. Pollo Tropical restaurant wages and related expenses, as a percentage of Pollo Tropical restaurant sales, decreased slightly to 24.7% in the third quarter of 2008 from 24.8% in the third quarter of 2007 as reductions in productive labor hours and the effect of menu price increases were substantially offset by higher workers compensation claim costs (0.7% of Pollo Tropical sales). Taco Cabana restaurant wages and related expenses, as a percentage of Taco Cabana restaurant sales, also decreased slightly to 28.7% in the third quarter of 2008 from 28.8% in the third quarter of 2007 due primarily to lower medical insurance claim costs (0.3% of Taco Cabana sales) partially offset by increases in labor rates on relatively flat sales. Burger King restaurant wages and related expenses, as a percentage of Burger King restaurant sales, decreased to 30.3% in the third quarter of 2008 from 31.5% in the third quarter of 2007 due primarily to reductions in productive labor hours and the effect of menu price increases and lower medical insurance claim costs (0.3% of Burger King sales).

Restaurant rent expense, as a percentage of total restaurant sales, increased to 5.6% in the third quarter of 2008 from 5.5% in the third quarter of 2007 due primarily to sale-leaseback transactions entered into since the beginning of the third quarter of 2007.

Other restaurant operating expenses, as a percentage of total restaurant sales, increased to 15.5% in the third quarter of 2008 from 15.0% in the third quarter of 2007. Pollo Tropical other restaurant operating expenses, as a percentage of Pollo Tropical restaurant sales, increased to 15.8% in the third quarter of 2008 from 14.0% in the third quarter of 2007 due primarily to higher utility costs (0.8% of Pollo Tropical sales), higher repair and maintenance expenses (0.2% of Pollo Tropical sales), higher general liability claim costs (0.2% of Pollo Tropical sales) and the effect of lower sales volumes on fixed costs. Taco Cabana other restaurant operating expenses, as a percentage of Taco Cabana restaurant sales, increased to 15.8% in the third quarter of 2008 from 15.6% in the third quarter of 2007 due primarily to higher utility costs (0.7% of Taco Cabana sales) partially offset by lower general liability claim costs (0.3% of Taco Cabana sales) and lower costs associated with opening new restaurants (0.2% of Taco Cabana sales). Burger King other restaurant operating expenses, as a percentage of Burger King restaurant sales, increased slightly to 15.3% in the third quarter of 2008 from 15.2% in the third quarter of 2007 due primarily to higher utility costs (0.4% of Burger King sales) offset in part by lower repairs and maintenance expenses (0.2% of Burger King sales).

Advertising expense, as a percentage of total restaurant sales, was 3.7% in both the third quarter of 2008 and the third quarter of 2007. Pollo Tropical advertising expense, as a percentage of Pollo Tropical restaurant sales, increased to 2.5% in the third quarter of 2008 from 1.5% in the third quarter of 2007 due to the timing of promotions in 2007. Taco Cabana advertising expense, as a percentage of Taco Cabana restaurant sales, decreased to 3.7% in the third quarter of 2008 from 4.1% in the third quarter of 2007 due primarily to the timing of promotions in 2008. Burger King advertising expense, as a percentage of Burger King restaurant sales, was 4.3% in both the third quarter of 2008 and the third quarter of 2007.

General and administrative expenses increased \$0.6 million in the third quarter of 2008 or, as a percentage of total restaurant sales, increased to 6.2% in the third quarter of 2008 from 6.1% in the third quarter of 2007.

Segment EBITDA. As a result of the factors above, Segment EBITDA for our Pollo Tropical restaurants decreased to \$5.2 million in the third quarter of 2008 from \$7.8 million in the third quarter of 2007. Segment EBITDA for our Taco Cabana restaurants was \$7.3 million in both the third quarter of 2008 and the third quarter of 2007. Segment EBITDA for our Burger King restaurants decreased to \$8.8 million in the third quarter of 2008 from \$9.2 million in the third quarter of 2007.

