

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 1, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 001-35373

FIESTA RESTAURANT GROUP, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	90-0712224 (I.R.S. Employer Identification No.)
14800 Landmark Boulevard, Suite 500 Dallas, TX (Address of principal executive office)	75254 (Zip Code)
Registrant's telephone number, including area code: (972) 702-9300 Securities registered pursuant to Section 12(b) of the Act:	
Title of each class: Common Stock, par value \$.01 per share	Name on each exchange on which registered: The NASDAQ Global Select Market
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes No

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 their 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(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 February 23, 2017, Fiesta Restaurant Group, Inc. had 26,884,992 shares of its common stock, \$.01 par value, outstanding. The aggregate market value of the common stock held by non-affiliates as of July 3, 2016 of Fiesta Restaurant Group, Inc. was \$582,150,821.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for Fiesta Restaurant Group, Inc.'s 2017 Annual Meeting of Stockholders, which is expected to be filed pursuant to Regulation 14A no later than 120 days after the conclusion of Fiesta Restaurant Group, Inc.'s fiscal year ended January 1, 2017 are incorporated by reference into Part III of this annual report.

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FIESTA RESTAURANT GROUP, INC.

**FORM 10-K
YEAR ENDED JANUARY 1, 2017**

	<u>Page</u>
PART I	
Item 1 Business	3
Item 1A Risk Factors	14
Item 1B Unresolved Staff Comments	25
Item 2 Properties	26
Item 3 Legal Proceedings	26
Item 4 Mine Safety Disclosures	26
PART II	
Item 5 Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	27
Item 6 Selected Financial Data	29
Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations	33
Item 7A Quantitative and Qualitative Disclosures about Market Risk	47
Item 8 Financial Statements and Supplementary Data	48
Item 9 Changes In and Disagreements with Accountants on Accounting and Financial Disclosure	48
Item 9A Controls and Procedures	48
Item 9B Other Information	51
PART III	
Item 10 Directors, Executive Officers and Corporate Governance	51
Item 11 Executive Compensation	51
Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	51
Item 13 Certain Relationships and Related Transactions, and Director Independence	51
Item 14 Principal Accountant Fees and Services	51
PART IV	
Item 15 Exhibits and Financial Statement Schedules	52
Item 16 Form 10-K Summary	53

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PART I

Presentation of Information

Throughout this Annual Report on Form 10-K, we refer to Fiesta Restaurant Group, Inc. as “Fiesta Restaurant Group” or “Fiesta” and, together with its consolidated subsidiaries, as “we,” “our” and “us” unless otherwise indicated or the context otherwise requires.

We own, operate and franchise two fast-casual restaurant brands, Pollo Tropical® and Taco Cabana®, through our wholly-owned subsidiaries Pollo Operations, Inc., and its subsidiaries, and Pollo Franchise, Inc., (collectively “Pollo Tropical”) and Taco Cabana, Inc. and its subsidiaries (collectively “Taco Cabana”). Prior to May 7, 2012, we were indirectly owned by Carrols Restaurant Group, Inc. (“Carrols”). On that date, Carrols completed a spin-off of Fiesta, and Fiesta became an independent public company, through the distribution of all of the outstanding shares of Fiesta’s common stock to the stockholders of Carrols. Our common stock is traded on The NASDAQ Global Select Market under the symbol “FRGI.”

We use a 52 or 53 week fiscal year ending on the Sunday closest to December 31. The fiscal years ended December 30, 2012, December 29, 2013, December 28, 2014 and January 1, 2017 each contained 52 weeks. The fiscal year ended January 3, 2016 contained 53 weeks. The next year to contain 53 weeks is expected to be the fiscal year ending January 3, 2021.

In this Annual Report on Form 10-K, we refer to information, forecasts and statistics regarding the restaurant industry. Unless otherwise indicated, all restaurant industry data in this Annual Report on Form 10-K refers to the U.S. restaurant industry and is taken from or based upon the Technomic, Inc. (“Technomic”) report titled “2016 Technomic Top 500 Chain Restaurant Report.” The information, forecasts and statistics we have used from Technomic may reflect rounding adjustments.

Use of Non-GAAP Financial Measures

Adjusted EBITDA, Adjusted EBITDA margin, Restaurant-Level Adjusted EBITDA and Restaurant-Level Adjusted EBITDA margin are all non-GAAP financial measures. Adjusted EBITDA is defined as earnings before interest, loss on extinguishment of debt, income taxes, depreciation and amortization, impairment and other lease charges, stock-based compensation expense and other income and expense. Adjusted EBITDA may not necessarily be comparable to other similarly titled captions of other companies due to differences in methods of calculation. Adjusted EBITDA for each of our Pollo Tropical and Taco Cabana segments includes an allocation of general and administrative expenses associated with administrative support for executive management, information systems and certain accounting, legal, supply chain, human resources, development and other administrative functions. Adjusted EBITDA margin represents Adjusted EBITDA divided by total revenues. Restaurant-Level Adjusted EBITDA represents Adjusted EBITDA excluding franchise royalty revenues and fees and general and administrative expenses (including corporate-level general and administrative expenses). Restaurant-Level Adjusted EBITDA margin represents Restaurant-Level Adjusted EBITDA divided by restaurant sales.

Management believes that such financial measures, when viewed with our results of operations calculated in accordance with GAAP and our reconciliation of Restaurant-Level Adjusted EBITDA and Adjusted EBITDA to net income (i) provide useful information about our operating performance and period-over-period growth, (ii) provide additional information that is useful for evaluating the operating performance of our business and (iii) permit investors to gain an understanding of the factors and trends affecting our ongoing earnings, from which capital investments are made and debt is serviced. However, such measures are not measures of financial performance or liquidity under GAAP and, accordingly, should not be considered as alternatives to net income 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.

All of such non-GAAP financial measures have important limitations as analytical tools. These limitations include the following:

- such financial information does not reflect our capital expenditures, future requirements for capital expenditures or contractual commitments to purchase capital equipment;

- such financial information does not reflect interest expense or the cash used to repay outstanding borrowings under our senior credit facility;
- 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 such financial information does not reflect the cash required to fund such replacements; and
- such financial information does not reflect the effect of earnings or charges resulting from matters that our management does not consider to be indicative of our ongoing operations. However, some of these charges (such as impairment and other lease charges, other income and expense and stock-based compensation expense) have recurred and may recur.

See Item 6 — “Selected Financial Data” for a quantitative reconciliation from net income, which we believe is the most directly comparable GAAP financial performance measure to Restaurant-Level Adjusted EBITDA and Adjusted EBITDA.

Forward-Looking Statements

This 2016 Annual Report on Form 10-K contains “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. “Forward-looking statements” are any statements that are not based on historical information. Statements other than statements of historical facts included herein, including, without limitation, statements regarding our future financial position and results of operations, business strategy, budgets, projected costs and plans and objectives of management for future operations, are “forward-looking statements.” Forward-looking statements generally can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “anticipate,” “intend,” “plan,” “believe,” “seek,” “estimate” or “continue” or the negative of such words or variations of such words and similar expressions. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements and we can give no assurance that such forward-looking statements will prove to be correct. Important factors that could cause actual results to differ materially from those expressed or implied by the forward-looking statements, or “cautionary statements,” include, but are not limited to:

- Increases in food and other commodity costs;
- Risks associated with the expansion of our business, including increasing construction costs;
- Risks associated with food borne illness or other food safety issues, including negative publicity through traditional and social media;
- Our ability to manage our growth and successfully implement our business strategy;
- Labor and employment benefit costs, including the impact of increases in federal and state minimum wages, increases in exempt status salary levels and healthcare costs imposed by the Affordable Care Act;
- Cyber security breaches;
- General economic conditions, particularly in the retail sector;
- Competitive conditions;
- Weather conditions;
- Significant disruptions in service or supply by any of our suppliers or distributors;
- Increases in employee injury and general liability claims;
- Changes in consumer perception of dietary health and food safety;
- Regulatory factors;
- Fuel prices;

- The outcome of pending or future legal claims or proceedings;
- Environmental conditions and regulations;
- Our borrowing costs;
- The availability and terms of necessary or desirable financing or refinancing and other related risks and uncertainties;
- The risk of an act of terrorism or escalation of any insurrection or armed conflict involving the United States or any other national or international calamity;
- Factors that affect the restaurant industry generally, including product recalls, liability if our products cause injury, ingredient disclosure and labeling laws and regulations; and
- Other factors discussed under Item 1A — “Risk Factors” and elsewhere herein.

ITEM 1. BUSINESS

Overview

Our Company

We own, operate and franchise two fast-casual restaurant brands, Pollo Tropical® and Taco Cabana®, which have almost 30 and 40 years, respectively, of operating history and loyal customer bases. Our Pollo Tropical restaurants offer a wide variety of freshly prepared Caribbean inspired food, while our Taco Cabana restaurants offer a broad selection of freshly prepared Mexican inspired food. We believe that both brands are differentiated from other restaurant concepts and offer a unique dining experience. Our brands are positioned within the value-oriented fast-casual restaurant segment and nearly all of our restaurants offer the convenience of drive-thru windows.

For the fiscal year ended January 1, 2017, the average annual sales per restaurant was approximately \$2.4 million for our company-owned Pollo Tropical restaurants and approximately \$1.9 million for our company-owned Taco Cabana restaurants, which we believe are among the highest in the fast-casual and quick-service segments based on industry data from Technomic. As of January 1, 2017, we owned and operated 177 Pollo Tropical restaurants in the southeast and south central United States, and 166 Taco Cabana restaurants primarily located in Texas, for a total of 343 restaurants across five states. We franchise our Pollo Tropical restaurants primarily in international markets, and as of January 1, 2017, we had 29 franchised Pollo Tropical restaurants outside the United States. In addition, as of January 1, 2017, we had five domestic non-traditional licensed locations on college campuses and one location in a hospital in Florida. As of January 1, 2017, we had five Taco Cabana franchised restaurants in New Mexico and two non-traditional Taco Cabana licensed domestic locations on college campuses in Texas. For the fiscal year ended January 1, 2017, we generated consolidated revenues of \$711.8 million, and comparable restaurant sales decreased 1.6% for Pollo Tropical and 2.5% for Taco Cabana.

On September 30, 2016, Timothy P. Taft, Chief Executive Officer, President and a member of the Company’s Board of Directors, retired as the Company’s Chief Executive Officer and President, and resigned as a member of the Company’s Board of Directors. Danny Meisenheimer, Chief Operating Officer, Pollo Tropical, was appointed interim Chief Executive Officer and President effective September 30, 2016.

On February 27, 2017, the Company announced that Richard C. Stockinger has been appointed Chief Executive Officer and President of the Company, effective February 28, 2017. Also, the Company announced that Danny Meisenheimer, the Interim Chief Executive Officer and President of the Company and Chief Operating Officer, Pollo Tropical through February 27, 2017 was appointed Chief Operating Officer and Senior Vice President of the Company effective February 28, 2017.

In 2016, we decided to suspend additional development of Pollo Tropical restaurants outside of Florida and to review our development strategy while we continue to build brand awareness, affinity and off premise consumption through several initiatives. Based on a restaurant portfolio examination, we closed ten Pollo Tropical restaurants in the fourth quarter of 2016 including eight restaurants in Texas, one restaurant in Nashville, Tennessee and one restaurant in Atlanta, Georgia. We plan to convert up to three of the closed restaurants in Texas to Taco Cabana restaurants in 2017.

In 2016, we recognized impairment charges with respect to ten closed restaurants and seven additional Pollo Tropical restaurants and seven Taco Cabana restaurants that we continue to operate. Impairment and other lease charges for the twelve months ended January 1, 2017 were \$25.6 million and included impairment charges of \$22.7 million and lease and other charges related to closed restaurants of \$2.9 million. The ten closed restaurants contributed approximately \$5.3 million in operating losses to income from operations for the twelve months ended January 1, 2017.

The restaurant industry experienced a continued general slowdown in 2016, that further declined in the fourth quarter. We believe the challenging market and industry conditions and, in the case of Pollo Tropical, sales cannibalization from new restaurants on existing restaurants contributed to a decline in comparable restaurant transactions and sales in 2016.

In the latter part of 2016 we reevaluated the previously announced separation of Taco Cabana and decided not to move forward with the separation transaction, concluding that continued ownership of the Taco Cabana brand was in our stockholders' best interest.

Our Brands. Our restaurants operate in the fast-casual restaurant segment, combining the convenience and value of quick-service restaurants in an appealing atmosphere with the menu variety, use of fresh ingredients, food quality and decor more typical of casual dining restaurants with limited table service and competitive pricing.

Pollo Tropical. Our Pollo Tropical restaurants offer Caribbean inspired menu items, featuring our bone-in chicken marinated in a proprietary blend of tropical fruit juices and spices and grilled over an open flame. Our menu also includes a line of TropiChops® (a create your own casserole bowl of grilled chicken breast, roast pork or grilled vegetables, or in some markets beef, served over white, brown or yellow rice and red or black beans and vegetables), a variety of sandwiches, wraps and salads offered with an array of Caribbean style made-from-scratch side dishes, including black beans and rice, fried yuca and sweet plantains, as well as more traditional menu items such as waffle fries, Caesar salad and corn. We also offer a self-service "Saucing Island" which includes a wide selection of made-from-scratch salsas, sauces, jalapeños, cilantro, onions and other items which allows our guests to further customize their orders. Our restaurants offer Caribbean dessert favorites, such as guava cheesecake and tres leche cake. Our beverage offerings include fountain soft drinks and other bottled drinks. Most menu items are prepared daily in each of our restaurants, which feature open display cooking on large, open-flame grills. We offer both individual and family meal-sized portions which enable us to provide a home meal replacement for our guests. We also offer catering for parties and corporate events.

Our Pollo Tropical restaurants feature dining areas designed to create an inviting, festive and tropical atmosphere. We also provide our guests the option of take-out, including the ability to order on-line in advance, and nearly all of our restaurants provide the convenience of drive-thru windows. In some locations, delivery is available. Our Pollo Tropical restaurants are generally open for lunch, dinner and late night seven days a week. As of January 1, 2017, substantially all of our company-owned Pollo Tropical restaurants were freestanding buildings. Our typical freestanding Pollo Tropical restaurant ranges from 2,800 to 3,700 square feet and provides interior seating for approximately 70 to 90 guests. For the year ended January 1, 2017, the average sales transaction at our company-owned Pollo Tropical restaurants was \$10.94, with dinner representing the largest day-part at 52.9%. For the year ended January 1, 2017, our Pollo Tropical brand generated total revenues of \$401.8 million and Adjusted EBITDA of \$55.5 million, including pre-opening costs of \$4.8 million (which include costs incurred prior to opening a new restaurant, including restaurant employee wages and related expenses, travel expenditures, recruiting, training, promotional costs associated with the restaurant opening and rent, including any non-cash rent expense recognized during the construction period).

Pollo Tropical opened its first restaurant in 1988 in Miami, Florida. As of January 1, 2017, we owned and operated a total of 177 Pollo Tropical restaurants, of which 128 were located in Florida, 30 were located in Texas, 16 were located in Georgia and three were located in Tennessee. In 2014, we introduced a new building design that we believe better differentiates our Pollo Tropical brand with a bolder, more Caribbean inspired look while continuing to utilize the elevated, limited table service and menu format that has been in place in certain locations outside of our core South Florida markets since 2009. We believe the new design will more effectively position the brand for a broader target audience and growth. In addition, in 2015 we began a reimagining program to conform select existing Pollo Tropical restaurants to the new building design. As of January 1, 2017, we had reimaged 30 Pollo Tropical restaurants located in the Orlando, Nashville, South Florida and Atlanta markets.

We are franchising our Pollo Tropical restaurants primarily internationally, and as of January 1, 2017, we had 29 franchised Pollo Tropical restaurants located in Puerto Rico, Panama, Trinidad & Tobago, Guatemala, the Bahamas, Venezuela, and Guyana, and five non-traditional licensed locations on college campuses and one located in a hospital in Florida. We have agreements for the continued development of franchised Pollo Tropical restaurants in certain of our existing franchised markets.

Taco Cabana. Our Taco Cabana restaurants serve fresh, Mexican-inspired food, including flame-grilled steak and chicken fajitas served on sizzling iron skillet, quesadillas, hand-rolled flautas, enchiladas, burritos, tacos, fresh-made flour tortillas, customizable salads served in our Cabana Bowl[®], and our popular breakfast tacos. We also offer a self-service salsa bar which includes a wide selection of made-from-scratch salsas, sauces, sliced jalapeños, chopped cilantro, chopped onions and other items which allow our guests to further customize their orders. Our beverage offerings include fountain soft drinks, our signature frozen margaritas and beer as well as bottled Mexican Coke and Fanta Orange soda made with real cane sugar. Most menu items are freshly-prepared at each restaurant daily.

Taco Cabana restaurants feature open display cooking that enables guests to observe fajitas cooking on an open grill, a tortilla machine pressing and grilling fresh flour tortillas and the fresh preparation of other menu items. Our Taco Cabana restaurants feature interior dining areas as well as semi-enclosed and outdoor patio areas, which provide a vibrant, contemporary decor and relaxing atmosphere. Additionally, we provide our guests the option of take-out, including the ability to order on-line in advance, as well as the convenience of drive-thru windows and catering. In some locations, delivery is available. Our typical freestanding Taco Cabana restaurants average approximately 3,500 square feet (exclusive of the exterior dining area) and provide seating for approximately 80 guests, with additional outside patio seating for approximately 50 guests. As of January 1, 2017, substantially all of our company-owned Taco Cabana restaurants were freestanding buildings.

Taco Cabana pioneered the Mexican patio cafe concept with its first restaurant in San Antonio, Texas in 1978. As of January 1, 2017, we owned and operated 166 Taco Cabana restaurants, of which 165 were located in Texas and one was located in Oklahoma. As of January 1, 2017, we also had five Taco Cabana franchised restaurants located in New Mexico and two non-traditional Taco Cabana licensed locations located on college campuses in Texas. A majority of our Taco Cabana restaurants are open 24 hours a day, generating guest traffic and restaurant sales balanced across multiple day-parts. For the year ended January 1, 2017, dinner sales represented the largest day-part at 24.9% and the average sales transaction at our company-owned Taco Cabana restaurants was \$9.27. For the year ended January 1, 2017, our Taco Cabana brand generated total revenues of \$310.0 million and Adjusted EBITDA of \$38.1 million, including pre-opening costs of \$0.7 million.

Our Competitive Strengths

We believe the success of our Pollo Tropical and Taco Cabana brands is a result of the following key attributes:

Well Positioned in the Fast Growing Fast-Casual Segment. As of January 1, 2017, we owned, operated and franchised 385 fast-casual restaurants under our Pollo Tropical and Taco Cabana brands which have almost 30 and 40 years, respectively, of operating history. According to Technomic, the fast-casual segment had sales growth of 11.5% in 2015 over 2014 for fast-casual chains in the Technomic Top 500 restaurant chains as compared to 5.0% growth for the overall Top 500 restaurant chains. In addition, at \$2.4 million and \$1.9 million, respectively, we believe Pollo Tropical and Taco Cabana have compelling average annual sales per restaurant within the fast-casual segment. However, average annual sales per restaurant for our Pollo Tropical restaurants will generally decrease as we open restaurants in newer markets, which have lower annual sales per restaurant than our mature markets. We believe our brands are well positioned to continue to benefit from the growing consumer demand for fast-casual restaurants because of our high quality, freshly-prepared food, value and differentiation of flavor profiles. In addition, we believe our brand elevation initiatives and reimagining programs have enhanced our Pollo Tropical and Taco Cabana restaurants in certain existing and new markets by providing our guests with an elevated fast-casual experience while better positioning our brands for successful and sustainable future growth.

Two Leading, Differentiated Brands Serving Fresh, High Quality Foods With Broad Appeal and a Compelling Value Proposition. Our Pollo Tropical and Taco Cabana brands are differentiated from other dining options and offer distinct flavor profiles and healthful menu choices at affordable prices that we believe have broad consumer appeal, provide guests with a compelling value proposition, attract a diverse customer base and drive guest frequency and loyalty. Pollo Tropical and Taco Cabana are committed to serving freshly-prepared food using quality ingredients that are made-to-order and customized for each guest. Both of our brands offer a wide range of menu

offerings with regional taste profiles and home meal replacement options in generous portion sizes and at affordable price points which appeal to a broad customer base. Our open display kitchen format allows guests to view and experience our food being freshly-prepared and cooked to order. Pollo Tropical's menu offers dishes inspired from various regions throughout the Caribbean, including our featured bone-in chicken marinated in a proprietary blend of tropical fruit juices and spices and grilled over an open flame. Taco Cabana's menu offers favorites such as sizzling fajitas served hot on an iron skillet and other Mexican inspired dishes. In order to provide variety to our guests and to address changes in consumer preferences, we frequently enhance our menu with seasonal offerings at our Pollo Tropical and Taco Cabana restaurants. We also selectively use promotions and limited time offers which are intended to reinforce our value proposition and to introduce new products. Additionally, our menus include a number of options to address consumers' increasing focus on healthful eating, and we offer our guests drive-thru service at the majority of our restaurants in order to provide a fast, convenience option including home meal replacement and family meals.

Compelling Business Model and Strong Financial Results. We enjoy significant brand recognition due to high market penetration of company-owned restaurants in our core markets which provides operating, marketing and distribution efficiencies, convenience for our guests, and the ability to effectively manage and enhance brand awareness. As a result of this brand recognition and the three factors discussed above, we believe that our brands have enjoyed strong financial results in our core markets, which reinforces our compelling business model in those markets. Both of our brands enjoy segment-leading average annual sales volumes, as noted above, with compelling Restaurant-Level Adjusted EBITDA margins.

Growth Strategies

Since 2012, we have focused our strategy on growing both of our brands, although Pollo Tropical has been our primary growth vehicle. In 2016, we opened 36 new company-owned restaurants comprised of 32 Pollo Tropical restaurants and four Taco Cabana restaurants, and we closed 10 underperforming company-owned Pollo Tropical restaurants. For 2017, our new restaurant development will be more balanced across both brands and for 2017 we are planning to open 12 new company-owned Pollo Tropical restaurants in Florida and ten new company-owned Taco Cabana restaurants in Texas. In 2016, we decided to suspend additional development of Pollo Tropical restaurants outside of Florida while we continue to build brand awareness, affinity and off premise consumption through several initiatives. Based on a restaurant portfolio examination as part of our strategic review process to enhance long-term shareholder value, we closed ten Pollo Tropical restaurants in the fourth quarter of 2016 including eight restaurants in Texas, one restaurant in Nashville, Tennessee and one restaurant in Atlanta, Georgia. We plan to convert three of the closed restaurants in Texas to Taco Cabana restaurants in 2017.

Our strategies for growth primarily include:

Develop New Restaurants. We believe that we have opportunities to develop additional Pollo Tropical and Taco Cabana restaurants in Florida and Texas, respectively, as well as potential future expansion opportunities in other existing markets and into other regions of the United States that match our targeted demographic and site selection criteria. However, taking into account challenging market conditions and because company-owned restaurants in new markets that have not yet reached media efficiency have typically opened at lower sales volumes than restaurants opened in existing, media-efficient markets and have not achieved expected sales volumes at the pace we anticipated, we have suspended near-term new restaurant development of Pollo Tropical restaurants outside of Florida while we focus on implementing operational and transactional growth plans and drive improved performance in these markets.

In 2014, Pollo Tropical developed a new format that includes a new exterior design and a more upscale décor that we believe better differentiates our brand with a more Caribbean inspired look, while continuing to utilize the elevated, limited table service platform and format that has been in place in certain locations since 2009.

In 2016, we developed a new small Taco Cabana format with approximately 2,500 square feet intended for new smaller markets and existing markets in Texas. The new format offers the same menu and has the same look and feel as existing Taco Cabana restaurants, but has a smaller dining room and patio. The first two small format Taco Cabana restaurants are scheduled to open in 2017.

We target opening freestanding company-owned restaurants in order to provide drive-thru service which is an important convenience and sales component for our brands. We believe that the location of our restaurants is a critical component of each restaurant's success. We evaluate potential new sites on many critical criteria including accessibility, visibility, costs, surrounding traffic patterns, competition and demographic characteristics. Our senior management team determines the acceptability of all new sites, based upon analyses prepared by our real estate, financial and operations professionals as well as a third party vendor that employs proprietary location research technology and performs site evaluations on our behalf. Historically, this process has typically resulted in entering into a long-term lease for the land followed by construction of the building or the conversion of an existing building using cash generated from our operations or with borrowings under our senior credit facility. Infrequently, we acquire land for which we may consider seeking to include the land and building in a sale and leaseback arrangement as a form of financing in order to reinvest the proceeds in additional restaurants.

The following table includes the recent historical initial interior cost (including equipment, seating, signage and other interior costs) of a typical new or converted freestanding restaurant, as well as the historical exterior cost (including building and site improvements) and land if acquired.

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>
Interior costs and signage	\$0.6 million to \$0.9 million	\$0.5 million to \$0.6 million
Exterior costs	\$0.7 million to \$1.4 million	\$1.2 million to \$1.3 million
Land	\$0.9 million to \$1.4 million	N/A

The cost of securing real estate and building and equipping new restaurants can vary significantly and depends on a number of factors, including the local economic conditions, geographic considerations, size of the restaurant and the characteristics of a particular site. Accordingly, the cost of opening new restaurants in the future may differ substantially from the historical cost of restaurants previously opened. The new smaller format Taco Cabana and Pollo Tropical Express locations will likely have lower interior and exterior costs than our recent larger format locations.

Increase Comparable Restaurant Sales. We experienced a decline in comparable restaurant sales in 2016, which we believe was attributable to challenging market and industry conditions and, in the case of Pollo Tropical, sales cannibalization from new restaurants on existing restaurants. However, we experienced an increase in comparable restaurant sales at each brand in 2011 through 2015 and we intend to increase comparable restaurant sales by attracting new customers and increasing guest frequency through the following strategies:

- *Focus on consistency of operations and food quality:* We believe the quality, consistency and accuracy of our operations result in an enjoyable guest experience, which drives guest frequency. We will continue to refine our menu offerings, supply chain and food preparation processes to ensure high quality, freshness and consistency of our food which we believe are critical components to the continued success of our brands.
- *New product innovation:* Across both brands, our menus are centered on fresh, high quality food offerings that we believe have both broad appeal and provide everyday value. Pollo Tropical and Taco Cabana each have separate teams of product research and development professionals that enables us to continually refine our menu offerings and develop new products. Maintaining a strong product pipeline is critical to keeping our offerings compelling, and we intend to introduce innovative new items and enhancements to existing menu favorites throughout the year to drive further guest traffic and maximize guest frequency. Also, the addition of portable menu items, such as wraps, sandwiches, bowls and salads, as well as home meal replacement and family meals will continue to be a key focus for both brands as we look to capture more meal occasions for people on the go.
- *Focus on effective advertising to highlight our everyday value proposition:* Pollo Tropical and Taco Cabana utilize an integrated, multi-level marketing approach that includes periodic chain-wide promotions, direct mail, outdoor marketing including billboards, in-restaurant promotions, local store marketing, social media marketing and web-based and other strategies, including the use of radio and television advertising and limited-time offer menu item promotions. The type, mix and volume of advertising spend is heavily influenced by the number of restaurants in each market, so that in new markets we achieve certain restaurant penetration levels prior to launching more expensive and broad-based radio and television advertising. We plan to continue to refine our advertising and media strategies to continue to reinforce the key attributes of our brands which include high quality,

freshly-prepared food, an enhanced guest experience, everyday value, convenience and new limited time menu offerings. We have experienced success emphasizing the attractive price points of our menu. We also provide guests with the opportunity to sign up for our respective eClubs to stay informed regarding product and promotional launches. In addition, we introduced a loyalty program at Pollo Tropical to further connect with our repeat guests, and we plan to pilot a loyalty program at Taco Cabana in 2017. As a percentage of Pollo Tropical restaurant sales, Pollo Tropical's advertising expenditures were 3.7% in 2016, 2.6% in 2015 and 2.5% in 2014. As a percentage of Taco Cabana restaurant sales, Taco Cabana's advertising expenditures were 3.9% in 2016, 3.8% in 2015 and 3.9% in 2014.

