

Meritage Hospitality Group Inc.  
Quarterly Report

**For Quarterly Period Ended April 1, 2012**

The following information provides updates to the Annual Report for Fiscal Year Ended January 1, 2012. Accordingly, this report does not contain all the information required of an issuer for its initial disclosure obligations, and should therefore be reviewed in conjunction with the Annual Report for Fiscal Year Ended January 1, 2012 and any interim reports or updates provided since the fiscal year-end report.

**Item 1     Exact name of the issuer and the address of its principal executive offices.**

Name of the Company or Issuer:

Meritage Hospitality Group Inc. (the “Company” or “Meritage”).

Address of Principal Office:

3310 Eagle Park Drive NE, Suite 205

Grand Rapids, MI 49525

Telephone: 616.776.2600

Facsimile: 616.776.2776

Web: www.meritagehospitality.com

**Item 2     Shares outstanding.**

<u>Common Shares</u>	<u>4/1/12</u>	<u>1/1/12</u>	<u>1/2/11</u>
Authorized:	30,000,000 shares	30,000,000 shares	30,000,000 shares
Outstanding:	5,500,561 shares	5,496,214 shares	5,472,642 shares
Freely Tradable (public float):	appx. 3,000,000 shs.	appx. 3,000,000 shs.	appx. 3,000,000 shs.
Number of beneficial holders:	appx. 450 holders	appx. 480 holders	appx. 450 holders
Number of record holders:	appx. 150 holders	appx. 140 holders	appx. 160 holders
 <u>Preferred A</u>			
Authorized:	200,000 shares	200,000 shares	200,000 shares
Outstanding:	29,520 shares	29,520 shares	29,520 shares
Freely Tradable (public float):	29,520 shares	29,520 shares	29,520 shares
Number of beneficial holders:	2 holders	2 holders	2 holders
Number of record holders:	2 holders	2 holders	2 holders
 <u>Preferred B</u>			
Authorized:	1,350,000 shares	1,350,000 shares	1,350,000 shares
Outstanding:	500,000 shares	500,000 shares	500,000 shares
Freely Tradable (public float):	300,000 shares	300,000 shares	300,000 shares
Number of beneficial holders:	not available	not available	15 holders
Number of record holders:	23 holders	23 holders	23 holders

### Class A Warrant

Authorized:	500,000 shares	500,000 shares	500,000 shares
Outstanding:	-	-	-
Freely Tradable (public float):	-	-	-
Number of beneficial holders:	-	-	-
Number of record holders:	-	-	-

### Class B Warrant

Authorized:	500,000 shares	500,000 shares	500,000 shares
Outstanding:	208,333 shares	208,333 shares	208,333 shares
Freely Tradable (public float):	75,000 shares	75,000 shares	75,000 shares
Number of beneficial holders:	3 holders	3 holders	3 holders
Number of record holders:	3 holders	3 holders	3 holders

### **Item 3 Interim financial statements.**

See the unaudited consolidated financial statements for the Quarter Ended April 1, 2012 attached at the end of this report. The unaudited consolidated financial statements include the following reports:

- (1) balance sheet;
- (2) statement of operations;
- (3) statement of equity;
- (4) statement of cash flows; and
- (5) notes to consolidated financial statements.

### **Item 4 Management's discussion and analysis or plan of operation.**

#### Overview

The Company reported revenues of \$23.6 million in the three months ended April 1, 2012 compared to revenues of \$19.4 million in the three months ended April 3, 2011, an increase of 21.6%. The net revenue increase was due to the 2011 acquisition of 16 Wendy's restaurants, a new Wendy's restaurant opening during the first half of 2011 and the successful launch of the Company's newly created Twisted Rooster casual dining concept.

Income from operations of \$569,000 in the first three months of 2012 represents a \$116,000 increase compared to income from operations of \$453,000 in the first three months of 2011. Net income from operations was impacted by several factors including increased commodity costs (see Cost of Food and Beverages) and increased operating costs associated with the integration of, and improvements to, the 16 newly acquired Wendy's restaurants.

