

CARROLS RESTAURANT GROUP, INC.

Form 10-Q

November 09, 2016

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended October 2, 2016

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 16-1287774  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

968 James Street 13203  
Syracuse, New York  
(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: (315) 424-0513

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 7, 2016, Carrols Restaurant Group, Inc. had 35,835,800 shares of its common stock, \$.01 par value, outstanding.

Table of Contents

CARROLS RESTAURANT GROUP, INC.  
FORM 10-Q  
QUARTER ENDED October 2, 2016

	Page
<u>PART I FINANCIAL INFORMATION</u>	
Item 1 <u>Interim Consolidated Financial Statements (Unaudited) - Carrols Restaurant Group, Inc.:</u>	
<u>Consolidated Balance Sheets as of October 2, 2016 and January 3, 2016</u>	<u>3</u>
<u>Consolidated Statements of Operations and Comprehensive Income (Loss) for the Three and Nine Months Ended October 2, 2016 and September 27, 2015</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows for the Nine Months Ended October 2, 2016 and September 27, 2015</u>	<u>5</u>
<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	<u>6</u>
Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
Item 3 <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>35</u>
Item 4 <u>Controls and Procedures</u>	<u>35</u>
<u>PART II OTHER INFORMATION</u>	
Item 1 <u>Legal Proceedings</u>	<u>36</u>
Item 1A <u>Risk Factors</u>	<u>36</u>
Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>36</u>
Item 3 <u>Defaults Upon Senior Securities</u>	<u>36</u>
Item 4 <u>Mine Safety Disclosures</u>	<u>36</u>
Item 5 <u>Other Information</u>	<u>36</u>
Item 6 <u>Exhibits</u>	<u>37</u>

Table of Contents

## PART I—FINANCIAL INFORMATION

## ITEM 1—INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## CARROLS RESTAURANT GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

	October 2, 2016	January 3, 2016
<b>ASSETS</b>		
Current assets:		
Cash	\$10,137	\$22,274
Trade and other receivables	7,595	6,161
Inventories	7,719	7,126
Prepaid rent	4,399	4,168
Prepaid expenses and other current assets	6,265	5,266
Total current assets	36,115	44,995
Property and equipment, net of accumulated depreciation of \$246,686 and \$226,140, respectively	251,618	220,114
Franchise rights, net of accumulated amortization of \$92,270 and \$87,869, respectively (Note 3)	127,017	118,881
Goodwill (Note 3)	21,804	20,438
Franchise agreements, at cost less accumulated amortization of \$9,431 and \$8,471, respectively	15,356	15,467
Favorable leases, net of accumulated amortization of \$1,770 and \$1,339, respectively (Note 3)	5,272	5,652
Other assets	1,843	1,709
Total assets	\$459,025	\$427,256
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt (Note 7)	\$1,585	\$1,435
Accounts payable	21,643	20,436
Accrued interest	6,675	2,672
Accrued payroll, related taxes and benefits	23,720	27,582
Accrued real estate taxes	4,993	5,117
Other liabilities	15,567	14,012
Total current liabilities	74,183	71,254
Long-term debt, net of current portion (Note 7)	212,317	202,042
Lease financing obligations	1,195	1,193
Deferred income—sale-leaseback of real estate (Note 6)	12,185	12,589
Accrued postretirement benefits	3,020	3,060
Unfavorable leases, net of accumulated amortization of \$4,328 and \$3,444, respectively (Note 3)	12,018	12,004
Other liabilities (Note 5)	18,471	17,115
Total liabilities	333,389	319,257
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, par value \$.01; authorized 20,000,000 shares, issued and outstanding—100 shares		—
Voting common stock, par value \$.01; authorized—100,000,000 shares, issued—35,835,800 and 35,508,660 shares, respectively, and outstanding—35,255,399 and 35,039,890 shares, respectively	353	350
Additional paid-in capital	140,707	139,083
Accumulated deficit	(14,948 )	(30,958 )

Edgar Filing: CARROLS RESTAURANT GROUP, INC. - Form 10-Q

Accumulated other comprehensive loss	(335 )	(335 )
Treasury stock, at cost	(141 )	(141 )
Total stockholders' equity	125,636	107,999
Total liabilities and stockholders' equity	\$459,025	\$427,256

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

3

---

Table of Contents

CARROLS RESTAURANT GROUP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
THREE AND NINE MONTHS ENDED OCTOBER 2, 2016 AND SEPTEMBER 27, 2015  
(In thousands of dollars)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 2,	September 27,	October 2,	September 27,
	2016	2015	2016	2015
Restaurant sales	\$238,870	\$ 217,676	\$702,757	\$ 629,948
Costs and expenses:				
Cost of sales	63,844	60,676	184,981	178,022
Restaurant wages and related expenses	75,678	67,116	221,306	197,135
Restaurant rent expense	16,081	14,106	48,077	43,101
Other restaurant operating expenses	37,606	34,261	110,611	100,407
Advertising expense	10,857	8,188	30,755	23,551
General and administrative (including stock-based compensation expense of \$456, \$367, \$1,627 and \$1,071, respectively)	13,000	11,764	40,561	36,263
Depreciation and amortization	12,070	9,418	34,613	29,216
Impairment and other lease charges (Note 4)	685	396	1,193	2,732
Other expense (income) (Note 13)	—	—	1,035	(126 )
Total operating expenses	229,821	205,925	673,132	610,301
Income from operations	9,049	11,751	29,625	19,647
Interest expense	4,560	4,512	13,615	14,026
Loss on extinguishment of debt (Note 7)	—	—	—	12,635
Income (loss) before income taxes	4,489	7,239	16,010	(7,014 )
Provision (benefit) for income taxes (Note 8)	—	—	—	—
Net income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )
Basic and diluted net income (loss) per share (Note 12)	\$0.10	\$ 0.16	\$0.35	\$ (0.20 )
Diluted weighted average common shares outstanding	44,855,778	44,678,514	44,892,188	44,930,326
Other comprehensive income (loss), net of tax:				
Net income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )
Other comprehensive income (loss)	—	—	—	—
Comprehensive income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )

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

Table of Contents

CARROLS RESTAURANT GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
NINE MONTHS ENDED OCTOBER 2, 2016 AND SEPTEMBER 27, 2015  
(In thousands of dollars)  
(Unaudited)

	Nine Months Ended October 2, 2016	September 27, 2015
Cash flows provided from operating activities:		
Net income (loss)	\$ 16,010	\$ (7,014 )
Adjustments to reconcile net income (loss) to net cash provided from operating activities:		
Loss on disposals of property and equipment	14	252
Stock-based compensation	1,627	1,071
Impairment and other lease charges	1,193	2,732
Depreciation and amortization	34,613	29,216
Amortization of deferred financing costs	593	663
Amortization of deferred gains from sale-leaseback transactions	(1,348 )	(1,953 )
Loss on extinguishment of debt	—	12,635
Change in refundable income taxes	—	2,416
Changes in other operating assets and liabilities	(1,863 )	15,567
Net cash provided from operating activities	50,839	55,585
Cash flows used for investing activities:		
Capital expenditures:		
New restaurant development	(5,857 )	(556 )
Restaurant remodeling	(45,312 )	(27,807 )
Other restaurant capital expenditures	(12,037 )	(7,367 )
Corporate and restaurant information systems	(2,181 )	(1,801 )
	(65,387 )	(37,531 )

Edgar Filing: CARROLS RESTAURANT GROUP, INC. - Form 10-Q

Total capital expenditures				
Acquisition of restaurants, net of cash acquired	(33,407	)	(1,657	)
Proceeds from sale of other assets	—		534	
Properties purchased for sale-leaseback	(4,096	)	(3,575	)
Proceeds from sale-leaseback transactions	29,394		3,136	
Proceeds from insurance recoveries	1,216		—	
Net cash used for investing activities	(72,280	)	(39,093	)
Cash flows provided from financing activities				
Proceeds from issuance of 8% senior secured second lien notes	—		200,000	
Redemption of 11.25% senior secured second lien notes	—		(159,771	)
Borrowings under senior credit facility	50,250		—	
Repayments under senior credit facility	(39,750	)	—	
Principal payments on capital leases	(1,094	)	(945	)
Financing costs associated with issuance of debt	(102	)	(5,164	)
Net cash provided from financing activities	9,304		34,120	
Net increase (decrease) in cash	(12,137	)	50,612	
Cash, beginning of period	22,274		21,221	
Cash, end of period	\$ 10,137		\$ 71,833	
Supplemental disclosures:				
Interest paid on long-term debt	\$ 8,941		\$ 8,565	
Interest paid on lease financing obligations	\$ 78		\$ 77	
Accruals for capital expenditures	\$ 3,468		\$ 3,084	
Income taxes refunded (paid)	\$ (3	)	\$ 2,416	
	\$ 553		\$ —	

Capital lease obligations  
acquired or incurred

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

5

---



Table of Contents

CARROLS RESTAURANT GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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

1. Basis of Presentation

**Business Description.** At October 2, 2016 Carrols Restaurant Group, Inc. ("Carrols Restaurant Group") operated, as franchisee, 734 restaurants under the trade name "Burger King ®" in 16 Northeastern, Midwestern and Southeastern states.

**Basis of Consolidation.** Carrols Restaurant Group is a holding company and conducts all of its operations through its wholly-owned subsidiary, Carrols Corporation ("Carrols") and Carrols' wholly-owned subsidiary, Carrols LLC, a Delaware limited liability company. The unaudited consolidated financial statements presented herein include the accounts of Carrols Restaurant Group and its wholly-owned subsidiary Carrols.

Unless the context otherwise requires, Carrols Restaurant Group, Carrols and Carrols LLC are collectively referred to as the "Company." All intercompany transactions have been eliminated in consolidation.

**Fiscal Year.** The Company uses a 52-53 week fiscal year ending on the Sunday closest to December 31. The fiscal year ended January 3, 2016 contained 53 weeks. The three and nine months ended October 2, 2016 and September 27, 2015 each contained thirteen and thirty-nine weeks, respectively. The 2016 fiscal year will end January 1, 2017 and will contain 52 weeks.

**Basis of Presentation.** The accompanying unaudited consolidated financial statements for the three and nine months ended October 2, 2016 and September 27, 2015 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 unaudited consolidated financial statements have been included. The results of operations for the three and nine months ended October 2, 2016 and September 27, 2015 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 contained in the Company's Annual Report on Form 10-K for the year ended January 3, 2016. The January 3, 2016 consolidated balance sheet data is derived from those audited consolidated financial statements.

**Use of Estimates.** The preparation of the accompanying unaudited consolidated 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 unaudited consolidated 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, evaluation for impairment of goodwill, long-lived assets and franchise rights, lease accounting matters, the valuation of assets and liabilities acquired and the valuation of deferred income tax assets. Actual results could differ from those estimates.