- *Grow our off premise sales:* While both Pollo Tropical and Taco Cabana offer family meals and catering, we believe both brands have significant opportunities to grow their off premise sales. We redesigned the Pollo Tropical on-line catering order site in 2016 to improve the on-line catering order experience and expect to complete a redesign of the Taco Cabana on-line catering order site in 2017. In addition to launching a redesigned website with enhanced on-line ordering capabilities and a smart phone app, we are also offering delivery in certain markets and plan to increase our delivery capabilities in 2017.
- *Continue our brand elevation and reimage program:* We believe that our elevated brand position continues to resonate with guests by enhancing the quality of the guest experience at our restaurants by aligning our image and service with our high quality food offerings. We continue to implement restaurant enhancement initiatives to elevate the dining experience at our Pollo Tropical and Taco Cabana restaurants in select markets. We believe these enhancements improve our brands' positioning in the fast-casual segment while appealing to a broader demographic. Our restaurant enhancements create an updated, contemporary look that we believe is more relevant to today's consumers and include changes to both the interior and exterior of our restaurants with the addition of new tables and chairs, upgraded salsa bars and the addition of photos and murals to create a more inviting feel and highlight our fresh ingredients. Our Pollo Tropical and Taco Cabana elevated formats also feature limited table service, Wi-Fi and new menu items, as well as hand-held menus and real plates and silverware in certain locations. Additionally, we plan to continue our restaurant reimagining efforts as we refresh and upgrade our entire system. As of January 1, 2017, we have reimaged 30 Pollo Tropical restaurants, and plan to continue to reimage additional Pollo Tropical restaurants, which we believe will further differentiate our Pollo Tropical brand with a more Caribbean inspired look, help us maintain a quality restaurant environment, and further drive incremental sales and profitability.

Improve Profitability and Optimize Our Infrastructure. We believe our Restaurant-Level Adjusted EBITDA margins, at 22.6% for Pollo Tropical and 18.8% for Taco Cabana, are competitive within the fast-casual segment. However, through new restaurant development, growing comparable restaurant sales and emerging market new Pollo Tropical restaurant sales, we believe we will grow our Restaurant-Level Adjusted EBITDA and related margins. We also believe that our large restaurant base, skilled management team, operating systems, technology initiatives and training and development programs support our strategy of enhancing operating efficiencies for our existing restaurants while concurrently growing our restaurant base. We continue to focus on maximizing cost efficiencies, including implementing profit enhancement initiatives focused on food and labor costs and leveraging our scale, as well as enhancing our supply chain expertise with the result of reduced costs and improved food quality, consistency and yield.

However, because our company-owned restaurants in new markets have lower sales than our company-owned restaurants in markets that have achieved media efficiency and require regional support structures in advance of new company-owned restaurant openings, our average annual sales per restaurant and Adjusted EBITDA margins, which include general and administrative costs, have been and could continue to be impacted by company-owned restaurants in newer markets. In 2017, we will implement a plan to improve sales and profitability in our new Pollo Tropical restaurants in new markets that includes retraining staff at all restaurants, operational investments in batch cooking, ensuring that each restaurant is adequately staffed to provide a great guest experience, improving brand awareness through promotions and advertising and adding new menu offerings.

Competition

The restaurant industry is highly competitive with respect to price, service, location and food quality. In each of our markets, our restaurants compete with a large number of national and regional restaurant chains, as well as locally owned restaurants, offering low and medium-priced fare. We also compete with convenience stores, delicatessens and prepared food counters in supermarkets, grocery stores, cafeterias and other purveyors of moderately priced and quickly prepared foods.

We believe that:

- product quality and taste;
- brand differentiation and recognition;
- convenience of location;
- speed of service;
- menu variety;
- value perception;
- ambiance;
- cleanliness; and
- hospitality

are among the most important competitive factors in the fast-casual restaurant segment and that our two concepts effectively compete in that category. Pollo Tropical's competitors include national and regional chicken-based concepts, as well as other concepts. Taco Cabana's restaurants compete with Mexican concepts.

Restaurant Operating Data

Selected restaurant operating data for our two restaurant concepts is as follows:

	Year ended		
	January 1, 2017	January 3, 2016	December 28, 2014
<i>Pollo Tropical:</i>			
Average annual sales per company-owned restaurant (in thousands) ⁽¹⁾ . . .	\$ 2,354	\$ 2,585	\$ 2,720
Average sales transaction	\$ 10.94	\$ 10.76	\$ 10.26
Drive-through sales as a percentage of total sales	46.3%	45.7%	45.3%
Day-part sales percentages:			
Lunch	47.1%	46.8%	46.5%
Dinner and late night.	52.9%	53.2%	53.5%
<i>Taco Cabana:</i>			
Average annual sales per company-owned restaurant (in thousands) ⁽¹⁾ . . .	\$ 1,894	\$ 1,920	\$ 1,831
Average sales transaction	\$ 9.27	\$ 9.16	\$ 8.75
Drive-through sales as a percentage of total sales	55.7%	54.7%	53.9%
Day-part sales percentages:			
Breakfast	22.3%	20.8%	19.8%
Lunch	22.0%	22.4%	22.5%
Dinner	24.9%	25.4%	25.8%
Late night (9pm to midnight)	11.8%	12.1%	12.4%
Afternoon (2pm to 5pm)	12.6%	12.7%	12.5%
Overnight (midnight to 6am)	6.4%	6.6%	7.0%

(1) Average annual sales for company-owned restaurants are derived by dividing restaurant sales for such year for the applicable segment by the average number of company-owned restaurants for the applicable segment for such year. For comparative purposes, the calculation of average annual sales per company-owned restaurant is based on a 52-week fiscal year. Restaurant sales data for the extra week in the fiscal year ended January 3, 2016 have been excluded for purposes of calculating average annual sales per company-owned restaurant.

Seasonality

Our business is marginally seasonal due to regional weather conditions, particularly in Florida and Texas. Average restaurant sales are typically higher during the first and second quarters and typically lower in the third and fourth quarters. In addition, we have outdoor seating at many of our restaurants and the effects of adverse weather may impact the use of these areas and may negatively impact our restaurant sales.

Operations

Management Structure

We conduct substantially all of our marketing and operations support functions from our Pollo Tropical division headquarters in Dallas, Texas and Miami, Florida, and our Taco Cabana division headquarters in San Antonio, Texas. The management structure for Pollo Tropical consists of our Chief Operating Officer, Danny Meisenheimer, who also serves as our Interim Chief Executive Officer and President and has over 25 years of experience in the restaurant industry, and two Vice Presidents of Operations supported by six Regional Directors, 25 District Managers and three Assistant District Managers. The management structure of Taco Cabana consists of our Interim Chief Operating Officer, Mark Phillips, who has over 37 years of restaurant industry experience, and who also serves as the Vice President of Operations and is supported by four Regional Directors, one Senior District Manager and 28 District Managers. The Taco Cabana Interim Chief Operating Officer reports to our Interim Chief Executive Officer and President, who are supported by a number of divisional and corporate executives with responsibility for operations, marketing, product development, purchasing, human resources, training, real estate and finance. For each of our brands, a district manager is responsible for the direct oversight of the day-to-day operations of an average of approximately seven restaurants. Typically, district managers have previously served as restaurant managers at one of our restaurants. Regional directors, district managers and restaurant managers are compensated with a fixed salary plus an incentive bonus based upon the performance of the restaurants under their supervision. Typically, our restaurants are staffed with hourly employees who are supervised by a salaried restaurant or general manager and one to three salaried assistant managers and one to eight shift leaders.

Our executive management functions are primarily conducted from our corporate headquarters in Dallas, Texas. Our management team is led by Danny Meisenheimer, who serves as our Interim Chief Executive Officer and President. Lynn Schweinfurth serves as our Chief Financial Officer and Treasurer, Joseph A. Zirkman serves as our General Counsel and Secretary and Joseph W. Brink serves as our Chief Procurement Officer.

Training

We maintain a comprehensive training and development program for all of our restaurant personnel and provide both classroom and in-restaurant training for our salaried and hourly personnel. The program emphasizes system-wide operating procedures, food preparation methods and guest service standards for each of the concepts. The first six months of a new manager's time is spent in initial training with close oversight and a limited span of control. This period covers basic shift control, team member supervision, procedural and technical skills and management development. Eight weeks of this time is spent under direct supervision of a dedicated field training manager. The ensuing four months contain intense classroom training with an emphasis on skills building. The next phase is an intensive, self-paced ongoing development program designed to prepare the participant for the next level of management.

Our training process for new restaurant openings has been developed over the last five years as we expanded into new territory. Dedicated trainers, a new restaurant opening support team and a well-documented training and logistics process to assist us in ensuring consistent execution of the brand standards at openings. Menu authenticity and knowledge, passion for our food and a culture of caring are our strengths in our traditional markets. Our opening processes help to instill these in our teams in new markets.

Management Information Systems

Our management information systems provide us the ability to efficiently and effectively manage our restaurants and to ensure consistent application of operating controls at our restaurants.

In all corporate-owned restaurants, we use computerized management information systems, which we believe are scalable to support our future growth plans. We use touch-screen point-of-sale (POS) systems designed specifically for the restaurant industry that facilitate accuracy and speed of order taking, are user-friendly, require limited cashier training and improve speed-of-service through the use of conversational order-taking techniques. The POS systems are integrated with above-store enterprise applications that are designed to facilitate financial and management control of our restaurant operations. All products sold and related prices at our company-owned restaurants are programmed into the system from our central support office.

We provide in-store access to enterprise systems that assist in labor scheduling and food cost management, allow on-line ordering from distributors, and reduce managers' administrative time. Critical information from such systems is available in near real-time to our restaurant managers, who are expected to react quickly to trends or situations in their restaurant. Our district managers also receive near real-time information from all restaurants under their control and have access to key operating data on a remote basis. Management personnel at all levels, from the restaurant manager through senior management, utilize key restaurant performance indicators to manage our business.

These enterprise systems provide daily tracking and reporting of traffic counts, menu item sales, labor and food data including costs, and other key operating information for each restaurant. These systems also provide the ability to monitor labor utilization and sales trends on a real-time basis at each restaurant and provide analyses, reporting and tools to enable all levels of management to review a wide-range of financial, product mix and operational data.

We use an integrated digital ordering system that is integrated with our POS system at each restaurant. Individual, group or catering orders placed on our website or that of our third party delivery partners, mobile app or through our call center are transmitted electronically to the restaurants to provide a seamless ordering, payment and pickup or delivery experience for our guests.

We expect to continue to make substantial investments in technology that we believe will drive sales and transaction growth through improved customer engagement and off-premise service offerings, improve the effectiveness of labor and inventory management and business analytics, and improve efficiencies with our core enterprise systems.

Suppliers and Distributors

For our Pollo Tropical and Taco Cabana restaurants, we have negotiated directly with local and national suppliers for the purchase of food and beverage products and supplies to ensure consistent quality and freshness and to obtain competitive prices. Food and supplies for both brands are ordered from approved suppliers and are shipped to the restaurants via distributors. Both brands are responsible for monitoring quality control, for the supervision of these suppliers and for conducting inspections to observe preparations and ensure the quality of products purchased.

For both our Pollo Tropical and Taco Cabana restaurants, we have long-term service agreements with our primary distributors of food and paper products. In 2014, we consolidated our food distribution with Performance Food Group, Inc., which is now our primary distributor of food and beverage products and supplies for both our Pollo Tropical and Taco Cabana restaurants under a distribution services agreement that expires on July 26, 2019. For our restaurants in the Southeast, Kelly Food Service is our primary chicken distributor under an agreement that expires on December 31, 2017. We also currently rely on six suppliers for chicken for our Pollo Tropical restaurants under agreements that expire on December 31, 2017.

Quality Assurance

Pollo Tropical and Taco Cabana are committed to obtaining quality ingredients and creating made-from-scratch, freshly-prepared food in a safe manner. In addition to operating in accordance with quality assurance and health standards mandated by federal, state and local governmental laws and regulations regarding minimum cooking times and temperatures, maximum time standards for holding prepared food, food handling guidelines and cleanliness, among other things, we have also developed our own internal quality control standards. We require our suppliers to adhere to our high quality control standards, and we regularly inspect their products and production and distribution facilities to ensure that they conform to those standards. In addition, we have implemented certain procedures to ensure that we serve safe, quality meals to our guests. As an example, we utilize

the nationally-recognized ServSafe program to train our kitchen staff and managers in proper food handling and preparation techniques. In addition, our quality assurance team conducts unscheduled inspections of our restaurants, and restaurant managers conduct internal inspections for taste, quality, cleanliness and food safety on a regular basis.

In addition to food safety, our operational focus at each of our two concepts is closely monitored to achieve a high level of guest satisfaction via speed of service, order accuracy and quality of service. Our senior management and restaurant management staffs are principally responsible for ensuring compliance with our operating policies. We have uniform operating standards and specifications relating to the quality, preparation and selection of menu items, maintenance and cleanliness of the restaurants and employee conduct. In order to maintain compliance with these operating standards and specifications, we distribute to our restaurant operations management team detailed reports measuring compliance with various guest service standards and objectives, including feedback obtained directly from our guests. The guest feedback is monitored by an independent agency and by us and consists of evaluations of speed of service, quality of service, quality of our menu items and other operational objectives including the cleanliness of our restaurants. We also have our own in-house guest service representatives that handle guest inquiries and feedback.

Trademarks

We believe that our trademarks, service marks, trade dress, logos and other proprietary intellectual property are important to our success. We have registered the principal Pollo Tropical and Taco Cabana logos and designs with the U.S. Patent and Trademark Office on the Principal Register as a service mark for our restaurant services. We also have secured or have applied for state and federal registrations for several other advertising or promotional marks, including variations of the Pollo Tropical and Taco Cabana principal marks as well as those related to our core menu offerings. In connection with our current and potential international franchising activities, we have applied for or been granted registrations in foreign countries of the Pollo Tropical and Taco Cabana principal marks and several other marks.

Other than the Pollo Tropical and Taco Cabana trademarks and the logo and trademark of Fiesta Restaurant Group (including Internet domain names and addresses) and proprietary rights relating to certain of our core menu offerings, we have no proprietary intellectual property.

Government Regulation

Various federal, state and local laws affect our business, including various health, sanitation, fire and safety standards. Restaurants to be constructed or reimaged are subject to state and local building code and zoning requirements. In connection with the development and reimaging of our restaurants, we may incur costs to meet certain federal, state and local regulations, including regulations promulgated under the Americans with Disabilities Act.

We are subject to the federal Fair Labor Standards Act and various other federal and state laws governing employment matters. While we pay, on average, rates that are above the federal minimum wage, and where applicable, state minimum wage, increases in those minimum wages have in the past increased wage rates at our restaurants and in the future will affect our labor costs. In addition, changes to the salary level used to determine exempt status that may become effective in 2017 could increase our labor costs. Also, certain provisions of the comprehensive federal health care reform law enacted in 2010 became effective in 2015. We believe that a combination of labor management, cost reduction initiatives, technology and menu price increases can materially offset the potential increased costs associated with these regulations for 2017.

Taco Cabana is subject to alcoholic beverage control regulations that require state, county or municipal licenses or permits to sell alcoholic beverages at each restaurant location that sells alcoholic beverages. Typically, licenses must be renewed every one to two years and may be revoked or suspended for cause at any time. Licensing entities, authorized with law enforcement authority, may issue violations and conduct audits and investigations of the restaurant's records and procedures. Alcoholic beverage control regulations relate to numerous aspects of the daily operations of our Taco Cabana restaurants including minimum age for consumption, certification requirements for employees, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages. These regulations also prescribe certain required banking and accounting practices related to alcohol sales and purchasing. Our Taco Cabana restaurants are subject to state "dram-shop" laws. Dram-shop laws provide a person injured by an intoxicated person the right to recover damages from an establishment that wrongfully served alcoholic beverages to the intoxicated or minor patron. We have specific

insurance that covers claims arising under dram-shop laws. However, we cannot ensure that this insurance will be adequate to cover any claims that may be instituted against us. During 2016 certain of our Pollo Tropical restaurants served alcoholic beverages; however, we discontinued the sale of alcoholic beverages at Pollo Tropical restaurants in early 2017.

Employees

As of January 1, 2017, we employed approximately 12,080 persons, of which approximately 250 were corporate and administrative personnel, including personnel for our information technology help desk which was outsourced prior to 2016, and approximately 11,830 were restaurant operations and other supervisory personnel. None of our employees are covered by collective bargaining agreements. We believe that overall relations with our employees are good.

Availability of Information

We file annual, quarterly and current reports and other information with the Securities and Exchange Commission (the "SEC"). The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1 800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

We make available through our internet website (www.frgi.com) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after electronically filing such material with the SEC. The reference to our website address is a textual reference only, meaning that it does not constitute incorporation by reference of the information contained on the website and should not be considered part of this document. In addition, at our website you may also obtain, free of charge, copies of our corporate governance materials, including the charters for the committees of our Board of Directors and copies of various corporate policies including our Code of Business Ethics and Conduct, Code of Ethics for Executives and our "Whistle Blower" policy.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below, as well as other information and data included in this Annual Report on Form 10-K. Any of the following risks, as well as additional risks and uncertainties not currently known to us, could materially adversely affect our business, consolidated financial condition or results of operations and could also adversely affect the trading price of our common stock.

Risks Related to Our Business

Intense competition in the restaurant industry could make it more difficult to grow our business and could also have a negative impact on our operating results if guests favor our competitors or we are forced to change our pricing and other marketing strategies.

The restaurant industry is highly competitive. In each of our markets, our restaurants compete with a large number of national and regional restaurant chains, as well as locally owned restaurants, offering low and medium-priced fare. We also compete with convenience stores, delicatessens and prepared food counters in grocery stores, supermarkets, cafeterias and other purveyors of moderately priced and quickly prepared food.

Pollo Tropical's competitors include national and regional chicken-based concepts as well as other types of quick-service and fast-casual restaurants. Our Taco Cabana restaurants compete with Mexican concepts, including those in the quick-service, fast-casual and casual dining segments.

To remain competitive, we, as well as certain of the other major fast-casual chains, have increasingly offered selected food items and combination meals at discounted prices. These pricing and other marketing strategies have had, and in the future may have, a negative impact on our sales and earnings.

Factors applicable to the fast-casual restaurant segment may adversely affect our results of operations, which may cause a decrease in earnings and revenues.

The fast-casual restaurant segment is highly competitive and can be materially adversely affected by many factors, including:

- changes in local, regional or national economic conditions;
- changes in demographic trends;
- changes in consumer tastes;
- changes in traffic patterns;
- increases in fuel prices and utility costs;
- consumer concerns about health, diet and nutrition;
- instances of food-borne or localized illnesses or other food safety issues;
- increases in the number of, and particular locations of, competing restaurants;
- changes in discretionary consumer spending;
- inflation;
- availability of key commodities such as beef, chicken, eggs and produce;
- increases in the cost of key commodities, such as beef, chicken, eggs and produce as well as the cost of paper goods and packaging;
- increased labor costs, including escalating wages due to competition for employees, unemployment insurance, minimum wage and overtime requirements;
- increases in the cost of providing healthcare and related benefits to employees, including the impact of the Affordable Care Act;

- costs related to remaining competitive and current with regard to new technologies in our restaurants such as, loyalty programs, gift cards, on-line ordering and credit card security;
- the availability of hourly-paid employees and experienced restaurant managers; and
- regional weather conditions.

Our continued growth depends on our ability to open and operate new restaurants profitably, which in turn depends on our continued access to capital, and newly developed restaurants may not perform as we expect and there can be no assurance that our growth and development plans will be achieved.

Our continued growth depends on our ability to develop additional Pollo Tropical and Taco Cabana restaurants. Development involves substantial risks, including the following:

- developed restaurants that do not achieve desired revenue or cash flow levels or other operating and performance targets once opened;
- the inability to recruit and retain managers and other employees necessary to staff each new restaurant;
- incurring substantial unrecoverable costs in the event a development project is abandoned prior to completion or a new restaurant is closed due to poor financial performance;
- changes in general economic and business conditions;
- the inability to fund development;
- increasing development costs or development costs that exceed budgeted amounts;
- delays in completion of construction;
- the inability to obtain all necessary zoning and construction permits;
- the inability to identify, or the unavailability of, suitable sites on acceptable leasing or purchase terms; and
- changes in governmental rules and regulations or enforcement thereof.

We cannot ensure that our growth and development plans can be achieved. Our long-term development plans will require additional management, operational and financial resources. For example, we will be required to recruit managers and other personnel for each new restaurant. We cannot ensure that we will be able to manage our expanding operations effectively and our failure to do so could adversely affect our results of operations. In addition, our ability to open new restaurants and to grow, as well as our ability to meet other anticipated capital needs, may depend on our continued access to external financing, including borrowing under our senior secured revolving credit facility, which we refer to as the “senior credit facility”. There can be no assurance that we will have access to the capital we need at acceptable terms or at all, which could materially adversely affect our business. In addition, our need to manage our indebtedness levels to ensure continued compliance with financial leverage ratio covenants under our senior credit facility may reduce our ability to develop new restaurants.

Our expansion into new markets may present increased risks due to a lack of market awareness of our brands.

We have encountered and may continue to encounter difficulties developing restaurants outside of our more mature markets, and there can be no assurance that we will be able to successfully grow our market presence beyond our more mature markets. We may be unable to find attractive locations or successfully market our products as we attempt to expand beyond our existing markets, as the competitive circumstances and consumer characteristics in these new areas may differ substantially from those in areas in which we currently operate. It may be more challenging for us to attract guests to our restaurants in areas where there is a limited or a lack of market awareness of the Pollo Tropical or Taco Cabana brand. Restaurants opened in new markets where we have not reached media efficiency may open at lower sales volumes than restaurants opened in more mature markets, and may have lower restaurant-level operating margins than more mature markets. Sales at restaurants opened in new markets that are not yet media efficient have taken and may continue to take longer to reach average restaurant sales volumes, if at all, thereby adversely affecting our operating results, including the recognition of future impairment and other

lease charges. Opening new restaurants in areas in which potential guests may not be familiar with our restaurants may include costs related to the opening and marketing of those restaurants that are substantially greater than those incurred by our restaurants in other areas. Even though we may incur substantial additional costs with respect to these new restaurants, they may attract fewer guests than our more established restaurants in existing markets. We may also not open a sufficient number of restaurants in new markets to adequately leverage distribution, supervision and marketing costs. As a result of the foregoing, we cannot ensure that we will be able to successfully or profitably operate our new restaurants outside our existing markets.

We could be adversely affected by food-borne or local illnesses, as well as widespread negative publicity regarding food quality, illness, injury or other health concerns.

Negative publicity about food quality, illness, injury or other health concerns (including health implications of obesity) or similar issues stemming from one restaurant or a number of restaurants could materially adversely affect us, regardless of whether they pertain to our own restaurants, restaurants operated by our franchisees or to restaurants owned or operated by other companies. For example, outbreaks of e-coli, norovirus, salmonella, listeria and other illnesses or health concerns about the consumption of beef or chicken or by specific events such as the outbreak of “mad cow” disease or “avian” flu could lead to changes in consumer preferences, reduce consumption of our products and adversely affect our financial performance. These events could also reduce the available supply of beef, chicken or other key commodities, such as eggs or produce, or significantly raise the price of these key commodities.

In addition, we cannot guarantee that our operational controls and employee training will be effective in preventing food-borne illnesses, food tampering and other food safety issues that may affect our restaurants. Food-borne or local illness or food tampering incidents could be caused by guests, employees, food suppliers or distributors and, therefore, could be outside of our control. Any publicity relating to health concerns or the perceived or specific outbreaks of food-borne illnesses, food tampering or other food safety issues attributed to one or more of our restaurants, could result in a significant decrease in guest traffic in all of our restaurants and could have a material adverse effect on our results of operations. In addition, similar publicity or occurrences with respect to other restaurants or restaurant chains could also decrease our guest traffic and have a similar material adverse effect on our business.

Changes in consumer tastes and purchasing habits could negatively impact our business.

We obtain a significant portion of our revenues from the sale of foods that are characterized as Caribbean and Mexican and if consumer preferences for these types of foods change, it could have a material adverse effect on our operating results. The fast-casual segment is characterized by the frequent introduction of new products, often accompanied by substantial promotional campaigns and are subject to changing consumer preferences, tastes, and eating and purchasing habits. Our success depends on our ability to anticipate and respond to changing consumer preferences, tastes and dining and purchasing habits, as well as other factors affecting the restaurant industry, including new market entrants and demographic changes. The fast-casual segment is characterized by the frequent introductions of new products, often accompanied by substantial promotional campaigns and is subject to changing consumer preferences and tastes and demographic changes. In addition, consumer dining and purchasing habits may shift due to competing alternatives and services including grab-and-go kiosks and home delivery of meals and groceries, and other factors affecting the restaurant industry. We may find it necessary to make changes to our menu items in order to respond to changes in consumer tastes or dining patterns, and we may lose guests who do not prefer the new menu items. In recent years, numerous companies in the fast-casual segment have introduced products positioned to capitalize on the growing consumer preference for food products that are, or are perceived to be, promoting good health, nutritious, low in calories and low in fat content. If we do not continually develop and successfully introduce new menu offerings that appeal to changing consumer preferences or if we do not timely capitalize on new products, our operating results could suffer. In addition, any significant event that adversely affects consumption of our products, such as cost, changing tastes or health concerns, could adversely affect our financial performance.

An increase in food costs could adversely affect our operating results.