Net income of \$412,000 in the first three months of 2012 represents a \$263,000 increase compared to net income of \$149,000 in the first three months of 2011. The increase in net income was due to several factors including improved income from operations, a reduction in equity in loss of an unconsolidated investee, and a decreased loss from discontinued operations. The Company continues to face significant economic and cost pressures brought on by Michigan, Florida, and Georgia unemployment rates that reached 8.8%, 9.4% and 9.1%, respectively, in the first quarter of 2012 and intense price discounting by competitors.

The Company continues to evaluate opportunities in both its Wendy's business and casual dining business. The Company purchased 20 Wendy's restaurants in Jacksonville, Florida in 2009. In 2011, the Company acquired an additional eight Wendy's restaurants in Jacksonville, Florida and acquired eight Wendy's restaurants in Atlanta, Georgia.

The Company has an interest in an entity that holds a development property (approximately 760 acres) known as *Lighthouse Point* on the island of Eleuthera in the Bahamas. The Company's plan is to either sell the property or develop it into a resort community, although at this time no assurance can be made in either regard.

### **Results of Operations**

Meritage operates in the quick-service and casual dining restaurant industries. The Company has experienced significant growth through its acquisition efforts and the launch of its own, newly created concept, Twisted Rooster. At January 1, 2012, the Company operated 86 Wendy's Old Fashioned Hamburger quick-service restaurants under franchise agreements with The Wendy's Company and three casual dining restaurants. Forty-nine of the Wendy's restaurants are located in Michigan, 29 of the Wendy's restaurants are located in Florida, and eight of the Wendy's restaurants are located in Georgia. All three Twisted Rooster restaurants are located in Michigan.

A schedule of Company restaurants follows:

	<u>Wendy's</u>	<u>O'Charley's</u>	<u>Twisted Rooster</u>	<u>Total Restaurants</u>
Restaurants as of January 2, 2011	69	3	1	73
Acquired restaurants	16	0	0	16
Newly opened restaurants	1	0	2	3
Closed restaurants	<u>0</u>	<u>(3)</u>	<u>0</u>	<u>(3)</u>
Restaurants as of January 1, 2012 and April 1, 2012	86	0	3	89

Results of operations are summarized below.

	Three Months Ended			
	(000's)			
	4/1/2012		4/3/2011	
Food and Beverage Revenue	\$23,607	100.0%	\$19,407	100.0%
Costs and Expenses				
Cost of food and beverages	6,621	28.0%	5,258	27.1%
Labor and related expenses	7,362	31.2%	6,092	31.4%
Advertising expenses	938	4.0%	769	4.0%
Other operating expenses	6,429	27.2%	5,342	27.5%
Total Operating Costs	<u>21,351</u>	<u>90.4%</u>	<u>17,461</u>	<u>90.0%</u>
General & administrative expense	1,218	5.2%	1,084	5.6%
Preopening and acquisition expenses	9	0.0%	65	0.3%
Depreciation and amortization	460	1.9%	343	1.8%
Total Costs and Expenses	<u>23,038</u>	<u>97.6%</u>	<u>18,954</u>	<u>97.7%</u>
Income from Operations	<u>569</u>	<u>2.4%</u>	<u>453</u>	<u>2.3%</u>
Other Income (Expense)				
Interest expense	(273)	-1.2%	(226)	-1.2%
Equity - unconsolidated investee	(68)	-0.3%	(150)	-0.8%
Other	(8)	0.0%	15	0.1%
Total Other Expense	<u>(349)</u>	<u>-1.5%</u>	<u>(361)</u>	<u>-1.9%</u>
Income Before Income Taxes	220	0.9%	92	0.5%
Income Tax Benefit	205	0.9%	107	0.6%
Net Income from Continuing Operations	426	1.8%	199	1.0%
Discontinued Operations (net of tax)	(14)	-0.1%	(51)	-0.3%
Net Income	412	1.7%	149	0.8%
Net Loss - Noncontrolling Interest	6	0.0%	12	0.1%
Net Income - Controlling Interest	<u>\$418</u>	<u>1.8%</u>	<u>\$160</u>	<u>0.8%</u>

### Food and Beverage Revenue

In the three months ended April 1, 2012 revenues increased 21.6%, to \$23.6 million from \$19.4 million in the three months ended April 3, 2011.

