

CUCOS INC  
Form 10KSB40  
September 28, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

Annual Report under Section 13 or 15(d) of the  
Securities Exchange Act of 1934 (Fee Required)  
for the fiscal year ended July 1, 2001

Transition report under Section 13 or 15(d) of the  
Securities Exchange Act of 1934 (No Fee Required) for the transition period  
from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-12701

CUCOS INC.

(Exact name of Small Business Issuer in its charter)

Louisiana

72-0915435

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification  
No.)

110 Veterans Blvd., Suite 222, Metairie, Louisiana

70005

(Address of principal executive offices)

(Zip Code)

Issuer's telephone number: (504) 835-0306

Securities registered under Section 12(b) of the Act: None

Securities registered under Section 12(g) of the Act:

Common Stock, no par value

(Title of Class)

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

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Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of issuer's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Issuer's revenues for its most recent fiscal year: \$14,221,544.

Aggregate market value (based on the average bid and asked prices in the over the-counter market) of the voting stock held by non-affiliates of the Issuer as of September 25, 2001: approximately 2,663,605.

Number of shares outstanding of each of the Issuer's Classes of common stock as of September 4, 2001: 2,663,605 shares of Common Stock, no par value.

### Documents Incorporated By Reference.

Portions of the definitive Proxy Statement for the 2001 Annual Meeting of Shareholders (the "2001 Proxy Statement") are incorporated by reference into Part III of this Form 10-KSB.

## INTRODUCTORY

Definitions. Except where the context indicates otherwise, the following terms have the following respective meanings when used in this Annual Report: the "Annual Report" means this report on Form 10-KSB, "Common Stock" means the common stock, no par value per share, of Cucos Inc., the "Company" or "Cucos" means Cucos Inc. and the "fiscal 2001" means the 52 weeks ended July 1, 2001, which is the year for which this Annual Report is filed.

Presentation and Dates of Information. The Item numbers appearing in this Annual Report correspond with those used in Securities and Exchange Commission (the "Commission") Form 10-KSB (and, to the extent that it is incorporated into Form 10-KSB, the letters used in the Commission's Regulation S-B) as effective on the date hereof, which specifies the information required to be included in Annual Reports to the Commission. The information contained in this Annual Report is, unless indicated to be given as of a specified date or for a specified period, given as of September 4, 2001. In computing the aggregate market value of the Company's voting stock held by non-affiliates disclosed on the cover page to this Annual Report, the following stockholders were treated as affiliates: all executive officers and directors of the Company; any person owning more than 10% of the Company's Common Stock.

## PART I

### Item 1.

#### Business

The Company is a Louisiana corporation organized in 1981. In November 1999, the shareholders of the Company acted by written consent to remove and replace six members of the board of directors. In August 2000, Jacksonville Restaurant Acquisition Corp. ("JRAC") acquired 1.2 million shares of Common Stock and became the majority shareholder of the Company. In connection with acquiring control of the Company, JRAC made a preliminary review of various potential business strategies. These strategies include acquiring other private companies in the casual dining segment and then considering strategic alternatives. The strategy also includes refurbishing existing Cucos restaurants and pursuing the expansion of both company and franchised Cucos restaurants. The strategies are totally dependent on JRAC obtaining the necessary financing which has not been activated to date.

The Company operates and franchises full-service restaurants serving moderately priced Sonoran and Tex-Mex Mexican appetizers and entrees and complementing alcoholic and non-alcoholic beverages.

At the end of the fiscal 2001, 14 restaurants were operating under the Cucos name, of which 10 were owned by the Company and 4 by franchisees. There were seventeen restaurants in operation at the end of fiscal year 2000. During the fiscal year 2001, one franchised restaurant and two Company-owned restaurants closed.

#### COMPANY-OWNED RESTAURANTS

General. Cucos Mexican Restaurants are full service restaurants emphasizing fresh ingredients and its own proprietary recipes.

Cucos serves a variety of traditional Mexican dishes and appetizers such as sizzling steak, chicken, or shrimp Fajitas, Burritos, Enchiladas, Tamales, and Chimichangas. Cucos also serves several large combination dinners. The restaurants serve vegetarian items as well as burgers. Cucos' margarita was voted Best Margarita in New Orleans for the eighth year in a row by *New Orleans Magazine*. Cucos was also voted Best Mexican Restaurant in New Orleans by the readers of *New Orleans Magazine* for the eighth year and by *Gambit* this year.

The restaurants are decorated with Mexican antiques and furniture, terra-cotta tile and large, hand-painted colorful murals, which are unique to each Cucos restaurant. Mexican pottery, southwestern plants, colorful hand-made Mexican flowers and festive lighting add more Mexican touches to the casual restaurants.

Food sales accounted for approximately 79% of revenues at the Company-owned restaurants operated in fiscal 2001, with alcoholic and other beverages representing approximately 20% of revenues. Special luncheon items range in price from \$5.50 to \$7.65. The prices of the specialty and combination dinner items range from \$5.95 to \$12.95. The per person average check, including beverage, for fiscal 2001 was \$11.46 and the average dining time per table was approximately 45 minutes.

Restaurant Management and Supervision. Each Company-owned restaurant operates under uniform standards set by management relating to the preparation and service of food and drink, appearance and conduct of employees, and cleanliness of facilities. Food and beverage products are periodically tested for quality and uniformity of portions. In accordance with the Company's standards, each restaurant is run by a general manager, assisted by two managers, a kitchen supervisor, a service supervisor and a bar supervisor. At least one manager is on duty during all serving periods. Each of the Company-owned restaurants' general managers and managers receives, in addition to a salary, incentive compensation calculated as a percentage of sales and profits in excess of a predetermined base level.

The Company requires each candidate for general manager to undergo a training program designed to familiarize the candidate with all aspects of the Company's operations. A candidate serves as a manager before becoming a general manager. Persons selected for training as general managers normally have several years of food service experience.

Purchasing. Management believes that centralized purchasing is advantageous to the Company in that it has allowed it to take advantage of certain volume discounts. Fresh produce, beverages and certain other items are purchased by each Company-owned restaurant from local wholesalers. The Company believes that satisfactory local sources of supply are generally available for all of the other items it regularly uses in its restaurants. However, the Company's credit condition may limit its ability to identify alternative sources of suppliers.

Insurance. Insurance costs have risen considerably in the restaurant business. The Company carries fire and casualty insurance on its Company-owned restaurants and liability insurance in amounts which management feels is adequate for its operations.

Marketing. The Company advertises primarily by print and radio advertising. Its advertising promotes the name "Cucos" and emphasizes quality dining serving tasty food in a festive atmosphere at moderate prices.

#### FRANCHISED RESTAURANTS

The Company, during fiscal year 2002, plans to attempt to re-activate the franchising program, seeking new franchisees to help grow the system. No assurances can be given as to the number of franchise development areas that will be sold during the fiscal year 2002 or the impact of development fee revenues upon the Company's profitability and cash position during fiscal year 2002.

The development agreements generally obligate the developer to construct a specified number of Cucos restaurants within the licensed territory. The restaurants may be either new restaurants or conversions of existing restaurants, although the Company encourages franchisees to convert existing restaurants whenever possible (see "Expansion Program"). A developer must open new Cucos restaurants within the development territory in accordance with the schedule set forth in the development agreement. If a developer fails to open restaurants in accordance with the schedule, generally the Company may notify the developer that it is in default under the development agreement and may terminate the agreement 30 days thereafter if the default has not been cured.

Generally, a development agreement expires three years after the latest date set forth in the development schedule. During the first year after completion of the schedule, the Company is prohibited from either opening a Cucos restaurant or granting a franchise to someone other than the developer to establish a Cucos restaurant within the licensed territory. If during the second and third year after the completion of the schedule, the Company desires to establish additional restaurants within the licensed territory, the developer for that area has a right of first refusal to enter into additional development agreements with respect to such additional restaurants so long as the developer is in compliance with the then existing development agreement. If the developer exercises its right of first refusal, the developer is required to pay the fees for each restaurant then being charged to new developers. Upon expiration of the development agreement, the Company may open Company-owned restaurants in the previously licensed territory or grant franchises to other persons to open additional franchised restaurants in the previously licensed territory.

Development agreements provide for the payment of an initial nonrefundable development fee by the developer upon execution of the agreement. The development fee with respect to development agreements is generally \$15,000 per restaurant up to five restaurants and \$10,000 per restaurant thereafter. The Company anticipates that the amount of the development fee with respect to future development agreements will be based upon the size and nature of the area covered by the development agreement.

Before acquiring a site for a restaurant in the licensed territory, the developer must submit to the Company certain information concerning the site and certain market information. Upon the Company's approval of the site, the developer is required to enter into a license agreement with the Company with respect to the restaurant to be developed under the development agreement.