Our profitability and operating margins are dependent in part on our ability to anticipate and react to changes in food costs. Changes in the cost or availability of certain food products could affect our ability to offer a broad

menu and maintain competitive prices and could materially adversely affect our profitability and reputation. The type, variety, quality and cost of produce, beef, poultry, cheese and other commodities can be subject to change and to factors beyond our control, including weather, governmental regulation, availability and seasonality, each of which may affect our food costs or cause a disruption in our supply. Our food distributors or suppliers also may be affected by higher costs to produce and transport commodities used in our restaurants, including higher minimum wage and benefit costs and other expenses that they pass through to their customers, which could result in higher costs for goods and services supplied to us. Although we utilize purchasing contracts to lock in the prices for a material portion of the food commodities used in our restaurants, some of the commodities used in our operations cannot be locked in for periods of longer than one month. Currently, we have contracts of varying lengths with several of our distributors and suppliers, including our distributors and suppliers of poultry and beef. We do not use financial instruments to hedge our risk against market fluctuations in the price of commodities at this time. We may not be able to anticipate and react to changing food costs through our purchasing practices and menu price adjustments in the future, and failure to do so could negatively impact our revenues and results of operations.

If a significant disruption in service or supply by any of our suppliers or distributors were to occur, it could create disruptions in the operations of our restaurants, which could have a material adverse effect on our business.

Our financial performance is dependent on our continuing ability to offer fresh, quality food at competitive prices. If a significant disruption in service or supply by our suppliers or distributors were to occur, it could create disruptions in the operations of our restaurants, which could have a material adverse effect on us.

We negotiate directly with local and national suppliers for the purchase of food and beverage products and supplies to ensure consistent quality and freshness and to obtain competitive prices. Food and supplies for both brands are ordered from approved suppliers and are shipped to the restaurants via distributors. Both brands are responsible for monitoring quality control, for the supervision of these suppliers and for conducting inspections to observe preparations and ensure the quality of products purchased. For both our Pollo Tropical and Taco Cabana restaurants, we have long-term service agreements with our primary distributors of food and paper products. In 2014, we consolidated our food distribution with Performance Food Group, Inc., which is now our primary distributor of food and beverage products and supplies for both our Pollo Tropical and Taco Cabana restaurants under a distribution services agreement that expires on July 26, 2019. For our restaurants in the Southeast, Kelly Food Service is our primary chicken distributor under an agreement that expires on December 31, 2017. We also currently rely on six suppliers for chicken for our Pollo Tropical restaurants under agreements that expire on December 31, 2017. If our distributors or suppliers were unable to service us, this could lead to a material disruption of service or supply until a new distributor or supplier is engaged, which could have a material adverse effect on our business.

If labor costs increase, we may not be able to make a corresponding increase in our prices and our operating results may be adversely affected.

Wage rates for a substantial number of our employees are above the federal and or state minimum wage rates. As federal and/or state minimum wage rates increase, we may need to increase not only the wage rates of our minimum wage employees but also the wages paid to other employees at wage rates which are above the minimum wage, which will increase our costs. To the extent that we are not able to raise our prices to compensate for increases in wage rates, including increases in state unemployment insurance costs, overtime costs or other costs including mandated health insurance, this could have a material adverse effect on our operating results. In addition, even if minimum wage rates do not increase, we may still be required to raise wage rates in order to compete for an adequate supply of labor for our restaurants.

Additionally, while we do not currently have any unionized employees, union organizers have engaged in efforts to organize employees of other restaurant companies. If a significant portion of our employees were to become union organized, our labor costs could increase. Potential changes in labor laws, including the possible passage of legislation designed to make it easier for employees to unionize, could increase the likelihood of some or all of our employees being subjected to greater organized labor influence, and could have an adverse effect on our business and financial results by imposing requirements that could potentially increase our costs.

The efficiency and quality of our competitors' advertising and promotional programs and the extent and cost of our advertising could have a material adverse effect on our results of operations and financial condition.

If our competitors increase spending on advertising and promotions, or the cost of television or radio advertising increases, or our advertising and promotions are less effective than our competitors, there could be a material adverse effect on our results of operations and financial condition.

Our business is regional and we therefore face risks related to reliance on certain markets as well as risks for other unforeseen events.

As of January 1, 2017, excluding our franchised locations, all but 19 of our Pollo Tropical restaurants were located in Florida and Texas and all but one of our Taco Cabana restaurants were located in Texas. Therefore, the economic conditions, state and local government regulations, weather conditions or other conditions affecting Florida and Texas, the tourism industry affecting Florida and other unforeseen events may have a material impact on the success of our restaurants in those locations.

Many of our restaurants are located in regions that may be susceptible to severe weather conditions. As a result, adverse weather conditions in any of these areas could damage these restaurants, and/or result in fewer guest visits to these restaurants and otherwise have a material adverse impact on our business. For example, our Florida and certain of our Texas restaurants are susceptible to hurricanes, other severe tropical weather events and flooding, and in the past, a number of our Texas restaurants have been periodically affected by severe winter weather.

Economic downturns may adversely impact consumer spending patterns.

Our business is dependent to a significant extent on national, regional and local economic conditions, particularly those that affect our guests that frequently patronize our restaurants. In particular, where our guests' disposable income is reduced (such as by job losses, credit constraints and higher housing, tax, utility, gas, consumer credit or other costs) or where the perceived wealth of guests has decreased (because of circumstances such as lower residential real estate values, lower investment values, increased foreclosure rates, increased tax rates or other economic disruptions), our restaurants have in the past experienced, and may in the future experience, lower sales and guest traffic as guests choose lower-cost alternatives or choose alternatives to dining out. The resulting decrease in our guest traffic or average sales per transaction has had an adverse effect in the past, and could in the future have a material adverse effect, on our business.

We cannot ensure that the current locations of our existing restaurants will continue to be economically viable or that additional locations will be acquired at reasonable costs.

The location of our restaurants has significant influence on their success. We cannot ensure that current locations will continue to be economically viable or that additional locations can be acquired at reasonable costs. In addition, the economic environment where restaurants are located could decline in the future, which could result in reduced sales in those locations. We cannot ensure that new sites will be profitable or as profitable as existing sites.

Government regulation could adversely affect our financial condition and results of operations.

We are subject to extensive laws and regulations relating to the development and operation of restaurants, including regulations relating to the following:

- health care;
- employer/employee relationships, including minimum wage requirements, overtime, working and safety conditions, family leave mandates, immigration and citizenship or work authorization or related requirements;
- federal and state laws that prohibit discrimination and laws regulating design and operation of, and access to, facilities, such as the Americans With Disabilities Act of 1990;
- requirements relating to labeling of caloric and other nutritional information on menu boards, advertising and food packaging;

- the preparation and sale of food;
- liquor licenses which allow us to serve alcoholic beverages at our Taco Cabana restaurants;
- zoning; and
- federal and state regulations governing the operations of franchises, including rules promulgated by the Federal Trade Commission.

In the event that legislation has a negative impact on our business, it could have a material adverse impact. For example, substantial increases in the minimum wage or state or Federal unemployment taxes could adversely affect our financial condition and results of operations. Local zoning or building codes or regulations and liquor license approvals can cause substantial delays in our ability to build and open new restaurants. Local authorities may revoke, suspend or deny renewal of our liquor licenses if they determine that our conduct violates applicable regulations. Any failure to obtain and maintain required licenses, permits and approvals could adversely affect our operating results. Complying with these rules and regulations subjects us to substantial expense and can expose us to liabilities from claims for non-compliance. We could suffer losses from, and we incur legal costs to defend, these claims and the amount of such losses could be significant.

The effect of recent changes to U.S. health care laws may increase our health care costs and negatively impact our financial results.

Under the comprehensive U.S. health care reform law enacted in 2010, the Affordable Care Act, changes that became effective in 2014, and the employer mandate and employer penalties that became effective in 2015, may increase our labor costs significantly. While changes in the law that became effective in 2015, including the imposition of a penalty on individuals who do not obtain health care coverage, have not resulted in significant numbers of additional employees electing to participate in our health care plans, there can be no assurance that this will not change in the future which may increase our health care costs. It is also possible that making changes or failing to make changes in the health care plans we offer will make us less attractive to our current or potential employees. The costs and other effects of these new health care requirements on future periods cannot be determined with certainty and could have a material adverse effect on our results of operations.

We are dependent on information technology, and any material failure of that technology could impair our ability to efficiently operate our business.

We rely on information systems across our operations, including, for example, point-of-sale processing in our restaurants, management of our supply chain, collection of cash, and payment of obligations and various other processes and procedures. Our ability to efficiently manage our business depends significantly on the reliability and capacity of these systems. The failure of these systems to operate effectively, problems with maintenance, upgrading or transitioning to replacement systems or a breach in security of these systems could cause delays in guest service and reduce efficiency in our operations. Significant capital investments might be required to remediate any problems.

In recent years, individuals and groups that are non-practicing entities, commonly referred to as “patent trolls”, have purchased technology related patents and other intellectual property assets related to our information technology for the purpose of making claims of infringement in order to extract settlements. From time to time, we may receive threatening letters or notices or may be the subject of claims that technology or equipment we use infringe or violate the intellectual property rights of others. Responding to such claims, regardless of their merit, can be time consuming, costly to defend in litigation, divert management’s attention and resources, damage our reputation and brand, and cause us to incur significant expenses.

Security breaches of confidential guest information in connection with our electronic processing of credit and debit card transactions or security breaches of confidential employee information may adversely affect our business.

A significant amount of our restaurant sales are by credit or debit cards. Other restaurants and retailers have experienced security breaches in which credit and debit card information of their guests has been stolen. We may in the future become subject to lawsuits or other proceedings for purportedly fraudulent transactions arising out of the

actual or alleged theft of our guests' credit or debit card information. Any such claim or proceeding, or any adverse publicity resulting from these allegations, may have a material adverse effect on us and our restaurants.

We also collect and maintain personal information about our employees and customers as part of some of our marketing and guest loyalty programs. The collection and use of such information is regulated at the federal and state levels, and the regulatory environment related to information security and privacy is increasingly demanding. We also rely increasingly on cloud computing and other technologies that result in third parties holding significant amounts of customer or employee information on our behalf. If the security and information systems of our outsourced third party providers we use to store or process such information are compromised or if we or such third parties otherwise fail to comply with these laws and regulations, we could face litigation and the imposition of penalties, which could adversely affect our financial performance. Our reputation as a brand or as an employer could also be adversely affected, which could impair our sales or ability to attract and keep qualified employees.

We may incur significant liability or reputational harm if claims are brought against us or against our franchisees.

We or our franchisees may be subject to complaints, regulatory proceedings or litigation from guests or other persons alleging food-related illness, injuries suffered on our premises or other food quality, health or operational concerns, including environmental claims. In addition, in recent years a number of restaurant companies have been subject to lawsuits, including class action lawsuits, alleging, among other things, violations of federal and state law regarding workplace and employment matters, discrimination, harassment, wrongful termination and wage, rest break, meal break and overtime compensation issues and, in the case of quick-service restaurants, alleging that they have failed to disclose the health risks associated with high-fat or high sodium foods and that their marketing practices have encouraged obesity. We may also be subject to litigation or other actions initiated by governmental authorities, our employees and our franchisees, among others, based upon these and other matters. Adverse publicity resulting from such allegations or occurrences or alleged discrimination or other operating issues stemming from one of our locations, a number of our locations or our franchisees could adversely affect our business, regardless of whether the allegations are true, or whether we are ultimately held liable. Any cases filed against us could materially adversely affect us if we lose such cases and have to pay substantial damages or if we settle such cases. In addition, any such cases may materially and adversely affect our operations by increasing our litigation costs and diverting our attention and resources to address such actions. In addition, if a claim is successful, our insurance coverage may not cover or be adequate to cover all liabilities or losses and we may not be able to continue to maintain such insurance, or to obtain comparable insurance at a reasonable cost, if at all. If we suffer losses, liabilities or loss of income in excess of our insurance coverage or if our insurance does not cover such loss, liability or loss of income, there could be a material adverse effect on our results of operations.

Our franchisees could take actions that harm our reputation.

As of January 1, 2017, a total of 42 Pollo Tropical and Taco Cabana restaurants were owned and operated by our franchisees. We do not exercise control of the day-to-day operations of our franchisees and the number of franchised restaurants may increase in the future. While we attempt to ensure that franchisee-owned restaurants maintain the same high operating standards as our company-owned restaurants, one or more of these franchisees may fail to meet these standards. Any shortcomings at our franchisee-owned restaurants could be attributed to our company as a whole and could adversely affect our reputation and damage our brands.

Our indebtedness could adversely affect our financial condition.

As of January 1, 2017, we had \$73.2 million of outstanding indebtedness comprised of \$69.9 million of revolving credit borrowings under our senior credit facility, lease financing obligations of \$1.7 million and capital lease obligations of \$1.6 million.

As a result of our indebtedness, a portion of our operating cash flow will be required to make payments on our outstanding indebtedness. In addition, to the extent we significantly increase our borrowings and interest rates increase under our senior credit facility, we may not generate sufficient cash flow from operations to enable us to both repay our indebtedness and fund our other liquidity needs.

Our indebtedness could have important consequences. For example, it could:

- make it more difficult for us to satisfy our obligations with respect to our debt;
- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a portion of our cash flow from operations to payments on our indebtedness and related interest, including indebtedness we may incur in the future, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- increase our cost of borrowing;
- place us at a competitive disadvantage compared to our competitors that may have less debt; and
- limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions, debt service requirements or general corporate purposes.

We expect to use cash flow from operations and revolving borrowings under our senior credit facility to meet our current and future financial obligations, including funding our operations, debt service and capital expenditures. Our ability to make these payments depends on our future performance, which will be affected by financial, business, economic and other factors, many of which we cannot control. Our business may not generate sufficient cash flow from operations in the future, which could result in our being unable to repay indebtedness, or to fund other liquidity needs. If we do not have enough money, we may be forced to reduce or delay our business activities and capital expenditures, sell assets, obtain additional debt or equity capital or restructure or refinance all or a portion of our debt, including our senior credit facility, on or before maturity. We cannot make any assurances that we will be able to accomplish any of these alternatives on terms acceptable to us, or at all. In addition, the terms of existing or future indebtedness, including the agreements for our senior credit facility, may limit our ability to pursue any of these alternatives.

Despite current indebtedness levels and restrictive covenants, we may still be able to incur more debt or make certain restricted payments, which could further exacerbate the risks described above.

We and our subsidiaries may be able to incur additional debt in the future. Although our senior credit facility contains restrictions on our ability to incur indebtedness, those restrictions are subject to a number of exceptions. We may also consider investments in joint ventures or acquisitions, which may increase our indebtedness. Moreover, although our senior credit facility contains restrictions on our ability to make restricted payments, including the declaration and payment of dividends, we are able to make such restricted payments under certain circumstances. Adding new debt to current debt levels or making restricted payments could intensify the related risks that we and our subsidiaries now face.

Our senior credit facility restricts our ability to engage in some business and financial transactions.

Our senior credit facility restricts our ability in certain circumstances to, among other things:

- incur additional debt;
- pay dividends and make other distributions on, redeem or repurchase, capital stock;
- make investments or other restricted payments;
- enter into transactions with affiliates;
- sell all, or substantially all, of our assets;
- create liens on assets to secure debt; or
- effect a consolidation or merger.

These covenants limit our operational flexibility and could prevent us from taking advantage of business opportunities as they arise, growing our business or competing effectively. In addition, our senior credit facility requires us to maintain specified financial ratios and satisfy other financial condition tests. Our ability to meet these financial ratios and tests can be affected by events beyond our control, and we cannot ensure that we will meet these tests.

Our ability to renew our senior credit facility by December 11, 2018 at favorable rates and conditions may be impacted by adverse market conditions.

Our senior credit facility matures on December 11, 2018. Our ability to renew our senior credit facility at favorable rates and conditions is based on credit conditions and availability which may be impacted by adverse market conditions.

If one of our employees sells alcoholic beverages to an intoxicated patron, we may be liable to third parties for the acts of the patron.

We serve alcoholic beverages at our Taco Cabana restaurants and at some of our Pollo Tropical restaurant locations and are subject to the “dram-shop” statutes of the jurisdictions in which we serve alcoholic beverages. “Dram-shop” statutes generally provide that serving alcohol to an intoxicated patron is a violation of the law. (We discontinued the sale of alcoholic beverages at Pollo Tropical restaurants in early 2017.)

In most jurisdictions, if one of our employees sells alcoholic beverages to an intoxicated patron we may be liable to third parties for the acts of the patron. We cannot guarantee that those patrons will not be served or that we will not be subject to liability for their acts. Our liquor liability insurance coverage may not be adequate to cover any potential liability and insurance may not continue to be available on commercially acceptable terms or at all, or we may face increased deductibles on such insurance. A significant dram-shop claim or claims could have a material adverse effect on us as a result of the costs of defending against such claims; paying deductibles and increased insurance premium amounts; implementing improved training and heightened control procedures for our employees; and paying any damages or settlements on such claims.

If one of our employees sells alcoholic beverages to a minor patron, we may be liable for significant fines or penalties including the suspension or loss of our liquor license.

We are subject to statutes of the jurisdictions in which we serve alcoholic beverages which prohibit us from selling or serving alcohol to minor patrons. These statutes generally provide that serving or selling alcohol to minors is a violation of the law, and will result in fines and other penalties including the suspension or loss of our license to sell alcohol in the future. If we were to incur a significant number of sale to minor violations the fines or penalties could have a material adverse effect on us.

Federal, state and local environmental regulations relating to the use, storage, discharge, emission and disposal of hazardous materials could expose us to liabilities, which could adversely affect our results of operations.

We are subject to a variety of federal, state and local environmental regulations relating to the use, storage, discharge, emission and disposal of hazardous substances or other regulated materials, release of pollutants into the air, soil and water, and the remediation of contaminated sites.

Failure to comply with environmental laws could result in the imposition of fines or penalties, restrictions on operations by governmental agencies or courts of law, as well as investigatory or remedial liabilities and claims for alleged personal injury or damages to property or natural resources. Some environmental laws impose strict, and under some circumstances joint and several, liability for costs of investigation and remediation of contaminated sites on current and prior owners or operators of the sites, as well as those entities that send regulated materials to the sites. We cannot ensure that we have been or will be at all times in complete compliance with such laws, regulations and permits. Therefore, our costs of complying with current and future environmental, health and safety laws could adversely affect our results of operations.

We are subject to all of the risks associated with leasing property subject to long-term non-cancelable leases.

The leases for our restaurant locations generally have initial terms of 10 to 20 years, and typically provide for renewal options in five year increments as well as for rent escalations. Generally, our leases are “net” leases, which require us to pay all of the costs of insurance, taxes, maintenance and utilities. We generally cannot cancel these leases. Additional sites that we lease are likely to be subject to similar long-term non-cancelable leases. If an existing or future restaurant is not profitable, and we decide to close it, we may nonetheless be obligated to perform our monetary obligations under the applicable lease including, among other things, paying all amounts due for the balance of the lease term. In addition, as each of our leases expire, we may fail to negotiate renewals, either on commercially acceptable terms or at all, which could cause us to close restaurants in desirable locations.

Our failure or inability to enforce our trademarks or other proprietary rights could adversely affect our competitive position or the value of our brand.

We own certain common law trademark rights and a number of federal and international trademark and service mark registrations, including the Pollo Tropical and Taco Cabana names and logos, and proprietary rights relating to certain of our core menu offerings. We believe that our trademarks, service marks, trade dress and other proprietary rights are important to our success and our competitive position. We, therefore, devote appropriate resources to the protection of our trademarks and proprietary rights. If our efforts to protect our intellectual property are inadequate or if any third party misappropriates or infringes on our intellectual property either in print or on the internet, the value of our brands may be harmed which could have a material adverse effect on our business. We are aware of restaurants in foreign jurisdictions using menu items, logos or branding that we believe are based on our intellectual property and our ability to prevent these restaurants from using these elements may be limited in jurisdictions in which we are not operating. This could have an adverse impact on our ability to expand into other jurisdictions in the future.

We are not aware of any assertions that our trademarks or menu offerings infringe upon the proprietary rights of third parties, but we cannot ensure that third parties will not claim infringement by us in the future. Any such claim, whether or not it has merit, could be time-consuming, result in costly litigation, cause delays in introducing new menu items in the future or require us to enter into royalty or licensing agreements. As a result, any such claim could have a material adverse effect on our business, results of operations and financial condition.

Risks Related to Our Common Stock

The market price of our common stock may be highly volatile or may decline regardless of our operating performance.

The trading price of our common stock may fluctuate substantially. The price of our common stock that will prevail in the market may be higher or lower than the price you pay, depending on many factors, some of which are beyond our control. Broad market and industry factors may adversely affect the market price of our common stock, regardless of our actual operating performance. The fluctuations could cause a loss of all or part of an investment in our common stock. Factors that could cause fluctuation in the trading price of our common stock may include, but are not limited to the following:

- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of our company as well as companies generally or restaurant companies;
- actual or anticipated variations in the earnings or operating results of our company or our competitors;
- actual or anticipated changes in financial estimates by us or by any securities analysts who might cover our stock or the stock of other companies in our industry;
- market conditions or trends in our industry and the economy as a whole;
- announcements by us or our competitors of significant acquisitions, strategic partnerships or divestitures and our ability to complete any such transaction;

- announcements of investigations or regulatory scrutiny of our operations or lawsuits filed against us;
- capital commitments;
- changes in accounting principles;
- additions or departures of key personnel; and
- sales of our common stock, including sales of large blocks of our common stock or sales by our directors and officers.

In addition, if the market for restaurant company stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, results of operations or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry or related industries even if these events do not directly affect us.

In the past, following periods of volatility in the market price of a company's securities, class action securities litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business, and could also require us to make substantial payments to satisfy judgments or to settle litigation.

Proxy contests threatened or commenced against us could be disruptive and costly, cause uncertainty about the strategic direction of our business and adversely affect our business, operating results and financial condition.

On January 26, 2017, JCP Investment Partnership, LLC, and other joint filers to a Schedule 13D filed with the SEC (collectively, "JCP"), notified us of their intention to nominate three persons for election as directors at our 2017 Annual Meeting of Stockholders. If JCP continues to pursue a proxy contest and related actions at our 2017 Annual Meeting of Stockholders to elect directors other than those recommended by our Board of Directors, or takes other actions that conflict with our strategic direction, such actions could have a material and adverse effect on us for the following reasons:

- Responding to proxy contests and related actions by activist stockholders such as JCP can be costly and time-consuming, disrupt our operations, and divert the attention of our management and employees away from their regular duties and the pursuit of our business strategies, which could materially and adversely affect our business, operating results and financial condition.
- Perceived uncertainties as to our future direction as a result of potential changes to the composition of the Board of Directors may lead to the perception of a change in the direction of our business, instability or lack of continuity. This may affect our relationship with current or potential suppliers, vendors, and other third parties, and make it more difficult to attract and retain management employees and executives which could adversely affect our business, operating results and financial condition.
- Proxy contests and related actions by activist stockholders such as JCP could cause significant fluctuations in our stock price based on temporary or speculative market perceptions or other factors that do not necessarily reflect the underlying fundamentals and prospects of our business.

We do not expect to pay any cash dividends for the foreseeable future, and our senior credit facility limits our ability to pay dividends to our stockholders.

We do not anticipate that we will pay any cash dividends to holders of our common stock in the foreseeable future. The absence of a dividend on our common stock may increase the volatility of the market price of our common stock or make it more likely that the market price of our common stock will decrease in the event of adverse economic conditions or adverse developments affecting our company. Our senior credit facility limits, and the debt instruments that we and our subsidiaries may enter into in the future may limit, our ability to pay dividends to our stockholders.

If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock will rely in part on the research and reports that industry or financial analysts publish about us or our business. We cannot ensure that these analysts will publish research or reports about us or that any analysts that do so will not discontinue publishing research or reports about us in the future. If one or more analysts who cover us downgrade our stock, our stock price could decline rapidly. If analysts do not publish reports about us or if one or more analyst ceases coverage of our stock, we could lose visibility in the market, which in turn could cause our stock price to decline.

Percentage ownership of our common stock may be diluted in the future.

Percentage ownership of our common stock may be diluted in the future because of equity awards that we expect will be granted to our directors, officers and employees. The Fiesta Restaurant Group, Inc. 2012 Stock Incentive Plan provides for the grant of equity-based awards, including restricted stock, restricted stock units, stock options, and other equity-based awards to our directors, officers and other employees, advisors and consultants. In addition, in the future we may also issue common stock or other securities to raise additional capital. Any new shares issued would dilute our existing shareholders.

Provisions in our restated certificate of incorporation and amended and restated bylaws or Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.

Delaware corporate law and our restated certificate of incorporation and amended and restated bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions:

- require that special meetings of our stockholders be called only by our board of directors or certain of our officers, thus prohibiting our stockholders from calling special meetings;
- deny holders of our common stock cumulative voting rights in the election of directors, meaning that stockholders owning a majority of our outstanding common stock will be able to elect all of our directors;
- authorize the issuance of “blank check” preferred stock that our board could issue to dilute the voting and economic rights of our common stock and to discourage a takeover attempt;
- provide the approval of our board of directors or a supermajority of stockholders is necessary to make, alter or repeal our amended and restated bylaws and that approval of a supermajority of stockholders is necessary to amend, alter or change certain provisions of our restated certificate of incorporation;
- establish advance notice requirements for stockholder nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings;
- divided our board into three classes of directors, with each class serving a staggered 3-year term, which generally increases the difficulty of replacing a majority of the directors;
- provide that directors only may be removed for cause by a majority of the board and/or by a supermajority of our stockholders; and
- require that any action required or permitted to be taken by our stockholders must be effected at a duly called annual or special meeting of stockholders and may not be effected by any consent in writing.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

As of January 1, 2017, we owned or leased the following operating restaurant properties:

	<u>Owned</u>	<u>Leased⁽¹⁾</u>	<u>Total⁽²⁾</u>
Restaurants:			
Pollo Tropical	11	166	177
Taco Cabana	<u>9</u>	<u>157</u>	<u>166</u>
Total operating restaurants	<u>20</u>	<u>323</u>	<u>343</u>

(1) Includes twelve restaurants located in in-line or storefront locations.

(2) Excludes restaurants operated by our Pollo Tropical and Taco Cabana franchisees. In addition, as of January 1, 2017, we had six restaurants under development, six properties subleased to third parties and seven properties available for sublease.

As of January 1, 2017, we leased 94% of our Pollo Tropical restaurants and 95% of our Taco Cabana restaurants. We typically enter into leases (including renewal options) ranging from 35 to 45 years. The average remaining term for all leases, including options, was approximately 27 years as of January 1, 2017. Generally, we have been able to renew leases, upon or prior to their expiration, at the prevailing market rates, although there can be no assurance that this will continue to occur.

Most leases require us to pay utility and water charges and real estate taxes. Certain leases also require contingent rentals based upon a percentage of gross sales of the particular restaurant that exceed specified minimums. In some of our mall locations, we are also required to pay certain other charges such as a pro-rata share of the mall's common area maintenance costs, insurance and security costs.