The Company's Wendy's restaurants reported sales of \$21.9 million in the three months ended April 1, 2012, an increase of 22.5% over the prior year's first quarter sales. The most significant contributing factors to the increase were the acquisition of six new Wendy's restaurants on March 15, 2011, the acquisition of eight new Wendy's restaurants on April 15, 2011, the addition of one new Wendy's restaurant that opened on May 9, 2011, and the acquisition of two new Wendy's restaurants on August 15, 2011. The Company's Wendy's restaurants experienced a "same store sales" decrease of 3.9% in the three months over prior year's sales.

The Company's casual dining restaurants reported sales of \$1.7 million in the three months ended April 1, 2012, an increase of 11.7% over prior year's sales. During 2011, the Company closed its last three

O'Charley's restaurant locations. Two locations were converted to the Company's newly created Twisted Rooster concept and one was permanently closed (see Discontinued Operations). The Company's casual dining sales increase is related to the timing of openings and the performance of the Company's Twisted Rooster restaurants.

### **Cost of Food and Beverages**

The 0.9% increase in cost of food and beverages as a percent of revenues was primarily due to increased commodity costs. The average cost of beef increased 23.0% in the first three months of 2012 compared to the first three months of 2011, ending the first quarter of 2012 at \$1.90 per pound compared to \$1.54 per pound at the end of the first quarter of 2011.

### **Labor and Related Expenses**

Labor and related expenses decreased to 31.2% of revenues in the three months ended April 1, 2012 from 31.4% of revenues in the same three months of 2011. The reduction is the result of continued store labor reductions due to efficiencies.

### **Other Operating Expenses**

Other operating expenses decreased as a percentage of revenues to 27.2% in the three months ended April 1, 2012 from 27.5% in the three months ended April 3, 2011. The decrease is primarily related to reductions in giveaway food costs, decreased cost of gas utilities, and reduction, as a percent of sales, in property taxes.

### **General and Administrative Expenses**

In the first three months of 2012, general and administrative expenses decreased as a percent of sales to 5.2% from 5.6% in 2011. The decrease in general and administrative expenses is mainly due to decreased salary and bonus expenses as a percent of sales, slightly offset by increased bank fees which are offset by reduced restaurant level labor expenses.

### **Interest Expense**

Interest expense remained unchanged as a percent of sales in the first quarter of 2012 and 2011.

## Income Tax Expense

Income tax expense is summarized below.

	Three Months Ended	
	(000's)	
	4/1/2012	4/3/2011
Michigan Business Tax expense	-	142
State and local income tax expense	88	2
Federal income tax expense	105	148
Reversal of deferred tax asset valuation allowance	(398)	(398)
Total income tax credit	<u>(205)</u>	<u>(107)</u>

The Company had net deferred tax assets totaling \$4,264,000 at April 1, 2012. The Company regularly assesses the realizability of its deferred tax assets and the related need for, and amount of, a valuation allowance. Management considers many factors in determining the likelihood of future realization of deferred tax assets including recent cumulative earnings and loss experiences and future reversals of timing differences. The Company previously recorded a valuation allowance of \$4,780,000. In the first quarter of 2010, the Company began reversing the valuation allowance resulting in a \$398,000 income tax credit per quarter. Management believes the deferred tax assets will be fully realized in the future as the Company generates earnings.

## Discontinued Operations

In March 2011, the Company closed one of its O'Charley's casual dining restaurant locations, at which time all activities ceased and the property and related fixed assets were returned to the landlord. Discontinued operations expense includes costs associated with the restaurant closure and estimated lease termination settlement costs.

## Financial Condition

Management monitors short and long-term cash needs and believes at this time, that with its ongoing operations and current cash balances, the Company has sufficient capital to meet its ongoing obligations.

Loan covenants of the various loan agreements include requirements for the maintenance of certain financial ratios. At April 1, 2012, the Company was in compliance with these covenants.