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Depreciation and Amortization and Impairment Losses. Depreciation and amortization expense was \$8.1 million in both the third quarter of 2008 and the third quarter of 2007. Impairment losses were \$0.1 million in the third quarter of 2008. Impairment losses were \$1.8 million in the third quarter of 2007 and included a \$1.7 million charge related to an underperforming Pollo Tropical restaurant in Brooklyn, New York which was subsequently closed in the fourth quarter of 2007.

Interest Expense. Interest expense decreased \$0.8 million to \$6.9 million in the third quarter of 2008 from \$7.7 million in the third quarter of 2007 due to lower effective interest rates on our LIBOR based borrowings under our senior credit facility. The weighted average interest rate on our long-term debt, excluding lease financing obligations, for the third quarter of 2008 decreased to 6.8% from 8.1% in the third quarter of 2007. Interest expense on lease financing obligations was \$1.1 million in the third quarter of 2008 compared to \$1.4 million in the third quarter of 2007.

Provision for Income Taxes. The provision for income taxes for the third quarter of 2008 was derived using an estimated effective annual income tax rate for all of 2008 of 37.2%, which excludes any discrete tax adjustments. The provision for income taxes for the third quarter of 2007 was derived using an estimated effective annual income tax rate for 2007 of 36.5%, excluding discrete tax adjustments. Discrete tax adjustments were minimal in the third quarter of 2008. Discrete tax adjustment reduced the provision for income taxes by \$0.8 million in the third quarter of 2007. We adopted the provisions of Financial Standards Accounting Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) and interpretation of FASB Statement No. 109 (SFAS 109) on January 1, 2007. As of the adoption date of January 1, 2007, we had \$0.6 million of unrecognized tax benefits. During the three months ended September 30, 2007 the statute of limitations affecting the taxing jurisdictions pertaining to \$0.6 million of unrecognized tax benefits expired, including interest. We also recorded as a discrete tax item in the third quarter of 2007 a reduction of tax expense of \$0.2 million related to a reduction of valuation allowances for deferred taxes pertaining to state net operating loss carry forwards.

Net Income. As a result of the foregoing, net income was \$3.7 million in the third quarter of 2008 compared to \$4.9 million in the third quarter of 2007.

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

The following table sets forth, for the nine months ended September 30, 2008 and 2007, selected operating results as a percentage of consolidated restaurant sales:

	2008	2007
Restaurant sales:		
Pollo Tropical	21.5%	21.3%
Taco Cabana	30.5%	30.5%
Burger King	48.0%	48.2%
Total restaurant sales	100.0%	100.0%
Costs and expenses:		
Cost of sales	30.1%	28.5%
Restaurant wages and related expenses	29.1%	29.4%
Restaurant rent expense	5.7%	5.5%
Other restaurant operating expenses	15.2%	14.7%
Advertising expense	4.0%	4.1%
General and administrative (including stock-based compensation expense)	6.4%	6.6%

Since January 1, 2007 through September 30, 2008 we have opened fourteen new Pollo Tropical restaurants, fifteen new Taco Cabana restaurants and two new Burger King restaurants, which were relocated within their market areas under a new franchise agreement. During the same time period we closed an additional eleven Burger King restaurants, one Pollo Tropical restaurant and five Taco Cabana restaurants.

Restaurant Sales. Total restaurant sales for the first nine months of 2008 increased \$23.3 million, or 3.9%, to \$614.4 million from \$591.2 million in the first nine months of 2007. Restaurant sales at our Hispanic Brand restaurants increased \$13.8 million, or 4.5%, to \$319.9 million in the first nine months of 2008 from \$306.1 million in the first nine months of 2007.

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Pollo Tropical restaurant sales increased \$6.2 million, or 4.9%, to \$132.3 million in the first nine months of 2008 due primarily to the opening of fourteen new Pollo Tropical restaurants since the beginning of 2007, which contributed \$8.8 million in additional sales in the first nine months of 2008 compared to the first nine months of 2007. This increase was partially offset by a decrease in comparable restaurant sales at our Pollo Tropical restaurants of 0.5% in the first nine months of 2008 due to lower customer traffic, and to a lesser extent, the closure of one Pollo Tropical restaurant since the beginning of 2007.