In addition to the restaurant locations, we lease approximately 21,000 square feet at 14800 Landmark Boulevard, Suite 500, Dallas, Texas and 18,700 square feet at 3220 Keller Springs Road, Suite 108, Carrollton, Texas which house our executive offices and certain of our administrative functions, including some of our administrative operations for our Pollo Tropical restaurants. We also lease approximately 10,400 square feet at 7255 Corporate Center Drive, Miami, Florida, which houses some of our administrative operations for our Pollo Tropical restaurants. In addition, we lease approximately 17,700 square feet of office space at 8918 Tesoro Drive, Suite 200, San Antonio, Texas, which houses most of our administrative operations for our Taco Cabana restaurants.

ITEM 3. LEGAL PROCEEDINGS

On November 24, 2015, Pollo Tropical received a legal demand letter alleging that assistant managers were misclassified as exempt from overtime wages under the Fair Labor Standards Act. On September 30, 2016, prior to any suit being filed, Pollo Tropical reached a settlement with seven named individuals and a proposed collective action class that will allow current and former assistant managers to receive notice and opt-in to the settlement. Pollo Tropical denies any liability or unlawful conduct. The Company has recorded a charge of \$0.8 million to cover the estimated costs related to the settlement, including estimated payments to individuals that opt-in to the settlement, premium payments to named individuals, attorneys' fees for the individuals' counsel, and related settlement administration costs. The charge does not include legal fees incurred by Pollo Tropical in defending the action. The settlement, which is subject to approval by an arbitrator and a judicial body, will result in dismissal with prejudice for the named individuals and all individuals that opt-in to the settlement.

We are a party to various other litigation matters incidental to the conduct of our business. We do not believe that the outcome of any of these matters will have a material adverse effect on our business, results of operations or financial condition.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on The NASDAQ Global Select Market under the symbol "FRGI". The common stock has been quoted on The NASDAQ Global Select Market since May 8, 2012. On February 23, 2017, there were 26,884,992 shares of our common stock outstanding held by 542 holders of record. This excludes persons whose shares are held by a brokerage house or clearing agency. The closing price of our common stock on February 23, 2017 was \$26.95.

The following table presents the range of high and low closing prices of our common stock for the periods indicated, as reported by The NASDAQ Global Select Market:

	Common Stock Price	
	High	Low
Year Ended January 1, 2017		
First Quarter	\$ 38.42	\$ 31.38
Second Quarter	\$ 35.70	\$ 21.01
Third Quarter	\$ 26.48	\$ 21.93
Fourth Quarter.	\$ 30.50	\$ 23.74
Year Ended January 3, 2016		
First Quarter	\$ 66.99	\$ 55.32
Second Quarter	\$ 62.32	\$ 46.45
Third Quarter	\$ 58.47	\$ 46.35
Fourth Quarter.	\$ 45.71	\$ 32.01

Dividends

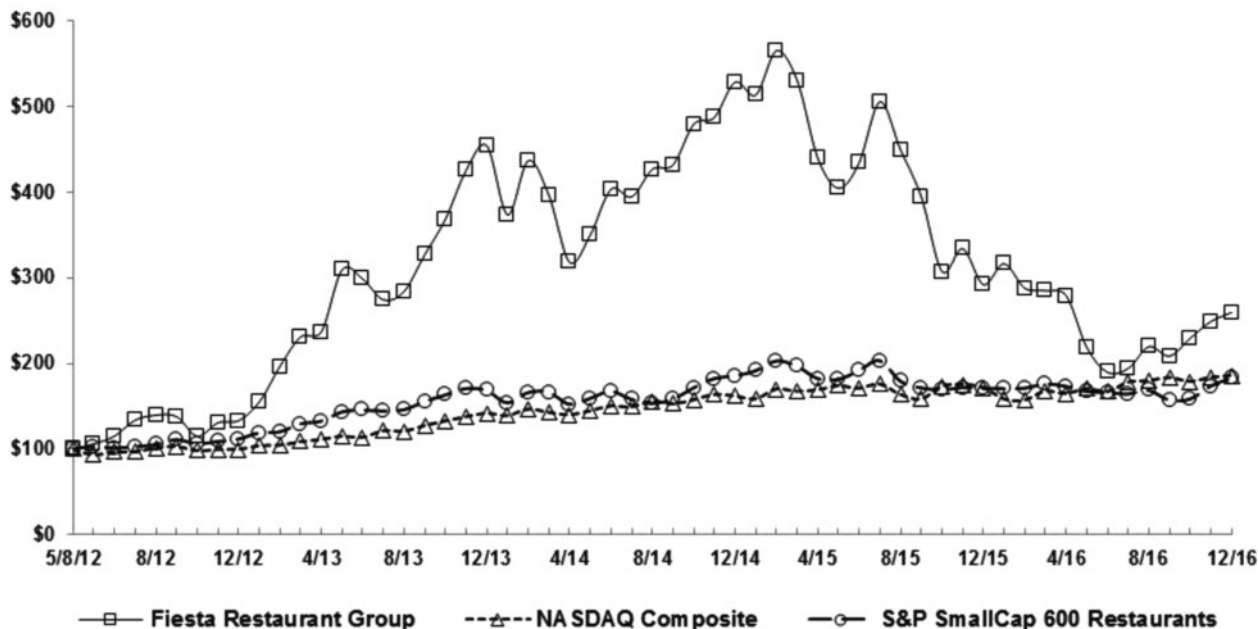
We did not pay any cash dividends during 2016 or 2015. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. We currently intend to retain the majority of available funds to fund the development and growth of our business or to use for other corporate related purposes such as the repayment of revolving credit borrowings under our senior credit facility. In addition, we are a holding company and conduct all of our operations through our direct and indirect subsidiaries. As a result, for us to pay dividends, we need to rely on dividends and distributions to us from our subsidiaries. Our senior credit facility limits, and debt instruments that we and our subsidiaries may enter into in the future may limit, our ability to pay dividends to our stockholders.

Stock Performance Graph

The following graph compares, from May 8, 2012 (the date on which our common stock began “regular way” trading on The NASDAQ Global Select Market), the cumulative total stockholder return on our common stock with the cumulative total returns of The NASDAQ Composite Index and a peer group, The S&P Small Cap 600 Restaurant Index. We have elected to use the S&P Small Cap 600 Restaurant Index in compiling our stock performance graph because we believe the S&P Small Cap 600 Restaurant Index represents a comparison to competitors with similar market capitalization as us.

The initial trading price of our common stock on May 8, 2012 was \$11.10 and the closing price of our common stock on December 30, 2016, the last trading day before our fiscal year end date of January 1, 2017, was \$29.85. The following graph is based upon the closing price of our common stock from May 8, 2012 through January 1, 2017.

COMPARISON OF 56 MONTH CUMULATIVE TOTAL RETURN*
Among Fiesta Restaurant Group, the NASDAQ Composite Index,
and S&P SmallCap 600 Restaurants



*\$100 invested on 5/8/12 in stock or 4/30/12 in index, including reinvestment of dividends.
Fiscal year ending December 31.

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Total Cumulative Shareholder Returns

	5/8/2012	06/30/2012	12/31/2012	06/30/2013	12/31/2013	06/30/2014	12/31/2014	6/30/2015	1/3/2016	6/30/2016	1/1/2017
Fiesta Restaurant Group, Inc.	\$ 100.00	\$ 115.04	\$ 133.22	\$ 298.75	\$ 454.26	\$ 403.57	\$ 528.70	\$ 434.78	\$292.17	\$ 189.65	\$259.57
NASDAQ Composite	\$ 100.00	\$ 96.66	\$ 99.81	\$ 113.79	\$ 141.87	\$ 150.29	\$ 161.78	\$ 170.84	\$171.75	\$ 166.99	\$185.66
S&P Small Cap 600 Restaurants	\$ 100.00	\$ 101.27	\$ 111.87	\$ 145.62	\$ 168.52	\$ 167.71	\$ 185.65	\$ 191.84	\$170.87	\$ 166.36	\$183.14

The graph and table above provide the cumulative change of \$100.00 invested on May 8, 2012, including reinvestment of dividends, if applicable, for the periods indicated.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial data derived from our audited consolidated financial statements for each of the years ended January 1, 2017, January 3, 2016, December 28, 2014, December 29, 2013 and December 30, 2012. The information in the following table should be read together with our consolidated financial statements and accompanying notes as of January 1, 2017, January 3, 2016 and December 28, 2014 and for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included under Item 7 of this Annual Report. These historical results are not necessarily indicative of the results to be expected in the future. Our fiscal years ended January 1, 2017, December 28, 2014, December 29, 2013, and December 30, 2012 each contained 52 weeks. The fiscal year ended January 3, 2016 contained 53 weeks.

(Dollars in thousands, except share and per share data)	Year ended				
	January 1, 2017	January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012
Statement of operations data:					
Revenues:					
Restaurant sales	\$ 708,956	\$ 684,584	\$ 608,540	\$ 548,980	\$ 507,351
Franchise royalty revenues and fees	2,814	2,808	2,603	2,357	2,375
Total revenues	<u>711,770</u>	<u>687,392</u>	<u>611,143</u>	<u>551,337</u>	<u>509,726</u>
Costs and expenses:					
Cost of sales	214,609	217,328	192,250	176,123	163,514
Restaurant wages and related expenses (including stock-based compensation expense of \$142, \$156, \$71, \$2 and \$11, respectively)	185,305	174,222	155,140	143,392	136,265
Restaurant rent expense	37,493	33,103	29,645	26,849	21,595
Other restaurant operating expenses	96,457	87,285	78,921	69,021	63,813
Advertising expense	26,800	21,617	19,493	17,138	16,791
General and administrative (including stock-based compensation expense of \$3,141, \$4,137, \$3,426, \$2,296 and \$2,025, respectively)	56,084	54,521	49,414	48,521	43,870
Depreciation and amortization	36,776	30,575	23,047	20,375	18,278
Pre-opening costs	5,511	4,567	4,061	2,767	1,673
Impairment and other lease charges	25,644	2,382	363	199	7,039
Other (income) expense, net ⁽¹⁾	(128)	(679)	(558)	(554)	(92)
Total operating expenses	<u>684,551</u>	<u>624,921</u>	<u>551,776</u>	<u>503,831</u>	<u>472,746</u>
Income from operations	27,219	62,471	59,367	47,506	36,980
Interest expense	2,171	1,889	2,228	18,043	24,424
Loss on extinguishment of debt ⁽²⁾	—	—	—	16,411	—
Income before income taxes	25,048	60,582	57,139	13,052	12,556
Provision for income taxes	8,336	22,046	20,963	3,795	4,289
Net income	<u>\$ 16,712</u>	<u>\$ 38,536</u>	<u>\$ 36,176</u>	<u>\$ 9,257</u>	<u>\$ 8,267</u>
Per share data:					
Basic net income per share	\$ 0.62	\$ 1.44	\$ 1.35	\$ 0.39	\$ 0.35
Diluted net income per share	\$ 0.62	\$ 1.44	\$ 1.35	\$ 0.39	\$ 0.35
Weighted average shares outstanding:					
Basic weighted average shares outstanding . . .	26,682,227	26,515,029	26,293,714	23,271,431	22,890,018
Diluted weighted average shares outstanding . .	26,689,179	26,522,196	26,296,049	23,271,431	22,890,018
Other financial data:					
Net cash provided from operating activities . . .	\$ 80,679	\$ 81,352	\$ 64,106	\$ 36,176	\$ 37,975
Net cash used for investing activities	(81,160)	(87,671)	(66,658)	(34,067)	(32,718)
Net cash (used for) provided from financing activities	(604)	6,513	(3,339)	(6,664)	(3,394)
Total capital expenditures	(82,365)	(87,570)	(74,079)	(47,025)	(40,996)

(Dollars in thousands)	Year ended				
	January 1, 2017	January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012
Balance sheet data:					
Total assets	\$441,565	\$ 415,645	\$ 357,956	\$ 318,785	\$ 303,729
Working capital	(19,827)	(15,067)	(14,243)	(8,180)	(12,370)
Long-term debt:					
8.875% Senior Secured Second Lien Notes ⁽²⁾	\$ —	\$ —	\$ —	\$ —	\$ 200,000
Revolving credit facility	69,900	71,000	66,000	71,000	—
Lease financing obligations	1,664	1,663	1,660	1,657	3,029
Capital leases	1,612	1,681	1,325	1,385	949
Total long-term debt	<u>\$ 73,176</u>	<u>\$ 74,344</u>	<u>\$ 68,985</u>	<u>\$ 74,042</u>	<u>\$ 203,978</u>
Stockholders' equity	<u>\$264,175</u>	<u>\$ 243,982</u>	<u>\$ 199,587</u>	<u>\$ 158,306</u>	<u>\$ 10,504</u>
Operating statistics:					
Consolidated:					
Restaurant-Level Adjusted EBITDA ⁽³⁾	\$148,434	\$ 151,185	\$ 133,162	\$ 116,459	\$ 105,384
Restaurant-Level Adjusted EBITDA margin ⁽³⁾	20.9%	22.1%	21.9%	21.2%	20.8%
Adjusted EBITDA ⁽³⁾	92,794	99,042	85,716	69,824	64,241
Adjusted EBITDA margin ⁽³⁾	13.0%	14.4%	14.0%	12.7%	12.6%
Total company-owned restaurants (at end of period)	343	317	291	267	251
Pollo Tropical:					
Company-owned restaurants (at end of period)	177	155	124	102	91
Average number of company-owned restaurants	169.8	138.5	112.3	96.7	89.6
Revenues:					
Restaurant sales	\$399,736	\$ 364,544	\$ 305,404	\$ 257,837	\$ 227,428
Franchise royalty revenues and fees	2,062	2,197	2,072	1,865	1,915
Total revenues	401,798	366,741	307,476	259,702	229,343
Average annual sales per company-owned restaurant ⁽⁴⁾	2,354	2,585	2,720	2,666	2,538
Restaurant-Level Adjusted EBITDA ⁽³⁾	90,294	90,374	78,960	67,785	58,184
Restaurant-Level Adjusted EBITDA margin ⁽³⁾	22.6%	24.8%	25.9%	26.3%	25.6%
Adjusted EBITDA ⁽³⁾	55,535	59,335	52,721	43,738	38,592
Adjusted EBITDA margin ⁽³⁾	13.8%	16.2%	17.1%	16.8%	16.8%
Change in comparable company-owned restaurant sales ⁽⁵⁾	(1.6)%	3.8%	6.6%	5.9%	8.1%

(Dollars in thousands)	Year ended				
	January 1, 2017	January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012
Taco Cabana:					
Company-owned restaurants (at end of period)	166	162	167	165	160
Average number of company-owned restaurants	163.3	163.9	165.6	163.3	158.3
Revenues:					
Restaurant sales	\$309,220	\$ 320,040	\$ 303,136	\$ 291,143	\$ 279,923
Franchise royalty revenues and fees.	752	611	531	492	460
Total revenues	309,972	320,651	303,667	291,635	280,383
Average annual sales per company-owned restaurant ⁽⁵⁾	1,894	1,920	1,831	1,783	1,768
Restaurant-Level Adjusted EBITDA ⁽³⁾	58,140	60,811	54,202	48,674	47,200
Restaurant-Level Adjusted EBITDA margin ⁽³⁾	18.8%	19.0%	17.9%	16.7%	16.9%
Adjusted EBITDA ⁽³⁾	38,081	39,707	32,995	26,086	25,649
Adjusted EBITDA margin ⁽³⁾	12.3%	12.4%	10.9%	8.9%	9.1%
Change in comparable company-owned restaurant sales ⁽⁵⁾	(2.5)%	4.4%	3.3%	0.5%	4.7%

- (1) Other (income) expense, net for the year ended January 1, 2017, includes additional proceeds related to a location that closed in 2015 as a result of an eminent domain proceeding, partially offset by costs for the removal of signs and equipment related to the closure of 10 Pollo Tropical restaurants in the fourth quarter of 2016. Other income for the year ended January 3, 2016 consisted primarily of a previously deferred gain of \$0.4 million from a sale-leaseback transaction that was recognized upon termination of the lease as a result of an eminent domain proceeding and expected business interruption proceeds of \$0.3 million related to a Pollo Tropical that was temporarily closed due to a fire. Other income for the year ended December 28, 2014 consisted primarily of a gain of \$0.6 million from a condemnation award resulting from an eminent domain proceeding related to a location that closed in 2014. Other income for the year ended December 29, 2013 resulted primarily from a gain of \$0.5 million from the sale of a non-operating Pollo Tropical restaurant property. Other income for the year ended December 30, 2012 also resulted from a gain of \$0.1 million from the sale of a non-operating Pollo Tropical restaurant property.
- (2) In the year ended December 29, 2013, we completed a tender offer and consent solicitation for all of our outstanding \$200.0 million 8.875% Senior Secured Second Lien Notes due 2016 (“Notes”) and called for redemption and redeemed all of our Notes that were not validly tendered and accepted for payment in the tender offer. We recognized a loss on extinguishment of debt of \$16.4 million in the fourth quarter of 2013 related to the repurchase and redemption of the Notes. The loss on extinguishment of debt includes the write-off of \$3.9 million in deferred financing costs related to the Notes and \$12.5 million of debt redemption premiums, consent payments, additional interest and other fees related to the redemption of the Notes.
- (3) Adjusted EBITDA is defined as earnings before interest, loss on extinguishment of debt, income taxes, depreciation and amortization, impairment and other lease charges, stock-based compensation expense and other income and expense. Adjusted EBITDA for each of our Pollo Tropical and Taco Cabana segments includes an allocation of general and administrative expenses associated with administrative support for executive management, information systems and certain accounting, legal, supply chain, human resources, development and other administrative functions. Adjusted EBITDA margin is derived by dividing Adjusted EBITDA by total revenues.

Restaurant-Level Adjusted EBITDA is defined as Adjusted EBITDA excluding franchise royalty revenue and fees, pre-opening costs and general and administrative expense (including corporate-level general and administrative expenses). Restaurant-Level Adjusted EBITDA margin is derived by dividing Restaurant-Level Adjusted EBITDA by restaurant sales.

Adjusted EBITDA, Adjusted EBITDA margin, Restaurant-Level Adjusted EBITDA and Restaurant-Level Adjusted EBITDA margin are non-GAAP financial measures. Management believes that such financial measures, when viewed with our results of operations calculated in accordance with GAAP and our reconciliation of Restaurant-Level Adjusted EBITDA and Adjusted EBITDA to net income (i) provide useful information about our operating performance and period-over-period growth, (ii) provide additional information that is useful for evaluating the operating performance of our business, and (iii) permit investors to gain an understanding of the factors and trends affecting our ongoing earnings, from which capital investments are made and debt is serviced. However, such measures are not measures of financial performance or liquidity under GAAP and, accordingly should not be considered as alternatives to net income 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.

A reconciliation from consolidated net income to Restaurant-Level Adjusted EBITDA and Adjusted EBITDA is presented below:

(Dollars in thousands)	Year ended				
	January 1, 2017	January 3, 2016	December 28, 2014	December 29, 2013	December 30, 2012
Net income	\$ 16,712	\$ 38,536	\$ 36,176	\$ 9,257	\$ 8,267
Add:					
Depreciation and amortization	36,776	30,575	23,047	20,375	18,278
Impairment and other lease charges	25,644	2,382	363	199	7,039
Interest expense	2,171	1,889	2,228	18,043	24,424
Loss on extinguishment of debt	—	—	—	16,411	—
Provision for income taxes	8,336	22,046	20,963	3,795	4,289
Stock-based compensation expense	3,283	4,293	3,497	2,298	2,036
Other (income) expense, net	(128)	(679)	(558)	(554)	(92)
Adjusted EBITDA:					
Pollo Tropical	\$ 55,535	\$ 59,335	\$ 52,721	\$ 43,738	\$ 38,592
Taco Cabana	38,081	39,707	32,995	26,086	25,649
Fiesta	(822)	—	—	—	—
Consolidated	92,794	99,042	85,716	69,824	64,241
Add:					
Pre-opening costs	5,511	4,567	4,061	2,767	1,673
General and administrative (excluding stock-based compensation expense of \$3,141, \$4,137, \$3,426, \$2,296 and \$2,025, respectively)	52,943	50,384	45,988	46,225	41,845
Less:					
Franchise royalty revenue and fees	2,814	2,808	2,603	2,357	2,375
Restaurant-Level Adjusted EBITDA:					
Pollo Tropical	\$ 90,294	\$ 90,374	\$ 78,960	\$ 67,785	\$ 58,184
Taco Cabana	58,140	60,811	54,202	48,674	47,200
Consolidated	148,434	151,185	133,162	116,459	105,384

- (4) Average annual sales per company-owned restaurant are derived by dividing restaurant sales for the applicable segment by the average number of company-owned and operated restaurants. For comparative purposes, the calculation of average annual sales per company-owned restaurant is based on a 52-week fiscal year. Restaurant sales data for the extra week in the fiscal year ended January 3, 2016 have been excluded for purposes of calculating average annual sales per company-owned restaurant.
- (5) Restaurants are included in comparable restaurant sales after they have been open for 18 months. For comparative purposes, the calculation of the changes in comparable restaurant sales is based on a 52-week fiscal year. Restaurant sales for the extra week in the fiscal year ended January 3, 2016 have been excluded for purposes of calculating the change in comparable company-owned restaurant sales.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of financial condition and results of operations ("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 consolidated financial statements and the accompanying financial statement notes. Any reference to restaurants refers to company-owned restaurants unless otherwise indicated.

On May 7, 2012, Carrols Restaurant Group, Inc. ("Carrols") completed the spin-off of Fiesta into an independent public company, through the distribution of all of the outstanding shares of Fiesta Restaurant Group's common stock to the stockholders of Carrols ("the Spin-off"). As a result of the Spin-off, we became an independent public company whose common stock is traded on The NASDAQ Global Select Market under the symbol "FRGI."

We use a 52-53 week fiscal year ending on the Sunday closest to December 31. The fiscal years ended January 1, 2017 and December 28, 2014 each contained 52 weeks. The fiscal year ended January 3, 2016 contained 53 weeks.

Company Overview

We own, operate and franchise two fast-casual restaurant brands, Pollo Tropical® and Taco Cabana®, which have almost 30 years and 40 years, respectively, of operating history and loyal customer bases in their core markets. Our Pollo Tropical restaurants offer a wide variety of freshly prepared Caribbean inspired food, while our Taco Cabana restaurants offer a broad selection of freshly prepared Mexican inspired food. We believe that both brands are differentiated from other restaurant concepts and offer a unique dining experience. We are positioned within the value-oriented fast-casual restaurant segment, which combines the convenience and value of quick-service restaurants with the variety, food quality, décor and atmosphere more typical of casual dining restaurants. Our open display kitchen format allows guests to view and experience our food being freshly-prepared and cooked to order. Additionally, nearly all of our restaurants offer the convenience of drive-thru windows. As of January 1, 2017, our company-owned restaurants included 177 Pollo Tropical restaurants and 166 Taco Cabana restaurants.

We franchise our Pollo Tropical restaurants primarily internationally and as of January 1, 2017, we had 29 franchised Pollo Tropical restaurants located in Puerto Rico, Trinidad & Tobago, the Bahamas, Venezuela, Panama, Guatemala and Guyana and six licensed locations on college campuses and at a hospital in Florida. We have agreements for the continued development of franchised Pollo Tropical restaurants in certain of our existing franchised markets.

As of January 1, 2017, we had five franchised Taco Cabana restaurants located in New Mexico and two non-traditional Taco Cabana licensed locations on college campuses in Texas.

Events Affecting our Results of Operations

In 2016, we decided to suspend additional development of Pollo Tropical restaurants outside of Florida and to review our development strategy while we continue to build brand awareness, affinity and off premise consumption through several initiatives. Based on a restaurant portfolio examination, we closed ten Pollo Tropical restaurants in the fourth quarter of 2016 including eight restaurants in Texas, one restaurant in Nashville, Tennessee and one restaurant in Atlanta, Georgia. We plan to convert up to three of the closed restaurants in Texas to Taco Cabana restaurants in 2017.

In 2016, we recognized impairment charges with the respect to ten closed restaurants and seven additional Pollo Tropical restaurants and seven Taco Cabana restaurants that we continue to operate. Impairment and other lease charges for the twelve months ended January 1, 2017 were \$25.6 million and included impairment charges of \$22.7 million and lease and other charges related to closed restaurants of \$2.9 million. The ten closed restaurants contributed approximately \$5.3 million in operating losses to income from operations for the twelve months ended January 1, 2017.

The restaurant industry experienced a continued general slowdown in 2016, that further declined in the fourth quarter. We believe the challenging market and industry conditions and, in the case of Pollo Tropical, sales cannibalization from new restaurants on existing restaurants contributed to a decline in comparable restaurant transactions and sales in 2016.

Executive Summary-Consolidated Operating Performance for the Year Ended January 1, 2017

Our fiscal year 2016 results include the following:

- Net income decreased \$21.8 million to \$16.7 million in 2016, or \$0.62 per diluted share, compared to net income of \$38.5 million, or \$1.44 per diluted share in 2015, due primarily to impairment and other lease charges, new restaurant performance, lower comparable restaurant sales and the extra week in our 2015 fiscal year.
- Total revenues increased 3.5% in 2016 to \$711.8 million from \$687.4 million in 2015, driven primarily by a net increase in the number of company-owned restaurants, partially offset by a decrease in comparable restaurant sales of 1.6% for our Pollo Tropical restaurants and 2.5% for our Taco Cabana restaurants and the extra week in our 2015 fiscal year. The decrease in comparable restaurant sales resulted primarily from a decrease in comparable restaurant transactions of 3.6% at Taco Cabana and 3.1% at Pollo Tropical, partially offset by an increase in average check of 1.1% at Taco Cabana and 1.5% at Pollo Tropical. Comparable restaurant transactions at Pollo Tropical was negatively impacted by sales cannibalization as a result of opening new restaurants in close proximity to existing restaurants of 1.5%.
- During 2016, we opened 32 new company-owned Pollo Tropical restaurants and four new company-owned Taco Cabana restaurants and permanently closed ten company-owned Pollo Tropical restaurants.