In February 2008, the Company acquired a minority interest in RDG for \$1.5 million. In August 2008, RDG became a 50% partner in TRG, a new joint venture entity established to own and develop a Bahamian real estate holding. TRG purchased the Bahamian property in August 2008. TRG is comprised of several investors who intend to sell or develop the property into a resort community. In April 2009, the Company acquired an additional 5% interest in RDG from one of its partners for a nominal amount. In December 2009, several partners, representing 50% ownership interest in RDG, assigned their interest to the Company for a nominal purchase price. An additional partner of RDG, representing ownership of 15%, had his ownership interest diluted by 90% in accordance with the provisions of the RDG operating agreement. After completion of the above transactions, the Company's ownership in RDG is 92.25%, representing a 46.125% net ownership interest in TRG. TRG has a first secured mortgage on the property with a bank. Additionally, the Company's interest in RDG is pledged as collateral for a \$2.4 million mezzanine loan to TRG from the Company's chairman of the board. The Company makes no assurances as to when development will proceed.

TRG's bank debt totaling \$7.0 million expired on April 30, 2012. Based on discussions with the bank, the Company believes the loan will be renewed, although no assurances can be given in this regard. If the bank does not renew the loan, RDG could be subject to either a capital call or a dilution event as defined in the TRG operating agreement.

**Off-Balance Sheet Arrangements**

There were no off-balance sheet arrangements as of April 1, 2012.

**Item 5 Legal proceedings.**

The Company is involved in various routine legal proceedings that are incidental to its business. All of these proceedings arose in the ordinary course of the Company's business and, in the opinion of the Company, any potential liability of the Company with respect to these legal proceedings will not, in the aggregate, be material to the Company's consolidated financial statements. The Company maintains various types of insurance standard to the industry that, subject to deductibles, will insure over many claims and legal proceedings brought against the Company.

**Item 6 Defaults upon senior securities.**

None.

**Item 7 Other information.**

None.

**Item 8 Exhibits.**

None.

**Item 9 Certifications.**

I, Robert E. Schermer, Jr., Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Meritage Hospitality Group Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

May 16, 2012

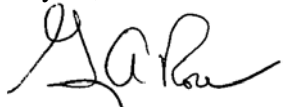


Robert E. Schermer, Jr.  
Chief Executive Officer

I, Gary A. Rose, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Meritage Hospitality Group Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

May 16, 2012



Gary A. Rose  
Chief Financial Officer

## FORWARD-LOOKING STATEMENTS

*Certain statements contained in this report that are not historical facts constitute forward-looking statements. These may be identified by words such as “estimates,” “anticipates,” “hopes,” “projects,” “plans,” “expects,” “believes,” “should,” and similar expressions, and by the context in which they are used. Such statements are based only upon current expectations of the Company. Any forward-looking statement speaks only as of the date made. Reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to differ materially from those expressed or implied. Meritage undertakes no obligation to update any forward-looking statements to reflect events or circumstances after the date on which they are made.*

*Statements concerning expected financial performance, business strategies and action which Meritage intends to pursue to achieve its strategic objectives, constitute forward-looking information. Implementation of these strategies and achievement of such financial performance are subject to numerous conditions, uncertainties and risk factors, which could cause actual performance to differ materially from the forward-looking statements. These include, without limitation: competition; changes in the national or local economy; changes in consumer tastes and eating habits; concerns about the nutritional quality of our restaurant menu items; concerns about consumption of beef or other menu items due to diseases including E. coli, hepatitis, and mad cow; promotions and price discounting by competitors; severe weather; changes in travel patterns; road construction; demographic trends; the cost of food, labor and energy; the availability and cost of suitable restaurant sites; the ability to finance expansion; interest rates; insurance costs; the availability of adequate managers and hourly-paid employees; directives issued by the franchisor regarding operations and menu pricing; the general reputation of Meritage’s and its franchisors’ restaurants; the relationship between Meritage and its franchisors; legal claims; and the recurring need for renovation and capital improvements. Meritage is also subject to extensive government regulations relating to, among other things, zoning, public health, sanitation, alcoholic beverage control, environment, food preparation, minimum and overtime wages and tips, employment of minors, citizenship requirements, working conditions, and the operation of its restaurants. Because Meritage’s operations are concentrated in certain areas of Michigan, Florida, and Georgia, continued economic decline in these states, or in the local economies where our restaurants are located, could adversely affect our operations. The current Michigan Business Tax structure has adversely impacted retail businesses. Additionally, with Meritage’s expansion into Florida, the Company could be adversely affected by tropical storms or hurricanes. Meritage’s expansion into hospitality and resort development in the Bahamas could subject Meritage to additional risks including, without limitation, risks associated with the stability of the Bahamian government including its fiscal and development policies, the ability to obtain necessary development permits and authorizations from the Bahamian government, unanticipated expenses or difficulties encountered in such developments, difficulties in obtaining needed financing to complete such developments, the fact that Meritage has no development or operating history associated with large-scale hospitality and resort developments, and changes in consumer preferences relating to the Bahamas as a travel or residential destination. The Company’s news releases and public reports are not intended to constitute an offer to sell or a solicitation of an offer to buy any securities of the Company or otherwise engage in a transaction with the Company.*