**Segment Information.** Operating segments are components of an entity for which separate financial information is available and is regularly reviewed by the chief operating decision maker in order to allocate resources and assess performance. The Company's chief operating decision maker currently evaluates the Company's operations from a number of different operational perspectives; however resource allocation decisions are made at a total-Company basis. The Company derives all significant revenues from a single operating segment. Accordingly, the Company views the operating results of its Burger King restaurants as one reportable segment.

**Business Combinations.** In accordance with ASC 805, Business Combinations, the Company allocates the purchase price of an acquired business to its net identifiable assets and liabilities based on the estimated fair values. The excess of the purchase price over the amount allocated to the assets and liabilities, if any, is recorded as goodwill. The Company uses all available information to estimate fair values of identifiable intangible assets and property



CARROLS RESTAURANT GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

acquired. In making these determinations, the Company may engage an independent third party valuation specialist to assist with the valuation of certain leasehold improvements, franchise rights and favorable and unfavorable leases.

The Company estimates that the seller's carrying value of acquired restaurant equipment, subject to certain adjustments, and restaurant equipment subject to capital leases is equivalent to fair value of this equipment at the date of the acquisitions. The fair values of assumed franchise agreements are valued as if the remaining term of the agreement is at the market rate. The fair values of acquired land, buildings and certain leasehold improvements are determined using both the cost approach and market approach. The fair value of the favorable and unfavorable leases acquired, as well as the fair value of land, buildings and leasehold improvements acquired, is measured using significant inputs observable in the open market. The Company categorizes all such inputs as Level 2 inputs under ASC 820. The fair value of acquired franchise rights is primarily determined using the income approach.

**Fair Value of Financial Instruments.** Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. In determining fair value, the accounting standards establish a three level hierarchy for inputs used in measuring fair value as follows: Level 1 inputs are quoted prices in active markets for identical assets or liabilities; Level 2 inputs are observable for the asset or liability, either directly or indirectly, including quoted prices in active markets for similar assets or liabilities; and Level 3 inputs are unobservable and reflect our own assumptions. Financial instruments include cash, accounts receivable, accounts payable and long-term debt. The carrying amounts of cash, accounts receivable and accounts payable approximate fair value because of the short-term nature of these financial instruments. The fair value of the Carrols Restaurant Group 8.0% Senior Secured Second Lien Notes due 2022 is based on a recent trading value, which is considered Level 2, and at October 2, 2016 was approximately \$216.3 million.

Fair value measurements of non-financial assets and non-financial liabilities are primarily used in the impairment analysis of long-lived assets and intangible assets. Long-lived assets and definite-lived intangible assets are measured at fair value on a nonrecurring basis using Level 3 inputs. Goodwill is reviewed annually for impairment on the last day of the fiscal year, or more frequently if impairment indicators arise.

**Recently Issued Accounting Pronouncements.** In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires the recognition of lease assets and lease liabilities on the balance sheet and the disclosure of key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years with early adoption permitted. The ASU requires a modified retrospective approach to implementation for leases existing at or subsequent to the earliest comparative period presented in the financial statements. The Company is currently evaluating the impact the adoption of this standard will have on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which to simplifies certain elements of accounting for employee share-based payment transactions, including income tax consequences, the classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for reporting periods beginning after December 15, 2016 with early adoption permitted. The Company is currently evaluating the impact the adoption of this standard will have on its consolidated financial statements.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

## 2. Acquisitions

In 2012, as part of an acquisition of restaurants from Burger King Corporation ("BKC"), the Company was assigned BKC's right of first refusal on franchisee restaurant sales in 20 states (the "ROFR"). Since the beginning of 2015, the Company has acquired an aggregate of 84 restaurants from other franchisees in the following transactions:

Closing Date	Number of Restaurants	Purchase Price	Number of Fee-Owned Restaurants (1)	Market Location
2015 Acquisitions:				
March 31, 2015	4	\$ 794		Northern Vermont
August 4, 2015	5	663		Charlotte, North Carolina
October 1, 2015	(2)5	5,044	1	Wheeling, West Virginia
October 20, 2015	1	709		Kalamazoo, Michigan
November 17, 2015	2	618		Evansville, Indiana
November 17, 2015	(2)6	10,945	5	Evansville, Indiana
December 1, 2015	(2)23	26,175	10	Detroit, Michigan
December 8, 2015	9	7,802		Northern New Jersey
	55	52,750	16	
2016 Acquisitions:				
February 23, 2016	(2)12	7,127		Scranton/Wilkes-Barre, Pennsylvania
May 25, 2016	6	12,080	5	Detroit, Michigan
July 14, 2016	(2)4	5,445	3	Detroit, Michigan
August 23, 2016	7	8,755	6	Portland, Maine
	29	33,407	14	
Total 2015 and 2016 Acquisitions	84	\$ 86,157	30	

The 2015 and 2016 acquisitions included the purchase of 30 fee-owned restaurants. Three of these fee-owned restaurants were sold in sale-leaseback transactions during 2015 for net proceeds of \$4.3 million and an additional (1) seventeen fee-owned restaurants were sold in sale-leaseback transactions in the first nine months of 2016 for net proceeds of \$24.9 million. Eight of the remaining fee-owned restaurants at October 2, 2016 are expected to be sold in sale-leaseback transactions during the remainder of 2016, although there can be no assurance that such transactions will be completed in 2016 or at all.

(2) Acquisitions resulting from the exercise of the ROFR.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The Company allocated the aggregate purchase price to the net tangible and intangible assets acquired in the acquisitions at their estimated fair values. The following table summarizes the allocation of the aggregate purchase price for the 2016 Acquisitions:

Inventory	\$304
Land and buildings	17,872
Restaurant equipment	772
Restaurant equipment - subject to capital lease	435
Leasehold improvements	1,070
Franchise fees	505
Franchise rights (Note 3)	12,537
Favorable leases (Note 3)	73
Goodwill (Note 3)	1,366
Capital lease obligations for restaurant equipment	(491 )
Unfavorable leases (Note 3)	(1,036 )
Net assets acquired	\$33,407

Goodwill recorded in connection with these acquisitions was attributable to the workforce of the acquired restaurants and synergies expected to arise from cost savings opportunities. Acquired goodwill that is expected to be deductible for income tax purposes was \$679 in the first nine months of 2016.

The restaurants acquired in 2015 and 2016 contributed restaurant sales of \$26.0 million and \$68.3 million in the three and nine months ended October 2, 2016, respectively. It is impracticable to disclose net earnings for the post-acquisition period for the acquired restaurants as net earnings of these restaurants were not tracked on a collective basis due to the integration of administrative functions, including field supervision.

The unaudited pro forma impact on the results of operations for the restaurants acquired in 2016 and 2015 for the three and nine months ended October 2, 2016 and September 27, 2015 is included below. The unaudited pro forma results of operations are not necessarily indicative of the results that would have occurred had the acquisitions been consummated at the beginning of the periods presented, nor are they necessarily indicative of any future consolidated operating results. The following table summarizes the Company's unaudited pro forma operating results:

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Restaurant sales	\$240,370	\$ 244,845	\$716,008	\$ 709,171
Net income (loss)	\$4,950	\$ 9,705	\$17,691	\$ (727 )
Basic and diluted net income (loss) per share	\$0.11	\$ 0.22	\$0.39	\$ (0.02 )

This unaudited pro forma financial information does not give effect to any anticipated synergies, operating efficiencies or cost savings or any integration costs related to the acquired restaurants. The unaudited pro forma financial information reflects \$0.5 million and \$0.1 million of transaction costs incurred by the Company during the three months ended October 2, 2016 and September 27, 2015, respectively, and \$1.1 million and \$0.3 million during the nine months ended October 2, 2016 and September 27, 2015, respectively.

On October 4, 2016, the Company completed the acquisition of three Burger King restaurants in the Raleigh, North Carolina market for a cash purchase price of \$1.6 million.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

## 3. Intangible Assets

**Goodwill.** The Company is required to review goodwill for impairment annually, or more frequently, when events and circumstances indicate that the carrying amount may be impaired. If the determined fair value of goodwill is less than the related carrying amount, an impairment loss is recognized. The Company performs its annual impairment assessment as of the last day of its fiscal year and does not believe circumstances have changed since the last assessment date which would make it necessary to reassess its value. There have been no recorded goodwill impairment losses during the three and nine months ended October 2, 2016 or September 27, 2015. The change in goodwill for the nine months ended October 2, 2016 is summarized below:

Balance at January 3, 2016	\$20,438
Acquisitions of restaurants (Note 2)	1,366
Balance at October 2, 2016	\$21,804

**Franchise Rights.** Amounts allocated to franchise rights for each acquisition of Burger King restaurants are amortized using the straight-line method over the average remaining term of the acquired franchise agreements 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 cash flows from the acquired restaurants is compared to the respective carrying value of franchise rights for each 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. No impairment charges were recorded related to the Company's franchise rights for the three and nine months ended October 2, 2016 and September 27, 2015. The change in franchise rights for the nine months ended October 2, 2016 is summarized below:

Balance at January 3, 2016	\$118,881
Acquisitions of restaurants (Note 2)	12,537
Amortization expense	(4,401 )
Balance at October 2, 2016	\$127,017

Amortization expense related to franchise rights was \$1.5 million and \$1.2 million for the three months ended October 2, 2016 and September 27, 2015, respectively, and \$4.4 million and \$3.4 million for the nine months ended October 2, 2016 and September 27, 2015, respectively. The Company expects annual amortization expense to be \$5.9 million in 2016 and in each of the following five years.

**Favorable and Unfavorable Leases.** Amounts allocated to favorable and unfavorable leases are being amortized using the straight-line method over the remaining terms of the underlying lease agreements as a net reduction of restaurant rent expense. Additions to favorable lease assets and unfavorable lease liabilities from the 2016 acquisitions included in Note 2 totaled \$0.1 million and \$1.0 million, respectively, for the nine months ended October 2, 2016.

The net reduction of rent expense related to the amortization of favorable and unfavorable leases was \$0.2 million in each of the three months ended October 2, 2016 and September 27, 2015 and \$0.6 million in each of the nine months ended October 2, 2016 and September 27, 2015. The Company expects the net annual reduction of rent expense to be \$0.8 million in 2016, \$0.7 million in 2017 and 2018, \$0.6 million in 2019 and 2020, and \$0.5 million in 2021.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

## 4. Impairment of Long-Lived Assets and Other Lease Charges

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 the undiscounted future cash flows over the life of the primary asset for each restaurant 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 and 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. For closed restaurant locations, the Company reviews the future minimum lease payments and related ancillary costs from the date of the restaurant closure to the end of the remaining lease term and records a lease charge for the lease liabilities to be incurred, net of any estimated sublease recoveries.

The Company determined the fair value of restaurant equipment, for those restaurants reviewed for impairment, based on current economic conditions and the Company's history of using these assets in the operation of its business. These fair value asset measurements rely on significant unobservable inputs and are considered Level 3 in the fair value hierarchy.