Results of Operations

The following table sets forth, for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, selected consolidated operating results as a percentage of consolidated restaurant sales and selected segment operating results as a percentage of applicable segment restaurant sales:

	Year Ended								
	January 1, 2017	January 3, 2016	December 28, 2014	January 1, 2017	January 3, 2016	December 28, 2014	January 1, 2017	January 3, 2016	December 28, 2014
	Pollo Tropical			Taco Cabana			Consolidated		
Restaurant sales:									
Pollo Tropical							56.38%	53.25%	50.19%
Taco Cabana							43.62%	46.75%	49.81%
Consolidated restaurant sales							100.0%	100.0%	100.0%
Costs and expenses:									
Cost of sales	31.7%	33.4%	32.9%	28.5%	29.9%	30.3%	30.3%	31.7%	31.6%
Restaurant wages and related expenses	23.5%	22.4%	22.1%	29.5%	28.9%	28.9%	26.1%	25.4%	25.5%
Restaurant rent expense	5.0%	4.4%	4.1%	5.7%	5.3%	5.7%	5.3%	4.8%	4.9%
Other restaurant operating expenses	13.6%	12.4%	12.6%	13.7%	13.1%	13.4%	13.6%	12.8%	13.0%
Advertising expense	3.7%	2.6%	2.5%	3.9%	3.8%	3.9%	3.8%	3.2%	3.2%
Pre-opening costs	1.2%	1.2%	1.1%	0.2%	0.1%	0.2%	0.8%	0.7%	0.7%

The following table summarizes the changes in the number and mix of Pollo Tropical and Taco Cabana company-owned and franchised restaurants in each fiscal year:

	2016			2015			2014		
	Owned	Franchised	Total	Owned	Franchised	Total	Owned	Franchised	Total
Pollo Tropical:									
Beginning of year	155	35	190	124	37	161	102	39	141
New	32	4	36	32	1	33	22	5	27
Closed	(10)	(4)	(14)	(1)	(3)	(4)	—	(7)	(7)
End of year	177	35	212	155	35	190	124	37	161
Taco Cabana:									
Beginning of year	162	6	168	167	7	174	165	7	172
New	4	1	5	2	—	2	4	—	4
Closed	—	—	—	(7)	(1)	(8)	(2)	—	(2)
End of year	166	7	173	162	6	168	167	7	174

Consolidated Revenues. Revenues include restaurant sales and franchise royalty revenues and fees. Restaurant sales consist of food and beverage sales, net of discounts, at our company-owned restaurants. Franchise royalty revenues and fees represent ongoing royalty payments that are determined based on a percentage of franchisee sales, franchise fees associated with new restaurant openings, and development fees associated with the opening of new franchised restaurants in a given market. Restaurant sales are influenced by new restaurant openings, closures of restaurants and changes in comparable restaurant sales.

Total revenues increased 3.5% to \$711.8 million in 2016 from \$687.4 million in 2015, while the 2015 revenues represent an increase of 12.5% from \$611.1 million in 2014. Restaurant sales also increased 3.6% to \$709.0 million in 2016 from \$684.6 million in 2015, which represents an increase of 12.5% from \$608.5 million in 2014. Restaurant sales in 2015 contained 53 weeks which increased sales by \$11.8 million for the additional week in 2015.

The following table presents the primary drivers of the increase or decrease in restaurant sales for both Pollo Tropical and Taco Cabana (in millions):

	<u>2016 vs. 2015</u>	<u>2015 vs. 2014</u>
Pollo Tropical:		
(Decrease) increase in comparable restaurant sales	\$ (5.2)	\$ 10.7
Incremental sales related to new restaurants, net of closed restaurants	46.9	41.9
Additional week in 2015	(6.5)	6.5
Total increase	<u>\$ 35.2</u>	<u>\$ 59.1</u>
Taco Cabana:		
(Decrease) increase in comparable restaurant sales	\$ (7.7)	\$ 12.9
Incremental sales related to new restaurants, net of closed restaurants	2.2	(1.3)
Additional week in 2015	(5.3)	5.3
Total (decrease) increase	<u>\$ (10.8)</u>	<u>\$ 16.9</u>

Comparable restaurant sales for Pollo Tropical restaurants decreased 1.6% in 2016 and increased 3.8% in 2015. Comparable restaurant sales for Taco Cabana restaurants decreased 2.5% in 2016 and increased 4.4% in 2015. Restaurants are included in comparable restaurant sales after they have been open for 18 months. For comparative purposes, the calculation of the changes in comparable restaurant sales is based on a 52-week fiscal year. Restaurant sales for the extra week in the fiscal year ended January 3, 2016 have been excluded for purposes of calculating the change in comparable company-owned restaurant sales. Increases or decreases in comparable restaurant sales result primarily from an increase or decrease in comparable restaurant transactions and in average check. The increase in average check is primarily driven by menu price increases. For Pollo Tropical, a decrease in comparable restaurant transactions of 3.1% was partially offset by menu price increases of 1.4% in 2016 as compared to 2015. For Pollo Tropical, menu price increases drove an increase in restaurant sales of 4.7% in 2015 as compared to 2014, partially offset by a decrease in average check due to sales mix and higher discounting. As a result of new restaurant openings, sales cannibalization of existing restaurants negatively impacted comparable restaurant sales for Pollo Tropical by 1.5% in 2016. For Taco Cabana, a decrease in comparable restaurant transactions of 3.6% was partially offset by menu price increases of 2.2% in 2016 as compared to 2015, partially offset by a decrease in average check driven by a negative change in sales mix. For Taco Cabana, menu price increases drove an increase in restaurant sales of 3.0% in 2015 as compared to 2014, and the remaining increase in average check was primarily driven by a positive change in sales mix due to the implementation of new menu boards during the first quarter of 2015. Comparable restaurant sales for both brands continue to be negatively impacted by the general industrywide slowdown in restaurant sales.

Restaurants in newer markets that have not reached media efficiency generally have lower sales than restaurants in mature, media-efficient markets. As a result, Pollo Tropical revenues are growing at a slower rate than the average number of restaurants.

Franchise revenues remained relatively stable and were \$2.8 million in 2016 and 2015. Franchise revenues were \$2.6 million in 2014.

Operating costs and expenses. Operating costs and expenses include cost of sales, restaurant wages and related expenses, other restaurant expenses and advertising expenses. Cost of sales consists of food, paper and beverage costs including packaging costs, less rebates and purchase discounts. Cost of sales is generally influenced by changes in commodity costs, the sales mix of items sold and the effectiveness of our restaurant-level controls to

manage food and paper costs. Key commodities, including chicken and beef, are generally purchased under contracts for future periods of up to one year.

Restaurant wages and related expenses include all restaurant management and hourly productive labor costs, employer payroll taxes, restaurant-level bonuses and related benefits. Payroll and related taxes and benefits are subject to inflation, including minimum wage increases and increased costs for health insurance, workers' compensation insurance and state unemployment insurance.

Other restaurant operating expenses include all other restaurant-level operating costs, the major components of which are utilities, repairs and maintenance, general liability insurance, real estate taxes, sanitation, supplies and credit card fees.

Advertising expense includes all promotional expenses including television, radio, billboards and other sponsorships and promotional activities.

Pre-opening costs include costs incurred prior to opening a restaurant, including restaurant employee wages and related expenses, travel expenditures, recruiting, training, promotional costs associated with the restaurant opening and rent, including any non-cash rent expense recognized during the construction period. Pre-opening costs are generally incurred beginning four to six months prior to a restaurant opening.

The following tables present the primary drivers of the changes in the components of restaurant operating margins for Pollo Tropical and Taco Cabana. All percentages are stated as a percentage of applicable segment restaurant sales.

	<u>2016 vs. 2015</u>	<u>2015 vs. 2014</u>
Pollo Tropical:		
Cost of sales:		
(Lower) higher commodity costs	(0.8)%	1.7%
Sales mix	(0.9)%	(0.2)%
Menu price increases	(0.5)%	(1.4)%
Operating inefficiencies	0.3%	0.4%
Other	0.2%	—%
Net (decrease) increase in cost of sales as a percentage of restaurant sales	<u>(1.7)%</u>	<u>0.5%</u>
Restaurant wages and related expenses:		
Impact of lower sales volumes and higher labor costs for new restaurants	0.8%	1.0%
Impact of lower (higher) sales volumes and higher labor costs for comparable restaurants	0.5%	(0.6)%
Higher workers compensation costs	0.1%	0.2%
Lower incentive bonus costs	(0.2)%	(0.2)%
Lower medical benefit costs	(0.1)%	(0.1)%
Net increase in restaurant wages and related expenses as a percentage of restaurant sales	<u>1.1%</u>	<u>0.3%</u>
Other operating expenses: ⁽¹⁾		
Higher (lower) repairs and maintenance costs	0.4%	(0.2)%
Higher real estate taxes generally related to new restaurants	0.3%	0.1%
Other	0.5%	(0.1)%
Net increase (decrease) in other restaurant operating expenses as a percentage of restaurant sales	<u>1.2%</u>	<u>(0.2)%</u>
Advertising expense:		
Increase in advertising	1.1%	0.1%
Net increase in advertising expense as a percentage of restaurant sales	<u>1.1%</u>	<u>0.1%</u>
Pre-opening costs:		
Increase in number and timing of restaurants openings	—%	0.1%
Net increase in pre-opening costs as a percentage of restaurant sales	<u>—%</u>	<u>0.1%</u>

(1) Includes the impact of lower sales at new restaurants.

	<u>2016 vs. 2015</u>	<u>2015 vs. 2014</u>
Taco Cabana:		
Cost of sales:		
(Lower) higher commodity costs	(1.1)%	0.7%
Menu price increases	(0.7)%	(1.0)%
Menu board changes	—%	(0.4)%
Higher promotions and discounts	0.2%	0.3%
Higher operating inefficiencies	0.2%	—%
Net decrease in cost of sales as a percentage of restaurant sales	<u>(1.4)%</u>	<u>(0.4)%</u>
Restaurant wages and related expenses:		
Impact of lower sales volumes and higher labor costs	1.1%	—%
(Lower) higher medical benefit costs	(0.2)%	0.2%
Lower incentive bonus costs	(0.2)%	—%
Other	(0.1)%	(0.2)%
Net increase in restaurant wages and related expenses as a percentage of restaurant sales	<u>0.6%</u>	<u>—%</u>
Other operating expenses:		
Lower utility costs	(0.3)%	(0.1)%
Higher (lower) repairs and maintenance costs	0.3%	(0.1)%
Higher (lower) insurance costs	0.2%	(0.1)%
Other	0.4%	—%
Net increase (decrease) in other restaurant operating expenses as a percentage of restaurant sales	<u>0.6%</u>	<u>(0.3)%</u>
Advertising expense:		
Impact of higher sales volumes	0.1%	(0.1)%
Net increase (decrease) in advertising expense as a percentage of restaurant sales	<u>0.1%</u>	<u>(0.1)%</u>
Pre-opening costs:		
Increase (decrease) in number of restaurants opened	0.1%	(0.1)%
Net increase (decrease) in pre-opening costs as a percentage of restaurant sales	<u>0.1%</u>	<u>(0.1)%</u>

Consolidated Restaurant Rent Expense. Restaurant rent expense includes base rent and contingent rent on our leases characterized as operating leases, reduced by amortization of gains on sale-leaseback transactions. Restaurant rent expense, as a percentage of total restaurant sales, increased to 5.3% in 2016 from 4.8% in 2015, primarily as a result of new restaurants that generally have higher rent and lower sales, and the impact of lower comparable restaurant sales. Restaurant rent expense, as a percentage of total restaurant sales, was 4.9% in 2014. The impact of new sale-leaseback transactions and new restaurants was offset by the impact of higher sales in 2015 compared to 2014 as a percentage of restaurant sales.

Consolidated General and Administrative Expenses. General and administrative expenses are comprised primarily of (1) salaries and expenses associated with the development and support of our company and brands and the management oversight of the operation of our restaurants; and (2) legal, auditing and other professional fees and stock-based compensation expense.

General and administrative expenses increased to \$56.1 million in 2016 from \$54.5 million in 2015 and as a percentage of total revenues, were 7.9% in 2016 and 2015 due primarily to the impact of higher sales and lower incentive-based compensation costs, partially offset by higher labor costs associated with current and future growth. In addition, general and administrative expenses in 2016 include \$1.6 million in financial and legal advisory fees, primarily related to a review of strategic alternatives, the write-off of \$1.3 million of site costs related to locations that we decided not to develop and a charge for estimated costs related to a class action litigation settlement plus legal and other fees incurred in defending the action totaling \$0.9 million, partially offset by the benefit of \$0.6 million related to litigation matters. General and administrative expenses in 2015 include a charge for estimated

costs related to a class action lawsuit settlement plus legal and other fees incurred in defending the action totaling \$1.6 million and the write-off of \$0.4 million of site costs related to locations that we decided not to develop.

General and administrative expenses increased to \$54.5 million in 2015 from \$49.4 million in 2014, but as a percentage of total revenues, decreased to 7.9% compared to 8.1% in 2014. The impact of higher sales on fixed costs was partially offset by additional costs for brand and corporate personnel and training to support the ongoing Pollo Tropical expansion into new markets and the impact of legal settlements and related costs. General and administrative expenses in 2014 included the benefit of a \$0.5 million payment received as a settlement of a litigation matter.

Adjusted EBITDA. Adjusted EBITDA, which is one of the measures of segment profit or loss used by our chief operating decision maker for purposes of allocating resources to our segments and assessing their performance, is defined as earnings attributable to the applicable segment before interest, income taxes, depreciation and amortization, impairment and other lease charges, stock-based compensation expense and other income and expense. Adjusted EBITDA may not necessarily be comparable to other similarly titled captions of other companies due to differences in methods of calculation. Adjusted EBITDA for each of our segments includes an allocation of general and administrative expenses associated with administrative support for executive management, information systems and certain accounting, legal, supply chain, human resources, development and other administrative functions. Adjusted EBITDA is a non-GAAP financial measure of performance. For a discussion of our use of Adjusted EBITDA and a reconciliation from net income to Adjusted EBITDA, see the heading entitled “Management’s Use of Non-GAAP Financial Measures”.

Adjusted EBITDA for our Pollo Tropical restaurants decreased to \$55.5 million in 2016 from \$59.3 million in 2015 primarily as a result of lower profitability at new restaurants, the impact of lower comparable restaurant sales, higher operating expenses and the write-off of site costs related to locations that we decided not to develop partially offset by a decrease in legal settlements and related costs and cost of sales as a percentage of sales. Adjusted EBITDA for our Taco Cabana restaurants decreased to \$38.1 million in 2016 from \$39.7 million in 2015 due primarily to the net impact of the decrease in revenues partially offset by a decrease in cost of sales as a percentage of sales.

Adjusted EBITDA for our Pollo Tropical restaurants increased to \$59.3 million in 2015 from \$52.7 million in 2014 due primarily to the net impact of the increase in revenues, partially offset by legal settlements and related costs and an increase in pre-opening costs. Adjusted EBITDA for our Taco Cabana restaurants increased to \$39.7 million in 2015 from \$33.0 million in 2014 due primarily to the net impact of the increase in revenues

Depreciation and Amortization. Depreciation and amortization expense increased to \$36.8 million in 2016 from \$30.6 million in 2015 due primarily to increased depreciation relating to new company-owned restaurant openings. Depreciation and amortization expense increased to \$30.6 million in 2015 from \$23.0 million in 2014 also due primarily to increased depreciation relating to new company-owned restaurant openings.

Impairment and Other Lease Charges. As discussed under Events Affecting our Results of Operations, we reviewed our restaurant portfolio during the third quarter of 2016 and subsequently closed ten Pollo Tropical restaurants in the fourth quarter of 2016, three of which will be converted to Taco Cabana restaurants in 2017. Impairment and other lease charges were \$25.6 million in 2016 and consisted of impairment charges totaling \$21.6 million primarily for ten closed Pollo Tropical restaurants and seven Pollo Tropical restaurants that we continue to operate and \$1.1 million for seven Taco Cabana restaurants that we continue to operate, as well as lease charges totaling \$2.9 million primarily related to the closed restaurants.

Impairment and other lease charges were \$2.4 million in 2015 and consisted primarily of impairment charges totaling \$1.7 million and a \$0.2 million lease charge related to the closure of a Pollo Tropical restaurant at the end of fiscal 2015, a \$0.3 million lease charge related to the closure of a Pollo Tropical restaurant that was relocated prior to the end of its lease term to a superior site in the same trade area and lease charges, net of recoveries, totaling \$0.2 million related to previously closed Pollo Tropical restaurants.

Impairment and other lease charges were \$0.4 million in 2014 and consisted primarily of a \$0.3 million impairment charge representing the write-down of the carrying value to fair value of certain assets related to the Pollo Tropical restaurant that closed in 2015 and \$0.1 million in impairment charges for additional assets acquired at previously impaired Taco Cabana restaurants.

Each quarter we assess the potential impairment of any long-lived assets that have experienced a triggering event, including restaurants for which the related trailing twelve month cash flows are below a certain threshold. Refer to Impairment of Long-Lived Assets under Application of Critical Accounting Policies for additional information about our impairment assessment process.

Thirteen Pollo Tropical restaurants open more than twelve months in markets outside of Florida with a combined carrying value of \$22.0 million have projected cash flows that exceed the restaurant's carrying value by a small margin. The thirteen restaurants contributed approximately \$6.1 million in operating losses to income from operations, including \$2.7 million in depreciation expense, for the twelve months ended January 1, 2017. In addition, 16 Pollo Tropical restaurants opened during 2016 in markets outside of Florida with a combined carrying value of \$30.2 million have initial sales volumes lower than expected, but do not have significant operating history to form a good basis for future projections. The 16 restaurants contributed approximately \$6.0 million in operating losses to income from operations, including \$1.5 million in depreciation expense and \$2.9 million in preopening costs, for the twelve months ended January 1, 2017.

In addition, three Taco Cabana restaurants with a combined carrying value of \$2.5 million have projected cash flows, that exceed the restaurants carrying value by a small margin. These restaurants contributed approximately \$0.4 million in operating losses to income from operations, including \$0.3 million in depreciation expense, for the twelve months ended January 1, 2017.

For these restaurants, if expected performance improvements are not realized, an impairment charge may be recognized in future periods, and such charge could be material.

Other (Income) Expense, Net. Other (income) expense, net in 2016 consisted primarily of additional proceeds related to a location that closed in 2015 as a result of an eminent domain proceeding, partially offset by costs for the removal of signs and equipment related to the closure of 10 Pollo Tropical restaurants in the fourth quarter of 2016. Other income in 2015 consisted primarily of a previously deferred gain from a sale-leaseback transaction that was recognized upon termination of the lease as a result of an eminent domain proceeding and expected business interruption insurance proceeds for a Pollo Tropical restaurant that was temporarily closed due to a fire. Other income in 2014 consisted primarily of a gain from a condemnation award resulting from an eminent domain proceeding related to a location that closed in 2014.

Interest Expense. Interest expense increased \$0.3 million to \$2.2 million in 2016 from 2015 due primarily to higher borrowing rates in 2016.

Interest expense decreased \$0.3 million to \$1.9 million in 2015 from 2014 due primarily to lower borrowing rates and higher capitalized interest in 2015.

Provision for Income Taxes. The effective tax rate for 2016 of 33.3% decreased as compared to an effective tax rate for 2015 of 36.4%, due primarily to the impact of tax credits on lower income before taxes and various other changes in permanent items.

The effective tax rate for 2015 of 36.4% decreased as compared to an effective tax rate for 2014 of 36.7%, due primarily to lower state taxes and various other changes in tax credits and permanent items.

Net Income. As a result of the foregoing, we had net income of \$16.7 million in 2016 compared to net income of \$38.5 million in 2015, and \$36.2 million in 2014.

Liquidity and Capital Resources

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

- restaurant operations are primarily conducted on a cash basis;
- rapid turnover results in a limited investment in inventories; and
- cash from sales is usually received before related liabilities for food, supplies and payroll become due.

Capital expenditures and payments related to our lease obligations represent significant liquidity requirements for us. We believe cash generated from our operations, availability of borrowings under our senior credit facility and proceeds from any sale-leaseback transactions which we may choose to do 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 by operating activities for 2016, 2015 and 2014 was \$80.7 million, \$81.4 million and \$64.1 million, respectively. The \$0.7 million decrease in net cash provided by operating activities in 2016 compared to 2015 was driven primarily by the decrease in Adjusted EBITDA and increase in deferred income taxes, partially offset by the timing of payments. The \$17.2 million increase in net cash provided by operating activities in 2015 compared to 2014 was driven primarily by the increase in Adjusted EBITDA and the decrease in deferred income taxes.

Investing Activities. Net cash used in investing activities in 2016, 2015 and 2014 was \$81.2 million, \$87.7 million and \$66.7 million, respectively. Capital expenditures are the largest component of our investing activities and include: (1) new restaurant development, which may include the purchase of real estate; (2) restaurant remodeling/reimaging, which includes the renovation or rebuilding of the interior and exterior of our existing restaurants; (3) other restaurant capital expenditures, which include capital maintenance expenditures for the ongoing reinvestment and enhancement of our restaurants; and (4) corporate and restaurant information systems.

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

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Other</u>	<u>Consolidated</u>
Year ended January 1, 2017:				
New restaurant development	\$ 58,325	\$ 7,791	\$ —	\$ 66,116
Restaurant remodeling	2,755	—	—	2,755
Other restaurant capital expenditures ⁽¹⁾	2,823	4,302	—	7,125
Corporate and restaurant information systems	1,886	1,113	3,370	6,369
Total capital expenditures	<u>\$ 65,789</u>	<u>\$ 13,206</u>	<u>\$ 3,370</u>	<u>\$ 82,365</u>
Number of new restaurant openings	32	4		36
Year ended January 3, 2016:				
New restaurant development	\$ 65,992	\$ 4,849	\$ —	\$ 70,841
Restaurant remodeling	2,757	2,045	—	4,802
Other restaurant capital expenditures ⁽¹⁾	3,299	4,415	—	7,714
Corporate and restaurant information systems	1,081	985	2,147	4,213
Total capital expenditures	<u>\$ 73,129</u>	<u>\$ 12,294</u>	<u>\$ 2,147</u>	<u>\$ 87,570</u>
Number of new restaurant openings	32	2		34
Year ended December 28, 2014:				
New restaurant development	\$ 49,142	\$ 7,960	\$ —	\$ 57,102
Restaurant remodeling	—	7,588	—	7,588
Other restaurant capital expenditures ⁽¹⁾	2,973	2,002	—	4,975
Corporate and restaurant information systems	240	419	3,755	4,414
Total capital expenditures	<u>\$ 52,355</u>	<u>\$ 17,969</u>	<u>\$ 3,755</u>	<u>\$ 74,079</u>
Number of new restaurant openings	22	4	26	

(1) Excludes restaurant repair and maintenance expenses included in other restaurant operating expenses in our consolidated financial statements. For the years ended January 1, 2017, January 3, 2016 and December 28, 2014, total restaurant repair and maintenance expenses were approximately \$18.9 million, \$15.9 million and \$15.0 million, respectively.

In 2017, the Company expects to open 12 new Company-owned Pollo Tropical restaurants in Florida and ten new Company-owned Taco Cabana restaurants in Texas. Three of the new Company-owned Taco Cabana restaurant openings will be closed Pollo Tropical restaurants converted to Taco Cabana restaurants. Total capital expenditures in 2017 are expected to be \$57.0 million to \$68.0 million. Capital expenditures in 2017 are expected to include \$35.0 million to \$43.0 million for development of new restaurants and purchase of related real estate. Our capital expenditures in 2017 are also expected to include expenditures of approximately \$14.0 million to \$16.0 million

for the ongoing reinvestment in our Pollo Tropical and Taco Cabana restaurants for remodeling costs and capital maintenance expenditures and approximately \$8.0 million to \$9.0 million of other expenditures.

In 2016, investing activities also included \$2.7 million for the purchase of a property for a sale-leaseback and a sale-leaseback transaction related to our restaurant properties, the net proceeds from which were \$3.6 million.

In 2014, investing activities included two sale-leaseback transactions related to our restaurant properties, the net proceeds from which were \$5.7 million, as well as the sale of an excess Taco Cabana property and a condemnation award resulting from an eminent domain proceeding, the net proceeds from which totaled \$1.7 million.

Financing Activities. Net cash used in financing activities in 2016 was \$0.6 million, net cash provided by financing activities in 2015 was \$6.5 million and net cash used in financing activities in 2014 was \$3.3 million.

Net cash used in financing activities in 2016 included net repayments of revolving credit borrowings under our senior credit facility of \$1.1 million and the excess tax benefit from vesting of restricted shares of \$0.6 million.

Net cash provided by financing activities in 2015 included net revolving credit borrowings under our senior credit facility of \$5.0 million and the excess tax benefit from vesting of restricted shares of \$1.6 million.

Net cash used in financing activities in 2014 included net repayments of revolving credit borrowings under our senior credit facility of \$5.0 million and the excess tax benefit from vesting of restricted shares of \$1.8 million.

Senior Credit Facility. Our senior credit facility provides for aggregate revolving credit borrowings of up to \$150 million (including \$15 million available for letters of credit) and matures on December 11, 2018. The senior credit facility also provides for potential incremental increases of up to \$50 million to the revolving credit borrowings available under the senior credit facility. On January 1, 2017, there were \$69.9 million in outstanding revolving credit borrowings under our senior credit facility.

Borrowings under the senior credit facility bear interest at a per annum rate, at our option, equal to either (all terms as defined in the senior credit facility):

- 1) the Alternate Base Rate plus the applicable margin of 0.50% to 1.50% based on our Adjusted Leverage Ratio (with a margin of 0.50% as of January 1, 2017), or
- 2) the LIBOR Rate plus the applicable margin of 1.50% to 2.50% based on our Adjusted Leverage Ratio (with a margin of 1.50% at January 1, 2017)

In addition, the senior credit facility requires us to pay (i) a commitment fee based on the applicable Commitment Fee margin of 0.25% to 0.45%, based on our Adjusted Leverage Ratio (with a margin of 0.25% at January 1, 2017) and the unused portion of the facility and (ii) a letter of credit fee based on the applicable LIBOR margin and the dollar amount of outstanding letters of credit.

All obligations under the senior credit facility are guaranteed by all of our material domestic subsidiaries. In general, our obligations under our senior credit facility and our subsidiaries' obligations under the guarantees are secured by a first priority lien and security interest on substantially all of our assets and the assets of our material subsidiaries (including a pledge of all of the capital stock and equity interests of our material subsidiaries), other than certain specified assets, including real property owned by us or our subsidiaries.

The outstanding borrowings under the senior credit facility are prepayable without penalty (other than customary breakage costs). The senior credit facility requires us to comply with customary affirmative, negative and financial covenants, including, without limitation, those limiting our and our subsidiaries' ability to (i) incur indebtedness, (ii) incur liens, (iii) loan, advance, or make acquisitions and other investments or other commitments to construct, acquire or develop new restaurants (subject to certain exceptions), (iv) pay dividends, (v) redeem and repurchase equity interests, (vi) conduct asset and restaurant sales and other dispositions (subject to certain exceptions), (vii) conduct transactions with affiliates and (viii) change our business. In addition, the senior credit facility will require us to maintain certain financial ratios, including minimum Fixed Charge Coverage and maximum Adjusted Leverage Ratios (all as defined under the senior credit facility).

Our senior credit facility contains customary default provisions, including without limitation, a cross default provision pursuant to which it is an event of default under this facility if there is a default under any of our indebtedness having an outstanding principal amount of \$5.0 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.