# **Meritage Hospitality Group Inc. and Subsidiaries**

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**Consolidated Financial Report  
April 1, 2012 and April 3, 2011**

# Meritage Hospitality Group Inc. and Subsidiaries

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### Consolidated Financials Statements

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# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Balance Sheet

	April 1, 2012	January 1, 2012
<b>Assets</b>		
<b>Current Assets</b>		
Cash	\$ 2,275,650	\$ 1,763,326
Receivables	130,482	314,370
Inventories	658,780	659,660
Prepaid expenses and other current assets	843,178	1,412,506
	<u>3,908,090</u>	<u>4,149,862</u>
<b>Property and Equipment - Net</b>	24,186,775	24,190,010
<b>Goodwill</b>	8,365,280	8,365,280
<b>Intangible Assets</b>	1,028,269	1,057,475
<b>Deferred Income Taxes</b>	4,264,000	3,865,667
<b>Other Assets</b>		
Note receivable	300,000	300,000
Long-term investment	1,391,181	1,459,211
Deposits and other assets	603,333	446,545
	<u>603,333</u>	<u>446,545</u>
<b>Total Assets</b>	<b><u>\$ 44,046,928</u></b>	<b><u>\$ 43,834,050</u></b>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Trade accounts payable	\$ 3,317,690	\$ 3,375,956
Revolving line of credit	-	150,000
Current portion of long-term debt	2,849,573	1,853,628
Accrued liabilities	4,025,742	4,380,609
	<u>10,193,005</u>	<u>9,760,193</u>
<b>Total Current Liabilities</b>	10,193,005	9,760,193
<b>Unearned Vendor Allowances</b>	1,205,050	467,440
<b>Accrued Rent</b>	1,240,531	1,185,202
<b>Other Long-term Obligations</b>	817,878	667,935
<b>Long-term Debt - Net of current portion</b>	15,856,134	17,155,778
<b>Deferred Gain - Sale and leaseback transactions</b>	10,916,569	11,116,287
<b>Equity</b>	<u>3,817,761</u>	<u>3,481,215</u>
<b>Total Liabilities and Equity</b>	<b><u>\$ 44,046,928</u></b>	<b><u>\$ 43,834,050</u></b>