During the three months ended October 2, 2016, the Company recorded asset impairment charges of \$0.3 million consisting primarily of capital expenditures at previously impaired restaurants, a loss of \$0.3 million associated with a sale-leaseback of a restaurant property, and \$0.1 million of other lease charges associated with changes in sublease income assumptions on previously closed restaurants. During the nine months ended October 2, 2016, the Company recorded impairment charges of \$1.2 million consisting additionally of capital expenditures at previously impaired restaurants.

During the three months ended September 27, 2015, the Company recorded asset impairment charges of \$0.4 million resulting primarily from capital expenditures at previously impaired restaurants. During the nine months ended September 27, 2015, the Company recorded other lease charges of \$1.5 million associated with the closure of ten of the Company's restaurants and asset impairment charges of \$1.2 million, including \$1.0 million of capital expenditures at previously impaired restaurants.

The following table presents the activity in the accrual for closed restaurant locations:

	Nine Months Ended October 2, 2016	Year Ended January 3, 2016
Balance, beginning of the period	\$ 2,088	\$ 1,721
Provisions for restaurant closures	—	1,472
Changes in estimates of accrued costs	(80 )	(95 )
Payments, net	(581 )	(1,228 )
Other adjustments, including the effect of discounting future obligations	114	218
Balance, end of the period	\$ 1,541	\$ 2,088

Changes in estimates of accrued costs primarily relate to revisions or terminations of certain closed restaurant leases, changes in sublease income assumptions and other costs.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

## 5. Other Liabilities, Long-Term

Other liabilities, long-term, at October 2, 2016 and January 3, 2016 consisted of the following:

	October 2, 2016	January 3, 2016
Accrued occupancy costs	\$ 11,747	\$ 10,473
Accrued workers' compensation and general liability claims	3,254	3,606
Deferred compensation	1,542	997
Long-term obligation to BKC for ROFR	—	190
Other	1,928	1,849
	\$ 18,471	\$ 17,115

Long-term accrued occupancy costs above include obligations pertaining to closed restaurant locations, contingent rent and accruals to expense operating lease rental payments on a straight-line basis over the lease term.

## 6. Sale-leaseback Transactions

In the three and nine months ended October 2, 2016, the Company sold eight and 20 restaurant properties, respectively, in sale-leaseback transactions for net proceeds of \$11,707 and \$29,394, respectively. In the nine months ended September 27, 2015, the Company sold three restaurant properties in sale-leaseback transactions for net proceeds of \$3,136, none of which occurred in the three months ended September 27, 2015. These leases have been classified as operating leases and contain a twenty-year initial term plus renewal options.

Deferred gains from sale-leaseback transactions of restaurant properties were \$392 and \$954 during the three and nine months ended October 2, 2016, respectively, and are being amortized over the term of the related leases. There were no deferred gains from sale-leaseback transactions during the nine months ended September 27, 2015.

## 7. Long-term Debt

Long-term debt at October 2, 2016 and January 3, 2016 consisted of the following:

	October 2, 2016	January 3, 2016
Collateralized:		
Carrols Restaurant Group 8% Senior Secured Second Lien Notes	\$200,000	\$200,000
Senior Credit Facility - Revolving credit borrowings	10,500	—
Capital leases	7,396	8,006
	217,896	208,006
Less: current portion	(1,585 )	(1,435 )
Less: deferred financing costs	(3,994 )	(4,529 )
	\$212,317	\$202,042

8% Notes. On April 29, 2015, the Company issued \$200 million of 8.0% Senior Secured Second Lien Notes due 2022 (the "8% Notes") pursuant to an indenture dated as of April 29, 2015 governing such notes. The 8% Notes mature and are payable on May 1, 2022. Interest is payable semi-annually on May 1 and November 1. The 8% Notes are guaranteed by the Company's subsidiaries and are secured by second-priority liens on substantially all of the Company's and its subsidiaries' assets (including a pledge of all of the capital stock and equity interests of its subsidiaries). The Company recorded a loss on debt extinguishment of \$12.6 million in the second quarter of 2015 due to the repurchase and redemption of its prior 11.25% Senior Secured Second Lien Notes.

The 8% Notes are redeemable at the option of the Company in whole or in part at any time after May 1, 2018 at a price of 104% of the principal amount plus accrued and unpaid interest, if any, if redeemed before May 1, 2019, 102% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 1, 2019 but before May 1,





CARROLS RESTAURANT GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

2020 and 100% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 1, 2020. Prior to May 1, 2018, the Company may redeem some or all of the 8% Notes at a redemption price of 100% of the principal amount of each note plus accrued and unpaid interest, if any, and a make-whole premium. In addition, the indenture governing the 8% Notes also provides that the Company may redeem up to 35% of the 8% Notes using the proceeds of certain equity offerings completed before May 15, 2018.

The 8% Notes are jointly and severally guaranteed, unconditionally and in full by the Company's subsidiaries which are directly or indirectly 100% owned by the Company. Separate condensed consolidating information is not included because Carrols Restaurant Group is a holding company that has no independent assets or operations. There are no significant restrictions on its ability or any of the guarantor subsidiaries' ability to obtain funds from its respective subsidiaries. All consolidated amounts in our unaudited consolidated financial statements are representative of the combined guarantors.

The indenture governing the 8% Notes includes certain covenants, including limitations and restrictions on the Company and its subsidiaries who are guarantors under such indenture to, among other things: incur indebtedness or issue preferred stock; incur liens; pay dividends or make distributions in respect of capital stock or make certain other restricted payments or investments; sell assets; agree to payment restrictions affecting certain subsidiaries; enter into transaction with affiliates; or merge, consolidate or sell substantially all of the Company's assets.

The indenture governing the 8% Notes and the security agreement provide that any capital stock and equity interests of any of the Company's subsidiaries will be excluded from the collateral to the extent that the par value, book value or market value of such capital stock or equity interests exceeds 20% of the aggregate principal amount of the 8% Notes then outstanding.

The indenture governing the 8% Notes contains customary default provisions, including without limitation, a cross default provision pursuant to which it is an event of default under the 8% Notes and the indenture governing the 8% Notes if there is a default under any of the Company's indebtedness having an outstanding principal amount of \$20.0 million or more which results in the acceleration of such indebtedness prior to its stated maturity or is caused by a failure to pay principal when due.

Senior Credit Facility. On May 30, 2012, the Company entered into a senior credit facility, which was most recently amended on February 12, 2016 to provide for aggregate revolving credit borrowings of up to \$55.0 million (including \$20.0 million available for letters of credit) and to extend the maturity date to February 12, 2021. The senior credit facility also provides for potential incremental borrowing increases of up to \$25.0 million, in the aggregate. As of October 2, 2016, \$10.5 million in revolving credit borrowings were outstanding under the senior credit facility. After reserving \$13.4 million for letters of credit issued under the senior credit facility, \$31.1 million was available for revolving credit borrowings under the senior credit facility at October 2, 2016.

Borrowings under the senior credit facility bear interest at a rate per annum, at the Company's option, of:

(i) the Alternate Base Rate plus the applicable margin of 1.75% to 2.75% based on the Company's Adjusted Leverage Ratio, or

(ii) the LIBOR Rate plus the applicable margin of 2.75% to 3.75% based on the Company's Adjusted Leverage Ratio (all terms as defined under the senior credit facility).

At October 2, 2016 the Company's LIBOR Rate margin was 2.75% and the Alternate Base Rate margin was 1.75% based on the Company's Adjusted Leverage Ratio at the end of the second quarter of 2016.

The Company's obligations under the senior credit facility are guaranteed by its subsidiaries and are secured by first priority liens on substantially all of the assets of the Company and its subsidiaries, including a pledge of all of the capital stock and equity interests of its subsidiaries.

## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Under the senior credit facility, the Company is required to make mandatory prepayments of borrowings in the event of dispositions of assets, debt issuances and insurance and condemnation proceeds (all subject to certain exceptions). The senior credit facility contains certain covenants, including without limitation, those limiting the Company's and its subsidiaries' ability to, among other things, incur indebtedness, incur liens, sell or acquire assets or businesses, change the character of its business in all material respects, engage in transactions with related parties, make certain investments, make certain restricted payments or pay dividends. In addition, the senior credit facility requires the Company to meet certain financial ratios, including a Fixed Charge Coverage Ratio, Adjusted Leverage Ratio and First Lien Leverage Ratio (all as defined under the senior credit facility). The Company was in compliance with the covenants under its senior credit facility at October 2, 2016.

The senior credit facility contains customary default provisions, including that the lenders may terminate their obligation to advance and may declare the unpaid balance of borrowings, or any part thereof, immediately due and payable upon the occurrence and during the continuance of customary defaults which include, without limitation, payment default, covenant defaults, bankruptcy type defaults, cross-defaults on other indebtedness, judgments or upon the occurrence of a change of control.

## 8. Income Taxes

The provision (benefit) for income taxes for the three and nine months ended October 2, 2016 and September 27, 2015 was comprised of the following:

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Current	\$ —	\$ —	\$ —	\$ —
Deferred	(466)	1,989	2,175	(4,210)
Valuation allowance	466	(1,989)	(2,175)	4,210
	\$ —	\$ —	\$ —	\$ —

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes.

Since 2014, the Company has recorded a valuation allowance on all of its net deferred income tax assets. The Company performs an ongoing assessment of positive and negative evidence regarding the realization of its deferred income tax assets as required by ASC 740. Under ASC 740, the weight given to negative and positive evidence is commensurate only to the extent that such evidence can be objectively verified. ASC 740 also prescribes that objective historical evidence, in particular the Company's three-year cumulative loss position at October 2, 2016, be given greater weight than subjective evidence, including the Company's forecasts of future taxable income, which include assumptions that cannot be objectively verified. The Company determined, based on the required weight of that evidence under ASC 740, that a valuation allowance was still needed on all of its net deferred income tax assets at October 2, 2016. Consequently, the Company recorded no provision or benefit for income taxes in the three and nine months ended October 2, 2016 and September 27, 2015.

The Company increased its valuation allowance by \$0.5 million in the three months ended October 2, 2016 due primarily to an increase in net deferred tax assets during the period. The valuation allowance decreased \$1.9 million in the nine months ended October 2, 2016 due primarily to the reduction of federal and state net operating loss carryforwards. At October 2, 2016, the Company's valuation allowance on all its net deferred tax assets was \$28.5 million.

In the three months ended September 27, 2015, the Company decreased its valuation allowance by \$1.9 million and in the nine months ended September 27, 2015 increased its valuation allowance by \$4.3 million for changes in the net deferred income tax assets recognized in the respective periods.



## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

The Company's federal net operating loss carryforwards expire beginning in 2033. As of October 2, 2016, the Company had federal net operating loss carryforwards of approximately \$53.5 million. The Company's state net operating loss carryforwards expire beginning in 2017 through 2034.

The estimation of future taxable income for federal and state purposes and the Company's ability to realize deferred tax assets can significantly change based on future events and operating results. Thus, recorded valuation allowances may be subject to future changes that could have a material impact on the consolidated financial statements. If the Company determines that it is more likely than not that it will realize these deferred tax assets in the future, the Company will make an adjustment to the valuation allowance at that time.