As of January 1, 2017, we were in compliance with the covenants under our senior credit facility. After reserving \$5.2 million for letters of credit issued under the senior credit facility, \$74.9 million was available for borrowing under the senior credit facility at January 1, 2017.

Contractual Obligations

The following table summarizes our contractual obligations and commitments as of January 1, 2017 (in thousands):

Contractual Obligations	Payments due by period				
	Total	Less than 1 Year	1 – 3 Years	3 – 5 Years	More than 5 Years
Credit facility debt obligations, including interest ⁽¹⁾	\$ 73,545	\$ 1,877	\$ 71,668	\$ —	\$ —
Capital lease obligations, including interest ⁽²⁾	2,973	282	564	587	1,540
Operating lease obligations ⁽³⁾	545,050	43,026	85,164	78,776	338,084
Lease financing obligations, including interest ⁽⁴⁾	2,656	143	290	296	1,927
Purchase obligations ⁽⁵⁾	14,340	2,390	4,780	4,780	2,390
Total contractual obligations	\$ 638,564	\$ 47,718	\$ 162,466	\$ 84,439	\$ 343,941

- (1) Our credit facility debt obligations at January 1, 2017 totaled \$69.9 million. Total interest payments on the obligations of \$3.1 million for all years presented are included at a weighted average interest rate of 2.29%. Total credit facility fees of \$0.5 million for all years presented are included based on January 1, 2017 rates and balances. Actual interest and fee payments will vary based on our outstanding credit facility balances and the rates in effect during those years. Refer to Note 7 of our consolidated financial statements included in this Annual Report on Form 10-K for details of our debt.
- (2) Includes total interest of \$1.4 million for all years presented.
- (3) Represents the aggregate minimum lease payments under operating leases. Many of our leases also require contingent rent based on a percentage of sales in addition to the minimum base rent and require expenses incidental to the use of the property, all of which have been excluded from this table.
- (4) Includes total interest of \$1.0 million for all years presented.
- (5) Represents a contractual obligation for the master subscription agreement for a new ERP system through April 27, 2024.

We have not included in the contractual obligations table payments we may make for workers' compensation, general liability and employee health care claims for which we pay all claims, subject to some annual stop-loss limitations both for individual claims and claims in the aggregate. The majority of our recorded liabilities related to employee health and insurance plans represent estimated reserves for incurred claims that have yet to be filed or settled. We are also party to various service and supply contracts that generally extend approximately twelve months. These arrangements are primarily individual contracts for routine goods and services that are part of our normal operations and are reflected in historical operating cash flow trends. These contract obligations are generally short-term in nature and can be canceled within a reasonable time period, at our option. We do not believe such arrangements will adversely affect our liquidity position.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements other than our operating leases, which are primarily for our restaurant properties and are 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 and energy costs. Labor costs in our restaurants are impacted by changes in the Federal and state hourly minimum wage rates as well as changes in payroll related taxes, including

Federal and state unemployment taxes. We typically attempt to offset the effect of inflation, at least in part, through periodic menu price increases and various cost reduction programs. However, no assurance can be given that we will be able to fully offset such inflationary cost increases in the future.

Application of Critical Accounting Policies

Our 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 our consolidated financial statements. Critical accounting estimates are those that require application of management’s most difficult, subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods.

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

Accrued occupancy costs. We make estimates of accrued occupancy costs pertaining to closed restaurant locations on an ongoing basis. These estimates require assessment and continuous evaluation of a number of factors such as the remaining contractual period under our lease obligations, the amount of sublease income we are able to realize on a particular property and estimates of other costs such as property taxes. Differences between actual future events and prior estimates will result in adjustments to these accrued costs. Total accrued occupancy costs pertaining to closed restaurant locations was \$4.9 million at January 1, 2017.

Insurance liabilities. We are insured for workers’ compensation, general liability and medical insurance claims under policies where we pay all claims, subject to annual stop-loss limitations both for individual claims and for general liability and certain workers’ compensation claims in the aggregate. At January 1, 2017, we had \$9.3 million accrued for these insurance claims. We record insurance liabilities based on historical and industry trends, which are continually monitored, with the assistance of actuaries, and adjust accruals as warranted by changing circumstances. Since there are estimates and assumptions inherent in recording these insurance liabilities, including the ability to estimate the future development of incurred claims based on historical trends or the severity of the claims, differences between actual future events and prior estimates and assumptions could result in adjustments to these liabilities.

Evaluation of Goodwill. We must evaluate our recorded goodwill for impairment on an ongoing basis. We have elected to conduct our annual impairment review of goodwill assets as of the last day of our fiscal year. Our review at January 1, 2017 indicated there was no impairment as of that date. In reviewing goodwill for impairment, we compare the net book values of our reporting units to their estimated fair values. In determining the estimated fair values of the reporting units, we employ a combination of a discounted cash flow analysis and a market-based approach. Assumptions include our anticipated growth rates and the weighted average cost of capital. The results of these analyses are corroborated with other value indicators where available, such as comparable company earnings multiples. This annual evaluation of goodwill requires us to make estimates and assumptions to determine the fair value of our reporting units including projections regarding future operating results and market values. We had two reporting units with goodwill balances as of our most recent measurement date. The fair value exceeded the carrying value of our respective reporting units by substantial amounts for both our Pollo Tropical and our Taco Cabana segments. These estimates may differ from actual future events and if these estimates or related projections change in the future, we may be required to record impairment charges for these assets.

Impairment of Long-lived Assets. We assess the potential impairment of long-lived assets, principally property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In addition to considering management's plans, known regulatory/governmental actions and damage due to acts of God (hurricanes, tornadoes, etc.), we consider an event indicating that the carrying value may not be recoverable to have occurred related to a specific restaurant if the restaurant's cash flows for the last twelve months are less than a minimum threshold or if consistent levels of cash flows for the remaining lease period are less than the carrying value of the restaurant's assets. We determine if there is impairment at the restaurant level by comparing undiscounted future cash flows from the related long-lived assets to their respective carrying values. In determining future cash flows, significant estimates are made by us with respect to future operating results of each restaurant over its remaining lease term, including sales trends, labor rates, commodity costs and other operating cost assumptions. If assets are determined to be impaired, the impairment charge is measured by calculating the amount by which the asset carrying amount exceeds its fair value. This process of assessing fair values requires the use of estimates and assumptions, including our ability to sell or reuse the related assets and market conditions, which are subject to a high degree of judgment. If these assumptions change in the future, we may be required to record impairment charges for these assets and these charges could be material.

As discussed under Events Affecting our Results of Operations, during the third quarter we reviewed our restaurant portfolio and subsequently closed ten Pollo Tropical restaurants in the fourth quarter of 2016, three of which will be converted to Taco Cabana restaurants in 2017. Impairment and other lease charges were \$25.6 million in 2016 and consisted of impairment charges totaling \$21.6 million primarily for ten closed Pollo Tropical restaurants and seven Pollo Tropical restaurants that we continue to operate and \$1.1 million for seven Taco Cabana restaurants that we continue to operate, as well as lease charges totaling \$2.9 million primarily related to the closed restaurants.

Many new restaurants in its emerging markets have opened at lower sales volumes and have not yet achieved the sales volumes required to generate positive cash flows. Pollo Tropical's emerging markets include Atlanta, Nashville and Texas. Generally, restaurants in Atlanta have performed better than restaurants in Nashville and Texas due primarily to higher average sales volumes and lower average wage rates, rent expense and real estate taxes. The combined carrying values of the restaurants in Atlanta, Nashville and Texas are \$26.7 million, \$3.2 million and \$48.3 million, respectively.

We have initiated operational and transactional growth plans to drive improved performance in these markets and will continue to evaluate their long-term viability. Our estimates of future cash flows for restaurants that were not impaired assume these plans will succeed and sales will reach the levels required to generate cash flows that exceed the carrying value of the restaurants. Our cash flow projections include, among other things, significant sales growth as the result of the introduction of broadcast media, dedicated sales positions to build our catering business, increased frequency with the launch of our loyalty program, third party delivery and local store marketing. If these assumptions change in the future or the performance of these restaurants does not improve as projected, an impairment charge could be recognized in future periods, and such charge could be material.

Thirteen Pollo Tropical restaurants open more than twelve months in markets outside of Florida with a combined carrying value of \$22.0 million have projected cash flows that exceed the restaurant's carrying value by a small margin. The thirteen restaurants contributed approximately \$6.1 million in operating losses to income from operations, including \$2.7 million in depreciation expense, for the twelve months ended January 1, 2017. In addition, 16 Pollo Tropical restaurants opened during 2016 in markets outside of Florida with a combined carrying value of \$30.2 million have initial sales volumes lower than expected, but do not have significant operating history to form a good basis for future projections. The 16 restaurants contributed approximately \$6.0 million in operating losses to income from operations, including \$1.5 million in depreciation expense and \$2.9 million in preopening costs, for the twelve months ended January 1, 2017.

In addition, three Taco Cabana restaurants with a combined carrying value of \$2.5 million have projected cash flows that exceed the restaurants carrying value by a small margin. These restaurants contributed approximately \$0.4 million in operating losses to income from operations, including \$0.3 million in depreciation expense, for the twelve months ended January 1, 2017.

For these restaurants, if expected performance improvements described above are not realized, an impairment charge may be recognized in future periods, and such charge could be material.

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

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

New Accounting Pronouncements

In May 2014, and in subsequent updates, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which amends the guidance in former Topic 605, Revenue Recognition, and provides for either a full retrospective adoption in which the standard is applied to all of the periods presented or a modified retrospective adoption in which the cumulative effect of initially applying the standard is recognized at the date of initial application. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers unless the contracts are in the scope of other US GAAP requirements. The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property and equipment, including real estate. We are currently evaluating the impact of the provisions of Topic 606; however, we do not believe the standard will impact our recognition of revenue from company-owned restaurants or our recognition of franchise royalty revenues, which are based on a percent of gross sales. We expect the provisions to primarily impact franchise and development fees as well as gift card programs and do not expect the standard to have a material effect on our financial statements. We do not plan to early adopt the standard and we plan to use the modified retrospective approach to adopt the standard. For us, the new standard is effective for interim and annual periods beginning after December 15, 2017.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessee recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. For the Company, the new standard is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. A modified retrospective approach is required with an option to use certain practical expedients. The new guidance is required to be applied at the beginning of the earliest comparative period presented. We are currently evaluating the impact on our financial statements. Although the impact is not currently estimable, we expect to recognize lease assets and lease liabilities for most of the leases we currently account for as operating leases. In addition, for our leases that are classified as sale-leaseback transactions, we will be required to record an initial adjustment to retained earnings associated with the previously deferred gains, and for any future sale-leaseback transactions, the gain, adjusted for any off-market terms, will be recorded immediately. Currently we amortize sale-leaseback gains over the lease term. We are continuing our assessment, which may identify other impacts.

In March 2016, the FASB issued ASU No. 2016-04, Recognition of Breakage for Certain Prepaid Stored-Value Products (Topic 405-20), which creates an exception under Topic 405-20 to derecognize financial liabilities related to certain prepaid stored-value products using a breakage model consistent with the revenue breakage model in Topic 606. The new guidance will be effective concurrent with Topic 606, which is effective for us for interim and annual periods beginning after December 15, 2017. We do not expect this standard to have a material effect on our financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718), to simplify various aspects of the accounting and presentation of share-based payments,

including the income tax effects of awards and forfeiture assumptions. Currently, tax deductions in excess of compensation costs (excess tax benefits) are recorded in equity and tax deduction shortfalls (tax deficiencies), to the extent of previous excess tax benefits, are recorded in equity and then to income tax expense. Under the new guidance, all excess tax benefits and tax deficiencies will be recorded to income tax expense in the income statement, which could create volatility in our income statement. The new guidance will also change the classification of excess tax benefits in the cash flow statement and impact the diluted earnings per share calculation. The guidance will be effective for interim and annual periods beginning after December 15, 2016, and early adoption is permitted. Different components of the guidance require prospective, retrospective and/or modified retrospective adoption. We will make a policy election to account for forfeitures of awards as they occur and we will record an immaterial cumulative-effect adjustment to beginning retained earnings as of January 2, 2017, as a result of adopting the standard.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230) — Classification of Certain Cash Receipts and Cash Payments, to reduce the diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance will be effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted and a retrospective approach is required. We do not expect this standard to have a material impact on our financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill if the fair value of a reporting unit is less than the carrying amount of the reporting unit. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. The guidance will be effective for interim and annual periods beginning after December 15, 2020. Early adoption is permitted for any goodwill impairment tests after January 1, 2017. We do not expect this standard to have a material impact on our financial statements.

Management's Use of Non-GAAP Financial Measures

Adjusted EBITDA is a non-GAAP financial measure. We use Adjusted EBITDA in addition to net income, income from operations, and income before income taxes to assess our performance, and we believe it is important for investors to be able to evaluate us using the same measures used by management. We believe this measure is an important indicator of our operational strength and the performance of our business. Adjusted EBITDA as calculated by us is not necessarily comparable to similarly titled measures reported by other companies, and should not be considered as an alternative to net income, earnings per share, cash flows from operating activities or other financial information determined under GAAP.

Adjusted EBITDA is defined as earnings before interest, income taxes, depreciation and amortization, impairment and other lease charges, stock-based compensation expense and other income and expense. Adjusted EBITDA for each of our segments includes an allocation of general and administrative expenses associated with administrative support for executive management, information systems and certain accounting, legal, supply chain, human resources, development and other administrative functions.

Management believes that Adjusted EBITDA, when viewed with our results of operations calculated in accordance with GAAP and our reconciliation of Adjusted EBITDA to net income (i) provide useful information about our operating performance and period-over-period growth, (ii) provide additional information that is useful for evaluating the operating performance of our business and (iii) permit investors to gain an understanding of the factors and trends affecting our ongoing earnings, from which capital investments are made and debt is serviced. However, such measures are not measures of financial performance or liquidity under GAAP and, accordingly, should not be considered as alternatives to net income 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.

All of such non-GAAP financial measures have important limitations as analytical tools. These limitations include the following:

- such financial information does not reflect our capital expenditures, future requirements for capital expenditures or contractual commitments to purchase capital equipment;

- such financial information does not reflect interest expense or the cash requirements necessary to service 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 such financial information does not reflect the cash required to fund such replacements; and
- such financial information does not reflect the effect of earning or charges resulting from matters that our management does not consider to be indicative of our ongoing operations. However, some of these charges (such as impairment and other lease charges, other income and expense and stock-based compensation expense) have recurred and may recur.

A reconciliation from net income to consolidated Adjusted EBITDA follows:

(Dollars in thousands)	Year ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Net income	\$ 16,712	\$ 38,536	\$ 36,176
Add:			
Depreciation and amortization	36,776	30,575	23,047
Impairment and other lease charges	25,644	2,382	363
Interest expense	2,171	1,889	2,228
Provision for income taxes	8,336	22,046	20,963
Stock-based compensation expense	3,283	4,293	3,497
Other (income) expense, net	(128)	(679)	(558)
Adjusted EBITDA:			
Pollo Tropical	\$ 55,535	\$ 59,335	\$ 52,721
Taco Cabana	38,081	39,707	32,995
Fiesta	(822)	—	—
Consolidated	\$ 92,794	\$ 99,042	\$ 85,716

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

We are exposed to market risk associated with fluctuations in interest rates, primarily limited to our senior credit facility, under which we had outstanding borrowings of \$69.9 million as of January 1, 2017. Borrowings under the senior credit facility bear interest at a per annum rate, at our option, of either (all terms as defined in the senior credit facility):

- 1) the Alternate Base Rate plus the applicable margin of 0.50% to 1.50% based on our Adjusted Leverage Ratio (with a margin of 0.50% as of January 1, 2017), or
- 2) the LIBOR Rate plus the applicable margin of 1.50% to 2.50% based on our Adjusted Leverage Ratio (with a margin of 1.50% at January 1, 2017).

For variable rate debt instruments, market risk is defined as the potential change in earnings resulting from a hypothetical adverse change in interest rates. As of January 1, 2017, we had primarily elected to be charged interest on borrowings under our senior credit facility at the LIBOR Rate plus the applicable margin. We elected a one-month LIBOR Rate for \$69.9 million of borrowings under the senior credit facility as of January 1, 2017. The weighted average interest rate applicable to these borrowings as of January 1, 2017 was 2.29%, which would result in interest expense in 2017 of \$1.6 million assuming that outstanding borrowings and interest rates remain unchanged during the year. A hypothetical increase of 100 basis points in the variable interest rate would increase interest expense in 2017 by \$0.7 million.

Commodity Price Risk

We purchase certain products which are affected by commodity prices and are, therefore, subject to price volatility caused by weather, market conditions and other factors which are not considered predictable or within our control. Although many of the products purchased are subject to changes in commodity prices, certain purchasing contracts or pricing arrangements have been negotiated in advance to minimize price volatility. Where possible, we use these types of purchasing techniques to control costs as an alternative to using financial instruments to hedge commodity prices. In many cases, we believe we will be able to address commodity cost increases that are significant and appear to be long-term in nature by adjusting our menu pricing. However, long-term increases in commodity prices may result in lower restaurant-level operating margins.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data of Fiesta Restaurant Group, Inc. required by this Item are described in Item 15 of this Annual Report on Form 10-K and are presented beginning on page F-1.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. Our senior management is responsible for establishing and maintaining disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 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 Interim Chief Executive Officer and Chief Financial Officer, as well as other key members of our management. Based on this evaluation, our Interim Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of January 1, 2017.

Changes in Internal Control over Financial Reporting. No change occurred in our internal control over financial reporting during the fourth quarter of 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control Over Financial Reporting

Our senior management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) under 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.

Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated the effectiveness of its internal control over financial reporting as of January 1, 2017 based on the criteria set forth in a report entitled *Internal Control-Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, we have concluded that, as of January 1, 2017, our internal control over financial reporting was effective based on those criteria.

Our independent registered public accounting firm, Deloitte & Touche LLP, has issued an audit report on the effectiveness of our internal control over financial reporting and their report is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Fiesta Restaurant Group, Inc. and subsidiaries
Dallas, Texas

We have audited the internal control over financial reporting of Fiesta Restaurant Group, Inc. and subsidiaries (the “Company”) as of January 1, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 1, 2017, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended January 1, 2017 of the Company and our report dated February 27, 2017 expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ Deloitte & Touche LLP
Dallas, Texas
February 27, 2017

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Incorporated by reference from our Definitive Proxy Statement to be filed in connection with the 2017 Annual Meeting of Stockholders.

We have adopted a written code of ethics applicable to our directors, officers and employees in accordance with the rules of The NASDAQ Stock Market and the SEC. We make our code of ethics available free of charge through our internet website, *www.frgi.com*. We will disclose on our website amendments to or waivers from our code of ethics in accordance with all applicable laws and regulations.

ITEM 11. EXECUTIVE COMPENSATION

Incorporated by reference from our Definitive Proxy Statement to be filed in connection with the 2017 Annual Meeting of Stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Incorporated by reference from our Definitive Proxy Statement to be filed in connection with the 2017 Annual Meeting of Stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Incorporated by reference from our Definitive Proxy Statement to be filed in connection with the 2017 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated by reference from our Definitive Proxy Statement to be filed in connection with the 2017 Annual Meeting of Stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements - Fiesta Restaurant Group, Inc. and Subsidiaries

	<u>Page</u>
FIESTA RESTAURANT GROUP, INC. AND SUBSIDIARIES	
Report of Independent Registered Public Accounting Firm	F-1
Financial Statements:	
Consolidated Balance Sheets	F-2
Consolidated Statements of Operations	F-3
Consolidated Statements of Changes in Stockholders' Equity	F-4
Consolidated Statements of Cash Flows	F-5
Notes to Consolidated Financial Statements	F-7

(a) (2) Financial Statement Schedules

<u>Schedule</u>	<u>Description</u>	<u>Page</u>
II	Valuation and Qualifying Accounts	F-24

Schedules other than those listed are omitted for the reason that they are not required, not applicable, or the required information is shown in the financial statements or notes thereto.

(a) (3) Exhibits

<u>Exhibit No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of Fiesta Restaurant Group, Inc. ("Fiesta") (incorporated by reference to Exhibit 3.1 to Amendment No. 3 to Fiesta's Form 10, File No. 001-35373, filed on April 5, 2012)
3.2	Amended and Restated Bylaws of Fiesta (incorporated by reference to Exhibit 3.2 to Amendment No. 1 to Fiesta's Form 10, File No. 001-35373, filed on January 26, 2012)
4.1	Form of Stock Certificate for Common Stock (incorporated by reference to Exhibit 4.4 to Amendment No. 2 to Fiesta's Form 10, File No. 001-35373, filed on March 14, 2012)
10.1	Form of Separation and Distribution Agreement among Fiesta, Carrols Restaurant Group and Carrols' (incorporated by reference to Exhibit 10.1 to Amendment No. 3 to Fiesta's Form 10, File No. 001-35373, filed on April 5, 2012)
10.2	Form of Tax Matters Agreement between Fiesta, Carrols and Carrols Restaurant Group (incorporated by reference to Exhibit 10.2 to Amendment No. 3 to Fiesta's Form 10, File No. 001-35373, filed on April 5, 2012)
10.3	Form of Employee Matters Agreement between Fiesta, Carrols and Carrols Restaurant Group (incorporated by reference to Exhibit 10.3 to Amendment No. 3 to Fiesta's Form 10, File No. 001-35373, filed on April 5, 2012)
10.4	Form of Transition Services Agreement among Fiesta, Carrols Restaurant Group and Carrols (incorporated by reference to Exhibit 10.4 to Amendment No. 3 to Fiesta's Form 10, File No. 001-35373, filed on April 5, 2012)
10.5	Fiesta Restaurant Group, Inc. 2012 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 to Fiesta's Current Report on Form 8-K filed on May 8, 2012)+
10.6	Executive Employment Agreement, dated as of February 20, 2014, between Fiesta Restaurant Group and Timothy P. Taft (incorporated by reference to Exhibit 10.1 of Fiesta's Current Report on Form 8-K filed on February 25, 2014)+
10.7	Agreement dated as of November 4, 2016 between Fiesta Restaurant Group, Inc. and Danny K. Meisenheimer (incorporated by reference to Exhibit 10.1 of Fiesta's Quarterly Report on Form 10-Q for the period ended October 2, 2016)+
10.8	Agreement dated as of November 4, 2016 between Fiesta Restaurant Group, Inc. and Lynn Schweinfurth (incorporated by reference to Exhibit 10.2 of Fiesta's Quarterly Report on Form 10-Q for the period ended October 2, 2016)+

Exhibit No.	Description
10.9	Agreement dated as of November 4, 2016 between Fiesta Restaurant Group, Inc. and Joseph A. Zirkman (incorporated by reference to Exhibit 10.3 of Fiesta's Quarterly Report on Form 10-Q for the period ended October 2, 2016)+
10.10	Agreement dated as of September 27, 2016 between Fiesta Restaurant Group, Inc. and Timothy P. Taft (incorporated by reference to Exhibit 10.4 of Fiesta's Quarterly Report on Form 10-Q for the period ended October 2, 2016)+
10.11	Executive Employment Agreement, dated as of February 24, 2017, between Fiesta Restaurant Group and Richard Stockinger (incorporated by reference to Exhibit 10.1 of Fiesta's Current Report on Form 8-K filed on February 27, 2017)+
10.12	Fiesta Restaurant Group, Inc. and Subsidiaries Deferred Compensation Plan (incorporated by reference to Exhibit 10.10 of Fiesta's Amendment No. 1 to Registration Statement on Form 10 filed on January 26, 2012)+
10.13	Offer letter between Fiesta Restaurant Group, Inc. and Lynn S. Schweinfurth (incorporated by reference to Exhibit 10.1 of Fiesta's Quarterly Report on Form 10-Q for the period ended July 1, 2012)+
10.14	Credit Agreement, dated as of December 11, 2013, between Fiesta Restaurant Group, Inc., the guarantors named therein, the lenders named therein and Wells Fargo Bank, National Association, as administrative agent (incorporated by reference to Exhibit 10.1 of Fiesta's Current Report on Form 8-K filed on December 12, 2013)
10.15	Security Agreement, dated as of December 11, 2013, between Fiesta Restaurant Group, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as administrative agent (incorporated by reference to Exhibit 10.2 of Fiesta's Current Report on Form 8-K filed on December 12, 2013)
10.16	Amendment to Fiesta Restaurant Group, Inc. 2012 Stock Incentive Plan+ (incorporated by reference to Exhibit 10.11 of Fiesta's Annual Report on Form 10-K filed on February 19, 2015)
21.1	Subsidiaries of Fiesta#
23.1	Consent of Deloitte & Touche LLP#
31.1	Chief Executive Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Fiesta Restaurant Group, Inc.#
31.2	Chief Financial Officer's Certificate Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Fiesta 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 Fiesta 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 Fiesta 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

Filed herewith.