The license agreements generally have terms of 20 years from the date of their execution. However, if the license agreement pertains to a franchised restaurant that is leased, the license agreement terminates upon the earlier of 20 years from the commencement date of the lease or upon the termination or expiration of the primary term of the lease, plus any options to renew the lease.

Generally, franchisees are required to pay to the Company under the license agreement a negotiated up front initial License fee plus a continuing royalty fee of 4% of gross revenues at the restaurant. In addition, franchisees are required to pay a continuing monthly contribution to an advertising materials fund equal to .5% of gross revenues at the restaurant and if a national advertising fund or a regional advertising fund applicable to the franchisee's region is established by the Company (the Company has not done so to date), the franchisees must also pay to the Company continuing monthly contributions, for use by such funds, equal to amounts not to exceed 1% and 2% of gross revenues

of the restaurant, respectively, for the national media fund or the regional advertising fund in the franchisee's region. The Company has not established and currently lacks the resources to establish a national or regional advertising fund and accordingly has not required contributions for such funds.

The license agreement provides that the franchisees will comply strictly with the Company's standards, specifications, processes, procedures, requirements and instructions regarding the operation of the franchisee's restaurant. The Company is obligated to provide initial training programs for franchisees and to provide personnel for on-site assistance in opening each franchised restaurant. The Company has the right to approve the person designated by the franchisee to have overall supervisory authority over franchised restaurant operations or, if no such overall operations manager is designed, to approve each restaurant general manager.

Franchisees purchase food products and restaurant supplies conforming to the Company's specifications from independent suppliers. Alternate sources of these items are generally readily available. The Company may sell equipment, food or supplies to franchisees upon request, but otherwise does not intend to do so. The Company continues to sell a small amount of proprietary advertising materials. The Company provides confidential recipe spice packs to franchisees through a third party. The Company anticipates continuing these sales.

### EMPLOYEES

At the end of fiscal 2001, the Company-owned restaurants employed 474 persons, consisting of 355 part-time and 119 full-time persons, which included 32 full-time general managers and managers. In addition, 8 persons were employed at the Company's executive office. The Company endeavors to control its employee turnover rate by offering to all full-time restaurant employees certain paid benefits, including life insurance, health insurance and vacation. None of the Company's employees are represented by a labor union. The Company has experienced no work stoppages attributable to labor disputes and considers its employee relations to be satisfactory.

### COMPETITION

The restaurant business is highly competitive and is often affected by changes in taste and eating habits, by local and national economic conditions affecting spending habits, and by population and traffic patterns. The Company believes that the quality and price of food products are the principal means of competition in the restaurant industry. Also of importance are site locations, quality and speed of service, cleanliness, advertising and attractiveness of facilities.

The Company competes with several national chains including El Chico, Rio Bravo, Don Pablo's, El Patio, Chili's, Applebees, Olive Garden, LaFiesta, and Chevy's, as well as many local dining concepts. Several of the national chains have had significant funding available provided by public stock offerings, which has enabled them to expand significantly in the Company's smaller markets. These expansions have adversely impacted the Company's guest counts in the smaller markets. These national chains, as well as some regional chains, operate more restaurants and have greater financial resources and greater name recognition than the Company. In addition, gaming operations in the Company's Louisiana and Mississippi markets often offer food at discounted or below cost prices which represent an additional level of indirect competition in those markets.

### GOVERNMENT REGULATION

The Company's franchise operations are subject to a variety of laws regulating the marketing of franchises. Federal Trade Commission regulations impose certain disclosure requirements on persons engaged in the business of offering franchises. States in which the Company offers franchises also may have franchising laws that require registration prior to the offering of franchises for sale in those states or that afford franchisees substantive rights, including limiting the circumstances under which franchises may be terminated.

The Company is also subject to the Fair Labor Standards Act, which governs such matters as minimum wages, overtime, and other working conditions. Many of the Company's food service personnel are paid at rates related to the minimum wage and, accordingly, increases in the minimum wage increase the Company's labor costs.

Each of the Company's restaurants is subject to licensing and regulation by state liquor control boards and the state police in Louisiana (with respect to video poker), and by municipal health, sanitation, safety and fire department agencies. The Company expects that liquor sales and video poker revenues will account for a significant portion of the Company's revenues. During fiscal 2001, liquor sales and video poker revenues accounted for approximately 20.2% and 1.2%, respectively, of food and beverage revenues. The loss of an existing liquor license or video poker license would adversely affect the Company's operations at that restaurant.

The Company is also subject to the provisions of the Americans with Disabilities Act. The Company has remodeled its restaurants to meet these requirements where necessary.

MISCELLANEOUS

Seasonality. The Company's results are materially impacted by seasonality. Usually the highest sales periods occur in late spring and summer, with sales declining in the fall and winter. This is especially true for the Gulf Coast restaurants where sales are more dependent on tourism.

Service Marks, Trademarks and Copyrights. The Company is the owner of United States Service Mark Registration Nos. 1,509,612, dated October 18, 1988, for the mark CUCOS & DESIGN; and 1,941,214, dated December 12, 1995, for the mark CUCOS MEXICAN CAFE & DESIGN. The Company is also the owner of United States Trademark Registration Nos. 1,405,169, dated August 12, 1986, for the mark FRESH-ITAS (Cucos' version of fajitas) and 1,465,729, dated November 17, 1987, for the mark FRESH-ITA NACHOS (Cucos' version of fajita nachos). The Company is also the owner of United States Service Mark Registration No. 1,996,748, dated August 27, 1996, for the mark THE TASTE TO MAKE YOU SAY OLE` and United States Service Mark Registration No. 2,019,308, issued November 27, 1996, for the mark IT TASTES BETTER OUR WAY. Those registrations, unless sooner terminated by law, issued prior to November 16, 1989 have an effective term of 20 years and those issued on or after November 16, 1989 have an effective term of 10 years, unless sooner terminated by law, and all may be renewed for successive terms so long as the marks continue to be used by Company in interstate commerce for the specified services or goods. The Company also owns a service mark registration as issued by the State of Louisiana, dated July 14, 1987; a Tennessee State Registration, issued July 2, 1987; a Florida State Registration No. 707,637, dated July 17, 1987; an Alabama State Registration No. 103,383, issued July 14, 1987; a Mississippi State Registration No. 1,509,612, issued on July 27, 1987; and an Arkansas State Registration No. 181-87, issued on July 8, 1987, all for the service mark CU-CO's. These registrations are effective for a term of 10 years and may be renewed for successive terms. All of these registrations are valid and subsisting. In addition, the Company is the owner of Copyright Registration No. TXU 357-784 for the Cucos Power Manual and Copyright Registration No. PAU 1,195,506 for the Video, both dated November 4, 1988.

Item 2

Properties.

All of the Company-owned restaurants are located in facilities that are leased from third parties. The following table summarizes certain information concerning Company-operated restaurants located in facilities that are leased from others as of September 4, 2001.

| <u>Location</u> | <u>Opened/Acquired</u> | Size | Dining | Lease | Lease |
|-----------------|------------------------|------|--------|-------|-------|
|-----------------|------------------------|------|--------|-------|-------|

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|                               |                | <u>(Sq. Ft.)</u> | <u>Capacity</u> | <u>Expires</u> | <u>Option(s)</u><br><u>Through</u> |
|-------------------------------|----------------|------------------|-----------------|----------------|------------------------------------|
| New Orleans -<br>Metairie, LA | June 1981      | 5,138            | 136             | 2007           | 2027                               |
| Biloxi, MS                    | April 1982     | 5,600            | 159             | 2002           | 2032                               |
| New Orleans -<br>Westbank, LA | September 1983 | 4,800            | 147             | 2005           | 2015                               |
| Monroe, LA                    | June 1984      | 4,476            | 146             | 2004           | 2019                               |
| Slidell, LA                   | November 1984  | 5,300            | 139             | 2008           | 2018                               |
| Alexandria, LA                | March 1985     | 5,125            | 143             | 2005           | 2005                               |
| New Orleans -<br>Uptown, LA   | November 1985  | 4,152            | 120             | 2005           | 2015                               |
| Hammond, LA                   | July 1990      | 6,062            | 130             | 2002           | None                               |
| Birmingham, AL                | March 1992     | 4,560            | 150             | 2006           | 2012                               |
| Houma, LA                     | September 1992 | 6,000            | 148             | 2007           | 2017                               |
| Ruston, LA                    | February 1996  | 5,476            | 162             | 2003           | 2026                               |

The New Orleans-Westbank, Slidell and Birmingham locations are in strip shopping centers. The Hammond and Houma locations are in shopping malls. Six leased locations are freestanding buildings. The restaurant leases require the Company to pay real estate taxes, insurance and utilities, and to bear repair, maintenance and other expenses normally borne by the lessee under a triple net lease. In the opinion of the management of Company, the leased properties are adequately covered by insurance.