The Company's policy is to recognize interest and/or penalties related to uncertain tax positions in income tax expense. At October 2, 2016 and January 3, 2016, the Company had no unrecognized tax benefits and no accrued interest related to uncertain tax positions. The tax years 2013 - 2015 remain open to examination by the major taxing jurisdictions to which the Company is subject. Although it is not reasonably possible to estimate the amount by which unrecognized tax benefits may increase within the next twelve months due to the uncertainties regarding the timing of any examinations, the Company does not expect unrecognized tax benefits to significantly change in the next twelve months.

## 9. Stock-Based Compensation

Stock-based compensation expense was \$0.5 million and \$0.4 million in the three months ended October 2, 2016 and September 27, 2015, respectively, and \$1.6 million and \$1.1 million in the nine months ended October 2, 2016 and September 27, 2015, respectively.

A summary of all non-vested shares activity for the nine months ended October 2, 2016 was as follows:

	Shares	Weighted Average Grant Date Price
Non-vested at January 3, 2016	468,770	\$ 7.40
Granted	327,140	12.28
Vested	(215,509)	6.72
Non-vested at October 2, 2016	580,401	\$ 10.40

The fair value of non-vested shares is based on the closing price on the date of grant. As of October 2, 2016, the total unrecognized stock-based compensation expense was approximately \$4.9 million, which the Company expects to recognize over a remaining weighted average vesting period for non-vested shares of 2.9 years. The Company expects to record an additional \$0.4 million in stock-based compensation expense for the remainder of 2016.

## 10. Commitments and Contingencies

**Lease Guarantees.** Fiesta Restaurant Group, Inc. ("Fiesta"), a former wholly-owned subsidiary of the Company, was spun-off in 2012 to the Company's stockholders. As of October 2, 2016, the Company is a guarantor under 27 Fiesta restaurant property leases, with lease terms expiring on various dates through 2030, and is the primary lessee on five Fiesta restaurant property leases, which it subleases to Fiesta. The Company is fully liable for all obligations under the terms of the leases in the event that Fiesta fails to pay any sums due under the lease, subject to indemnification provisions of the Separation and Distribution Agreement entered into in connection with the spin-off of Fiesta. The maximum potential amount of future undiscounted rental payments the Company could be required to make under these leases at October 2, 2016 was \$26.4 million. The obligations under these leases will generally continue to decrease over time as these operating leases expire. No payments related to these guarantees have been made by the Company to date and none are expected to be required to be made in the future. The Company has not recorded a liability for these guarantees in accordance with ASC 460 - Guarantees as Fiesta has indemnified the Company for all



CARROLS RESTAURANT GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

such obligations and the Company did not believe it was probable it would be required to perform under any of the guarantees or direct obligations.

Litigation. On August 21, 2012 Alan Vituli, the Company's former chairman and chief executive officer, filed an action in the Superior Court of the State of Delaware ( the "Court") against the Company and Carrols. On July 29, 2016 the Company, Carrols, and Mr. Vituli agreed to fully resolve all of Mr. Vituli's claims in the lawsuit for a total payment by the Company of \$2.0 million, which was paid on September 15, 2016. The Company accrued \$1.85 million in the second quarter of 2016 for this settlement which was net of a contribution from its insurance carrier and is reflected in other income (expense) in the accompanying unaudited consolidated statements of comprehensive income (loss). Upon the execution of releases and payment of the settlement amount, the litigation was dismissed. The Company is a party to various other litigation matters that arise in the ordinary course of business. The Company does not believe that the outcome of any of these other matters meet the disclosure or recognition standards, nor will they have a material adverse effect on its consolidated financial statements.

#### 11. Transactions with Related Parties

In connection with an acquisition of restaurants from BKC in 2012, the Company issued to BKC 100 shares of Series A Convertible Preferred Stock which is convertible into 9,414,580 shares of Carrols Restaurant Group Common Stock, which currently constitutes approximately 20.8% of the outstanding shares of the Company's common stock on a fully diluted basis. Pursuant to the terms of the Series A Convertible Preferred Stock, BKC also has two representatives on the Company's board of directors.

Each of the Company's restaurants operates under a separate franchise agreement with BKC. These franchise agreements generally provide for an initial term of twenty years and currently have an initial franchise fee of fifty thousand dollars. Any franchise agreement, including renewals, can be extended at the Company's discretion for an additional twenty-year term, with BKC's approval, provided that among other things, the restaurant meets the current Burger King image standard and the Company is not in default under terms of the franchise agreement. In addition to the initial franchise fee, the Company generally pays BKC a monthly royalty at a rate of 4.5% of sales. Royalty expense was \$10.1 million and \$9.2 million in the three months ended October 2, 2016 and September 27, 2015, respectively, and was \$29.7 million and \$26.5 million in the nine months ended October 2, 2016 and September 27, 2015, respectively.

The Company is also generally required to contribute 4% of restaurant sales from its restaurants to an advertising fund utilized by BKC for its advertising, promotional programs and public relations activities, and additional amounts for participation in local advertising campaigns in markets that approve such additional spending. Advertising expense related to BKC was \$10.5 million and \$8.1 million in the three months ended October 2, 2016 and September 27, 2015, respectively, and was \$30.0 million and \$23.5 million in the nine months ended October 2, 2016 and September 27, 2015, respectively.

As of October 2, 2016, the Company leased 285 of its restaurant locations from BKC and for 157 of these locations the terms and conditions of the lease with BKC are identical to those between BKC and the third-party lessor. Aggregate rent related to BKC leases for the three months ended October 2, 2016 and September 27, 2015 was \$7.2 million and \$7.0 million, respectively, and was \$21.7 million and \$21.4 million in the nine months ended October 2, 2016 and September 27, 2015, respectively. The Company believes the related party lease terms have not been significantly affected by the fact that the Company and BKC are deemed related parties.

As of October 2, 2016, the Company owed BKC \$0.4 million associated with its purchase of the ROFR and \$6.5 million related to the payment of advertising, royalties and rent, which is remitted on a monthly basis.

#### 12. Net Income (Loss) per Share

The Company applies the two-class method to calculate and present net income (loss) per share. The Company's non-vested share awards and Series A Convertible Preferred Stock issued to BKC contain non-forfeitable rights to dividends and are considered participating securities for purposes of computing net income (loss) per share pursuant





## CARROLS RESTAURANT GROUP, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

to the two-class method. Under the two-class method, net earnings are reduced by the amount of dividends declared (whether paid or unpaid) and the remaining undistributed earnings are then allocated to common stock and participating securities, based on their respective rights to receive dividends. As the Company incurred a net loss for the nine months ended September 27, 2015 and losses are not allocated to participating securities under the two-class method, such method is not applicable for the aforementioned interim reporting period.

Basic net income (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of shares of common stock outstanding for the reporting period. Diluted net income (loss) per share reflects additional shares of common stock outstanding, where applicable, calculated using the treasury stock method or the two-class method.

The following table sets forth the calculation of basic and diluted net income (loss) per share:

	Three Months Ended		Nine Months Ended	
	October 2, 2016		September 27, 2015	
	2016	2015	2016	2015
Basic net income (loss) per share:				
Net income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )
Less: Income attributable to non-vested shares	(60 )	(80 )	(240 )	—
Less: Income attributable to preferred stock	(934 )	(1,517 )	(3,332 )	—
Net income (loss) available to common stockholders	\$3,495	\$ 5,642	\$12,438	\$ (7,014 )
Weighted average common shares outstanding	35,237,055	35,009,656	35,152,094	34,930,326
Basic net income (loss) per share	\$0.10	\$ 0.16	\$0.35	\$ (0.20 )
Diluted net income (loss) per share:				
Net income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )
Shares used in computing basic net income (loss) per share	35,237,055	35,009,656	35,152,094	34,930,326
Dilutive effect of preferred stock and non-vested shares	9,618,729	9,668,858	9,740,097	—
Shares used in computing diluted net income (loss) per share	44,855,784	44,678,514	44,892,191	34,930,326
Diluted net income (loss) per share (1)	\$0.10	\$ 0.16	\$0.35	\$ (0.20 )
Shares excluded from diluted net income (loss) per share computations (2)	—	—	—	9,886,530

Diluted net income (loss) per share is equal to basic net income (loss) per share for the periods presented due to the allocation of earnings to participating securities under the two-class method of calculating basic net income (loss) per share causing basic net income (loss) per share to be lower than diluted net income (loss) per share calculated under the treasury-stock method.

(2) Shares issuable upon conversion of preferred stock and non-vested shares were excluded from the computation of diluted net income (loss) per share because their effect would have been anti-dilutive.

## 13. Other Expense (Income)

In the nine months ended October 2, 2016, the Company recorded a gain \$0.5 million related to a settlement for a partial condemnation on one of its operating restaurant properties, a gain of \$0.5 million related to an insurance

CARROLS RESTAURANT GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

recovery from a fire at one of its restaurants and expense of \$1.85 million related to the settlement of litigation with its former Chairman and CEO, as indicated in Note 10.

18

---

Table of Contents

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 our 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 subsidiary, unless otherwise indicated or the context otherwise requires. Any reference to "Carrols LLC" refers to Carrols' wholly-owned subsidiary, Carrols LLC, a Delaware limited liability company.

We use a 52-53 week fiscal year ending on the Sunday closest to December 31. The three and nine months ended October 2, 2016 and September 27, 2015 each contained thirteen and thirty-nine weeks, respectively. Our fiscal year ending January 1, 2017 will contain 52 weeks and our fiscal year ended January 3, 2016 contained 53 weeks.

Introduction

We are a holding company and conduct all of our operations through our direct and indirect subsidiaries and have no assets other than the shares of capital stock of Carrols, our direct wholly-owned subsidiary. The following Management's Discussion and Analysis of Financial Condition and Results of Operations (or "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 our unaudited interim Consolidated Financial Statements and the accompanying financial statement notes appearing elsewhere in this report and our Annual Report on Form 10-K for the year ended January 3, 2016. 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.

Results from Operations—an analysis of our results of operations for the three and nine months ended October 2, 2016 compared to the three and nine months ended September 27, 2015 including a review of material items and known trends and uncertainties.

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.

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 projections.

Table of Contents

Company Overview

We are one of the largest restaurant companies in the United States and have been operating restaurants for more than 55 years. We are the largest Burger King® franchisee in the United States, based on number of restaurants, and have operated Burger King restaurants since 1976. As of October 2, 2016, our restaurant operations consisted of 734 franchised Burger King restaurants in 16 states.

In 2012, as part of an acquisition of restaurants from Burger King Corporation ("BKC") we were assigned BKC's right of first refusal on franchisee restaurant sales in 20 states (the "ROFR"). In the first nine months of 2016 we acquired 29 restaurants, twelve in the Scranton-Wilkes Barre, Pennsylvania market, ten in the Detroit, Michigan market and seven in the Portland, Maine market. During the year ended January 3, 2016 we acquired 55 restaurants in eight separate transactions and during the year ended December 28, 2014 we acquired 123 restaurants in five separate transactions.