Taco Cabana restaurant sales increased \$7.6 million, or 4.2%, to \$187.6 million in the first nine months of 2008 due primarily to the opening of fifteen new Taco Cabana restaurants since the beginning of 2007 which contributed \$9.5 million of additional sales in the first nine months of 2008 compared to the first nine months of 2007. This increase was partially offset by the closure of five Taco Cabana restaurants since the beginning of 2007 and, to a lesser extent, a decrease in comparable restaurant sales at our Taco Cabana restaurants of 0.2% in the first nine months of 2008 due to lower customer traffic.

Burger King restaurant sales increased by \$9.5 million, or 3.3%, to \$294.5 million in the first nine months of 2008 due to a comparable restaurant sales increase of 4.3% at our Burger King restaurants primarily due to increases in customer traffic. This increase was partially offset by the closure of eleven Burger King restaurants since the beginning of 2007.

Operating Costs and Expenses. Cost of sales (food and paper costs), as a percentage of total restaurant sales, increased to 30.1% in the first nine months of 2008 from 28.5% in the first nine months of 2007. Pollo Tropical cost of sales, as a percentage of Pollo Tropical restaurant sales, increased to 33.2% in the first nine months of 2008 from 32.1% in the first nine months of 2007 due primarily to higher chicken commodity prices (1.3% of Pollo Tropical sales in the first nine months of 2008) and higher prices of other commodities (1.5% of Pollo Tropical sales) partially offset by the effect of menu price increases. Taco Cabana cost of sales, as a percentage of Taco Cabana restaurant sales, increased to 30.9% in the first nine months of 2008 from 29.7% in the first nine months of 2007 due to higher commodity prices (2.2% of Taco Cabana sales in the first nine months of 2008) including higher cheese prices (0.9% of Taco Cabana sales) and higher wheat-based product prices (0.3% of Taco Cabana sales) partially offset by the effect of menu price increases. Burger King cost of sales, as a percentage of Burger King restaurant sales, increased to 28.2% in the first nine months of 2008 from 26.1% in the first nine months of 2007 due primarily to higher commodity prices including beef, cheese, shortening and wheat-based products (2.5% of Burger King sales in the first nine months of 2008) and increased promotional discounting in 2008 (0.3% of Burger King sales), offset in part by the effect of menu price increases.

Restaurant wages and related expenses, as a percentage of total restaurant sales, decreased to 29.1% in the first nine months of 2008 from 29.4% in the first nine months of 2007. Pollo Tropical restaurant wages and related expenses, as a percentage of Pollo Tropical restaurant sales, decreased to 24.8% in the first nine months of 2008 from 25.0% in the first nine months of 2007 due primarily to lower medical claim costs (0.2% of Pollo Tropical sales). Taco Cabana restaurant wages and related expenses, as a percentage of Taco Cabana restaurant sales, increased to 29.1% in the first nine months of 2008 from 28.6% in the first nine months of 2007 due primarily to the effect of labor rate increases on slightly negative comparable store sales and higher restaurant level bonus accruals (0.1% of Taco Cabana sales). Burger King restaurant wages and related expenses, as a percentage of Burger King restaurant sales, decreased to 31.1% in the first nine months of 2008 from 31.9% in the first nine months of 2007 due primarily to the effect of higher sales volumes on fixed labor costs and lower medical insurance claim costs (0.2% of Burger King sales).

Restaurant rent expense, as a percentage of total restaurant sales, increased to 5.7% in the first nine months of 2008 from 5.5% in the first nine months of 2007 due primarily to the effect of sale-leaseback transactions entered into since the beginning of 2007.

Other restaurant operating expenses, as a percentage of total restaurant sales, increased to 15.2% in the first nine months of 2008 from 14.7% in the first nine months of 2007. Pollo Tropical other restaurant operating expenses, as a percentage of Pollo Tropical restaurant sales, increased to 14.8% in the first nine months of 2008 from 13.3% in the first nine months of 2007 due primarily to higher repair and maintenance expenses (0.4% of Pollo Tropical sales), higher utility costs (0.4% of Pollo Tropical sales) and higher general liability claim costs (0.2% of Pollo Tropical sales). Taco Cabana other restaurant operating expenses, as a percentage of Taco Cabana restaurant sales, increased to 15.3% in the first nine months of 2008 from 14.9% in the first nine months of 2007 due primarily to higher utility costs (0.4% of Taco Cabana sales). Burger King other restaurant operating expenses, as a percentage of Burger King restaurant sales, increased to 15.3% in the first nine months of 2008 from 15.2% in the first nine months of 2007 due primarily to higher utility costs.