In addition to the leases above, the Company has leases on three restaurant properties that are no longer used in its operations. The properties have been subleased to other companies. The following table provides certain information about these properties:

| <u>Location</u> | <u>Lease Expires</u> | <u>Sublease Expires</u> |
|-----------------|----------------------|-------------------------|
| Montgomery, AL  | 2002                 | 2002                    |
| Columbus, GA    | 2004                 | 2004                    |
| Macon, GA       | 2011                 | 2011                    |

Item 3

Legal Proceedings.

On April 11, 1990, a franchisee filed a complaint in the 24th District Court, State of Louisiana, Parish of Jefferson, Case No. 397856-5, against the Company and certain of its officers alleging breach of contract and misrepresentation and seeks damages in excess of \$1.6 million. There has been no activity in this litigation for more than ten years except for a discovery request filed in January 1996, which avoided a dismissal of the litigation for non-prosecution. The Company believes the claims are without merit and the likelihood of a loss is remote.

Ronnie Natal Contractors, Inc. versus Cucos, Inc., Civil Action No. 95-17928, Section "L", Civil District Court for the Parish of Orleans, State of Louisiana. On January 22, 2001, a Consent Judgment was rendered in favor of Ronnie Natal Contractors, Inc. against Cucos Inc. Natal alleged it was owed \$64,934, and a subcontractor, Current Electric, was owed \$3,408.00 in connection with the build out of a Cucos restaurant in New Orleans, Louisiana. Cucos Inc. contended the restaurant at issue was not owned by Cucos, but rather a franchised restaurant owned by L.B.G., Inc., a closely held corporation controlled by former members of management of Cucos, Inc. The Company thought it was in the Company's best interest to settle this matter, and on January 8, 2001, the Company authorized a negotiated settlement of \$31,500.00. Cucos Inc. shall make 30 consecutive payments of \$1,000.00 on the first and fifteenth of each month beginning February 2, 2001, and a final payment of \$1,500.00 on May 2, 2002.

Item 4

. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of the Registrant's security holders, through the solicitation of proxies or otherwise, during the fourth quarter of the Fiscal Year.

PART II

Item 5

. Market for the Company's Common Stock and Related Shareholder Matters.

Cucos Inc. - Stock Data

The Company's Common Stock, which was formerly traded on The NASDAQ Small-Cap Market under the symbol CUCO, was delisted on February 2, 1999. The Company's Common Stock is currently listed on the OTC Bulletin Board. The following table sets forth the range of the high and low bid and ask prices for each of the quarters indicated for fiscal 2001 and fiscal 2000 as indicated by Yahoo Finance website.

| <u>Fiscal 2001</u>         | <u>High Ask</u> | <u>Low Bid</u> |
|----------------------------|-----------------|----------------|
| 1st Quarter ended 10/22/00 | \$2.000         | \$0.6562       |
| 2nd Quarter ended 1/14/01  | 0.7500          | 0.2969         |
| 3rd Quarter ended 4/8/01   | 0.3438          | 0.1875         |
| 4th Quarter ended 7/1/01   | 0.3000          | 0.1200         |
| <u>Fiscal 2000</u>         | <u>High Ask</u> | <u>Low Bid</u> |



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|                            |         |         |
|----------------------------|---------|---------|
| 1st Quarter ended 10/17/99 | \$0.875 | \$0.125 |
| 2nd Quarter ended 1/9/00   | 2.2650  | 0.6520  |
| 3rd Quarter ended 4/2/00   | 1.6875  | 1.0000  |
| 4th Quarter ended 7/2/00   | 1.3750  | 0.6250  |

On September 24, 2001, the closing bid and ask prices for the Company's Common Stock were \$.13 bid and \$.21 ask.

The foregoing quotations reflect inter-dealer prices, without retail markup, markdown or commission and may not necessarily represent actual transactions.

Since becoming a public company, the Company has paid no cash dividends and has no present capability or intention of paying dividends. Payment of dividends is precluded by the Company's current financial condition and is prohibited by the Company's agreements with its commercial lenders.

Approximate number of shareholders (including beneficial shareholders through nominee registration) as of September 23, 2001: 736.

On January 26, 2000, the Company sold 300,000 shares of its Series A Preferred Stock, no par value per share (the Preferred Stock), to JRAC for \$300,000. On February 1, 2000, the Company sold 100,000 shares of Preferred Stock to JRAC for \$100,000. Each share of Preferred Stock is convertible at JRAC's option into one share of the Company's Common Stock. These shares were issued in transactions exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), in a private offering to a single investor.

On February 21, 2000, Mr. Daniel Earles, former Executive Vice President of Operations of the Company, exercised his options to purchase 11,875 shares of Common Stock at a price of \$1.00 per share. These shares were issued in a transaction exempt from registration pursuant to Section 4(2) of the Securities Act.

On January 20, 2000, and on May 16, 2000, the Company granted options to purchase an aggregate of 135,000 shares of Common Stock to some of its officers and directors. These options were issued in transactions exempt from registration pursuant to Section 4(2) of the Securities Act.

On August 24, 2000, the Company granted options to purchase an aggregate of 50,000 shares of Common Stock to some of its outside directors. These options were issued in transactions exempt from registration pursuant to Section 4(2) of the Securities Act.

## Item 6

### Management's Discussion and Analysis.

#### Overview

The Company operates and franchises full-service restaurants serving moderately priced Sonoran and Tex-Mex Mexican appetizers and entrees and complementing alcoholic and non-alcoholic beverages. At the end of fiscal 2001, 14 restaurants were operating under the Cucos name, 10 of which were owned by the Company and 4 by franchisees. There were seventeen restaurants in operation at the end of fiscal 2000. During fiscal 2001, one franchised restaurant and two Company-owned restaurants were closed.

## Fiscal 2001 Compared to Fiscal 2000

Sales of Food and Beverages declined \$1,870,845 (11.6%) to \$14,221,554 from \$16,082,399. During Fiscal 2001, the company-owned restaurant in Pascagoula, Mississippi, was closed at the end of the Third Quarter. During Fiscal 2000, two company-owned restaurants in Alabama were closed during the first quarter. The decrease in sales is primarily the result of three fewer restaurants in Fiscal 2001 accounting for \$617,985 of the decline. Sales of Food and Beverages at Cucos' restaurants open throughout the 2001 and 2000 fiscal years (the "Comparable Cucos Restaurants") decreased 8% or \$1,178,397. Guest counts declined for Comparable Cucos Restaurants 8.5%. In addition, Video Poker revenues declined \$64,463 (27.7%) due to the effect of a new contract with its Video Poker Operator.

Net Royalty and Franchisee Revenues decreased \$12,232 (9.76%) to \$113,079 from \$125,311. The decrease is due to \$17,500 in Development Fees forfeited by two franchisees that gave up Development rights during Fiscal 2000. This decrease was offset by an increase in royalties of \$4,570 (4.2%) from the remaining four franchised restaurants and a reduction in franchise supervision expenses.

Commissary and Other Income increased \$5,510 (31.8%) to \$22,828 from \$17,318. During the Second Quarter of Fiscal 2000, the Company's contract to manage a franchise restaurant was cancelled. The reduction in management fee income and the Company's share of profit from this restaurant was \$37,409. The loss of this revenue was partially offset by the decline of expense the Company incurred in Fiscal 2000 when its Commissary was closed and by incentive income the Company received in Fiscal 2001 from the new Video Poker Operator.

Restaurant Cost of Sales decreased \$655,254 (15%) to \$3,708,105 from \$4,363,359. The reduction due to the three closed restaurants was \$169,679, while Comparable Cucos Restaurants' Cost of Sales decreased \$485,575. Cost of Sales as a percentage of sales of Food and Beverage Sales decreased .09% for Comparable Cucos Restaurants.

Restaurant Labor and Benefits decreased \$705,477 (11.8%) to \$5,290,839 from \$5,996,316. Closed restaurants accounted for \$249,674 while Comparable Cucos Restaurants Labor and Benefit costs declined \$455,803. Comparable Labor and Benefit costs increased .71% as a percentage of sales.

Other Operating Expenses decreased \$752 (.03%) to \$2,430,876 from \$2,431,628. Comparable Cucos Restaurants Other Operating Costs increased \$85,373 (3.82%) offset by decreased costs of \$86,125 associated with the closed restaurants. The increase in costs for Comparable Cucos Restaurants is due primarily to increased utility costs.

Occupancy Costs decreased \$104,824 (6.1%) to \$1,614,364 from \$1,719,188. The reduction attributed to the closed restaurants was \$69,972, while Comparable Cucos Restaurants Occupancy expenses declined \$34,852. As a percentage of sales, Comparable Cucos Restaurants Occupancy Costs declined 2.2%.

Operations Supervision Expenses declined \$154,875 (27.6%) to \$406,202 from \$561,077. The decrease is primarily a reduction in supervisory costs and bad debt provision offset by an increase in management training labor and benefits.