+ Compensatory plan or arrangement

ITEM 16. FORM 10-K SUMMARY

None.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Fiesta Restaurant Group, Inc. and subsidiaries
Dallas, Texas

We have audited the accompanying consolidated balance sheets of Fiesta Restaurant Group, Inc. and subsidiaries (the "Company") as of January 1, 2017 and January 3, 2016, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended January 1, 2017. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Fiesta Restaurant Group, Inc. and subsidiaries as of January 1, 2017 and January 3, 2016, and the results of their operations and their cash flows for each of the three years in the period ended January 1, 2017, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of January 1, 2017, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2017 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
Dallas, Texas
February 27, 2017

FIESTA RESTAURANT GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands of dollars, except share and per share amounts)

	<u>January 1, 2017</u>	<u>January 3, 2016</u>
ASSETS		
Current assets:		
Cash	\$ 4,196	\$ 5,281
Trade receivables	8,771	9,217
Inventories	2,865	2,910
Prepaid rent	3,575	3,163
Income tax receivable	3,304	7,448
Prepaid expenses and other current assets	4,231	3,219
Total current assets	<u>26,942</u>	<u>31,238</u>
Property and equipment, net	270,920	248,992
Goodwill	123,484	123,484
Deferred income taxes	14,377	8,497
Other assets	5,842	3,434
Total assets	<u>\$ 441,565</u>	<u>\$ 415,645</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 89	\$ 69
Accounts payable	16,165	12,405
Accrued payroll, related taxes and benefits	12,275	15,614
Accrued real estate taxes	6,924	6,121
Other liabilities	11,316	12,096
Total current liabilities	<u>46,769</u>	<u>46,305</u>
Long-term debt, net of current portion	71,423	72,612
Lease financing obligations	1,664	1,663
Deferred income – sale-leaseback of real estate	27,165	30,086
Other liabilities	30,369	20,997
Total liabilities	<u>177,390</u>	<u>171,663</u>
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Common stock, par value \$.01; authorized 100,000,000 shares, issued 26,884,992 and 26,829,220 shares, respectively, and outstanding 26,755,640 and 26,571,602 shares, respectively	267	266
Additional paid-in capital	163,204	159,724
Retained earnings	100,704	83,992
Total stockholders' equity	<u>264,175</u>	<u>243,982</u>
Total liabilities and stockholders' equity	<u>\$ 441,565</u>	<u>\$ 415,645</u>

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

FIESTA RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except share and per share amounts)

	Years Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Revenues:			
Restaurant sales	\$ 708,956	\$ 684,584	\$ 608,540
Franchise royalty revenues and fees	2,814	2,808	2,603
Total revenues	<u>711,770</u>	<u>687,392</u>	<u>611,143</u>
Costs and expenses:			
Cost of sales	214,609	217,328	192,250
Restaurant wages and related expenses (including stock-based compensation expense of \$142, \$156 and \$71, respectively)	185,305	174,222	155,140
Restaurant rent expense	37,493	33,103	29,645
Other restaurant operating expenses	96,457	87,285	78,921
Advertising expense	26,800	21,617	19,493
General and administrative (including stock-based compensation expense of \$3,141, \$4,137 and \$3,426, respectively)	56,084	54,521	49,414
Depreciation and amortization	36,776	30,575	23,047
Pre-opening costs	5,511	4,567	4,061
Impairment and other lease charges	25,644	2,382	363
Other (income) expense, net	(128)	(679)	(558)
Total operating expenses	<u>684,551</u>	<u>624,921</u>	<u>551,776</u>
Income from operations	27,219	62,471	59,367
Interest expense	2,171	1,889	2,228
Income before income taxes	25,048	60,582	57,139
Provision for income taxes	8,336	22,046	20,963
Net income	<u>\$ 16,712</u>	<u>\$ 38,536</u>	<u>\$ 36,176</u>
Basic net income per share	<u>\$ 0.62</u>	<u>\$ 1.44</u>	<u>\$ 1.35</u>
Diluted net income per share	<u>\$ 0.62</u>	<u>\$ 1.44</u>	<u>\$ 1.35</u>
Basic weighted average common shares outstanding	<u>26,682,227</u>	<u>26,515,029</u>	<u>26,293,714</u>
Diluted weighted average common shares outstanding	<u>26,689,179</u>	<u>26,522,196</u>	<u>26,296,049</u>

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

FIESTA RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except share amounts)

	Number of Common Stock Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
Balance at December 29, 2013	26,082,800	\$ 261	\$ 148,765	\$ 9,280	\$ 158,306
Additional transfers from Carrols	—	—	(127)	—	(127)
Stock-based compensation	—	—	3,497	—	3,497
Vesting of restricted shares	275,648	3	(3)	—	—
Tax benefit from stock-based compensation	—	—	1,765	—	1,765
Share issuance costs	—	—	(30)	—	(30)
Net income	—	—	—	36,176	36,176
Balance at December 28, 2014	<u>26,358,448</u>	<u>264</u>	<u>153,867</u>	<u>45,456</u>	<u>199,587</u>
Stock-based compensation	—	—	4,293	—	4,293
Vesting of restricted shares	213,154	2	(2)	—	—
Tax benefit from stock-based compensation	—	—	1,566	—	1,566
Net income	—	—	—	38,536	38,536
Balance at January 3, 2016	<u>26,571,602</u>	<u>266</u>	<u>159,724</u>	<u>83,992</u>	<u>243,982</u>
Stock-based compensation	—	—	3,283	—	3,283
Vesting of restricted shares	184,038	1	(1)	—	—
Tax benefit from stock-based compensation	—	—	198	—	198
Net income	—	—	—	16,712	16,712
Balance at January 1, 2017	<u>26,755,640</u>	<u>\$ 267</u>	<u>\$ 163,204</u>	<u>\$ 100,704</u>	<u>\$ 264,175</u>

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

FIESTA RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars)

	Year Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Cash flows from operating activities:			
Net income	\$ 16,712	\$ 38,536	\$ 36,176
Adjustments to reconcile net income to net cash provided from operating activities:			
Loss (gain) on disposals of property and equipment	779	(170)	(369)
Stock-based compensation	3,283	4,293	3,497
Impairment and other lease charges	25,644	2,382	363
Depreciation and amortization	36,776	30,575	23,047
Amortization of deferred financing costs	309	315	309
Amortization of deferred gains from sale-leaseback transactions	(3,583)	(3,618)	(3,671)
Deferred income taxes	(5,880)	5,483	957
Other	1	4	4
Changes in other operating assets and liabilities:			
Accounts receivable	446	(2,877)	(329)
Other assets – long term	(2,796)	(48)	4
Accounts payable	3,330	283	(529)
Accrued payroll, related taxes and benefits	(3,339)	(243)	1,561
Accrued real estate taxes	803	1,077	539
Other liabilities – current	(780)	3,325	(113)
Other liabilities – long term	6,498	4,752	3,441
Income tax receivable/payable	4,144	(2,474)	(477)
Other	(1,668)	(243)	(304)
Net cash provided from operating activities	<u>80,679</u>	<u>81,352</u>	<u>64,106</u>
Cash flows from investing activities:			
Capital expenditures:			
New restaurant development	(66,116)	(70,841)	(57,102)
Restaurant remodeling	(2,755)	(4,802)	(7,588)
Other restaurant capital expenditures	(7,125)	(7,714)	(4,975)
Corporate and restaurant information systems	(6,369)	(4,213)	(4,414)
Total capital expenditures	<u>(82,365)</u>	<u>(87,570)</u>	<u>(74,079)</u>
Properties purchased for sale-leaseback	(2,663)	(250)	—
Proceeds from disposals of other properties	226	149	1,729
Proceeds from sale-leaseback transactions	3,642	—	5,692
Net cash used in investing activities	<u>(81,160)</u>	<u>(87,671)</u>	<u>(66,658)</u>
Cash flows from financing activities:			
Proceeds from issuance of stock, net of issuance costs	—	—	(30)
Excess tax benefit from vesting of restricted shares	566	1,566	1,765
Borrowings on revolving credit facility	18,400	28,500	25,000
Repayments on revolving credit facility	(19,500)	(23,500)	(30,000)
Principal payments on capital leases	(70)	(53)	(61)
Other financing costs	—	—	(13)
Net cash (used in) provided from financing activities	<u>(604)</u>	<u>6,513</u>	<u>(3,339)</u>
Net (decrease) increase in cash	(1,085)	194	(5,891)
Cash, beginning of year	5,281	5,087	10,978
Cash, end of year	<u>\$ 4,196</u>	<u>\$ 5,281</u>	<u>\$ 5,087</u>

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

FIESTA RESTAURANT GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS — (Continued)
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars)

	Year Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Supplemental disclosures:			
Interest paid on long-term debt (including capitalized interest of \$255 in 2016 and \$335 in 2015)	\$ 1,867	\$ 1,748	\$ 1,971
Interest paid on lease financing obligations	\$ 141	\$ 140	\$ 139
Accruals for capital expenditures	\$ 5,288	\$ 4,858	\$ 2,889
Income tax payments, net	\$ 9,873	\$ 17,472	\$ 18,718
Capital lease obligations incurred	\$ —	\$ 410	\$ —
Non-cash transfers of income tax assets and liabilities from Carrols	\$ —	\$ —	\$ (127)

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

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

1. Basis of Presentation

Business Description. Fiesta Restaurant Group, Inc. (“Fiesta Restaurant Group” or “Fiesta”) owns, operates and franchises two fast-casual restaurant brands through its wholly-owned subsidiaries Pollo Operations, Inc., and its subsidiaries, and Pollo Franchise, Inc., (collectively “Pollo Tropical”) and Taco Cabana, Inc. and its subsidiaries (collectively “Taco Cabana”). Unless the context otherwise requires, Fiesta and its subsidiaries, Pollo Tropical and Taco Cabana, are collectively referred to as the “Company”. At January 1, 2017, the Company owned and operated 177 Pollo Tropical® restaurants and 166 Taco Cabana® restaurants. The Pollo Tropical restaurants include 128 located in Florida, 30 located in Texas, 16 located in Georgia and three located in Tennessee. The Taco Cabana restaurants include 165 located in Texas and one located in Oklahoma. At January 1, 2017, Fiesta franchised a total of 35 Pollo Tropical restaurants and seven Taco Cabana restaurants. The franchised Pollo Tropical restaurants include 17 in Puerto Rico, one in the Bahamas, one in Guyana, three in Trinidad & Tobago, one in Venezuela, four in Panama, two in Guatemala, and six on college campuses in Florida and a hospital in Florida. The franchised Taco Cabana restaurants include five in New Mexico and two on college campuses in Texas.

Basis of Consolidation. The consolidated financial statements presented herein reflect the consolidated financial position, results of operations and cash flows of Fiesta and its wholly-owned subsidiaries. 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 years ended January 1, 2017 and December 28, 2014 each contained 52 weeks. The fiscal year ended January 3, 2016 contained 53 weeks.

Use of Estimates. The preparation of the consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements. Estimates also affect the reported amounts of expenses during the reporting periods. Significant items subject to such estimates and assumptions include: accrued occupancy costs, insurance liabilities, evaluation for impairment of goodwill and long-lived assets and lease accounting matters. Actual results could differ from those estimates.

Reclassifications. Deferred financing costs, net was reclassified to other assets to conform with the current year presentation. In addition, other assets - long term was reclassified to a separate line from other in the consolidated statements of cash flows to conform with the current year presentation.

Cash and Cash Equivalents. The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Inventories. Inventories, primarily consisting of food and paper, are stated at the lower of cost (first-in, first-out) or market.

Property and Equipment. The Company capitalizes all direct costs incurred to construct and substantially improve its restaurants. These costs are depreciated and charged to expense based upon their property classification when placed in service. Property and equipment is recorded at cost. Application development stage costs for significant internally developed software projects are capitalized and amortized. Repairs and maintenance activities are expensed as incurred. Depreciation and amortization is provided using the straight-line method over the following estimated useful lives:

Buildings and improvements	5 to 30 years
Equipment	3 to 7 years
Computer hardware and software	3 to 7 years
Assets subject to capital lease	Shorter of useful life or lease term

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

1. Basis of Presentation (cont.)

Leasehold improvements, including new buildings constructed on leased land, are depreciated over the shorter of their estimated useful lives or the underlying lease term. In circumstances where an economic penalty would be presumed by the non-exercise of one or more renewal options under the lease, the Company includes those renewal option periods when determining the lease term. For significant leasehold improvements made during the latter part of the lease term, the Company amortizes those improvements over the shorter of their useful life or an extended lease term. The extended lease term would consider the exercise of renewal options if the value of the improvements would imply that an economic penalty would be incurred without the renewal of the option. Building costs incurred for new restaurants on leased land are depreciated over the lease term, which is generally a twenty-year period.

Goodwill. Goodwill represents the excess purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets acquired by Carrols Restaurant Group, Inc. (“Carrols”), Fiesta’s former parent company, from the acquisition of Pollo Tropical in 1998 and Taco Cabana in 2000. Goodwill is not amortized but is tested for impairment at least annually as of the last day of the fiscal year or more frequently if impairment indicators exist.

Long-Lived Assets. The Company assesses the recoverability of property and equipment and definite-lived 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. Impairment is reviewed whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable. See Note 4 for results of the Company’s impairment review.

Deferred Financing Costs. Financing costs incurred in obtaining long-term debt, credit facilities and lease financing obligations are capitalized and amortized over the life of the related obligation as interest expense using the effective interest method.

Leases. All leases are reviewed for capital or operating classification at their inception. The majority of the Company’s leases are operating leases. Many of the lease agreements contain rent holidays, rent escalation clauses and/or contingent rent provisions. Rent expense for leases that contain scheduled rent increases or rent holidays is recognized on a straight-line basis over the lease term, including any option periods included in the determination of the lease term. Contingent rentals are generally based upon a percentage of sales or a percentage of sales in excess of stipulated amounts and are not considered minimum rent payments but are recognized as rent expense when incurred.

Revenue Recognition. Revenues from the Company’s owned and operated restaurants are recognized when payment is tendered at the time of sale. Franchise royalty revenues are based on a percent of gross sales and are recorded as income when earned. Franchise fees, which are associated with opening new franchised restaurants, are recognized as income when all required activities have been performed by the Company. Area development fees, which are associated with opening new franchised restaurants in a given market, are recognized as income over the term of the related agreement.

Income Taxes. Deferred income tax assets and liabilities are based on the difference between the financial statement and tax bases of assets and liabilities as measured by the tax rates that are anticipated to be in effect when those differences reverse. The deferred tax provision generally represents the net change in deferred tax assets and liabilities during the period. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is established when it is necessary to reduce deferred tax assets to amounts for which realization is more likely than not. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

Advertising Costs. All advertising costs are expensed as incurred.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

1. Basis of Presentation (cont.)

Cost of Sales. The Company includes the cost of food, beverage and paper, net of any discounts, in cost of sales.

Pre-opening Costs. The Company's pre-opening costs are generally incurred beginning four to six months prior to a restaurant opening and generally include restaurant employee wages and related expenses, travel expenditures, recruiting, training, promotional costs associated with the restaurant opening and rent, including any non-cash rent expense recognized during the construction period.

Insurance. The Company is insured for workers' compensation, general liability and medical insurance claims under policies where it pays all claims, subject to stop-loss limitations both for individual claims and for general liability and certain workers' compensation claims in the aggregate. Losses are accrued based upon estimates of the aggregate liability for claims based on the Company's experience and certain actuarial methods used to measure such estimates. The Company does not discount any of its self-insurance obligations.

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. The following methods were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the fair value:

- *Current Assets and Liabilities.* The carrying values reported on the balance sheet of cash, accounts receivable and accounts payable approximate fair value because of the short maturity of those financial instruments.
- *Revolving Credit Borrowings.* The fair value of outstanding revolving credit borrowings under our senior credit facility, which is considered Level 2, is based on current LIBOR rates. At January 1, 2017 and January 3, 2016, the fair value and carrying value of the Company's senior credit facility were approximately \$69.9 million and \$71.0 million, respectively.

See Note 4 for discussion of the fair value measurement of non-financial assets.

Gift cards. The Company sells gift cards to its customers in its restaurants and through select third parties. The Company recognizes revenue from gift cards upon redemption by the customer. The gift cards have no stated expiration dates. Revenues from unredeemed gift cards are not material to the Company's financial statements.

Recent Accounting Pronouncements. In May 2014, and in subsequent updates, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which amends the guidance in former Topic 605, Revenue Recognition, and provides for either a full retrospective adoption in which the standard is applied to all of the periods presented or a modified retrospective adoption in which the cumulative effect of initially applying the standard is recognized at the date of initial application. The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers unless the contracts are in the scope of other US GAAP requirements. The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property and equipment, including real estate. The Company is currently evaluating the impact of the provisions of Topic 606; however, the Company does not believe the standard will impact its recognition of revenue from company-owned restaurants or its recognition of franchise royalty revenues, which are based on a percent of gross sales. The Company expects the provisions to primarily impact franchise and development fees as well as gift card programs and does not expect the standard to have a material effect on its financial statements. The Company does not plan to early adopt the standard

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

1. Basis of Presentation (cont.)

and plans to use the modified retrospective approach to adopt the standard. For the Company, the new standard is effective for interim and annual periods beginning after December 15, 2017.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessee recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. For the Company, the new standard is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. A modified retrospective approach is required with an option to use certain practical expedients. The new guidance is required to be applied at the beginning of the earliest comparative period presented. The Company is currently evaluating the impact on its financial statements. Although the impact is not currently estimable, the Company expects to recognize lease assets and lease liabilities for most of the leases it currently accounts for as operating leases. In addition, for the Company's leases that are classified as sale-leaseback transactions, the Company will be required to record an initial adjustment to retained earnings associated with the previously deferred gains, and for any future transactions, the gain, adjusted for any off-market terms, will be recorded immediately. Currently the Company amortizes sale-leaseback gains over the lease term. The Company is continuing its assessment, which may identify other impacts.

In March 2016, the FASB issued ASU No. 2016-04, Recognition of Breakage for Certain Prepaid Stored-Value Products (Topic 405-20), which creates an exception under Topic 405-20 to derecognize financial liabilities related to certain prepaid stored-value products using a breakage model consistent with the revenue breakage model in Topic 606. The new guidance will be effective concurrent with Topic 606, which is effective for the Company for interim and annual periods beginning after December 15, 2017. The Company does not expect this standard to have a material effect on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718), to simplify various aspects of the accounting and presentation of share-based payments, including the income tax effects of awards and forfeiture assumptions. Currently, tax deductions in excess of compensation costs (excess tax benefits) are recorded in equity and tax deduction shortfalls (tax deficiencies), to the extent of previous excess tax benefits, are recorded in equity and then to income tax expense. Under the new guidance, all excess tax benefits and tax deficiencies will be recorded to income tax expense in the income statement, which could create volatility in the Company's income statement. The new guidance will also change the classification of excess tax benefits in the cash flow statement and impact the diluted earnings per share calculation. The guidance will be effective for interim and annual periods beginning after December 15, 2016, and early adoption is permitted. Different components of the guidance require prospective, retrospective and/or modified retrospective adoption. The Company will make a policy election to account for forfeitures of awards as they occur and it will record an immaterial cumulative-effect adjustment to beginning retained earnings as of January 2, 2017, as a result of adopting the standard.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments, to reduce the diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance will be effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted and a retrospective approach is required. The Company does not expect this standard to have a material impact on its financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill if the fair value of a reporting unit is less than the carrying amount of the reporting unit. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. The guidance will be effective for interim and annual periods beginning after December 15, 2020. Early adoption is permitted for any goodwill impairment tests after January 1, 2017. The Company does not expect this standard to have a material impact on its financial statements.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

2. Property and Equipment

Property and equipment consisted of the following:

	<u>January 1, 2017</u>	<u>January 3, 2016</u>
Land	\$ 23,395	\$ 23,363
Owned buildings	22,008	20,101
Leasehold improvements ⁽¹⁾	249,507	206,293
Equipment	220,397	194,181
Assets subject to capital leases	<u>2,057</u>	<u>2,057</u>
	517,364	445,995
Less accumulated depreciation and amortization	<u>(246,444)</u>	<u>(197,003)</u>
	<u>\$ 270,920</u>	<u>\$ 248,992</u>

(1) Leasehold improvements include the cost of new buildings constructed on leased land.

Assets subject to capital leases primarily pertain to buildings leased for certain restaurant locations and certain office equipment and had accumulated amortization at January 1, 2017 and January 3, 2016 of \$1.0 million and \$0.8 million, respectively. At January 1, 2017 and January 3, 2016, land of \$0.7 million and owned buildings of 0.8 million were subject to lease financing obligations accounted for under the lease financing method. See Note 8 — Lease Financing Obligations. Accumulated depreciation pertaining to owned buildings subject to lease financing obligations at January 1, 2017 and January 3, 2016 was \$0.4 million and \$0.3 million.

Depreciation and amortization expense for all property and equipment for the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$36.8 million, \$30.6 million and \$23.0 million, respectively.

3. 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 the fiscal year and has determined its reporting units to be its operating segments, Pollo Tropical and Taco Cabana.

In performing its goodwill impairment test, the Company compared the net book values of its reporting units to their estimated fair values, the latter determined by employing a discounted cash flow analysis, which was corroborated with other value indicators where available, such as comparable company earnings multiples.

There have been no changes in goodwill or goodwill impairment losses recorded during the year ended January 1, 2017 or the years ended January 3, 2016 and December 28, 2014. Goodwill balances are summarized below:

	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Total</u>
Balance, January 1, 2017 and January 3, 2016	<u>\$ 56,307</u>	<u>\$ 67,177</u>	<u>\$ 123,484</u>

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. In addition to considering management's plans, known regulatory or governmental actions and damage due to acts of God (hurricanes, tornadoes, etc.), the Company considers a triggering event to have occurred related to a specific restaurant if the restaurant's cash flows for the last twelve months are less than a minimum threshold or if consistent levels of cash flows for the remaining lease period are less than the carrying value of the restaurant's assets. If an indicator of impairment exists for any of its assets, an estimate of undiscounted future cash

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

4. Impairment of Long-Lived Assets and Other Lease Charges (cont.)

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. There is uncertainty in the projected undiscounted future cash flows used in the Company's impairment review analysis. If actual performance does not achieve the projections, the Company may recognize impairment charges in future periods, and such charges could be material. 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.

A summary of impairment on long-lived assets and other lease charges recorded by segment is as follows:

	Year Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Pollo Tropical	\$ 24,419	\$ 510	\$ 254
Taco Cabana	1,225	1,872	109
	<u>\$ 25,644</u>	<u>\$ 2,382</u>	<u>\$ 363</u>

In 2016, the Company decided to suspend additional development of Pollo Tropical restaurants outside of Florida and to review its strategy for development while it continues to build brand awareness, affinity and off premise consumption through several initiatives and to suspend all near-term development of Pollo Tropical restaurants outside of Florida. Based on a restaurant portfolio examination, the Company closed ten Pollo Tropical restaurants in the fourth quarter of 2016 including eight restaurants in Texas, one restaurant in Nashville, Tennessee and one restaurant in Atlanta, Georgia. The Company plans to convert three of the closed restaurants in Texas to Taco Cabana restaurants in 2017.

In 2016, the Company recognized impairment charges with respect to the ten closed restaurants and seven additional Pollo Tropical restaurants and seven Taco Cabana restaurants that it continues to operate. Impairment and other lease charges in 2016 consisted of impairment charges for Pollo Tropical and Taco Cabana restaurants of \$21.6 million and \$1.1 million, respectively and lease and other charges related to closed Pollo Tropical and Taco Cabana restaurants of \$2.8 million and \$0.2 million, respectively, net of recoveries.

The Company determined the fair value of restaurant equipment, for those restaurants reviewed for impairment, based on current economic conditions, the Company's history of using these assets in the operation of its business, the Company's plans to use this equipment in new restaurants that are scheduled to open in 2017 and 2018, and the Company's expectation of how a market participant would value the equipment. These fair value asset measurements rely on significant unobservable inputs and are considered Level 3 in the fair value hierarchy. The Level 3 assets measured at fair value associated with impairment charges recorded during 2016 totaled \$6.9 million.

Impairment and other lease charges in 2015 consisted primarily of impairment charges totaling \$1.7 million and a \$0.2 million lease charge related to a restaurant closure at the end of fiscal 2015, a \$0.3 million lease charge related to the closure of a Pollo Tropical restaurant that was relocated prior to the end of its lease term to a superior site in the same trade area and lease charges, net of recoveries, totaling \$0.2 million related to previously closed Pollo Tropical restaurants.

Impairment and other lease charges in 2014 included a \$0.3 million impairment charge representing the write-down of the carrying value to fair value of certain assets related to the Pollo Tropical restaurant that closed in 2015 and \$0.1 million in impairment charges for additional assets acquired at previously impaired Taco Cabana locations.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

5. Other Liabilities

Other liabilities, current, consist of the following:

	January 1, 2017	January 3, 2016
Accrued workers' compensation and general liability claims	\$ 4,838	\$ 5,540
Sales and property taxes	1,844	3,031
Accrued occupancy costs	2,161	980
Other	2,473	2,545
	<u>\$ 11,316</u>	<u>\$ 12,096</u>

Other liabilities, long-term, consist of the following:

	January 1, 2017	January 3, 2016
Accrued occupancy costs	\$ 20,172	\$ 15,349
Deferred compensation	2,027	1,665
Accrued workers' compensation and general liability claims	4,030	697
Other	4,140	3,286
	<u>\$ 30,369</u>	<u>\$ 20,997</u>

Accrued occupancy costs include obligations pertaining to closed restaurant locations and accruals to expense operating lease rental payments on a straight-line basis over the lease term.

The following table presents the activity in the closed-store reserve, of which \$3.1 million and \$1.2 million are included in long-term accrued occupancy costs at January 1, 2017 and January 3, 2016, respectively, with the remainder in other current liabilities.

	Year Ended	
	January 1, 2017	January 3, 2016
Balance, beginning of period	\$ 1,832	\$ 1,251
Provisions for restaurant closures	3,093	554
Additional lease charges, net of (recoveries)	(237)	258
Payments, net	(806)	(358)
Other adjustments	1,030	127
Balance, end of period	<u>\$ 4,912</u>	<u>\$ 1,832</u>

6. Leases

The Company utilizes land and buildings in its operations under various lease agreements. The Company does not consider any one of these individual leases material to the Company's operations. Initial lease terms are generally for twenty years and, in many cases, provide for renewal options and in most cases rent escalations. Certain leases require contingent rent, determined as a percentage of sales as defined by the terms of the applicable lease agreement. For most locations, the Company is obligated for occupancy related costs including payment of property taxes, insurance and utilities.

During the years ended January 1, 2017 and December 28, 2014 the Company sold one and two restaurant properties in each year, respectively, in sale-leaseback transactions for net proceeds of \$3.6 million and \$5.7 million, respectively. These leases have been classified as operating leases and generally contain a twenty-year initial term plus renewal options.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

6. Leases (cont.)

Deferred gains on sale-leaseback transactions of \$0.7 million and \$1.9 million were recognized during the years ended January 1, 2017 and December 28, 2014, respectively and are being amortized over the term of the related leases. The amortization of deferred gains on sale-leaseback transactions was \$3.6 million, \$3.6 million and \$3.7 million for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, respectively.

Minimum rent commitments due under capital and non-cancelable operating leases at January 1, 2017 were as follows:

	<u>Capital</u>	<u>Operating</u>
2017.....	\$ 282	\$ 43,026
2018.....	282	42,784
2019.....	282	42,380
2020.....	286	40,852
2021.....	301	37,924
Thereafter	<u>1,540</u>	<u>338,084</u>
Total minimum lease payments ⁽¹⁾	2,973	<u>\$ 545,050</u>
Less amount representing interest.....	<u>(1,361)</u>	
Total obligations under capital leases	1,612	
Less current portion	<u>(89)</u>	
Long-term debt under capital leases	<u>\$ 1,523</u>	

- (1) Minimum operating lease payments have not been reduced by minimum sublease rentals of \$6.7 million due in the future under noncancelable subleases.