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Advertising expense, as a percentage of total restaurant sales, decreased to 4.0% in the first nine months of 2008 from 4.1% in the first nine months of 2007. Pollo Tropical advertising expense, as a percentage of Pollo Tropical restaurant sales, increased to 2.8% in the first nine months of 2008 from 2.4% in the first nine months of 2007 due to the timing of promotions in 2007. Pollo Tropical advertising costs are currently expected to be approximately 2.5% to 2.7% of Pollo Tropical restaurant sales for all of 2008, but there can be no assurance in this regard. Taco Cabana advertising expense, as a percentage of Taco Cabana restaurant sales, decreased to 4.3% in the first nine months of 2008 from 4.7% in the first nine months of 2007 due primarily to the timing of promotions in 2007. Taco Cabana advertising costs are currently expected to be approximately 3.8% to 4.0% of Taco Cabana restaurant sales for all of 2008, but there can be no assurance in this regard. Burger King advertising expense, as a percentage of Burger King restaurant sales, was 4.5% in both the first nine months of 2008 and 2007. Our Burger King advertising costs are currently expected to be approximately 4.5% of Burger King restaurant sales for all of 2008, but there can be no assurance in this regard.

General and administrative expenses in the first nine months of 2008 increased \$0.8 million to \$39.6 million. As a percentage of total restaurant sales, general and administrative expenses decreased to 6.4% in the first nine months of 2008 from 6.6% in the first nine months of 2007 due primarily to lower administrative bonus accruals of \$1.8 million.

Segment EBITDA. As a result of the factors above, Segment EBITDA for our Pollo Tropical restaurants decreased to \$18.0 million in the first nine months of 2008 from \$21.9 million in the first nine months of 2007. Segment EBITDA for our Taco Cabana restaurants decreased to \$19.7 million in the first nine months of 2008 from \$22.7 million in the first nine months of 2007. Segment EBITDA for our Burger King restaurants decreased to \$22.5 million in the first nine months of 2008 from \$23.4 million in the first nine months of 2007.

Depreciation and Amortization and Impairment Losses. Depreciation and amortization expense increased \$0.5 million to \$24.2 million in the first nine months of 2008 from \$23.7 million in the first nine months of 2007 due primarily to additional depreciation expense related to our capital expenditures since the beginning of 2007. Impairment losses were \$0.2 million in the first nine months of 2008 and \$1.9 million in the first nine months of 2007. Impairment losses in the third quarter of 2007 included a \$1.7 million charge related to an underperforming Pollo Tropical restaurant in Brooklyn, New York which was subsequently closed in the fourth quarter of 2007.

Interest Expense. Interest expense decreased \$2.2 million to \$21.4 million in the first nine months of 2008 from \$23.6 million in the first nine months of 2007. This reduction is primarily due to lower effective interest rates on our LIBOR based borrowings under our senior credit facility. The weighted average interest rate on our long-term debt, excluding lease financing obligations, for the first nine months of 2008 decreased to 7.0% from 8.2% in the first nine months of 2007. Interest expense on lease financing obligations was \$3.8 million in the first nine months of 2008 compared to \$4.2 million in the first nine months of 2007.

Provision for Income Taxes. The provision for income taxes for the first nine months of 2008 was derived using an estimated effective annual income tax rate for 2008 of 37.2%, which excludes any discrete tax adjustments. Discrete tax adjustments reduced the provision for income taxes by \$0.1 million in the first nine months of 2008 and \$0.8 million in the first nine months of 2007. The provision for income taxes for the first nine months of 2007 was derived using an estimated effective annual income tax rate for 2007, excluding discrete tax adjustments, of 36.5%.