Corporate Expenses decreased \$243,072 (20.4%) to \$950,434 from \$1,193,506. The reductions are attributable to reductions of personnel in the marketing, accounting, and administration departments, reduced management salary expense, downsizing of the corporate offices, and reduced accounting and legal fees. These reductions were offset by fewer reductions of vendor payables negotiated by a consultant begun in Fiscal 2000.

During Fiscal 2000, the Company recorded a charge of \$364,251 in connection with the settlement with the former Chairman and CEO. The expense primarily included amounts attributable to the transfer of the Company's interest in a franchised restaurant to the former Chairman and CEO and the forgiveness of a receivable from a

company affiliated with the former Chairman and CEO.

Closed units and impaired assets recorded income of \$126,516 in Fiscal 2001. The settlement of a lease for equipment at the Meridian, Mississippi, unit, closed in Fiscal 1999, resulted in savings of \$222,102. These savings were offset by closing expenses related to the Pascagoula, Mississippi, restaurant, and an adjustment of impaired property in Macon and Columbus, Georgia. During Fiscal 2000, management's effort to dispose of these assets and settle related lease liabilities resulted in a net benefit of \$117,304.

Interest expense decreased \$68,709 (9%) to \$698,089 from \$766,798. The decline is primarily reduced interest expense associated with the credit facility, settlement of the Meridian equipment lease, and declining balances on other leases offset by new loans provided by JRAC, which will be discussed in the Liquidity and Capital Resources discussed below.

### Liquidity and Capital Resources

The Company continues to incur net losses, is in default with its commercial lender, has a net capital deficiency, and lacks short-term or long-term financial resources. There can be no assurance, accordingly, that the Company will be able to meet its obligations as they come due in 2002.

In Fiscal 2001, the Company's operating activities used \$23,852 versus \$407,298 in Fiscal 2000. The change in net cash used by operating activities from Fiscal 2000 to Fiscal 2001 resulted primarily from the settlement of the lease for the Meridian, Mississippi, unit, and an increase in deferred revenue. During Fiscal 2000, the Company significantly reduced its trade accounts payable. During Fiscal 2001, the Company decreased its trade payables, but not to the extent of Fiscal 2000.

During Fiscal 2001, the Company's working capital needs were financed by loans of \$320,000 from a line of credit to Jacksonville Restaurants Acquisition Corp. ("JRAC"). During Fiscal 2000, the Company funded working capital needs through the sale of \$400,000 of Convertible Preferred Stock to JRAC.

Net cash used by investing activities was \$154,059 in Fiscal 2001 compared to \$86,120 in Fiscal 2000. In Fiscal 2000, the Company received \$78,600 from the sale of assets for a closed unit.

Net cash provided by financing activities was \$250,814 in Fiscal 2001, including the loans from JRAC totaling \$320,000 netted against \$69,186 used for payments on long-term debt. Net cash provided by financing activities was \$245,720 in Fiscal 2000, and included \$400,000 of proceeds from the sale of convertible preferred stock and \$166,155 of principal payments on long-term debt.

The Company considers earnings before interest, taxes, depreciation and amortization (EBITDA) to be a relevant indicator of liquidity. EBITDA is not a measure defined by accounting principles generally accepted in the United States, however. The amounts presented below may not be comparable to similarly titled measures reported by other companies. EBITDA decreased to \$445,908 for fiscal year ended July 1, 2001 compared to \$503,347 for fiscal year ended July 2, 2000.

|          | EBITDA            |                |
|----------|-------------------|----------------|
|          | Fiscal Year Ended |                |
|          | July 1, 2001      | July 2, 2000   |
| Net Loss | \$ (614,932)      | \$ (1,053,791) |
| Add:     |                   |                |

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|   |            |            |
|---|------------|------------|
| Depreciation and amortization of property and equipment   | 584,853    | 543,393    |
| Interest  | 698,089    | 766,798    |
| Charges related to closed units and asset impairment, net | (222,102)  | (117,304)  |
| Charges related to settlement with former management      | 0          | 364,251    |
| EBITDA  | \$ 445,908 | \$ 503,347 |

The Company has been in default under its credit facility with its principal commercial lender since October 17, 1999. In May 1999, the Company and its commercial lender entered into a forbearance agreement whereby the commercial lender agreed to defer the Company's requirement to make required principal and interest payments for May - July 1999 until April 2001, and to defer required principal payments for August - October 1999 until April 2001. The Company was unable to make the required payments beginning October 1, 1999. On October 17, 1999, the company received notice from its lender that under the terms of the credit facility, the entire principal amount outstanding, \$3,105,031, was immediately due, and the lender could take possession of the assets pledged as collateral. On September 29, 2000, the commercial lender agreed pursuant to a forbearance agreement, to not exercise its right to the collateral until October 31, 2000. Since October 31, 2000, the commercial lender has extended month to month forbearance agreements with the stipulation that the Company pay required interest payments each month, and the Company either refinances its debt, merge, or sell the Company. There can be no assurance that the commercial lender will continue to forbear from attempting to enforce rights against its collateral. If the commercial lender were to attempt to enforce such rights, the company could be required to cease operations or to operate only under the protection of the United States Bankruptcy Courts.

On September 29, 2000, the Company entered into a ten year Line of Credit Agreement (the "Credit Agreement") with JRAC, the Company's majority shareholder. Under the terms of the Credit Agreement, JRAC may lend the Company up to \$5 million for working capital, payment of outstanding indebtedness, refurbishing units, establishing new units, and future acquisitions. The loan is secured by substantially all of the assets of the Company. Advances will accrue interest at an annual rate equal to three percentage points above the prime-lending rate of Wells Fargo Bank. JRAC will receive an origination fee of two percent of the amount of each cash advance. The Company has the right to prepay in whole or part at any time any indebtedness outstanding under the Credit Agreement.

During fiscal 2001, JRAC advanced a total of \$320,000 to the Company. Further advances under this line of credit are subject to the ability of JRAC to fund such advances. The company believes that JRAC currently lacks such ability. Under the terms of the Credit Agreement, the Company was scheduled to begin monthly principal and interest payments on January 1, 2001, but has not done so. JRAC has not, at this time, placed the Company in default or initiated collection proceedings against the Company.

#### Impact of Inflation and Changing Prices

Inflation in food, labor, construction costs and interest rates can affect the Company's operations. Many of the Company's employees are paid hourly rates related to the minimum wage, which is subject to fluctuation.

Management reviews its pricing regularly to ensure that its Company's product(s) are priced competitively, that it offers outstanding value to its customers, and that margins are maintained. Inflation can also affect rent, taxes, maintenance, and insurance costs.

#### Seasonality

The Company's results are materially affected by seasonality. Usually the highest sales periods occur in late spring and summer, with sales declining in the fall and winter. This is especially true for the Gulf Coast restaurants where sales are more dependent on tourism.

## Forward-Looking Statements

Forward-looking statements regarding management's present plans or expectations for new unit openings, remodels, other capital expenditures, the financing thereof, and disposition of impaired units, involve risks and uncertainties relative to return expectations and related allocation of resources, and changing economic or competitive conditions, as well as the negotiation of agreements with third parties, which could cause actual results to differ from present plans or expectations, and such differences could be material. Similarly, forward-looking statements regarding management's present expectations for operating results involve risk and uncertainties relative to these and other factors, such as advertising effectiveness and the ability to achieve cost reductions, which also would cause actual results to differ from present plans. Such differences could be material. Management does not expect to update such forward-looking statements continually as conditions change, and readers should consider that such statements speak only as to the date hereof.

Item 7. Financial Statements.

Cucos Inc.

Balance Sheet

July 1, 2001

|  |                  |
|--|------------------|
| Assets   |                  |
| Current assets:  |                  |
| Cash   | \$ 241,792       |
| Receivables less allowance for doubtful accounts of \$20,517 | 73,461           |
| Inventories  | 129,518          |
| Prepaid expenses   | 155,816          |
| Other current assets   | 3,906            |
| <b>TOTAL CURRENT ASSETS</b>                                  | <b>604,493</b>   |
|  |                  |
| Property and equipment:                                      |                  |
| Equipment  | 1,672,486        |
| Leasehold improvements                                       | 2,804,573        |
|  | <b>4,477,059</b> |

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|  |                     |
|--|---------------------|
| Less accumulated depreciation and amortization and impairment reserves   | 2,804,967           |
|  | 1,672,092           |
|  |                     |
| Deferred costs, less accumulated amortization of \$127,043   | 195,131             |
| Other assets   | 225,644             |
| <b>TOTAL ASSETS</b>  | <b>\$ 2,697,360</b> |
|  |                     |
| <b>Liabilities and Net Capital Deficiency</b>  |                     |
| <b>Current liabilities:</b>  |                     |
| Trade accounts payable   | \$ 1,243,865        |
| Accrued interest   | 580,377             |
| Accrued expenses   | 439,577             |
| Current portion of long-term debt  | 53,542              |
| Debt in default  | 3,105,031           |
| <b>TOTAL CURRENT LIABILITIES</b>   | <b>5,422,392</b>    |
|  |                     |
| Long-term debt, less current portion   | 346,546             |
| Deferred revenue   | 234,706             |
|  |                     |
| <b>Net Capital Deficiency:</b>   |                     |
| Convertible preferred stock, no par value-1,000,000 shares authorized: 400,000 issued and outstanding, stated at liquidation preference value of \$1 per share | 400,000             |
| Common stock, no par value - 20,000,000 shares: authorized, 2,663,605 shares issued and outstanding  | 5,264,649           |
| Additional paid-in capital   | 110,788             |

|  |              |
|--|--------------|
| Retained earnings deficit                    | (9,081,721)  |
| NET CAPITAL DEFICIENCY                       | (3,306,284)  |
| TOTAL LIABILITIES AND NET CAPITAL DEFICIENCY | \$ 2,697,360 |

See accompanying notes.