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

## Consolidated Statement of Operations

	Three Months Ended	
	April 1, 2012	April 3, 2011
<b>Food and Beverage Revenue</b>	\$ 23,606,937	\$ 19,406,670
<b>Costs and Expenses</b>		
Cost of food and beverages	6,621,133	5,258,415
Labor and related expenses	7,362,497	6,092,415
Advertising expenses	938,264	768,692
Other operating expenses	6,429,239	5,341,658
Total Operating Expenses	21,351,134	17,461,179
General and administrative expenses	1,217,833	1,084,437
Preopening and acquisition expenses	8,933	64,791
Depreciation and amortization	459,866	343,167
Total Costs and Expenses	23,037,766	18,953,574
<b>Income from Operations</b>	569,171	453,096
<b>Other Income (Expense)</b>		
Interest expense	(272,825)	(226,077)
Equity in loss of unconsolidated investee	(68,031)	(150,322)
Other income (expense)	(7,955)	15,350
Total Other Expense	(348,810)	(361,049)
<b>Income Before Income Taxes</b>	220,361	92,047
<b>Income Tax Benefit</b>	205,428	107,208
<b>Net Income from Continuing Operations</b>	\$ 425,789	\$ 199,255
<b>Discontinued Operations</b>	(13,700)	(50,740)
(net of income tax benefit of \$9,134 in 2012 and \$33,827 in 2011)		
<b>Net Income</b>	\$ 412,088	\$ 148,515
<b>Plus: Net Loss Attributable to Noncontrolling Interest</b>	5,846	11,667
<b>Net Income Attributable to Controlling Interest</b>	<b>\$ 417,934</b>	<b>\$ 160,181</b>

See notes to consolidated financial statements

## Meritage Hospitality Group Inc. and Subsidiaries

### Consolidated Statement of Equity

	Controlling Interest						Total
	Series A Convertible Preferred Stock	Series B Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings and Members Interest	Noncontrolling Interest	
<b>Balance - January 2, 2011</b>	\$ 295	\$ 5,000	\$ 54,726	\$ 16,740,574	\$ (15,437,334)	\$ 102,816	\$ 1,466,077
Net income					2,316,311	(50,331)	2,265,980
Issuance of 23,571 shares of common stock			236	38,566			38,801
Preferred dividends declared				(426,568)			(426,568)
Stock option expense				136,924			136,924
<b>Balance - January 1, 2012</b>	<u>\$ 295</u>	<u>\$ 5,000</u>	<u>\$ 54,962</u>	<u>\$ 16,489,496</u>	<u>\$ (13,121,023)</u>	<u>\$ 52,485</u>	<u>\$ 3,481,215</u>
Net income					417,934	(5,846)	412,088
Issuance of 4,347 shares of common stock			43	6,912			6,955
Preferred dividends declared				(106,642)			(106,642)
Stock option expense				24,145			24,145
<b>Balance - April 1, 2012</b>	<u>\$ 295</u>	<u>\$ 5,000</u>	<u>\$ 55,005</u>	<u>\$ 16,413,911</u>	<u>\$ (12,703,089)</u>	<u>\$ 46,639</u>	<u>\$ 3,817,761</u>

See notes to consolidated financial statements

## Meritage Hospitality Group Inc. and Subsidiaries

### Consolidated Statement of Cash Flows

	Year Ended	
	April 1, 2012	April 3, 2011
<b>Cash Flows from Operating Activities</b>		
Net Income	\$ 412,088	\$ 160,181
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	475,785	356,389
Deferred income taxes	(398,333)	(398,333)
Amortization of deferred gain from sale and leaseback transactions	(199,718)	(204,196)
Compensation paid by issuance of common stock	6,955	10,000
Equity in earnings of unconsolidated investee	-	(11,667)
Loss on disposal of fixed assets	-	637
Stock option expense	24,145	52,089
Changes in operating assets and liabilities which provided (used) cash:		
Receivables	183,888	381,287
Inventories	880	(7,464)
Prepaid expenses and other current assets	569,328	(38,736)
Deposits and other assets	(157,907)	(4,251)
Accounts payable	(58,266)	(307,141)
Accrued liabilities	(354,867)	(220,055)
Other long-term liabilities	149,943	(5,301)
Accrued rent	55,329	56,829
Unearned vendor allowances	737,610	1,146,347
Net cash provided by operating activities	1,446,860	966,616
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(442,225)	(1,661,061)
Purchase of intangible assets	-	(40,000)
Business combination	-	(1,208,430)
Increase in other long term obligations	-	55,044
Investment in equity method investee	68,030	-
Net cash used in investing activities	(374,195)	(2,854,447)