Net Income. As a result of the foregoing, net income was \$8.4 million in the first nine months of 2008 compared to \$11.5 million in the first nine months of 2007.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements other than our operating leases, which are primarily for our restaurant properties and not recorded on our consolidated balance sheet.

Application of Critical Accounting Policies

Our unaudited interim consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by the application of our accounting policies. Our significant accounting

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policies are described in the Significant Accounting Policies footnote in the notes to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. Critical accounting estimates are those that require application of management's most difficult, subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods.

Sales recognition at our company-owned and operated restaurants is straightforward as customers pay for products at the time of sale and inventory turns over very quickly. Payments to vendors for products sold in the restaurants are generally settled within 30 days. The earnings reporting process is covered by our system of internal controls and generally does not require significant management estimates and judgments. However, critical accounting estimates and judgments, as noted below, are inherent in the assessment and recording of accrued occupancy costs, insurance liabilities, legal obligations, income taxes, the valuation of goodwill and intangible assets for impairment, assessing impairment of long-lived assets and lease accounting matters. While we apply our judgment based on assumptions believed to be reasonable under the circumstances, actual results could vary from these assumptions. It is possible that materially different amounts would be reported using different assumptions.

Accrued occupancy costs. We make estimates of accrued occupancy costs pertaining to closed restaurant locations on an ongoing basis. These estimates require assessment and continuous evaluation of a number of factors such as the remaining contractual period under our lease obligations, the amount of sublease income we are able to realize on a particular property and estimates of other costs such as property taxes. Differences between actual future events and prior estimates could result in adjustments to these accrued costs. At September 30, 2008 we had six non-operating restaurant properties.

Insurance liabilities. We are insured for workers' compensation, general liability and medical insurance claims under policies where we pay all claims, subject to annual stop-loss limitations both for individual claims and claims in the aggregate. At September 30, 2008, we had \$8.8 million accrued for these insurance claims. We record insurance liabilities based on historical and industry trends, which are continually monitored, and adjust accruals as warranted by changing circumstances. Since there are many estimates and assumptions involved in recording these insurance liabilities, including the ability to estimate the future development of incurred claims based on historical trends, differences between actual future events and prior estimates and assumptions could result in adjustments to these liabilities.

Legal obligations. In the normal course of business, we must make estimates of potential future legal obligations and liabilities which require the use of management's judgment. Management may also use outside legal advice to assist in the estimating process. However, the ultimate outcome of various legal issues could be different than management estimates and adjustments to income could be required.

Income taxes. We record income tax liabilities utilizing known obligations and estimates of potential obligations. We are required to record a valuation allowance if it is more likely than not that the value of estimated deferred tax assets are different from those recorded. This would include making estimates and judgments on future taxable income, the consideration of feasible tax planning strategies and existing facts and circumstances. When the amount of deferred tax assets to be realized is expected to be different from that recorded, the asset balance and income statement would reflect any change in valuation in the period such determination is made.

Evaluation of Goodwill. We must evaluate our recorded goodwill under Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets (SFAS 142) on an ongoing basis. We have elected to conduct our annual impairment review of goodwill assets at December 31. Our review at December 31, 2007 indicated there has been no impairment as of that date. This annual evaluation of goodwill requires us to make estimates and assumptions to determine the fair value of our reporting units including projections regarding future operating results of each restaurant over its remaining lease term and market values. These estimates may differ from actual future events and if these estimates or related projections change in the future, we may be required to record impairment charges for these assets.

Impairment of Long-lived Assets. We assess the potential impairment of long-lived assets, principally property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We determine if there is impairment at the restaurant level by comparing undiscounted future cash flows from the related long-lived assets with their respective carrying values. In determining future cash flows, significant estimates are made by us with respect to future operating results of each restaurant over its remaining lease term. If assets are determined to be impaired, the impairment charge is measured by calculating the amount by which the asset carrying amount exceeds its fair value. This process of assessing fair values requires the use of estimates and assumptions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Impairment of Burger King Franchise Rights. We assess the potential impairment of Burger King franchise rights whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We determine if there is impairment by comparing the aggregate undiscounted future cash flows from those acquired restaurants with the respective

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carrying value of franchise rights for each Burger King acquisition. In determining future cash flows, significant estimates are made by us with respect to future operating results of each group of acquired restaurants over their remaining franchise life. If acquired franchise rights are determined to be impaired, the impairment charge is measured by calculating the amount by which the franchise rights carrying amount exceeds its fair value. This process requires the use of estimates and assumptions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets.