Cucos Inc.

Statements of Operations

|  | Fiscal Year Ended |              |
|--|-------------------|--------------|
|  | July 1, 2001      | July 2, 2000 |
| Restaurant operations:   |                   |              |
| Sales of food and beverages  | \$14,221,554      | \$16,082,399 |
| Restaurant expenses:   |                   |              |
| Cost of sales  | 3,708,105         | 4,363,359    |
| Restaurant labor and benefits  | 5,290,839         | 5,996,316    |
| Other operating expenses   | 2,430,876         | 2,431,628    |
| Occupancy expenses   | 1,614,364         | 1,719,188    |
| Total restaurant expenses  | 13,044,184        | 14,510,491   |
| Income from restaurant operations  | 1,177,370         | 1,571,908    |
|  |                   |              |
| Royalties and franchise revenues, net of expenses of \$1,394 and \$2,093, respectively | 113,079           | 125,311      |
| Commissary and other income  | 22,828            | 17,318       |
|  | 1,313,277         | 1,714,537    |
|  |                   |              |
| Operations supervision expenses  | 406,202           | 561,077      |
| Corporate expenses   | 950,434           | 1,193,506    |
| Charges related to settlement with former management                                   | -                 | 364,251      |

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|   |              |               |
|---|--------------|---------------|
| Charges related to closed units and asset impairment, net of favorable settlements                    | (126,516)    | (117,304)     |
| Operating income (loss)   | 83,157       | (286,993)     |
| Interest expense  | 698,089      | 766,798       |
| Loss before income taxes  | (614,932)    | (1,053,791)   |
| Income taxes  | -            | -             |
| Net loss  | \$ (614,932) | \$(1,053,791) |
|   |              |               |
| Net loss per share - basic and diluted  | \$ (0.23)    | \$ (0.40)     |
|   |              |               |
| Weighted average number of common shares and common share equivalents outstanding - basic and diluted | 2,663,605    | 2,661,188     |

See accompanying notes.

Cucos Inc.

Statements of Cash Flows

|   | Fiscal Year Ended |                |
|---|-------------------|----------------|
|   | July 1, 2001      | July 2, 2000   |
| Operating activities  |                   |                |
| Net loss  | \$ (614,932)      | \$ (1,053,791) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                   |                |
| Costs paid related to closed units  | (16,372)          | (42,961)       |
| Settlement related to closed units  | (219,465)         | -              |
| Depreciation and amortization of property and equipment                                   | 584,853           | 543,393        |
| Amortization of deferred costs  | 30,283            | 30,283         |
| Change in deferred revenue  | (36,248)          | 187,212        |



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|  |           |           |
|--|-----------|-----------|
| Gain on sale of assets and other                     | -         | (76,156)  |
| Charges related to settlement with former management | -         | 364,251   |
| Changes in operating assets and liabilities:         |           |           |
| Receivables  | 25,554    | 80,728    |
| Inventories  | 21,439    | 48,348    |
| Prepaid expenses and other current assets            | (960)     | 183,300   |
| Other non current assets                             | 28,254    | -         |
| Trade accounts payable                               | (102,762) | (815,452) |
| Accrued expenses                                     | 176,681   | 143,547   |
| Net cash used in operating activities                | (123,675) | (407,298) |
|  |           |           |
| Investing activities                                 |           |           |
| Purchases of property and equipment                  | (154,059) | (164,720) |
| Proceeds from sale of assets                         | -         | 78,600    |
| Net cash used in investing activities                | (154,059) | (86,120)  |
|  |           |           |
| Financing activities                                 |           |           |
| Changes in short-term debt payable to banks          | -         | -         |
| Proceeds from borrowings                             | 320,000   | -         |
| Principal payments on borrowings                     | (69,186)  | (166,155) |
| Proceeds from sale of convertible preferred stock    | -         | 400,000   |
| Proceeds from sale of common stock                   | -         | 11,875    |
| Net cash provided by financing activities            | 250,814   | 245,720   |
|  |           |           |
| Change in cash                                       | (26,920)  | (247,698) |

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|   |            |            |
|---|------------|------------|
| Cash at beginning of year                                       | 268,712    | 516,410    |
| Cash at end of year   | \$ 241,792 | \$ 268,712 |
|   |            |            |
| Supplemental cash flow information:                             |            |            |
| Non-cash financing and investing activities:                    |            |            |
| Equipment and leasehold improvements financed by capital leases | \$ -       | \$ 48,349  |
| Interest paid   | \$ 438,964 | \$ 543,094 |

See accompanying notes.

## Cucos Inc.

## Statements of Shareholders' Equity

|                             | Preferred Shares | Common Shares | Preferred Stock | Common Stock | Additional Paid-In Capital | Retained Earnings (Deficit) | Total         |
|-----------------------------|------------------|---------------|-----------------|--------------|----------------------------|-----------------------------|---------------|
| Balance as of June 27, 1999 | -                | J,651,730     | \$ -            | \$M,252,774  | \$I10,788                  | \$(7,412,998)               | \$(2,049,436) |
|                             |                  |               |                 |              |                            |                             |               |
| Net loss for Fiscal 2000    | -                | -             | -               | -            | -                          | (1,053,791)                 | (1,053,791)   |
| Sale of common stock        | -                | 11,875        | -               | 11,875       | -                          | -                           | 11,875        |
| Sale of preferred stock     | 400,000          | -             | L00,000         | -            | -                          | -                           | L00,000       |
| Balance as of July 2, 2000  | L00,000          | J,663,605     | \$400,000       | \$M,264,649  | \$I10,788                  | \$(8,466,789)               | \$(2,691,352) |
|                             |                  |               |                 |              |                            |                             |               |

|                          |           |           |           |             |           |               |               |
|--------------------------|-----------|-----------|-----------|-------------|-----------|---------------|---------------|
| Net Loss for Fiscal 2001 | -         | -         | -         | -           | -         | (614,932)     | (614,932)     |
|                          |           |           |           |             |           |               |               |
| Balance July 1, 2001     | 1,000,000 | 1,663,605 | \$400,000 | \$5,264,649 | \$110,788 | \$(9,081,721) | \$(3,306,284) |

See accompanying notes.

Cucos Inc.

July 1, 2001

#### Notes to Financial Statements

##### 1. Basis of Presentation and Significant Accounting Policies

**Basis of Presentation:** Cucos Inc. (the "Company") incurred a net loss of \$614,932 in the Fiscal Year 2001 and \$1,053,791 in the Fiscal Year 2000. In addition, at July 1, 2001, the Company had a net capital deficiency of \$3,306,284 and was in default on debt totaling \$3,105,031. See note 3. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments to reflect the uncertainties related to the recoverability and classification of assets or the amounts and classification of liabilities that may result from the inability of the Company to continue as a going concern.

The Company has developed plans to refocus its operations, reverse sales declines, increase restaurant profitability and reduce other operating and corporate expenses. The Company is also attempting to obtain alternate financing to repay the debt in default, or negotiate with its commercial lender to restructure the terms of the debt in default. The Company believes that it can continue to meet its obligations through the end of fiscal year 2002 if it can extend its existing forbearance agreement with its commercial lender, or restructure the terms of the debt in default, or obtain alternate financing to repay the debt, on terms acceptable to the Company. However, considering, among other things, the Company's history of net losses and the debt in default, there can be no assurance that these plans will have the expected effect on the Company's results of operations and its cash flows in fiscal 2002.

**Fiscal Year:** The Company uses a 52/53-week year for financial reporting purposes with its fiscal year ending on the Sunday closest to June 30. Fiscal year 2001 was a 52-week year, and fiscal year 2000 was a 53-week year.

**Use of Estimates:** The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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

**Property and Equipment:** Property and equipment is stated at cost. Depreciation and amortization are computed by the straight-line method over the assets' useful lives or their lease terms, whichever is shorter. Amortization of assets

recorded under capital leases is included in depreciation expense. The useful lives of equipment range from 3-10 years, and the useful lives of leasehold improvements are generally 15 years.