For 2016, we have modified our groupings of restaurants for reporting and analysis purposes. We refer to our restaurants acquired in 2014, 2015 and 2016 as our "acquired restaurants". All of our other restaurants, including restaurants acquired before 2014, are referred to as our "legacy restaurants".

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

Restaurant sales consist of food and beverage sales at our restaurants, net of discounts and excluding sales tax collected. Restaurant sales are influenced by changes in comparable restaurant sales, menu price increases, acquisitions, new restaurant development and closures of restaurants. Restaurants, including restaurants we acquire, are included in comparable restaurant sales after they have been open for 12 months. For comparative purposes, the calculation of the changes in comparable restaurant sales is based on either a 52-week or 53-week year.

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 mix of items sold, promotional discounting and the effectiveness of our restaurant-level controls to manage food and paper costs.

Restaurant wages and related expenses include all restaurant management and hourly productive labor costs and related benefits, employer payroll taxes and restaurant-level bonuses. Payroll and related benefits are subject to inflation, including minimum wage increases, increases in the annual salary amount for employees to be exempt from receiving overtime pay and increased costs for health insurance, workers' compensation insurance and federal and state unemployment insurance.

Restaurant rent expense includes base rent and contingent rent on our leases characterized as operating leases, the amortization of acquired favorable and unfavorable leases and is reduced by the amortization of deferred gains on sale-leaseback transactions.

Other restaurant operating expenses include all other restaurant-level operating costs, the major components of which are royalty expenses paid to BKC, utilities, repairs and maintenance, real estate taxes and credit card fees.

Advertising expense includes advertising payments to BKC based on a percentage of sales as required under our franchise and operating agreements and additional marketing and promotional expenses in certain of our markets.

General and administrative expenses are comprised primarily of (1) salaries and expenses associated with corporate and administrative functions that support the development, growth and operations of our restaurants, (2) legal, auditing and other professional fees, (3) acquisition costs and (4) stock-based compensation expense.

EBITDA, Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income. EBITDA, Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income are non-GAAP financial measures. EBITDA represents net income or loss, before provision or benefit for income taxes, interest expense and depreciation and amortization.

Adjusted EBITDA represents EBITDA as adjusted to exclude impairment and other lease

Table of Contents

charges, acquisition costs, loss on extinguishment of debt, stock compensation expense and non-recurring income or expense. Restaurant-Level EBITDA represents income or loss from operations adjusted to exclude general and administrative expenses, depreciation and amortization, impairment and other lease charges and other income and expense. Adjusted net income represents net income or loss adjusted to exclude loss on extinguishment of debt, impairment and other lease charges, acquisition costs and non-recurring income and expense. These adjustments for all periods in 2016 and 2015 are not net of tax due to the valuation allowance required on all of our deferred income tax assets.

We are presenting Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income because we believe that they provide a more meaningful comparison than EBITDA and net income or loss of our core business operating results, as well as with those of other similar companies. Additionally, we present Restaurant-Level EBITDA because it excludes the impact of general and administrative expenses and other income and expense which are not directly related to restaurant operations. Management believes that Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income, when viewed with our results of operations in accordance with GAAP and the accompanying reconciliations on page 30, provide useful information about operating performance and period-over-period growth, and provide additional information that is useful for evaluating the operating performance of our core business without regard to potential distortions. Additionally, management believes that Adjusted EBITDA and Restaurant-Level EBITDA permit investors to gain an understanding of the factors and trends affecting our ongoing cash earnings, from which capital investments are made and debt is serviced.

However, EBITDA, Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income are not measures of financial performance or liquidity under GAAP and, accordingly, should not be considered as alternatives to net income or loss, income or loss from operations or cash flow from operating activities as indicators of operating performance or liquidity. Also, these measures may not be comparable to similarly titled captions of other companies. For a reconciliation between net income or loss to EBITDA, Adjusted EBITDA and Adjusted net income and the reconciliation of income or loss from operations to Restaurant-Level EBITDA, see page 30.

EBITDA, Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income have important limitations as analytical tools. These limitations include the following:

- EBITDA, Adjusted EBITDA and Restaurant-Level EBITDA do not reflect our capital expenditures, future requirements for capital expenditures or contractual commitments to purchase capital equipment;

- EBITDA, Adjusted EBITDA and Restaurant-Level EBITDA do not reflect the interest expense or the cash requirements necessary to service principal or interest payments on our debt;

Although depreciation and amortization are non-cash charges, the assets that we currently depreciate and amortize will likely have to be replaced in the future, and EBITDA, Adjusted EBITDA and Restaurant-Level EBITDA do not reflect the cash required to fund such replacements; and

- EBITDA, Adjusted EBITDA, Restaurant-Level EBITDA and Adjusted net income do not reflect the effect of earnings or charges resulting from matters that our management does not consider to be indicative of our ongoing operations. In addition, some of these charges (such as impairment and other lease charges and acquisition and integration costs) have recurred and may reoccur.

Depreciation and amortization primarily includes the depreciation of fixed assets, including equipment, owned buildings and leasehold improvements utilized in our restaurants, the amortization of franchise rights resulting from our acquisitions of Burger King restaurants and the amortization of franchise fees paid to BKC.

Impairment and other lease charges are determined through our assessment of the recoverability of property and equipment and intangible assets by determining whether the carrying value of these assets can be recovered over their respective remaining lives through undiscounted future operating cash flows. A potential impairment charge is evaluated whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable. Losses on sale-leaseback transactions are recognized when they are

Table of Contents

incurred. Lease charges are recorded for our obligations under the related leases for closed locations net of estimated sublease recoveries.

Interest expense consists primarily of interest expense associated with our \$200.0 million of 8% Senior Secured Second Lien Notes due 2022 (the "8% Notes"), amortization of deferred financing costs and interest on revolving credit borrowings under our senior secured credit facility.

Recent and Future Events Affecting our Results of Operations

Burger King Restaurant Acquisitions

From the beginning of 2015 through October 2, 2016, we have acquired 84 restaurants from other franchisees in the following transactions (\$ in thousands):

Closing Date	Number of Restaurants	Purchase Price	Number of Fee-Owned Restaurants	Market Location
2015 Acquisitions:				
March 31, 2015	4	\$ 794		Northern Vermont
August 4, 2015	5	663		Charlotte, North Carolina
October 1, 2015	(1)5	5,044	1	Wheeling, West Virginia
October 20, 2015	1	709		Kalamazoo, Michigan
November 17, 2015	2	618		Evansville, Indiana
November 17, 2015	(1)6	10,945	5	Evansville, Indiana
December 1, 2015	(1)23	26,175	10	Detroit, Michigan
December 8, 2015	9	7,802		Northern New Jersey
	55	52,750	16	
2016 Acquisitions:				
February 23, 2016	(1)12	7,127		Scranton/Wilkes-Barre, Pennsylvania
May 25, 2016	6	12,080	5	Detroit, Michigan
July 14, 2016	(1)4	5,445	3	Detroit, Michigan
August 23, 2016	7	8,755	6	Portland, Maine
	29	33,407	14	
	84	\$86,157	30	

(1) Acquisitions resulting from the exercise of our ROFR.

The 2015 and 2016 acquisitions included the purchase of 30 fee-owned properties of which three were sold in sale-leaseback transactions in 2015 for net proceeds of \$4.3 million and an additional seventeen properties were sold in sale-leaseback transactions in the first nine months of 2016 for net proceeds of \$24.9 million. Eight of the remaining fee-owned restaurants valued at \$10.3 million are expected to be sold in sale-leaseback transactions during the remainder of 2016, although there can be no assurance that such transactions will be completed in 2016 or at all.

Table of Contents

The unaudited pro forma impact on the results of operations for the 2015 and 2016 acquisitions is included below. The unaudited pro forma results of operations are not necessarily indicative of the results that would have occurred had the acquisitions been consummated at the beginning of the period presented, nor are they necessarily indicative of any future consolidated operating results. Acquisition costs of \$0.5 million and \$0.1 million for the three months ended October 2, 2016 and September 27, 2015, respectively, and \$1.1 million and \$0.3 million for the nine months ended October 2, 2016 and September 27, 2015, respectively, are excluded from income from operations below. The following table summarizes certain unaudited pro forma financial information related to our operating results for the three and nine months ended October 2, 2016 and September 27, 2015 (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, September 27,		October 2, September 27,	
	2016	2015	2016	2015
Restaurant sales	\$240,370	\$ 244,845	\$716,008	\$ 709,171
Income from operations	\$9,510	\$ 14,217	\$31,306	\$ 25,934
Adjusted EBITDA	\$22,783	\$ 25,375	\$70,311	\$ 61,918

**2016 Capital Expenditures and Remodeling Commitment with BKC**

On December 17, 2015, we and BKC entered into the Second Amendment to Operating Agreement (the "Amendment"), which amended the operating agreement and a subsequent amendment to the operating agreement, previously entered into between us and BKC in connection with an acquisition of restaurants from BKC in 2012. As amended, the operating agreement requires that we will remodel to BKC's current 20/20 image a cumulative total of 455 restaurants by December 31, 2016. As of October 2, 2016 we had remodeled a total of 447 restaurants associated with this requirement. In addition, under a separate agreement we have agreed to remodel 46 of the restaurants acquired in 2014 over a five year period ending in 2018 and at October 2, 2016 we had remodeled a total of 27 restaurants associated with this agreement. At October 2, 2016 we had 521 restaurants with the 20/20 restaurant image including restaurants we have acquired.

Under the operating agreement, beginning on January 1, 2016 and until we exceed operating 1,000 Burger King restaurants, a minimum of 10% of our annual new restaurant growth (including acquisitions) must come from the development of new Burger King restaurants (which includes restaurants we relocate within their market area); provided that for 2016 only, any new restaurant development that would otherwise have been required to be opened in 2016 may be deferred and opened in 2017.

In 2016, we anticipate that total capital expenditures will range from \$90 million to \$95 million although the actual amount of capital expenditures may differ from these estimates. Capital expenditures in 2016 include remodeling approximately 85 restaurants to the BKC 20/20 image standard at an approximate average cost of \$480,000 per restaurant, rebuilding four restaurants and the construction of six new restaurants (all of which will be relocations within their respective markets) at an average cost of \$1,200,000 per restaurant, which excludes \$2.7 million of expenditures for land. Capital expenditures in 2016 also include approximately \$4 million to \$5 million for the replacement of certain restaurant-level back of house systems and kitchen equipment and other BKC restaurant initiatives. Expenditures also include approximately \$11 million to \$12 million for ongoing restaurant maintenance capital expenditures, \$2 million for the purchase on new point-of-sale systems for the restaurants we have or will acquire and the carryover of approximately \$13 million in 2016 for 2015 remodeling projects that spanned two fiscal years. We will review on an ongoing basis our future remodel and development plans in relation to our available capital resources and alternate investment opportunities.