Lease Accounting. Judgments made by management for our lease obligations include the lease term including the determination of renewal options that are reasonably assured which can affect the classification of a lease as capital or operating for accounting purposes, the term over which related leasehold improvements for each restaurant are amortized, and any rent holidays and/or changes in rental amounts for recognizing rent expense over the term of the lease. These judgments may produce materially different amounts of depreciation, amortization and rent expense than would be reported if different assumed lease terms were used.

We also must evaluate under SFAS 98 sales of our restaurants which occur in sale-leaseback transactions to determine the proper accounting for the proceeds of such sales either as a sale or a financing. This evaluation requires certain judgments in determining whether or not clauses in the lease or any related agreements constitute continuing involvement under SFAS 98. These judgments must also consider the various interpretations of SFAS 98 since its issuance. For those sale-leasebacks that are accounted for as financing transactions, we must estimate our incremental borrowing rate, or another rate in cases where the incremental borrowing rate is not appropriate to utilize, for purposes of determining interest expense and the resulting amortization of the lease financing obligation. Changes in the determination of the incremental borrowing rates or other rates utilized in connection with the accounting for lease financing transactions could have a significant effect on the interest expense and underlying balance of the lease financing obligations.

In addition, if a purchase option exists for any properties subject to a lease financing obligation, the purchase option is evaluated for its probability of exercise on an ongoing basis. This evaluation considers many factors including, without limitation, our intentions, the fair value of the underlying properties, our ability to acquire the property, economic circumstances and other available alternatives to us for the continued use of the property. These factors may change and be considered differently in future assessments of probability.

Stock-based Compensation. We account for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)). As required by SFAS No. 123(R), stock-based compensation is estimated for equity awards at fair value at the grant date. We determine the fair value of equity awards using the Black-Scholes model which requires the use of certain assumptions. The assumptions include the risk-free rate of interest, expected dividend yield, expected volatility and the expected life of the award. The risk-free rate of interest is based on the zero coupon U.S. Treasury rate appropriate for the expected term of the award. There are no dividend assumptions as we do not currently plan to pay dividends on our common stock. Expected stock price volatility is based on the implied volatility of a peer group that had actively traded stock during the period immediately preceding the share-based award grant as we currently do not have sufficient historical stock price data for our stock. This period is equal in length to the award's expected term. Compensation expense is recognized only for those options expected to vest, with forfeitures estimated based on our historical experience and future expectations.

Effects of New Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS 157). This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities and expands disclosures about fair value measurements. The statement applies whenever other pronouncements require or permit assets or liabilities to be measured at fair value. In February 2007, the FASB issued FSP FAS 157-2, delaying the effective date of SFAS 157 for certain nonfinancial assets and liabilities to fiscal years beginning after November 15, 2008. The implementation of SFAS 157 for financial assets and financial liabilities, effective for fiscal 2008, did not have a material impact on our consolidated financial statements. We are currently evaluating the impact SFAS 157 may have for nonfinancial assets and liabilities in our consolidated financial statements.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities – Including an Amendment of FASB Statement No. 115* (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for our fiscal year beginning January 1, 2008. We did not elect to begin reporting any financial assets or liabilities at fair value upon adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financials Statements, an Amendment of ARB No. 51* (SFAS 160). SFAS 160 clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact SFAS 160 will have on our consolidated financial statements.

In April 2008, the FASB issued FSP SFAS No. 142-3 *Determination of the Useful Life of Intangible Assets* (SFAS 142-3). SFAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. The requirement for determining useful lives must be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. SFAS No. 142-3 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, which will require us to adopt these provisions in the first quarter of 2009. We have reviewed this pronouncement and do not anticipate the adoption of SFAS No. 142-3 will materially impact our financial statements.