**Deferred Costs:** Deferred costs represent debt issuance and other costs, which are primarily trademarks. Deferred debt issuance costs are amortized over the life of the related debt. Deferred site costs incurred in the selection of sites for new Company-owned restaurants are capitalized and amortized on a straight-line basis over a 10-year period. Other deferred costs, primarily trademarks, are amortized on a straight-line basis over 20 years

**Advertising Costs:** Advertising costs are expensed as incurred. Advertising expense was \$150,000 in fiscal 2001 and \$222,000 in fiscal 2000.

**Franchise Fees and Royalties:** The Company sells exclusive rights to develop Cucos restaurants in designated territories (Area Development Agreements), as well as individual franchises for each restaurant. The Area Development Agreements call for a nonrefundable fee paid to the Company in exchange for territorial exclusivity. Franchise development fee revenue from these agreements is deferred and recognized as income on a pro rata basis as restaurants are developed in the designated territory or when the developer forfeits the development rights under the agreement. Franchise fee revenue related to the individual restaurants is recognized as income when all obligations of the Company are substantially fulfilled, which occurs when the franchise restaurant begins operations. Royalty income is based upon a percentage of franchise sales and is recognized as income when earned. Royalties and other receivables are often collateralized by personal guarantees and sometimes by equipment owned by the franchisee.

**Income Taxes:** The Company accounts for income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

**Impairment of Long-Lived Assets:** The Company reviews long-lived assets to be held and used in the business for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or a group of assets may not be recoverable. Assets are evaluated for impairment at the operating unit level. The Company considers a history of operating losses to be its primary indicator of potential impairment. An asset is deemed to be impaired if a forecast of undiscounted future operating cash flows directly related to the asset, including disposal value if any, is less than its carrying amount. If an asset is determined to be impaired, the loss is measured as the amount by which the carrying amount of the asset exceeds its fair value. The Company generally estimates fair value by discounting estimated future cash flows. Considerable judgment is necessary to estimate cash flows. Accordingly, it is reasonably possible that actual results could vary significantly from such estimates.

**Stock-Based Compensation:** The Company accounts for its stock compensation arrangements with its employees under the provision of Accounting Principles Board No. 25, *Accounting for Stock Issued to Employees*.

## **2. New Accounting Principle**

The Company adopted Financial Accounting Standards Board No. 133, "Accounting for Derivative Instrument and Hedges Activities," as amended on July 3, 2000. As the Company had no derivative on July 3, 2000, there was no financial statement impact.

## **3. Tender Offer**

In August 2000, pursuant to a tender offer to the Company's shareholders, the Jacksonville Restaurant Acquisition Corp. (JRAC) purchased 1.2 million shares of the Company's Common Stock for \$1,200,000 in cash. During fiscal 2000, JRAC purchased 400,000 shares of convertible Preferred Stock at \$1 per share

## 4. Debt

|  |             |
|--|-------------|
| Capital lease obligations, fixed interest rates of 12.09% to 13.64% with monthly payments of \$3,662 | \$ 80,088   |
| Notes payable to JRAC  | 320,000     |
|  | 400,088     |
| Less current portion   | 53,542      |
|  | \$ 346,546  |
|  |             |
| Debt in default  | \$K,105,031 |

Debt in default represents a note payable to a commercial lender. This note is part of a pool of loans financed by the commercial lender at a stated interest rate of 11.6%. However, the loan agreement requires the Company to pay additional interest each month if certain loan pool conditions are not met. These monthly payments, if required, would increase interest incurred by a maximum of \$400,000 over the life of the loan. During fiscal 2001, the Company incurred additional interest of \$48,000 as a result of these requirements. The loan agreement also contains a provision that requires the Company to pay prepayment premiums in the event the loan is paid prior to its maturity. At July 1, 2001, this premium was approximately \$660,000.

In May 1999, the Company and its commercial lender entered into a forbearance agreement whereby the commercial lender agreed to defer the Company's requirement to make required principal and interest payments for May - July 1999 until April 2001, and to defer required principal payments for August - October 1999 until April 2001. The Company did not make its required interest payment on October 1, 1999, until April 2000. On October 17, 1999, the company received notice from its lender that under the terms of the credit facility, the entire principal amount outstanding, \$3,105,031, was immediately due, and the lender could take possession of the assets pledged as collateral. On September 29, 2000, the commercial lender agreed pursuant to a forbearance agreement, to not exercise its right to the collateral until October 31, 2000. Since October 31, 2000, the commercial lender has extended month to month forbearance agreements with the stipulation that the Company pay required interest payments each month, and the Company either refinances its debt, merge, or sell the Company.

On September 29, 2000, the Company entered into a ten year Line of Credit Agreement (the "Credit Agreement") with JRAC, the Company's majority shareholder. Under the terms of the Credit Agreement, JRAC may lend the Company up to \$5 million for working capital, payment of outstanding indebtedness, refurbishing units, establishing new units, and future acquisitions. The loan is secured by substantially all of the assets of the Company. Advances will accrue interest at an annual rate equal to three percentage points above the prime lending rate of Wells Fargo Bank. JRAC will receive an origination fee of two percent of the amount of each cash advance. The Company has the right to prepay in whole or part at any time any indebtedness outstanding under the Credit Agreement.

During fiscal 2001, JRAC advanced a total of \$320,000 to the Company. Further advances under this line of credit are subject to the ability of JRAC to fund such advances. The company believes that JRAC currently lacks such ability. Under the terms of the Credit Agreement, the Company was scheduled to begin monthly principal and interest payments on January 1, 2001, but has not done so. JRAC has not, at this time, placed the Company in default or initiated collection proceedings against the Company.

Maturities of long-term debt, including capital leases, not in default for each of the next five fiscal years are \$53,542 in fiscal year 2002, \$52,030 in fiscal year 2003, \$31,870 in fiscal year 2004, \$27,812 in fiscal year 2005, and \$28,443 in fiscal year 2006.

The carrying amounts reported in the balance sheet for debt not in default approximate fair value, as estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing instruments. The Company is not able to calculate the fair value of debt in default

5. Charges Related to Closed Units and Asset Impairment

In fiscal year 2000, the Company recorded a benefit in impaired assets of \$117,304, primarily related to equipment, leasehold improvements, reacquired franchise rights and certain subleased properties. This benefit was determined based upon the Company's accounting policy for impairment of long-lived assets, as described in Note 1. During fiscal 2001, management's efforts to dispose of these assets and settle related lease liabilities resulted in a net benefit of \$126,516.

6. Income Taxes

Significant components of the Company's deferred tax assets and liabilities are as follows:

|   |             |
|---|-------------|
| Deferred tax assets:                        |             |
| Net operating loss carryforwards            | \$2,884,000 |
| Tax credit carryforwards                    | 642,000     |
| Property and equipment                      | 205,000     |
| Other - net                                 | 53,000      |
| Total deferred tax assets                   | 3,784,000   |
| Valuation allowance for deferred tax assets | (3,721,000) |
|   | 63,000      |
|   |             |
| Deferred tax liabilities:                   |             |
| Prepaid expenses and deferred costs         | 63,000      |
| Net deferred tax assets                     | \$ -        |

The following is a reconciliation of income taxes at the federal statutory rate of 34% to income taxes reported in the statements of operations based on the loss before income taxes:

|  | July 1 | July 2 |
|--|--------|--------|
|  |        |        |

|  | 2001        | 2000      |
|--|-------------|-----------|
| Income tax benefit at the federal statutory rate | \$(209,000) | \$318,000 |
| State taxes, net of federal deductions           | (25,000)    | (37,000)  |
| Change in valuation allowance                    | 234,000     | 355,000   |
| Income taxes                                     | \$ -        | \$ -      |

At July 1, 2001, the Company had net operating loss carryforwards of approximately \$7,588,800 and investment and jobs tax credits carryforwards of approximately \$642,000. These carryforwards expire beginning in 2002. The acquisition of 45% of the Company's stock by JRAC in August 2000 constituted a change in control. Internal Revenue Code provisions limit the amount of net operating loss carryforwards which can be utilized each year to approximately \$200,000.

The Company has provided a valuation allowance for deferred tax assets, which may not be realized through future taxable income and the reversals of taxable temporary differences.

#### 7. Leases

The Company leases 11 restaurant facilities and its corporate headquarters under noncancelable operating lease agreements with initial lease terms expiring in fiscal 2002 and through fiscal 2008. The restaurant leases have remaining renewal options and provide for contingent rentals based on sales performance in excess of specified minimums. Contingent rentals were not material in any year. Some of the leases also have varying escalation clauses based either on fixed dollar increases, a percentage of the previous minimum annual rental, or the consumer price index.