**Refinancing of Indebtedness and Amendment to our Senior Credit Facility**

On April 29, 2015, we issued \$200 million of the 8% Notes and used a portion of the net proceeds to repurchase and redeem all of our \$150 million of outstanding 11.25% Senior Secured Second Lien Notes and to pay related fees and expenses. We received net proceeds of approximately \$35.2 million which were used for working capital and general corporate purposes, capital expenditures to remodel our restaurants and subsequent restaurant acquisitions.

Table of Contents

On February 12, 2016, we entered into an amendment to our senior credit facility to increase revolving credit borrowing capacity by \$25 million to \$55 million (including \$20.0 million available for letters of credit). The amendment also extended the maturity date of the senior credit facility to February 12, 2021 and reduced by 0.25% the interest rate for revolving credit borrowings to, at our option, (i) the alternate base rate plus the applicable margin of 1.75% to 2.75% based on our adjusted leverage ratio, or (ii) the LIBOR rate plus the applicable margin of 2.75% to 3.75% based on our adjusted leverage ratio (all as defined under the amended credit agreement).

At October 2, 2016 our LIBOR Rate margin was 2.75% and the Alternate Base Rate margin was 1.75%.

See —"Liquidity and Capital Resources" for a further discussion of the 8% Notes and our amended senior credit facility.

**Future Restaurant Closures**

We evaluate the performance of our restaurants on an ongoing basis including an assessment of the current and future operating results of the restaurant in relation to its cash flow and future occupancy costs, and with regard to franchise agreement renewals, the cost of required capital improvements. We may elect to close restaurants based on these evaluations.

In the first nine months of 2016 we closed one restaurant, excluding two restaurants relocated within their respective markets. In 2015, we closed 23 restaurants and sold one restaurant. We may incur lease charges in the future from closures of underperforming restaurants prior to the expiration of their lease term. We currently anticipate that for all of 2016 we will close eight restaurants, which includes seven restaurants whose franchise agreements expire at the end of our fiscal year and excludes restaurants relocated within their market area. Our determination of whether to close restaurants in the future is subject to further evaluation and may change.

We do not believe that the future impact on our results of operations due to restaurant closures will be material, although there can be no assurance in this regard.

**Valuation of Deferred Income Tax Assets**

In 2014 we established a valuation allowance on all of our net deferred income tax assets as required under ASC 740. We currently perform an ongoing assessment of positive and negative evidence regarding the realization of our net deferred income tax assets as required by ASC 740 and consider all available positive and negative evidence to determine, based on the required weight of that evidence as prescribed by ASC 740, that a valuation allowance for all of our net deferred income tax assets is still needed.

At October 2, 2016, we determined a valuation allowance was still needed. During the three and nine months ended October 2, 2016, the total valuation allowance increased \$0.5 million and decreased \$1.9 million, respectively. At October 2, 2016, our valuation allowance on all of our net deferred tax assets was \$28.5 million.

We believe that it is likely that our Federal net operating loss carryforwards, included in our deferred tax assets, will be utilized in the future as they do not begin to expire until 2033, although no assurance of this can be provided. However, the valuation allowance on our net deferred tax assets is required based on the relevant accounting literature which does not permit us to consider our projection of future taxable income as more persuasive evidence than our recent operating losses over the past three years when assessing recoverability. As of October 2, 2016, we had federal net operating loss carryforwards of approximately \$53.5 million.

As a result of the valuation allowance on all of our net deferred tax assets, we recorded no provision or benefit for income taxes in the first nine months of 2016 or the first nine months of 2015. We will continue to monitor and evaluate the positive and negative evidence considered in arriving at the above conclusion, in order to assess whether such conclusion remains appropriate in future periods, given our current operating results in 2016.



Table of Contents

## Regulatory Changes Affecting Labor Costs

Certain of the states and municipalities in which we operate have increased their minimum wage rates for 2016 and in many cases have also approved additional increases for future periods. Most notably, New York State has increased the minimum wage applicable to our business to \$9.75 an hour in 2016 (from \$8.75 an hour in 2015) with subsequent annual increases (\$10.75 in 2017) reaching \$15.00 an hour by July 1, 2021. Beginning for 2015, we are receiving a New York State minimum wage tax credit subsidy that is partially offsetting these additional costs for our employees who are 19 and under and also in college or high school. The credit diminishes over the next few years but currently totals approximately \$500,000 per year. We had 132 restaurants in New York State at October 2, 2016. We typically attempt to offset the effects of wage inflation, at least in part, through periodic menu price increases. However, no assurance can be given that we will be able to offset these wage increases in the future.

In 2016 the Department of Labor issued a rule, effective December 1, 2016, which amended the minimum wage and overtime pay protections of the Fair Labor Standards Act and significantly increased the annual salary level of an employee to be considered exempt from being an hourly employee to \$47,476 from \$23,660. The rule also establishes a mechanism for automatically updating this salary level every three years and primarily affects our restaurant managers which we intend to convert to be paid on an hourly basis. We are currently evaluating how much additional labor costs we will incur for overtime for our current salaried employees currently under the new exempt salary level.

## Results of Operations

Three Months Ended October 2, 2016 Compared to Three Months Ended September 27, 2015

The following table sets forth, for the three months ended October 2, 2016 and September 27, 2015, selected operating results as a percentage of total restaurant sales:

	Three Months Ended		
	October 2,	September 27,	
	2016	2015	
Costs and expenses (all restaurants):			
Cost of sales	26.7%	27.9	%
Restaurant wages and related expenses	31.7%	30.8	%
Restaurant rent expense	6.7 %	6.5	%
Other restaurant operating expenses	15.7%	15.7	%
Advertising expense	4.5 %	3.8	%
General and administrative	5.4 %	5.4	%

Since the beginning of the third quarter of 2015, we have acquired 80 restaurants, opened three new restaurants that were relocations within their market area, and closed four restaurants (excluding relocations).

Restaurant Sales. Total restaurant sales in the third quarter of 2016 increased 9.7% to \$238.9 million from \$217.7 million in the third quarter of 2015. Comparable restaurant sales were flat as an increase in average check of 2.3% was offset by a decrease in customer traffic of 2.3%. Comparable restaurant sales increased 6.5% in the third quarter of 2015. The effect in the third quarter of 2016 from menu price increases taken since the beginning of 2015 was approximately 2.8%. Sales in the third quarter of 2016 were \$176.2 million for our legacy restaurants and \$62.7 million for our acquired restaurants.

Operating Costs and Expenses (percentages stated as a percentage of total restaurant sales). Cost of sales decreased to 26.7% in the third quarter of 2016 from 27.9% in the third quarter of 2015 due primarily to lower commodity costs (1.1%), which included an 11% decrease in beef prices compared to the prior year period, the effect of menu price increases (0.8%) and improvements in restaurant-level food and cash controls at our legacy and acquired restaurants, partially offset by higher promotional discounting.

Table of Contents

Restaurant wages and related expenses increased to 31.7% in the third quarter of 2016 from 30.8% in the third quarter of 2015 due primarily to the effect of hourly labor rate increases on flat comparable restaurant sales and the deleveraging of fixed management wages (1.2%), partially offset by lower restaurant-level incentive bonuses (0.3%). Other restaurant operating expenses were 15.7% in both the third quarter of 2016 and the third quarter of 2015.

Advertising expense increased to 4.5% in the third quarter of 2016 from 3.8% in the third quarter of 2015 due to the expiration of advertising credits at the end of 2015 that were associated with 2012 BKC restaurant equipment initiatives and an increase in local advertising in certain of our markets that began in the first quarter of 2016.

Restaurant rent expense was 6.7% in both the third quarter of 2016 and the third quarter of 2015.

Restaurant-Level EBITDA. As a result of the factors discussed above and the acquisition of 80 restaurants since the beginning of the third quarter of 2015, Restaurant-Level EBITDA increased \$1.5 million, or 4.4%, to \$34.8 million in the third quarter of 2016, however as a percentage of total restaurant sales, decreased to 14.6% in the third quarter of 2016 from 15.3% in the prior year period. For a reconciliation between Restaurant-Level EBITDA and income from operations see page 30.

	Three Months Ended	
	October 2, % <sup>(1)</sup> 2016	September 27, % <sup>(1)</sup> 2015

(in thousands of dollars)

## Restaurant Sales:

Legacy restaurants	\$ 176,215	\$ 178,243
Acquired restaurants	62,655	39,433
Total	\$ 238,870	\$ 217,676

## Restaurant-Level EBITDA:

Legacy restaurants	\$ 27,277	15.5%	\$ 28,765	16.1%
Acquired restaurants	7,527	12.0%	4,564	11.6%
Total	\$ 34,804	14.6%	\$ 33,329	15.3%

(1) Restaurant-Level EBITDA margin is calculated as a percentage of restaurant sales for each respective group of restaurants.

Restaurant-Level EBITDA margin decreased 0.6% for our legacy restaurants due to flat comparable restaurant sales in conjunction with higher labor and advertising costs, partially offset by lower beef and other commodity prices and lower restaurant-level incentive bonuses.

Comparable restaurant sales for our acquired restaurants increased 0.4% in the third quarter of 2016. Restaurant-Level EBITDA margin increased 0.4% for our acquired restaurants due to higher average unit sales volumes at the restaurants we acquired in the fourth quarter of 2015 and 2016, relative to our 2014 acquisitions. This was partially offset by the similar expense factors mentioned above. Restaurant-Level EBITDA margin for our acquired restaurants was lower in the third quarter of 2016 compared to our legacy restaurants due primarily to the effect of lower average restaurant sales volumes on fixed labor and operating costs, including rent and utility costs, and higher repairs and maintenance expenses related to deferred maintenance prior to our ownership.

General and Administrative Expenses. General and administrative expenses increased \$1.2 million in the third quarter of 2016 to \$13.0 million, and as a percentage of total restaurant sales, was 5.4% in both periods. The increase in total general and administrative expenses was due primarily to incremental district manager salaries and travel costs and restaurant manager training costs related to the fourth quarter 2015 and 2016 acquisitions and higher acquisition costs of \$0.4 million, partially offset by lower administrative bonus accruals of \$0.7 million.

Adjusted EBITDA. As a result of the factors above, Adjusted EBITDA increased 3.2% to \$22.7 million in the third quarter of 2016 from \$22.0 million in the third quarter of 2015, and, as a percentage of total restaurant sales,

Table of Contents

decreased to 9.5% in the third quarter of 2016 from 10.1% in the prior year period. For a reconciliation between net income (loss) and EBITDA and Adjusted EBITDA see page 30.

Depreciation and Amortization Expense. Depreciation and amortization expense increased \$2.7 million to \$12.1 million in the third quarter of 2016 from \$9.4 million in the third quarter of 2015 due primarily to our ongoing remodeling initiatives and our acquisition of restaurants in the fourth quarter of 2015 and 2016.

Impairment and Other Lease Charges. Impairment and other lease charges were \$0.7 million in the third quarter of 2016 due primarily to capital expenditures at previously impaired restaurants of \$0.2 million and a loss of \$0.3 million from the sale-leaseback of a restaurant property.