See notes to consolidated financial statements

## Meritage Hospitality Group Inc. and Subsidiaries

### Consolidated Statement of Cash Flows Continued (Continued)

	Year Ended	
	April 1, 2012	April 3, 2011
<b>Cash Flows from Financing Activities</b>		
Proceeds from long-term debt	72,238	2,447,241
Net Paydown from revolving line of credit	(150,000)	-
Principal payments on long-term debt	(375,937)	(283,028)
Payments on financing costs	-	(38,119)
Payments on obligations under capital lease	-	(11,700)
Preferred stock dividends paid	(106,642)	(106,642)
Net cash provided (used) in financing activities	(560,341)	2,007,752
<b>Net Increase in Cash</b>	512,324	119,921
<b>Cash</b> - Beginning of year	1,763,326	1,829,754
<b>Cash</b> - End of period	\$ 2,275,650	\$ 1,949,675
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid for:		
Interest	\$ 283,632	\$ 222,047
Income taxes	16,276	102,275
Significant non-cash investing and financing transactions:		
Seller financed notes payable related to Wendy's acquisitions	\$ -	\$ 600,000

See notes to consolidated financial statements

# Meritage Hospitality Group Inc. and Subsidiaries

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## Notes to Unaudited Consolidated Financial Statements Three Months Ended April 1, 2012 and April 3, 2011

### Note 1 - Consolidation

The consolidated financial statements include the accounts of Meritage Hospitality Group Inc., all of its wholly owned subsidiaries, and its 92.25% owned subsidiary, RDG-MHG, LLC., ("RDG"). RDG is a 50% partner in TRG-Meritage Bahamas, LLC., ("TRG"). All intercompany transactions and balances have been eliminated in consolidation.

### Note 2 - Stockholders' Equity

The Company has 5,000,000 authorized shares of \$.01 par value per share preferred stock. 200,000 shares are designated as Series A convertible cumulative preferred stock, with 29,520 shares issued and outstanding as of April 1, 2012 and January 1, 2012. 1,350,000 shares are designated as Series B convertible cumulative preferred stock, with 500,000 shares issued and outstanding as of April 1, 2012 and January 1, 2012.

The Company has 30,000,000 authorized shares of \$.01 par value per share common stock, with 5,500,561 and 5,496,214 shares issued and outstanding as of April 1, 2012 and January 1, 2012, respectively.

### Note 3 - Deferred Income Taxes

The Company has net deferred tax assets totaling \$4,264,000 and \$3,865,667 at April 1, 2012 and January 1, 2012 respectively. The Company regularly assesses the realizability of its deferred tax assets and the related need for, and amount of, a valuation allowance. Management considers many factors in determining the likelihood of future realization of deferred tax assets including recent cumulative earnings and loss experiences, future reversals of timing differences, and carryforwards.

### Note 4 - Long-Term Investment

The Company has an interest in an entity (TRG) that holds a development property known as Lighthouse Point on the island of Eleuthera in the Bahamas. TRG's bank debt totaling \$7.0 million expires on April 30, 2012. Based on discussions with the bank, the Company believes the loan will be renewed. If the bank does not renew the loan, RDG could be subject to either a capital call or a dilution event as defined in the TRG operating agreement.

### Note 5 - Discontinued Operations

In March 2011, the Company closed one of its casual dining restaurants, at which time all activities ceased and the property and related fixed assets were returned to the landlord. Discontinued operations expense includes costs associated with the closure and estimated lease termination settlement costs.

### Note 6 - Reclassification

Certain 2011 amounts have been reclassified to conform to the 2012 presentation.

# Meritage Hospitality Group Inc. and Subsidiaries

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## Notes to Unaudited Consolidated Financial Statements Three Months Ended April 1, 2012 and April 3, 2011

### Note 7 - Subsequent Event

On April 24, 2012, the Company entered a lease settlement agreement on a formerly closed restaurant. As a result of the settlement, in the second quarter of 2012, the Company will record a \$225,000 loss from discontinued operations.

On May 16, 2012, the Company issued 209,000 new shares of Series B convertible cumulative preferred stock with a face value of \$2,090,000, to the Company's chairman of the board, in exchange for a TRG promissory note receivable of approximately \$2,400,000 (See Note 1 and 4). Prior to completing the transaction, an independent fair market valuation assessment was obtained.