The Company subleases three restaurant facilities under noncancelable sublease agreements with lease terms expiring in fiscal year 2002 through fiscal year 2011. The Company anticipates that income from these sublease agreements will be sufficient to cover the Company's remaining minimum lease payments.

Future minimum lease and sublease payments under the non-cancelable leases were as follows at year end:

|      | Operating Leases |          |           | Capital  |
|------|------------------|----------|-----------|----------|
|      | Lease            | Sublease | Net       | Lease    |
| 2002 | \$ 830,000       | \$N6,000 | \$O64,000 | \$L4,000 |
| 2003 | 704,000          | 66,000   | 638,000   | 36,000   |
| 2004 | 590,000          | 66,000   | 524,000   | 10,000   |
| 2005 | 433,000          | 35,000   | 398,000   | 3,000    |
| 2006 | 278,000          | 5,000    | 273,000   | -        |

|            |  |        |         |           |
|------------|--|--------|---------|-----------|
| Thereafter | 389,000                                    | 43,000 | 346,000 | -         |
|            |  |        |         | 93,000    |
|            | Less unamortized discount (12.09% - 13.6%) |        |         | 13,000    |
|            |  |        |         | \$ 80,000 |

Rent expense on all the Company's operating leases was \$995,000 in fiscal 2001 and \$1,029,000 in fiscal 2000.

#### 8. Related Party Transactions

The Company recorded a charge of \$364,251 in the second quarter of the fiscal year 2000 in connection with the settlement with its former Chairman and CEO. The charge includes amounts attributable to the transfer of the Company's interest in a franchisee, LaMexiCo, L.L.C., to the former Chairman and CEO and the forgiveness of debts owed to the Company by affiliated entities. The Company believes that the settlement was in the best interests of the Company and its shareholders.

During the third quarter of fiscal 2000, the Company negotiated a settlement with a former board member and franchisee. Receivables of \$55,000 were settled for a cash payment of \$15,000 and forfeiture of \$17,000 in development fees.

In addition, during the fourth quarter of fiscal 2000, the Company agreed to forgive \$20,000 of debts owed by its former President. In return, the development fee of \$500 for the Baton Rouge area was forfeited.

Also, in connection with the settlement with the former Chairman and CEO, the Company terminated agreements with Brothers Video, Inc., formerly an affiliated company, to supply video poker machines in nine Cucos restaurants located in Louisiana.

On January 26, 2000, the Company sold 300,000 shares of its Series A Preferred Stock, no par value per share (the Preferred Stock), to JRAC for \$300,000. On February 1, 2000, the Company sold 100,000 shares of Preferred Stock to JRAC for \$100,000. Each share of Preferred Stock is convertible at JRAC's option into one share of the Company's Common Stock. These shares were issued in transactions exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), in a private offering to a single investor.

Starting August 14, 2000, through January 24, 2001, JRAC advanced to the Company \$320,000 under the Line of Credit executed September 29, 2000.

#### 9. Capital Stock

*Convertible Preferred Stock:* Each share of convertible preferred stock is convertible, at the option of the holder, into one share of common stock at any time.

#### Stock Option:

The Company's 1993 Incentive Stock Option Plan (Option Plan) authorizes the grant of options to directors and management personnel for up to 509,000 shares of the Company's Common Stock. The option price of each incentive stock option granted may not be less than the fair market value of the Common Stock at date of grant. Additionally, the Company may award nonqualified stock options under the Option Plan at an exercise price of not less than the fair market value of the Common Stock at the date of grant. All options granted have 10-year terms and vest and become



exercisable in four equal annual installments beginning one year after the grant date.

The following table summarizes options outstanding for fiscal 2001 and fiscal 2000.

|                                  | 2001     |                                 | 2000      |                                 |
|----------------------------------|----------|---------------------------------|-----------|---------------------------------|
|                                  | Shares   | Weighted Average Exercise Price | Shares    | Weighted Average Exercise Price |
| Outstanding at beginning of year | 363,200  | \$1.17                          | 402,700   | \$1.26                          |
| Granted                          | 52,000   | \$1.02                          | 162,000   | \$1.02                          |
| Forfeited                        | (80,000) | \$1.06                          | (189,625) | \$1.25                          |
| Exercised                        | -        | -                               | (11,875)  | \$1.00                          |
| Outstanding at end of year       | 335,200  | \$1.17                          | 363,200   | \$1.17                          |
| Exercisable at end of year       | 111,075  |                                 | 187,950   |                                 |
| Exercise price                   |          | \$0.41- \$1.94                  |           | \$0.41- \$1.94                  |

The weighted average remaining contractual life of the options outstanding at July 1, 2001 is 6.9 years. The weighted average fair value of options granted during fiscal 2001 and fiscal 2000 were \$.82 and \$1.08 per share, respectively.

Pro forma information regarding net income and earnings per share is required by FASB Statement 123, *Accounting for Stock Based Compensation*, which also requires that the information be determined as if the Company has accounted for its employee stock options under the fair value method. The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for fiscal 2001 and the fiscal year 2000, respectively: weighted average risk-free interest rates of 5.18% and 6.34%; no dividends; volatility factors of the expected market price of the Company's common stock of 1.091 and .74; and a weighted-average expected life of the options of 5 years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information follows (in thousands except for earnings per share information).

|  | 2001 | 2000 |
|--|------|------|
|  |      |      |

|  |             |               |
|--|-------------|---------------|
| Pro forma net loss                           | \$(677,000) | \$(1,099,000) |
| Pro forma loss per share - basic and diluted | \$(.25)     | \$ (.42)      |

#### 10. Per Share Amounts

Basic loss per share amounts are based on the weighted average number of shares of common stock outstanding. Diluted per share amounts give effect to securities (stock options and convertible securities) outstanding, if any. All such securities were anti-dilutive in fiscal 2001 and fiscal 2000.

#### 11. Franchise Operations

In addition to its company-owned restaurants, the Company had four franchised restaurants in operation at the end of fiscal 2001. During fiscal 2000 two franchised restaurants opened and one franchised restaurant closed.

#### 12. Defined Contribution Plan

The Company sponsors a defined contribution savings plan which is available to substantially all employees. Eligible employees may contribute up to 20% of their compensation. The Company contributes an additional amount to the plan equal to 15% of employee contributions up to 5% of compensation. Company contributions were \$10,960 and \$13,086 in fiscal year 2001 and fiscal year 2000 respectively.

#### 13. Contingencies

On April 11, 1990, a franchisee filed a complaint in 24th District Court, State of Louisiana, Parish of Jefferson, Case No. 397856-5 against the Company and certain of its officers alleging breach of contract and misrepresentation and seeks damages in excess of \$1.6 million. There has been no activity in this litigation for more than ten years except for a discovery request filed in January 1996, which avoided a dismissal of the litigation for non-prosecution. The Company believes the claims are without merit and the likelihood of a loss is remote.

Ronnie Natal Contractors, Inc. versus Cucos, Inc., Civil Action No. 95-17928, Section "L", Civil District Court for the Parish of Orleans, State of Louisiana. On January 22, 2001, a Consent Judgment was rendered in favor of Ronnie Natal Contractors, Inc. against Cucos Inc. Natal alleged it was owed \$64,934, and a subcontractor, Current Electric, was owed \$3,408.00 in connection with the build out of a Cucos restaurant in New Orleans, Louisiana. Cucos Inc. contended the restaurant at issue was not owned by Cucos, but rather a franchised restaurant owned by L.B.G., Inc., a closely held corporation controlled by former members of management of Cucos, Inc. The Company thought it was in the Company's best interest to settle this matter, and on January 8, 2001, the Company authorized a negotiated settlement of \$31,500.00. Cucos Inc. shall make 30 consecutive payments of \$1,000.00 on the first and fifteenth of each month beginning February 2, 2001, and a final payment of \$1,500.00 on May 2, 2002.

The Company has various other lawsuits arising from its normal operations for which the Company carries appropriate levels of insurance. It is the opinion of management that the outcome of these matters will not have a material adverse effect on the Company's financial position or results of operations.

#### Report of Independent Auditors

The Board of Directors and Shareholders

Cucos Inc.

We have audited the accompanying balance sheet of Cucos Inc. as of July 1, 2001, and the related statements of operations, shareholders' equity, and cash flows for each of the two years in the period ended July 1, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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, the financial statements referred to above present fairly, in all material respects, the financial position of Cucos Inc. at July 1, 2001, and the results of its operations and its cash flows for each of the two years in the period ended July 1, 2001, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the financial statements, the Company is in default on debt totaling \$3,105,000. This default, combined with the Company's recurring losses from operations and net capital deficiency raise substantial doubt about its ability to continue as a going concern. Management's plans as to these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Ernst & Young LLP

New Orleans, Louisiana

August 31, 2001

Item 8

. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

**PART III**

Item 9

. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act of the Company.