Interest Expense. Interest expense increased slightly to \$4.6 million in the third quarter of 2016 from \$4.5 million in the third quarter of 2015. The weighted average interest rate on our long-term debt, excluding lease financing obligations, was 7.96% in the third quarter of 2016 and 8.00% in the third quarter of 2015.

Provision (Benefit) for Income Taxes. Due to the valuation allowance on all of our net deferred income tax assets discussed above, we did not record any provision or benefit for income taxes in the third quarter of 2016 and the third quarter of 2015.

Net Income (Loss). As a result of the above, net income for the third quarter of 2016 was \$4.5 million, or \$0.10 per diluted share, compared to net income in the third quarter of 2015 of \$7.2 million, or \$0.16 per diluted share.

#### Nine Months Ended October 2, 2016 Compared to Nine Months Ended September 27, 2015

The following table sets forth, for the nine months ended October 2, 2016 and September 27, 2015, selected operating results as a percentage of total restaurant sales:

	Nine Months Ended		
	October 2,	September 27,	
	2016	2015	
Costs and expenses (all restaurants):			
Cost of sales	26.3%	28.3	%
Restaurant wages and related expenses	31.5%	31.3	%
Restaurant rent expense	6.8	% 6.8	%
Other restaurant operating expenses	15.7%	15.9	%
Advertising expense	4.4	% 3.7	%
General and administrative	5.8	% 5.8	%

Since the beginning of 2015, we acquired 84 restaurants, opened three new restaurants that were relocations within their market area, closed 24 restaurants (excluding relocations) and sold one restaurant.

Restaurant Sales. Total restaurant sales in the first nine months of 2016 increased 11.6% to \$702.8 million from \$629.9 million in the first nine months of 2015. Comparable restaurant sales increased 2.0% in the first nine months of 2016 due to an increase in average check of 2.5% offset by a decrease in customer traffic of 0.5%. Comparable restaurant sales increased 8.4% in the first nine months of 2015. The effect in the first nine months of 2016 from menu price increases taken since the beginning of 2015 was approximately 2.7%. Sales in the first nine months of 2016 were \$526.2 million for our legacy restaurants and \$176.6 million for our acquired restaurants.

Operating Costs and Expenses (percentages stated as a percentage of total restaurant sales). Cost of sales decreased to 26.3% in the first nine months of 2016 from 28.3% in the first nine months of 2015 due primarily to lower commodity prices (1.3%), which included a 17% decrease in beef prices compared to the prior year period, the effect of menu price increases (0.8%) and improvements in restaurant-level food and cash controls at our legacy and acquired restaurants (0.2%), partially offset by higher promotional discounting.

Table of Contents

Restaurant wages and related expenses increased to 31.5% in the first nine months of 2016 from 31.3% in the first nine months of 2015 due primarily to higher hourly labor rates partially offset by lower restaurant-level incentive bonuses (0.2%) and lower unemployment taxes.

Other restaurant operating expenses decreased to 15.7% in the first nine months of 2016 from 15.9% in the first nine months of 2015 due primarily to lower utility costs and lower repair and maintenance expenses.

Advertising expense increased to 4.4% in the first nine months of 2016 from 3.7% in the first nine months of 2015 due to the expiration of advertising credits at the end of 2015 that were associated with 2012 BKC restaurant equipment initiatives and an increase in local advertising in certain of our markets that began in March 2016. We currently anticipate advertising expenditures for all of 2016 to be approximately 4.3%.

Restaurant rent expense was 6.8% in both the first nine months of 2016 and the first nine months of 2015.

Restaurant-Level EBITDA. As a result of the factors above and the acquisition of 84 restaurants since the beginning of 2015, Restaurant-Level EBITDA increased \$19.3 million, or 22.0%, to \$107.0 million in the first nine months of 2016, and, as a percentage of total restaurant sales, increased to 15.2% in the first nine months of 2016 from 13.9% in the prior year period. For a reconciliation between Restaurant-Level EBITDA and income from operations see page 30.

	Nine Months Ended	
	October 2, 2016, % <sup>(1)</sup>	September 27, 2015, % <sup>(1)</sup>
	(in thousands of dollars)	
Restaurant Sales:		
Legacy restaurants	\$526,183	\$ 519,138
Acquired restaurants	176,574	110,810
Total	\$702,757	\$ 629,948

## Restaurant-Level EBITDA:

Legacy restaurants	\$84,877	16.1%	\$ 76,464	14.7%
Acquired restaurants	22,150	12.5%	11,268	10.2%
Total	\$107,027	15.2%	\$ 87,732	13.9%

(1) Restaurant-Level EBITDA margin is calculated as a percentage of restaurant sales for each respective group of restaurants.

Restaurant-Level EBITDA margin increased 1.4% for our legacy restaurants due primarily to a comparable restaurant sales increase in the first nine months of 2016 of 2.1%, lower beef prices and lower utility costs, partially offset by higher advertising costs as discussed above. Restaurant-Level EBITDA margin increased 2.3% for our acquired restaurants due to similar factors including a comparable restaurant sales increase of 1.7% in the first nine months of 2016 (primarily our 2014 acquisitions), higher vendor rebates, lower repairs and maintenance expenses compared to the prior year period and higher average unit sales volumes at the restaurants we acquired in 2015, relative to our 2014 acquisitions. Restaurant-Level EBITDA margin for our acquired restaurants was lower in the first nine months of 2016 compared to our legacy restaurants due primarily to the effect of lower average restaurant sales volumes on fixed operating expenses, including fixed labor costs, rent and utility costs.

General and Administrative Expenses. General and administrative expenses increased \$4.3 million in the first nine months of 2016 to \$40.6 million and, as a percentage of total restaurant sales, were 5.8% in both periods. The increase in total general and administrative expenses was due primarily to additional district manager salaries and travel costs and restaurant manager training costs related to the 2015 and 2016 acquisitions, higher acquisition costs of \$0.8 million and higher stock-based compensation expense of \$0.6 million partially offset by lower administrative bonus accruals of \$1.1 million.

Table of Contents

Adjusted EBITDA. As a result of the factors above, Adjusted EBITDA increased 30.4% to \$69.1 million in the first nine months of 2016 from \$53.0 million in the first nine months of 2015. For a reconciliation between net income (loss) and EBITDA and Adjusted EBITDA see page 30.

Depreciation and Amortization Expense. Depreciation and amortization expense increased to \$34.6 million in the first nine months of 2016 from \$29.2 million in the first nine months of 2015 due primarily to our ongoing remodeling initiatives and our acquisition of restaurants in 2015 and 2016.

Impairment and Other Lease Charges. Impairment and other lease charges were \$1.2 million in the first nine months 2016 due primarily to capital expenditures at previously impaired restaurants and a loss of \$0.3 million from the sale-leaseback of a restaurant property.

Other Income and Expense. In the first nine months of 2016 we had a gain of \$0.5 million related to a settlement for a partial condemnation on one of our operating restaurant properties, a gain of \$0.5 million related to an insurance recovery from a fire at one of our restaurants and expense of \$1.9 million related to a litigation settlement with our former Chairman and CEO.

Interest Expense. Interest expense decreased to \$13.6 million in the first nine months of 2016 from \$14.0 million in the first nine months of 2015 due to our refinancing in the second quarter of 2015 discussed above. The weighted average interest rate on our long-term debt, excluding lease financing obligations, decreased to 7.99% in the first nine months of 2016 from 9.27% in the first nine months of 2015.

Provision (Benefit) for Income Taxes. Due to the valuation allowance on all of our net deferred income tax assets discussed above, we did not record any provision or benefit for income taxes in the first nine months of 2016 and 2015.

Net Income (Loss). As a result of the above, net income for first nine months of 2016 was \$16.0 million, or \$0.35 per diluted share, compared to a net loss in first nine months of 2015 of \$7.0 million, or \$0.20 per diluted share.

Table of Contents

Reconciliations of net income (loss) to EBITDA, Adjusted EBITDA and Adjusted net income and income from operations to Restaurant-Level EBITDA for three and nine months ended October 2, 2016 and September 27, 2015 are as follows (in thousands, except for per share data):

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Reconciliation of EBITDA and Adjusted EBITDA:				
Net income (loss)	\$4,489	\$ 7,239	\$16,010	\$ (7,014 )
Provision (benefit) for income taxes	—	—	—	—
Interest expense	4,560	4,512	13,615	14,026
Depreciation and amortization	12,070	9,418	34,613	29,216
EBITDA	21,119	21,169	64,238	36,228
Impairment and other lease charges	685	396	1,193	2,732
Acquisition costs (1)	453	79	1,091	339
Gain on partial condemnation and fire (2)	—	—	(906 )	—
Litigation settlement (3)	—	—	1,850	—
Stock-based compensation expense	456	367	1,627	1,071
Loss on extinguishment of debt	—	—	—	12,635
Adjusted EBITDA	\$22,713	\$ 22,011	\$69,093	\$ 53,005
Reconciliation of Restaurant-Level EBITDA:				
Income from operations	\$9,049	\$11,751	\$29,625	\$19,647
Add:				
General and administrative expenses	13,000	11,764	40,561	36,263
Depreciation and amortization	12,070	9,418	34,613	29,216
Impairment and other lease charges	685	396	1,193	2,732
Other expense (income)	—	—	1,035	(126 )
Restaurant-Level EBITDA	\$34,804	\$33,329	\$107,027	\$87,732
Reconciliation of Adjusted net income:				
Net income (loss)	\$4,489	\$7,239	\$16,010	\$(7,014)
Add:				
Loss on extinguishment of debt	—	—	—	12,635
Impairment and other lease charges	685	396	1,193	2,732
Gain on partial condemnation and fire (2)	—	—	(906 )	—
Litigation settlement (3)	—	—	1,850	—
Acquisition costs (1)	453	79	1,091	339
Adjusted net income	\$5,627	\$7,714	\$19,238	\$8,692
Adjusted diluted net earnings per share (4)	\$0.13	\$0.17	\$0.43	\$0.19

(1) Acquisition costs for the periods presented include primarily legal and professional fees incurred in connection with the 2015 and 2016 acquisitions, which were included in general and administrative expense.

(2) Other (income) expense for the nine months October 2, 2016 includes a gain of \$0.5 million related to an insurance recovery from a fire at one of our restaurants and a gain of \$0.5 million related to a settlement for a partial condemnation on one of our operating restaurant properties.

(3) Other (income) expense includes an expense of \$1.85 million from a litigation settlement with our former Chairman and CEO.

Table of Contents

(4) Adjusted diluted net earnings per share is calculated based on Adjusted net income and the dilutive weighted average common shares outstanding for the respective periods.

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 are paid.

Interest payments under our debt obligations, capital expenditures, including our commitment to BKC to remodel restaurants in 2016, payments of royalties and advertising to BKC and payments related to our lease obligations represent significant liquidity requirements for us as well as any discretionary expenditures for the acquisition of additional Burger King restaurants. We believe that cash generated from our operations and availability of revolving credit borrowings under our senior credit facility will provide sufficient cash availability to cover our anticipated working capital needs, capital expenditures and debt service requirements for the next twelve months.