Total rent expense on operating leases, including contingent rentals, was as follows:

	<u>Year Ended</u>		
	<u>January 1, 2017</u>	<u>January 3, 2016</u>	<u>December 28, 2014</u>
Minimum rent on real property, excluding rent included in pre-opening costs	\$ 37,180	\$ 32,716	\$ 29,309
Additional rent based on percentage of sales	313	387	336
Restaurant rent expense	<u>37,493</u>	<u>33,103</u>	<u>29,645</u>
Rent included in pre-opening costs.....	2,066	1,736	1,421
Administrative and equipment rent.....	<u>1,119</u>	<u>1,026</u>	<u>1,042</u>
	<u>\$ 40,678</u>	<u>\$ 35,865</u>	<u>\$ 32,108</u>

7. Long-term Debt

Long term debt at January 1, 2017 and January 3, 2016 consisted of the following:

	<u>January 1, 2017</u>	<u>January 3, 2016</u>
Revolving credit facility	\$ 69,900	\$ 71,000
Capital leases	<u>1,612</u>	<u>1,681</u>
	71,512	72,681
Less: current portion of long-term debt	<u>(89)</u>	<u>(69)</u>
	<u>\$ 71,423</u>	<u>\$ 72,612</u>

Senior Credit Facility. In December 2013, the Company terminated its former senior secured revolving credit facility, referred to as the “former senior credit facility”, and entered into a new senior secured revolving

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

7. Long-term Debt (cont.)

credit facility with a syndicate of lenders, which is referred to as the “senior credit facility”. The senior credit facility provides for aggregate revolving credit borrowings of up to \$150 million (including \$15 million available for letters of credit) and matures on December 11, 2018. The senior credit facility also provides for potential incremental increases of up to \$50 million to the revolving credit borrowings available under the senior credit facility. On January 1, 2017, there were \$69.9 million in outstanding revolving credit borrowings under the senior credit facility.

Borrowings under the senior credit facility bear interest at a per annum rate, at the Company’s option, equal to either (all terms as defined in the senior credit facility):

- 1) the Alternate Base Rate plus the applicable margin of 0.50% to 1.50% based on the Company’s Adjusted Leverage Ratio (with a margin of 0.50% as of January 1, 2017), or
- 2) the LIBOR Rate plus the applicable margin of 1.50% to 2.50% based on the Company’s Adjusted Leverage Ratio (with a margin of 1.50% at January 1, 2017).

In addition, the senior credit facility requires the Company to pay (i) a commitment fee based on the applicable Commitment Fee margin of 0.25% to 0.45%, based on the Company’s Adjusted Leverage Ratio (with a margin of 0.25% at January 1, 2017) and the unused portion of the facility and (ii) a letter of credit fee based on the applicable LIBOR margin and the dollar amount of outstanding letters of credit.

All obligations under the Company’s senior credit facility are guaranteed by all of the Company’s material domestic subsidiaries. In general, the Company’s obligations under the senior credit facility and its subsidiaries’ obligations under the guarantees are secured by a first priority lien and security interest on substantially all of its assets and the assets of its material subsidiaries (including a pledge of all of the capital stock and equity interests of its material subsidiaries), other than certain specified assets, including real property owned by the Company or its subsidiaries.

The outstanding borrowings under the Company’s senior credit facility are prepayable without penalty (other than customary breakage costs). The senior credit facility requires the Company to comply with customary affirmative, negative and financial covenants, including, without limitation, those limiting Fiesta’s and its subsidiaries’ ability to (i) incur indebtedness, (ii) incur liens, (iii) loan, advance, or make acquisitions and other investments or other commitments to construct, acquire or develop new restaurants (subject to certain exceptions), (iv) pay dividends, (v) redeem and repurchase equity interests, (vi) conduct asset and restaurant sales and other dispositions (subject to certain exceptions), (vii) conduct transactions with affiliates and (viii) change its business. In addition, the senior credit facility requires the Company to maintain certain financial ratios, including a Fixed Charge Coverage Ratio and an Adjusted Leverage Ratio (all as defined under the senior credit facility).

The Company’s senior credit facility contains customary default provisions, including without limitation, a cross default provision pursuant to which it is an event of default under this facility if there is a default under any of the Company’s indebtedness having an outstanding principal amount of \$5.0 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.

As of January 1, 2017, the Company was in compliance with the covenants under its senior credit facility. After reserving \$5.2 million for letters of credit issued under the senior credit facility, \$74.9 million was available for borrowing under the senior credit facility at January 1, 2017.

At January 1, 2017, principal payments required on borrowings under the senior credit facility were \$69.9 million in 2018. The weighted average interest rate on the borrowings under the senior credit facility was 2.29% and 2.08% at January 1, 2017 and January 3, 2016, respectively. Interest expense on the Company’s long-term debt, excluding lease financing obligations, was \$1.9 million, \$1.6 million and \$2.1 million for the years ended January 1, 2017, January 3, 2016, and December 28, 2014, respectively.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

8. Lease Financing Obligations

The Company entered into a sale-leaseback transaction that did not qualify for sale-leaseback accounting due to a form of continuing involvement and, as a result, the lease was classified as a financing transaction in the Company's consolidated financial statements.

Under the financing method, the assets remain on the consolidated balance sheet and the net proceeds received by the Company from the transaction are recorded as a lease financing liability. Payments under the lease are applied as payments of imputed interest and deemed principal on the underlying financing obligations.

The lease provides for an initial term of 20 years plus renewal options and requires payment of property taxes, insurance and utilities.

At January 1, 2017, payments required on lease financing obligations were as follows:

2017.....	\$	143
2018.....		144
2019.....		146
2020.....		147
2021.....		149
Thereafter, through 2023.....		1,927
Total minimum lease payments.....		<u>2,656</u>
Less: Interest implicit in obligations.....		<u>(992)</u>
Total lease financing obligations.....	\$	<u><u>1,664</u></u>

The interest rate on lease financing obligations was 8.6% at January 1, 2017. Interest expense associated with lease financing obligations was 0.1 million, for each of the years ended January 1, 2017, January 3, 2016, and December 28, 2014.

9. Income Taxes

The Company's income tax provision was comprised of the following:

	Year Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Current:			
Federal.....	\$ 11,979	\$ 14,086	\$ 17,335
Foreign.....	372	396	380
State.....	1,865	2,081	2,291
	<u>14,216</u>	<u>16,563</u>	<u>20,006</u>
Deferred:			
Federal.....	(4,908)	5,318	417
State.....	(792)	139	46
	<u>(5,700)</u>	<u>5,457</u>	<u>463</u>
Valuation allowance.....	(180)	26	494
	<u>\$ 8,336</u>	<u>\$ 22,046</u>	<u>\$ 20,963</u>

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

9. Income Taxes (cont.)

Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. The components of deferred income tax assets and liabilities at January 1, 2017 and January 3, 2016 were as follows:

	<u>January 1, 2017</u>	<u>January 3, 2016</u>
Deferred income tax assets:		
Accrued vacation benefits	1,640	1,494
Incentive compensation	986	1,571
Other accruals	3,924	3,188
Deferred income on sale-leaseback of real estate	9,861	10,929
Lease financing obligations	162	133
Occupancy costs	8,036	5,840
Tax credit carryforwards	1,148	1,036
Other	1,738	1,618
Gross deferred income tax assets	27,495	25,809
Deferred income tax liabilities:		
Property and equipment depreciation	(8,311)	(12,176)
Amortization of other intangibles, net	(3,250)	(3,211)
Other	(701)	(889)
Gross deferred income tax liabilities	(12,262)	(16,276)
Less: Valuation allowance	(856)	(1,036)
Net deferred income tax assets	<u>\$ 14,377</u>	<u>\$ 8,497</u>

The Company establishes a valuation allowance to reduce the carrying amount of deferred income tax assets when it is more likely than not that it will not realize some portion or all of the tax benefit of its deferred tax assets. The Company evaluates whether its deferred income tax assets are probable of realization on a quarterly basis. In performing this analysis, the Company considers all available evidence including historical operating results, the estimated timing of future reversals of existing taxable temporary differences and estimated future taxable income exclusive of reversing temporary differences and carryforwards. At January 1, 2017 and January 3, 2016, the Company had a valuation allowance of \$856 and \$1,036 respectively, against net deferred income tax assets due to foreign income tax credit carryforwards where it was determined to be more likely than not that the deferred income tax asset amounts would not be realized. The valuation allowance decreased \$180 in 2016 and increased \$26 in 2015, primarily due to foreign tax credit carryforwards, net of expired foreign income tax credits. The estimation of future taxable income for federal and state purposes and the Company's ability to realize deferred income tax assets can significantly change based on future events and operating results.

The Company's effective tax rate was 33.3%, 36.4%, and 36.7% for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, respectively. A reconciliation of the statutory federal income tax provision to the effective tax provision was as follows:

	<u>Year Ended</u>		
	<u>January 1, 2017</u>	<u>January 3, 2016</u>	<u>December 28, 2014</u>
Statutory federal income tax provision	\$ 8,767	\$ 21,204	\$ 19,999
State income taxes, net of federal benefit	689	1,435	1,453
Change in valuation allowance	(180)	26	494
Non-deductible expenses	(3)	260	293
Foreign taxes	372	396	380
Employment tax credits	(905)	(889)	(1,174)
Foreign tax credits	(372)	(396)	(380)
Other	(32)	10	(102)
	<u>\$ 8,336</u>	<u>\$ 22,046</u>	<u>\$ 20,963</u>

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

9. Income Taxes (cont.)

The Company recognizes interest and/or penalties related to uncertain tax positions in income tax expense. As of January 1, 2017 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 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 uncertainties regarding the timing of any examinations, the Company does not expect unrecognized tax benefits to significantly change in the next twelve months.

10. Stock-Based Compensation

The Company established the Fiesta Restaurant Group, Inc. 2012 Stock Incentive Plan (the "Fiesta Plan") in order to be able to compensate its employees and directors by issuing stock options, stock appreciation rights, or stock awards to them under this plan. The aggregate number of shares of stock authorized for distribution under the Fiesta Plan is 3,300,000. As of January 1, 2017, there were 2,169,321 shares available for future grants under the Fiesta Plan.

During the years ended January 1, 2017, January 3, 2016 and December 28, 2014, the Company granted certain employees and directors in the aggregate 97,859, 50,600 and 80,290 non-vested restricted shares, respectively, under the Fiesta Plan. Shares granted to employees during the years ended January 1, 2017, January 3, 2016 and December 28, 2014 vest and become non-forfeitable over a four year vesting period, or for certain grants, at the end of a four year vesting period. Shares granted to directors during the years ended January 1, 2017, January 3, 2016 and December 28, 2014 vest and become non-forfeitable over a one year vesting period. The weighted average fair value at the grant date for restricted non-vested shares issued during the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$34.98, \$61.47 and \$44.22, respectively. The grant date fair value of each non-vested share award was determined based on the closing price of the Company's stock on the date of grant.

During the years ended January 1, 2017, January 3, 2016 and December 28, 2014, the Company granted certain employees 39,453, 27,508 and 24,252 restricted stock units, respectively, under the Fiesta Plan. Certain of the restricted stock units vest and become non-forfeitable over a four year vesting period, certain of the restricted units vest and become non-forfeitable at the end of a four year vesting period, and certain of the restricted stock units vest at the end of a three year vesting period. The weighted average fair value at grant date for the restricted stock units issued to employees during the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$35.25, \$63.93 and \$45.04. The grant date fair value of each restricted stock unit award was determined based on the closing price of the Company's stock on the date of grant.

During the years ended January 1, 2017 and January 3, 2016, the Company granted 33,691 and 17,501 non-vested restricted shares, respectively, and 33,691 and 17,501 restricted stock units, respectively, under the Fiesta Plan to certain employees subject to financial performance conditions. The non-vested restricted shares vest and become non-forfeitable over a four year vesting period subject to the attainment of financial performance conditions. The restricted stock units vest and become non-forfeitable at the end of a three year vesting period. The number of shares into which the restricted stock units convert is based on the attainment of certain financial performance conditions and for the restricted stock units granted during the years ended January 1, 2017 and January 3, 2016, ranges from no shares, if the minimum financial performance condition is not met, to 67,382 and 35,002 shares, respectively, if the maximum financial performance condition is met. The weighted average fair value at grant date for both restricted non-vested shares and restricted stock units subject to performance conditions granted during the years ended January 1, 2017 and January 3, 2016 was \$35.25 and \$65.01, respectively.

Stock-based compensation expense is measured at the grant date based on the fair value of the award and is recognized as expense over the applicable requisite service period of the award (the vesting period) using the

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

10. Stock-Based Compensation (cont.)

straight-line method. Stock-based compensation expense for the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$3.3 million, \$4.3 million and \$3.5 million, respectively. As of January 1, 2017, the total unrecognized stock-based compensation expense related to non-vested shares and restricted stock units was approximately \$3.4 million. At January 1, 2017, the remaining weighted average vesting period for non-vested restricted shares was 1.7 years and restricted stock units was 1.8 years.

During 2016, a portion of the awards previously granted to the Company's former Chief Executive Officer were modified and vested in connection with his retirement. The modification reduced stock compensation expense by \$0.1 million.

A summary of all non-vested restricted shares and restricted stock units activity for the year ended January 1, 2017 is as follows:

	Non-Vested Shares		Restricted Stock Units	
	Shares	Weighted Average Grant Date Price	Units	Weighted Average Grant Date Price
Outstanding at January 3, 2016	257,618	\$ 30.69	42,840	\$ 56.46
Granted	97,859	34.98	39,453	35.25
Vested/Released	(183,369)	24.83	(669)	51.27
Forfeited	(42,756)	40.57	(30,179)	45.67
Outstanding at January 1, 2017	129,352	\$ 37.94	51,445	\$ 46.59

The fair value of the shares vested and released during the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$5.2 million, \$11.9 million and \$12.8 million, respectively.

11. Business Segment Information

The Company is engaged in the fast-casual restaurant industry, with two restaurant concepts (each of which is an operating segment): Pollo Tropical and Taco Cabana. Pollo Tropical restaurants offer a wide variety of freshly prepared Caribbean inspired food, while our Taco Cabana restaurants offer a broad selection of freshly prepared Mexican inspired food.

Each segment's accounting policies are the same as those described in the summary of significant accounting policies in Note 1. The Company reports more than one measure of segment profit or loss to the chief operating decision maker for the purposes of allocating resources to the segments and assessing their performance. The primary measures of segment profit or loss used to assess performance and allocate resources are income before taxes and Adjusted EBITDA, which is defined as earnings attributable to the applicable operating segment before interest, income taxes, depreciation and amortization, impairment and other lease charges, stock-based compensation expense and other income and expense. Although the chief operating decision maker uses Adjusted EBITDA as a measure of segment profitability, in accordance with Accounting Standards Codification 280, Segment Reporting, the following table includes segment income before taxes, which is the measure of segment profit or loss determined in accordance with the measurement principles that are most consistent with the principles used in measuring the corresponding amounts in the consolidated financial statements.

The "Other" column includes corporate related items not allocated to reportable segments and consists primarily of corporate owned property and equipment, miscellaneous prepaid costs, capitalized costs associated with the issuance of indebtedness, corporate cash accounts, a current income tax receivable, and advisory fees related to a previously proposed separation transaction.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

11. Business Segment Information (cont.)

<u>Year Ended</u>	<u>Pollo Tropical</u>	<u>Taco Cabana</u>	<u>Other</u>	<u>Consolidated</u>
January 1, 2017:				
Restaurant sales	\$ 399,736	\$ 309,220		\$ 708,956
Franchise revenue	2,062	752		2,814
Cost of sales	126,539	88,070		214,609
Restaurant wages and related expenses ⁽¹⁾	93,958	91,347		185,305
Restaurant rent expense	19,998	17,495		37,493
Other restaurant operating expenses	54,198	42,259		96,457
Advertising expense	14,819	11,981		26,800
General and administrative expense ⁽²⁾	33,776	21,486	822	56,084
Depreciation and amortization	23,587	13,189		36,776
Pre-opening costs	4,837	674		5,511
Impairment and other lease charges	24,419	1,225		25,644
Interest expense	930	1,241		2,171
Income (loss) before taxes	4,639	21,231	(822)	25,048
Capital expenditures	65,789	13,206	3,370	82,365
January 3, 2016:				
Restaurant sales	\$ 364,544	\$ 320,040		\$ 684,584
Franchise revenue	2,197	611		2,808
Cost of sales	121,689	95,639		217,328
Restaurant wages and related expenses ⁽¹⁾	81,647	92,575		174,222
Restaurant rent expense	16,003	17,100		33,103
Other restaurant operating expenses	45,376	41,909		87,285
Advertising expense	9,527	12,090		21,617
General and administrative expense ⁽²⁾	31,142	23,379		54,521
Depreciation and amortization	18,000	12,575		30,575
Pre-opening costs	4,310	257		4,567
Impairment and other lease charges	510	1,872		2,382
Interest expense	806	1,083		1,889
Income before taxes	38,021	22,561		60,582
Capital expenditures	73,129	12,294	2,147	87,570
December 28, 2014:				
Restaurant sales	\$ 305,404	\$ 303,136		\$ 608,540
Franchise revenue	2,072	531		2,603
Cost of sales	100,468	91,782		192,250
Restaurant wages and related expenses ⁽¹⁾	67,487	87,653		155,140
Restaurant rent expense	12,473	17,172		29,645
Other restaurant operating expenses	38,331	40,590		78,921
Advertising expense	7,714	11,779		19,493
General and administrative expense ⁽²⁾	26,672	22,742		49,414
Depreciation and amortization	11,596	11,451		23,047
Pre-opening costs	3,385	676		4,061
Impairment and other lease charges	254	109		363
Interest expense	1,035	1,193		2,228
Income before taxes	38,061	19,078		57,139
Capital expenditures	52,355	17,969	3,755	74,079
Identifiable Assets:				
January 1, 2017	\$ 263,868	\$ 165,195	\$ 12,502	\$ 441,565
January 3, 2016	237,065	165,549	13,031	415,645
December 28, 2014	177,923	167,729	12,304	357,956

(1) Includes stock-based compensation expense of \$142, \$156 and \$71 for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, respectively.

(2) Includes stock-based compensation expense of \$3,141, \$4,137 and \$3,426 for the years ended January 1, 2017, January 3, 2016 and December 28, 2014, respectively.

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

12. Net Income per Share

The Company computes basic net income per share by dividing net income applicable to common shares by the weighted average number of common shares outstanding during each period. Our non-vested restricted shares contain a non-forfeitable right to receive dividends on a one-to-one per share ratio to common shares and are thus considered participating securities. The impact of the participating securities is included in the computation of basic net income per share pursuant to the two-class method. The two-class method of computing earnings per share is an earnings allocation formula that determines earnings attributable to common shares and participating securities according to dividends declared (whether paid or unpaid) and participation rights in undistributed earnings. Net income per common share is computed by dividing undistributed earnings allocated to common stockholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and non-vested restricted shares based on the weighted average shares outstanding during the period.

Diluted earnings per share reflects the potential dilution that could occur if our restricted stock units were to be converted into common shares. Restricted stock units with performance conditions are only included in the diluted earnings per share calculation to the extent that performance conditions have been met at the measurement date. We compute diluted earnings per share by adjusting the basic weighted average number of common shares by the dilutive effect of the restricted stock units, determined using the treasury stock method.

Weighted average outstanding restricted stock units totaling 9,379, 4,491 and 5,899 shares were not included in the computation of diluted earnings per share for the twelve months ended January 1, 2017, January 3, 2016 and December 28, 2014, respectively, because to do so would have been antidilutive.

The computation of basic and diluted net income per share is as follows:

	Year Ended		
	January 1, 2017	January 3, 2016	December 28, 2014
Basic and diluted net income per share:			
Net income	\$ 16,712	\$ 38,536	\$ 36,176
Less: income allocated to participating securities	135	441	647
Net income available to common stockholders.	<u>\$ 16,577</u>	<u>\$ 38,095</u>	<u>\$ 35,529</u>
Weighted average common shares, basic	26,682,227	26,515,029	26,293,714
Restricted stock units	6,952	7,167	2,335
Weighted average common shares, diluted.	<u>26,689,179</u>	<u>26,522,196</u>	<u>26,296,049</u>
Basic net income per common share	<u>\$ 0.62</u>	<u>\$ 1.44</u>	<u>\$ 1.35</u>
Diluted net income per common share	<u>\$ 0.62</u>	<u>\$ 1.44</u>	<u>\$ 1.35</u>

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

13. Commitments and Contingencies

Lease Assignments. Taco Cabana has assigned three leases to various parties on properties where it no longer operates restaurants with lease terms expiring on various dates through 2029. The assignees are responsible for making the payments required by the leases. The Company is a guarantor under one of the leases, and it remains secondarily liable as a surety with respect to two of the leases. The maximum potential liability for future rental payments that the Company could be required to make under these leases at January 1, 2017 was \$1.7 million. The Company could also be obligated to pay property taxes and other lease related costs. The obligations under these leases will generally continue to decrease over time as the operating leases expire. The Company does not believe it is probable that it will be ultimately responsible for the obligations under these leases.

Legal Matters. The Company is a party to legal proceedings incidental to the conduct of business, including the matter described below. The Company records accruals for outstanding legal matters when it believes it is probable that a loss will be incurred and the amount can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal matters that could affect the amount of any accrual and developments that would make a loss contingency both probable and reasonably estimable. If a loss contingency is not both probable and estimable, the Company does not establish an accrued liability.

On November 24, 2015, Pollo Tropical received a legal demand letter alleging that assistant managers were misclassified as exempt from overtime wages under the Fair Labor Standards Act. On September 30, 2016, prior to any suit being filed, Pollo Tropical reached a settlement with seven named individuals and a proposed collective action class that will allow current and former assistant managers to receive notice and opt-in to the settlement. Pollo Tropical denies any liability or unlawful conduct. The Company has recorded a charge of \$0.8 million to cover the estimated costs related to the settlement, including estimated payments to individuals that opt-in to the settlement, premium payments to named individuals, attorneys' fees for the individuals' counsel, and related settlement administration costs. The charge does not include legal fees incurred by Pollo Tropical in defending the action. The settlement, which is subject to approval by an arbitrator and a judicial body, will result in dismissal with prejudice for the named individuals and all individuals that opt-in to the settlement.

On September 29, 2014, Daisy, Inc., an automotive repair shop in Cape Coral, Florida, filed a putative class action suit against Pollo Tropical in the United States District Court for the Middle District of Florida. The suit alleged that Pollo Tropical engaged in unlawful activity in violation of the Telephone Consumer Protection Act, § 227 et seq. occurring in December 2010 and January 2011. During the first quarter of 2016, Pollo Tropical reached a settlement with the plaintiff that resulted in dismissal of the case and paid all settlement claims.

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

14. Retirement Plans

Fiesta offers the Company's salaried employees the option to participate in the Fiesta Corporation Retirement Savings Plan (the "Retirement Plan"). The Retirement Plan includes a savings option pursuant to section 401(k) of the Internal Revenue Code in addition to a post-tax savings option. Fiesta may elect to contribute to the Retirement Plan on an annual basis. Contributions made by Fiesta to the Retirement Plan for the Company's employees are made after the end of each plan year. For 2016 and 2015, Fiesta's annual contribution is equal to 50% of the employee's contribution up to a maximum Fiesta contribution of 3% of eligible compensation per participating employee. For 2014, Fiesta's annual contribution was equal to 50% of the employee's contribution up to a maximum Fiesta contribution \$0.5 per participating employee. Under the Retirement Plan, Fiesta contributions begin to vest after 1 year and fully vest after 5 years of service. A year of service is defined as a plan year during which an employee completes at least 1,000 hours of service. Participating employees may contribute up to 50% of their salary annually

FIESTA RESTAURANT GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars, except per share amounts)

14. Retirement Plans (cont.)

to either of the savings options, subject to other limitations. The employees have various investment options available under a trust established by the Retirement Plan. Retirement Plan employer matching expense for the years ended January 1, 2017, January 3, 2016 and December 28, 2014 was \$0.3 million, \$0.3 million and \$0.2 million respectively.

Fiesta also has a Deferred Compensation Plan which permits employees not eligible to participate in the Retirement Plan because they have been excluded as “highly compensated” employees (as so defined in the Retirement Plan) to voluntarily defer portions of their base salary and annual bonus. All amounts deferred by the participants earn interest at 8% per annum. There is no Company matching on any portion of the funds. At January 1, 2017 and January 3, 2016, a total of \$2.0 million and \$1.7 million, respectively, was deferred by the Company’s employees under the Retirement Plan, including accrued interest.

15. Selected Quarterly Financial and Earnings Data (Unaudited)

	Year Ended January 1, 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue.	\$ 176,677	\$ 181,532	\$ 182,256	\$ 171,305
Income (loss) from operations	16,141	14,576	(6,737) ⁽¹⁾	3,239 ⁽¹⁾
Net income (loss)	9,895	8,916	(4,531) ⁽¹⁾	2,432 ⁽¹⁾
Basic net income (loss) per share	\$ 0.37	\$ 0.33	\$ (0.17)	\$ 0.09
Diluted net income (loss) per share	\$ 0.37	\$ 0.33	\$ (0.17)	\$ 0.09

	Year Ended January 3, 2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue.	\$ 163,875	\$ 171,900	\$ 172,105	\$ 179,512
Income from operations	17,458	18,646	13,009	13,358
Net income	10,501	11,249	7,945	8,841
Basic net income per share	\$ 0.39	\$ 0.42	\$ 0.30	\$ 0.33
Diluted net income per share	\$ 0.39	\$ 0.42	\$ 0.30	\$ 0.33

(1) The Company recognized impairment and other lease charges of \$18.5 million and \$7.0 million in the third and fourth quarters of 2016, respectively (See Note 4).

FIESTA RESTAURANT GROUP, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED JANUARY 1, 2017, JANUARY 3, 2016 AND DECEMBER 28, 2014
(In thousands of dollars)

<u>Description</u>	<u>Column B</u> Balance at beginning of period	<u>Column C</u> Charged to costs and expenses Charged to other accounts		<u>Column D</u> Deduction	<u>Column E</u> Balance at end of period
Year Ended January 1, 2017:					
Deferred income tax valuation allowance.	\$ 1,036	\$ (180)	\$ —	\$ —	\$ 856
Year Ended January 3, 2016:					
Deferred income tax valuation allowance.	1,010	26	—	—	1,036
Year Ended December 28, 2014:					
Deferred income tax valuation allowance.	516	494	—	—	1,010

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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 on the 27th day of February 2017.

FIESTA RESTAURANT GROUP, INC.

Date: February 27, 2017

/S/ DANNY K. MEISENHEIMER

(Signature)

Danny K. Meisenheimer
Interim Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ JACK A. SMITH</u> Jack A. Smith	Director and Chairman of the Board of Directors	February 27, 2017
<u>/s/ DANNY K. MEISENHEIMER</u> Danny K. Meisenheimer	Interim Chief Executive Officer	February 27, 2017
<u>/s/ LYNN S. SCHWEINFURTH</u> Lynn S. Schweinfurth	Senior Vice President, Chief Financial Officer and Treasurer	February 27, 2017
<u>/s/ CHERI L. KINDER</u> Cheri L. Kinder	Vice President, Corporate Controller	February 27, 2017
<u>/s/ BRIAN P. FRIEDMAN</u> Brian P. Friedman	Director	February 27, 2017
<u>/s/ NICHOLAS DARAVIRAS</u> Nicholas Daraviras	Director	February 27, 2017
<u>/s/ STACEY RAUCH</u> Stacey Rauch	Director	February 27, 2017
<u>/s/ BARRY J. ALPERIN</u> Barry J. Alperin	Director	February 27, 2017
<u>/s/ STEPHEN P. ELKER</u> Stephen P. Elker	Director	February 27, 2017

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