Reference is made to the information concerning the directors of the Company and the nominees for re-election as directors appearing under the caption "Election of Directors" in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities and Exchange Commission in October 2001.

Reference is made to the information concerning the executive officers of the Company who are not directors appearing under the caption "Executive Officers of the Company" in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities

and Exchange Commission in October 2001.

Reference is made to the information concerning compliance with Section 16(a) of the Exchange Act appearing under the caption "Section 16(a), Beneficial Ownership Reporting Compliance" in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities and Exchange Commission in October 2001.

#### Item 10

##### Executive Compensation.

Reference is made to the information concerning remuneration of directors and executive officers of the Company appearing under the captions "Additional Information-Executive Compensation," "Additional Information-Stock Option Grants During Fiscal 2001," "Additional Information-Aggregated Stock Option Exercises and Fiscal Year-Ended Option Values," and "Additional Information-Compensation of Directors," in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities and Exchange Commission in October 2001.

#### Item 11

##### Security Ownership of Certain Beneficial Owners and Management.

Reference is made to the information concerning beneficial ownership of the Company's Common Stock, which is the only class of the Company's voting securities, appearing under the captions "Beneficial Ownership" and "Election of Directors" in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities and Exchange Commission in October, 2001.

#### Item 12. Certain Relationships and Related Transactions.

Reference is made to the information regarding certain relationships and transactions between the Company and its directors, nominees for re-election as directors of the Company, its executive officers, beneficial owners of 5% or more of its Common Stock and any member of the immediate family of any of the foregoing persons, appearing under the caption "Additional Information-Certain Relationships and Related Transactions" in the 2001 Proxy Statement. Such information is incorporated herein by reference to the Company's 2001 Proxy Statement to be filed with the Securities and Exchange Commission in October 2001.

#### Item 13

##### Exhibits and Reports on Form 8-K.

(a) The following exhibits are filed with this Annual Report or are incorporated herein by reference:

| <u>Exhibit Number</u> | <u>Title</u>   |
|-----------------------|--|
| (1) 2 -               | Joint Agreement of Merger, dated February 23, 1983, of Cu-Co's of Biloxi, Inc. |
| (1) 3-A -             | Copy of Articles of Incorporation of the Company.                              |
| (1) 3-A-1 -           | Copy of Amendment to Articles of Incorporation of the Company.                 |
| (1) 3-A-2 -           | Copy of Amendment to Articles of Incorporation of the Company.                 |

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- (1) 3-A-3 - Copy of Amendment to Articles of Incorporation of the Company.
- (1) 3-B - Copy of By-Laws of the Company.
- (2) 3-B-1 - Copy of Amendment to By-Laws of Company.
- (9) 3-B-2 - Amended and Restated By-Laws of the Company.
- (3) 4-A - Rights Agreement, dated as of February 5, 1990, between the Company and Commercial National Bank in Shreveport.
- (3) 4-B - Letter, dated February 26, 1991, from Whitney National Bank to the Company confirming the change of Rights Agent from Commercial National Bank in Shreveport to Whitney National Bank.
- (3) 4-C - Assignment of Rights Agreement dated August 30, 1993, among Whitney National Bank, Boatmen's National Bank and the Company with respect to the change of Rights Agent from Whitney National Bank to Boatmen's National Bank.
- (11) 4-D - Copy of Mortgage and Security Agreement dated April 25, 1994, with First National Bank of Commerce for \$450,000.
- (11) 4-E - Copy of Promissory Note dated October 27, 1994, with First National Bank of Commerce for \$200,000.
- (11) 4-F - Copy of Promissory Note dated October 27, 1994, with First National Bank of Commerce for \$250,000.
- (11) 4-G - Copy of Promissory Note dated October 27, 1994, with First National Bank of Commerce for \$500,000.
- (10) 4-H - Note Purchase Agreement dated July 28, 1995 (with Exhibits).
- (10) 4-I - Amendment No. 1 to Rights Agreement dated March 12, 1991.
- (12) 4-J - Assignment of Rights Agreement dated June 2, 1997, among Boatman's National Bank, ChaseMellon Shareholder Services, L.L.C. and the Company with respect to the change of Rights Agent to ChaseMellon Shareholder Services, L.L.C.
- (13) 4-K - Assignment of Rights Agreement dated September 21, 1998, among ChaseMellon shareholder Services, L.L.C., Registrar and Transfer Company and the Company with respect to the change of Rights Agent to Registrar and Transfer Company.
- (1) 10-A - Copy of Company's 1983 Stock Option Plan.
- (1) 10-B - Copy of letter agreement between the Company and certain stockholders of the Company relating to piggyback registration rights.
- (4) 10-C - Amendment No. 1 to 1983 Stock Option Plan of Cucos Inc.
- (5) 10-D - Amendment No. 2 to 1983 Stock Option Plan of Cucos Inc.
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|            |  |
|------------|--|
| (7) 10-G - | Amendment No. 5 to 1983 Stock Option Plan of Cucos Inc.                                    |
| (5) 10-H - | Form of Incentive Stock Option Agreement for 1983 Stock Option Plan.                       |
| (5) 10-I - | Form of Non-Qualified (Employee) Stock Option Agreement for 1983 Stock Option Plan.        |
| (5) 10-J - | Form of Non-Qualified (Director) Stock Option Agreement for 1983 Stock Option Plan.        |
| (8) 10-K - | Description of Company's Bonus Plan.   |
| (9) 10-L - | Copy of Company's 1993 Stock Option Plan as amended.                                       |
| (9) 10-M   | Form of Non-Qualified Stock Option Agreement for 1993 Stock Option Plan                    |
| (9) 10-N   | Form of Incentive Stock Option Agreement for 1993 Stock Option Plan                        |
| (14) 10    | Line of Credit Agreement between the Company and Jacksonville Restaurant Acquisition Corp. |
| 23 -       | Consent of Independent Auditors  |

---

(1) Filed as an exhibit to the Company's Registration Statement on Form S-18 (Commission File No. 2-87372A) and incorporated herein by reference.

(2) Filed as an exhibit to Form 10-K for the fiscal year ended July 1, 1984 (Commission File No. 0-12701) and incorporated herein by reference.

(3) Filed as an exhibit to Form 8-K dated February 23, 1991 (Commission File No. 0-12701), as amended by Form 8 dated March 12, 1991, and incorporated herein by reference.

(4) Filed as an exhibit to the Company's Registration Statement on Form S-8 (Commission File No. 33-03953) and incorporated herein by reference.

(5) Filed as an exhibit to the Company's Registration Statement on Form S-8 (Commission File No. 33-15785) and incorporated herein by reference.

(6) Filed as an exhibit to the Company's Registration Statement on Form S-8 (Commission File No. 33-26941) and incorporated herein by reference.

(7) Filed as an exhibit to Form 10-K for the fiscal year ended June 28, 1992 (Commission File No. 0-12701) and incorporated herein by reference.

(8) Filed as an exhibit to Form 10-K for the fiscal year ended June 28, 1987 (Commission File No. 0-12701) and incorporated herein by reference.

(9) Filed as an exhibit to Form 10-KSB for the fiscal year ended July 3, 1994 (Commission File No. 0-12701) and incorporated herein by reference.

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- (11) Filed as an exhibit to Form 10-KSB for the fiscal year ended July 2, 1995 (Commission File No. 0-12701) and incorporated herein by reference.
- (12) Filed as an exhibit to Form 8-A dated September 11, 1998, and incorporated herein by reference.
- (13) Filed as an exhibit to Form 10-KSB dated September 29, 1998.
- (14) Filed as an exhibit to Form 10-KSB dated October 2, 2000.

The Company is a party to various agreements defining the rights of holders of long-term debt of the Company, but no single agreement authorizes securities in an amount that exceeds 10% of the total assets of the Company. Accordingly, such agreements are omitted as exhibits as permitted by Item 601(b) (4) (ii) of Regulation S-B.

- (b) No reports on Form 8-K were filed during the fourth quarter of fiscal 2000.

QUALIFICATION BY REFERENCE

Information contained in this Annual Report as to the contents of any contract or other document referred to or evidencing a transaction referred to is necessarily not complete, and in each instance reference is made to the copy of such contract or other document filed as an exhibit to this Annual Report or incorporated herein by reference, all such information being qualified in its entirety by such reference.

SIGNATURE

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CUCOS INC.

Date: September 27, 2001

By: /s/ James W. Osborn

James W. Osborn

Chairman of the Board and

Chief Executive Officer

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities indicated as of September 27, 2001.

/s/ Elias Daher

/s/ Thomas L. McCormick

Elias Daher, Vice President of Operations

Thomas L. McCormick, Director and Secretary

and Director

/s/ Calvin O. Cox

/s/ William F. Saculla

Calvin O. Cox, Director

William F. Saculla, Director

/s/ James W. Osborn.

James W. Osborn., President, Chairman

of the Board of Directors and

Chief Executive Officer

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