Operating Activities. Net cash provided from operating activities in the first nine months of 2016 decreased to \$50.8 million from \$55.6 million in the first nine months of 2015 due primarily to a decrease in cash from changes in the components of net working capital of \$19.8 million offset by an increase in Adjusted EBITDA of \$16.1 million.

Investing Activities. Net cash used for investing activities in the first nine months of 2016 and 2015 was \$72.3 million and \$39.1 million, respectively.

As discussed above, in the first nine months of 2016 we acquired 29 restaurants in four transactions for a total cash purchase price of \$33.4 million and in the first nine months of 2015 we acquired nine restaurants for a total cash purchase price of \$1.5 million.

Capital expenditures are a large component of our investing activities and include: (1) new restaurant development, which may include the purchase of real estate; (2) restaurant remodeling, which includes the renovation or rebuilding of the interior and exterior of our existing restaurants, including expenditures associated with our commitment to BKC to remodel restaurants to the 20/20 image and franchise agreement renewals; (3) other restaurant capital expenditures, which include capital maintenance expenditures for the ongoing reinvestment and enhancement of our restaurants, and from time to time, to support BKC's initiatives; and (4) corporate and restaurant information systems, including expenditures for our point-of-sale systems for restaurants that we acquire.

Table of Contents

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

Nine Months Ended October 2, 2016

New restaurant development	\$5,857
Restaurant remodeling	45,312
Other restaurant capital expenditures	12,037
Corporate and restaurant information systems	2,181
Total capital expenditures	\$65,387

Number of new restaurant openings including relocations 3

Nine Months Ended September 27, 2015

New restaurant development	\$556
Restaurant remodeling	27,807
Other restaurant capital expenditures	7,367
Corporate and restaurant information systems	1,801
Total capital expenditures	\$37,531

Number of new restaurant openings including relocations —

Investing activities in the first nine months of 2016 and 2015 also included proceeds from sale-leaseback transactions of \$29.4 million and \$3.1 million, respectively, and in the first nine months of 2016 insurance proceeds of \$1.2 million related to fires at two of our restaurants.

Investing activities in the first nine months of 2016 and 2015 also included the purchase of certain operating restaurant properties to be sold in sale-leaseback transactions of \$4.1 million and \$3.6 million, respectively.

Financing Activities. Net cash provided from financing activities in the first nine months of 2016 was \$9.3 million due primarily to net revolving credit borrowings of \$10.5 million offset by principal payments on capital leases of \$1.1 million. Net cash provided from financing activities in the first nine months of 2015 was \$34.1 million due primarily to the refinancing in the second quarter of 2015 discussed above.

8% Senior Secured Second Lien Notes. The 8% Notes mature on May 1, 2022. Interest is payable semi-annually on May 1 and November 1. The 8% Notes are guaranteed by our material subsidiaries and are secured by second-priority liens on substantially all of our and our subsidiaries' assets (including a pledge of all of the capital stock and equity interests of our subsidiaries).

The 8% Notes are redeemable at our option in whole or in part at any time after May 1, 2018 at a price of 104% of the principal amount plus accrued and unpaid interest, if any, if redeemed before May 1, 2019, 102% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 1, 2019 but before May 1, 2020 and 100% of the principal amount plus accrued and unpaid interest, if any, if redeemed after May 1, 2020. Prior to May 1, 2018, we may redeem some or all of the 8% Notes at a redemption price of 100% of the principal amount of each 8% Note plus accrued and unpaid interest, if any, and a make-whole premium. In addition, the indenture governing the 8% Notes also provides that we may redeem up to 35% of the 8% Notes using the proceeds of certain equity offerings completed before May 1, 2018.

The 8% Notes are jointly and severally guaranteed, unconditionally and in full by our subsidiaries which are directly or indirectly 100% owned by us. Separate condensed consolidating information is not included because Carrols Restaurant Group is a holding company that has no independent assets or operations. There are no significant restrictions on our ability or any of the guarantor subsidiaries' ability to obtain funds from its respective subsidiaries. All consolidated amounts in our financial statements are representative of the combined guarantors.

The indenture governing the 8% Notes includes certain covenants, including limitations and restrictions on our and our subsidiaries who are guarantors under such indenture to, among other things: incur indebtedness or issue preferred stock; incur liens; pay dividends or make distributions in respect of capital stock or make certain other restricted payments or investments; sell assets; agree to payment restrictions affecting certain subsidiaries; enter into transaction with affiliates; or merge, consolidate or sell substantially all of our assets.



Table of Contents

The indenture governing the 8% Notes and the security agreement provide that any capital stock and equity interests of any of our subsidiaries will be excluded from the collateral to the extent that the par value, book value or market value of such capital stock or equity interests exceeds 20% of the aggregate principal amount of the 8% Notes then outstanding.

The indenture governing the 8% Notes contains customary default provisions, including without limitation, a cross default provision pursuant to which it is an event of default under the 8% Notes and the indenture governing the 8% Notes if there is a default under any of our indebtedness having an outstanding principal amount of \$20.0 million or more which results in the acceleration of such indebtedness prior to its stated maturity or is caused by a failure to pay principal when due.

Senior Credit Facility. On May 30, 2012, we entered into a senior credit facility, which was most recently amended on February 12, 2016 to provide for aggregate revolving credit borrowings of up to \$55.0 million (including \$20.0 million available for letters of credit) and to extend the maturity date to February 12, 2021. The senior credit facility also provides for potential incremental borrowing increases of up to \$25.0 million, in the aggregate.

At October 2, 2016 there were revolving credit borrowings of \$10.5 million outstanding under the senior credit facility. After reserving \$13.4 million for letters of credit issued under the senior credit facility for workers' compensation and other insurance policies, \$31.1 million was available for revolving credit borrowings at October 2, 2016.

Borrowings under the senior credit facility bear interest at a rate per annum, at our option, of:

(i) the Alternate Base Rate plus the applicable margin of 1.75% to 2.75% based on the our Adjusted Leverage Ratio, or

(ii) the LIBOR Rate plus the applicable margin of 2.75% to 3.75% based on the our Adjusted Leverage Ratio (all terms as defined under the senior credit facility).

At October 2, 2016 our LIBOR Rate margin was 2.75% and the Alternate Base Rate margin was 1.75% based on our Adjusted Leverage Ratio at the end of the second quarter of 2016.

Our obligations under the senior credit facility are guaranteed by our subsidiaries and are secured by first priority liens on substantially all of our assets and those of our subsidiaries, including a pledge of all of the capital stock and equity interests of our subsidiaries.

Under the senior credit facility, we are required to make mandatory prepayments of borrowings in the event of dispositions of assets, debt issuances and insurance and condemnation proceeds (all subject to certain exceptions).

The senior credit facility contains certain covenants, including without limitation, those limiting our and our subsidiaries' ability to, among other things, incur indebtedness, incur liens, sell or acquire assets or businesses, change the character of our business in all material respects, engage in transactions with related parties, make certain investments, make certain restricted payments or pay dividends. In addition, the senior credit facility requires us to meet certain financial ratios, including a Fixed Charge Coverage Ratio, Adjusted Leverage Ratio and First Lien Leverage Ratio (all as defined under the senior credit facility). We were in compliance with the covenants under our senior credit facility at October 2, 2016.

The senior credit facility contains customary default provisions, including that the lenders may terminate their obligation to advance and may declare the unpaid balance of borrowings, or any part thereof, immediately due and payable upon the occurrence and during the continuance of customary defaults which include, without limitation, payment default, covenant defaults, bankruptcy type defaults, cross-defaults on other indebtedness, judgments or upon the occurrence of a change of control.

Table of Contents

Contractual Obligations

A table of our contractual obligations as of January 3, 2016 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 January 3, 2016. There have been no significant changes to our contractual obligations during the nine months ended October 2, 2016.

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.

Inflation

The inflationary factors that have historically affected our results of operations include increases in food and paper costs, labor and other operating expenses, the cost of providing medical and prescription drug insurance to our employees and energy costs. Wages paid in our restaurants are impacted by changes in the Federal and state hourly minimum wage rates and the Fair Labor Standards Act. Accordingly, changes in the Federal and state hourly minimum wage rates and increases in the wage level to not be considered an hourly employee will 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 offset such inflationary cost increases in the future.

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 policies are described in the “Significant Accounting Policies” footnote in the notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended January 3, 2016. 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. There have been no material changes affecting our critical accounting policies previously disclosed in our Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

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 (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). 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”, “plan” 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 have identified significant factors that could cause actual results to differ materially from those stated 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 January 3, 2016:

Table of Contents

Effectiveness of the Burger King® advertising programs and the overall success of the Burger King brand;  
Increases in food costs and other commodity costs;  
Competitive conditions;  
Our ability to integrate any restaurants we acquire;  
Regulatory factors;  
Environmental conditions and regulations;  
General economic conditions, particularly in the retail sector;  
Weather conditions;  
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;  
Labor and employment benefit costs, including the effects of minimum wage increases, health care reform and changes in the Fair Labor Standards Act;  
The outcome of pending or future legal claims or proceedings;  
Our ability to manage our growth and successfully implement our business strategy;  
Our inability to service our indebtedness;  
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;  
and  
Factors that affect the restaurant industry generally, including recalls if products become adulterated or misbranded, liability if our products cause injury, ingredient disclosure and labeling laws and regulations, reports of cases of food borne illnesses such as "mad cow" disease, 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.

**ITEM 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There were no material changes from the information presented in Item 7A included in our Annual Report on Form 10-K for the year ended January 3, 2016 with respect to our market risk sensitive instruments.

A 1% change in interest rates would have resulted in a nominal change to interest expense for the nine months ended October 2, 2016 and no change in the nine months ended September 27, 2015.

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

**Evaluation of Disclosure Controls and Procedures.** 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 October 2, 2016.

No change occurred in our internal control over financial reporting during the third quarter of 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



Table of Contents

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

On August 21, 2012 Alan Vituli, our former chairman and chief executive officer, filed an action in the Superior Court of the State of Delaware ( the “Court”) against us and Carrols. On July 29, 2016, the Company, Carrols, and Mr. Vituli agreed to fully resolve all of Mr. Vituli’s claims in the lawsuit for a total payment by us of \$2.0 million, which was paid on September 15, 2016. Upon execution of releases and payment of the settlement amount, the litigation was dismissed.

We are a party to various other litigation matters that arise in the ordinary course of business. We do not believe that the outcome of any of these other matters meet the disclosure or recognition standards, nor will they have a material adverse effect on our consolidated financial statements.

Item 1A. Risk Factors

Part I-Item 1A of Annual Report on Form 10-K for the fiscal year ended January 3, 2016 describes important factors that could materially adversely affect our business, consolidated financial condition or results of operations or cause our 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 January 3, 2016.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Table of Contents

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.
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.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

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 9, 2016 /s/ Daniel T. Accordino

(Signature)

Daniel T. Accordino

Chief Executive Officer

Date: November 9, 2016 /s/ Paul R. Flanders

(Signature)

Paul R. Flanders

Vice President – Chief Financial Officer and Treasurer