Forward Looking Statements

This Quarterly Report on Form 10-Q contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are predictive in nature or that depend upon or refer to future events or conditions are forward-looking statements. These statements are often identified by the words may, might, will, should, anticipate, believe, expect, intend, estimate, hope or similar expressions. In addition, expressions of our strategies, intentions or plans are also forward looking statements. These statements reflect management's current views with respect to future events and are subject to risks and uncertainties, both known and unknown. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their date. There are important factors that could cause actual results to differ materially from those in forward-looking statements, many of which are beyond our control. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected or implied in the forward-looking statements. We believe important factors that could cause actual results to differ materially from our expectations include the following, in addition to other risks and uncertainties discussed herein and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007:

Competitive conditions;

Regulatory factors;

Environmental conditions and regulations;

General economic conditions, particularly at the retail level;

Weather conditions;

Increases in commodity costs;

Fuel prices;

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

Changes in consumer perception of dietary health and food safety;

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Labor and employment benefit costs;

The outcome of pending or future legal proceedings;

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

The risks associated with the expansion of our business;

General risks associated with the restaurant industry;

Our inability to integrate any businesses we acquire;

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

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

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

Factors that affect the restaurant industry generally, including recalls if products become adulterated or misbranded, liability if product consumption causes injury, ingredient disclosure and labeling laws and regulations, reports of cases of mad cow disease and avian flu or other food-borne illnesses, and the possibility that consumers could lose confidence in the safety and quality of certain food products, as well as negative publicity regarding food quality, illness, injury or other health concerns.

Inflation

The inflationary factors that have historically affected our results of operations include increases in food and paper costs, labor and other operating expenses and energy costs. Wages paid in our restaurants are impacted by changes in the Federal and state hourly minimum wage rates. Accordingly, changes in the Federal and state hourly minimum wage rates directly affect our labor costs. We typically attempt to offset the effect of inflation, at least in part, through periodic menu price increases and various cost reduction programs. However, no assurance can be given that we will be able to fully offset such inflationary cost increases in the future.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

There were no material changes from the information presented in Item 7A included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 with respect to the Company's market risk sensitive instruments.

ITEM 4 CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Our senior management is responsible for establishing and maintaining disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer

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or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report, with the participation of our Chief Executive Officer and Chief Financial Officer, as well as other key members of our management. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 28, 2008.

No change occurred in our internal control over financial reporting during the third quarter of 2008 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

There were no material changes to the disclosure made in our Annual Report on Form 10-K for the year ended December 31, 2007 regarding these matters.

Item 1A. RISK FACTORS

Part I Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 describes important factors that could cause our actual operating results to differ materially from those indicated or suggested by forward-looking statements made in this Form 10-Q or presented elsewhere by management from time-to-time. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Default Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

(a) The following exhibits are filed as part of this report.

Exhibit No.

- | | |
|------|---|
| 31.1 | Chief Executive Officer s Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc. |
| 31.2 | Chief Financial Officer s Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc. |
| 31.3 | Chief Executive Officer s Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation. |
| 31.4 | Chief Financial Officer s Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation. |
| 32.1 | Chief Executive Officer s Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc. |
| 32.2 | Chief Financial Officer s Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Restaurant Group, Inc. |
| 32.3 | Chief Executive Officer s Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation. |
| 32.4 | Chief Financial Officer s Certificate Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Carrols Corporation. |

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SIGNATURES

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

CARROLS RESTAURANT GROUP, INC.

Date: November 5, 2008

/s/ ALAN VITULI
(Signature)
Alan Vituli
Chairman of the Board and
Chief Executive Officer

Date: November 5, 2008

/s/ PAUL R. FLANDERS
(Signature)
Paul R. Flanders
Vice President Chief Financial Officer and Treasurer

SIGNATURES

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

CARROLS CORPORATION

Date: November 5, 2008

/s/ ALAN VITULI
(Signature)
Alan Vituli
Chairman of the Board and
Chief Executive Officer

Date: November 5, 2008

/s/ PAUL R. FLANDERS
(Signature)
Paul R. Flanders
Vice President Chief Financial Officer and Treasurer