



TACO CABANA, INC.
1999 ANNUAL REPORT

**OUR BEST
YEAR EVER
AND OTHER
HOT
STUFF**

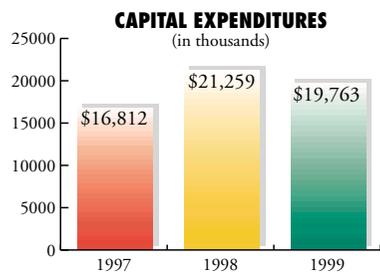
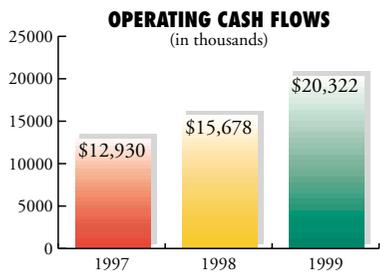
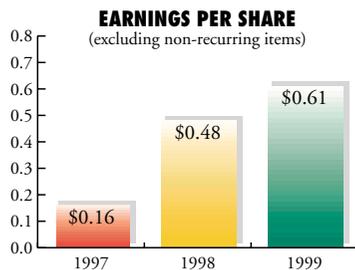
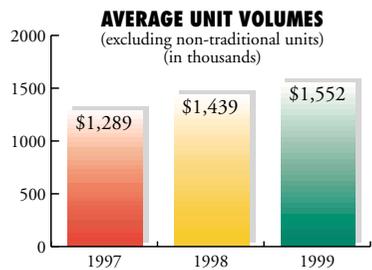
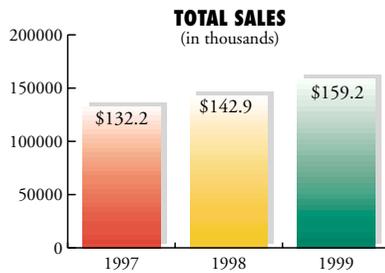


YOU'RE HOT ON THE TRAIL OF ONE GREAT COMPANY.

- 12% increase in sales
- 5.5% increase in comparable sales
- Eight consecutive quarters of positive comparable sales
- 27% increase in diluted Earnings Per Share
- 30% increase in cash flows from operations
- 10 restaurant openings

1999 was the best year in Taco Cabana's 21-year history, an outstanding follow-up to the breakthrough performance we achieved in 1998. Over the past 12 months, we accomplished more. Grew more. Learned more. And earned more. So pardon us for putting our dollars-and-cents news front-and-center in this year's Annual Report. With even bigger and better plans in the works for 2000, the best is still yet to come. But it's the financial highlights of the phenomenal year gone by that we can't wait to share.

HOT NUMBERS



FINANCIAL HIGHLIGHTS.

All of Taco Cabana's financial indicators in 1999 were positive. Our initiatives in marketing and enhancing the guest experience continued to pay dividends in the form of comparable restaurant sales. Comparable sales were up 5.5% in 1999, an especially impressive fact given the 4.7% increase achieved in 1998. Total sales climbed 12% to \$159.2 million. And average volume pushed beyond the \$1.5 million threshold to \$1.55 million per free-standing unit.

We leveraged these increased sales into increased profitability. Earnings Per Share (excluding all non-recurring items) were up 27% to \$.61 on a fully taxed basis. Equally important, we saw a 30% increase in our cash flows from operations to just over \$20.3 million. These strong cash flows empowered us to invest almost \$20 million in both existing restaurants and new construction.

While all of these accomplishments were not reflected in our share price, we seized this opportunity to repurchase nearly 1.5 million Taco Cabana shares on the open market. This stock repurchase boldly demonstrates management's belief that the market has yet to realize the value being created by the Taco Cabana restaurant system.



HOT NEWS

DEAR FELLOW SHAREHOLDERS,

Throughout last year, the Taco Cabana team continued to implement effective systemwide marketing, growth, and operational strategies that produced the most exciting financial results in our company's 21-year history. With great pride in the dedication and tireless efforts of our entire team, I submit to you our 1999 Annual Report. It details the record-setting sales and profits, continued new unit growth, and major achievements that support our emergence as a leading force in the quality, quick-service marketplace.

We were extremely gratified by the continuation of our strong financial success. Total restaurant sales were up 12%, while our earnings soared by 27%. Comparable restaurant sales increased by 5.5% for the year, with every market being positive. The upshot of this momentum has been positive comparable sales for nine consecutive quarters through Q1 of 2000. We believe this performance is the result of several components: our

reimaging program, a focus on value-based marketing promotions (\$2.99/\$3.99), and our continued investments in labor which have enhanced operational execution.

Despite two consecutive years of strong performance, our company faces the challenge of a public market that is wary of small cap and restaurant stocks. As a reaction to this environment, we continued to repurchase shares at an attractive value. During 1999, we repurchased nearly 1.5 million shares, bringing the total number of shares repurchased since 1997 to over 4.5 million. We will continue to evaluate this strategy in 2000 based on market conditions.

We plan to sustain this momentum in the year 2000 with consistent execution, while continuing to prove our ability to grow the concept. This year, Taco Cabana will open another 15 new restaurants, primarily outside Texas. In addition to further development in Oklahoma, we will enter the Phoenix, Arizona market. We continue to refine our second-generation prototype design to enhance capacity and image elements. We will also test two smaller in-line units that reflect simplified operations and a greatly reduced initial investment. This vehicle could effectively address the challenge of rising real estate costs and a shrinking workforce, while developing possible franchise opportunities.

The accomplishments of last year are the culmination of an even more impressive three-year performance. These efforts centered on restoring confidence in the concept, building financial stability, and cultivating future growth prospects. The following are significant highlights in our team's history of success since 1997:

- We addressed a number of underperforming assets through a special charge (\$78.7 million).
- We invested \$30 million to open 25 new restaurants.
- We allocated \$15 million to reimage 70 restaurants.
- We repurchased more than 4.5 million shares utilizing \$29 million in capital.
- We achieved nine consecutive quarters of comparable sales.
- We realized a 70% increase in EBITDA to 25.1 million.

As you can see, this team has been extremely active and effective in engineering sustained success. On behalf of every team member, I extend my thanks for your investment and confidence in our company. Rest assured, we are hard at work on what we believe will be another record-breaking year.

In closing, I bring your attention to one important addition to this year's Annual Report: Taco Cabana's new Corporate Governance Standards, printed inside the back cover. Recently adopted by our Board of Directors, these Standards address specific responsibilities and practices that the Board will exercise in its overseeing of

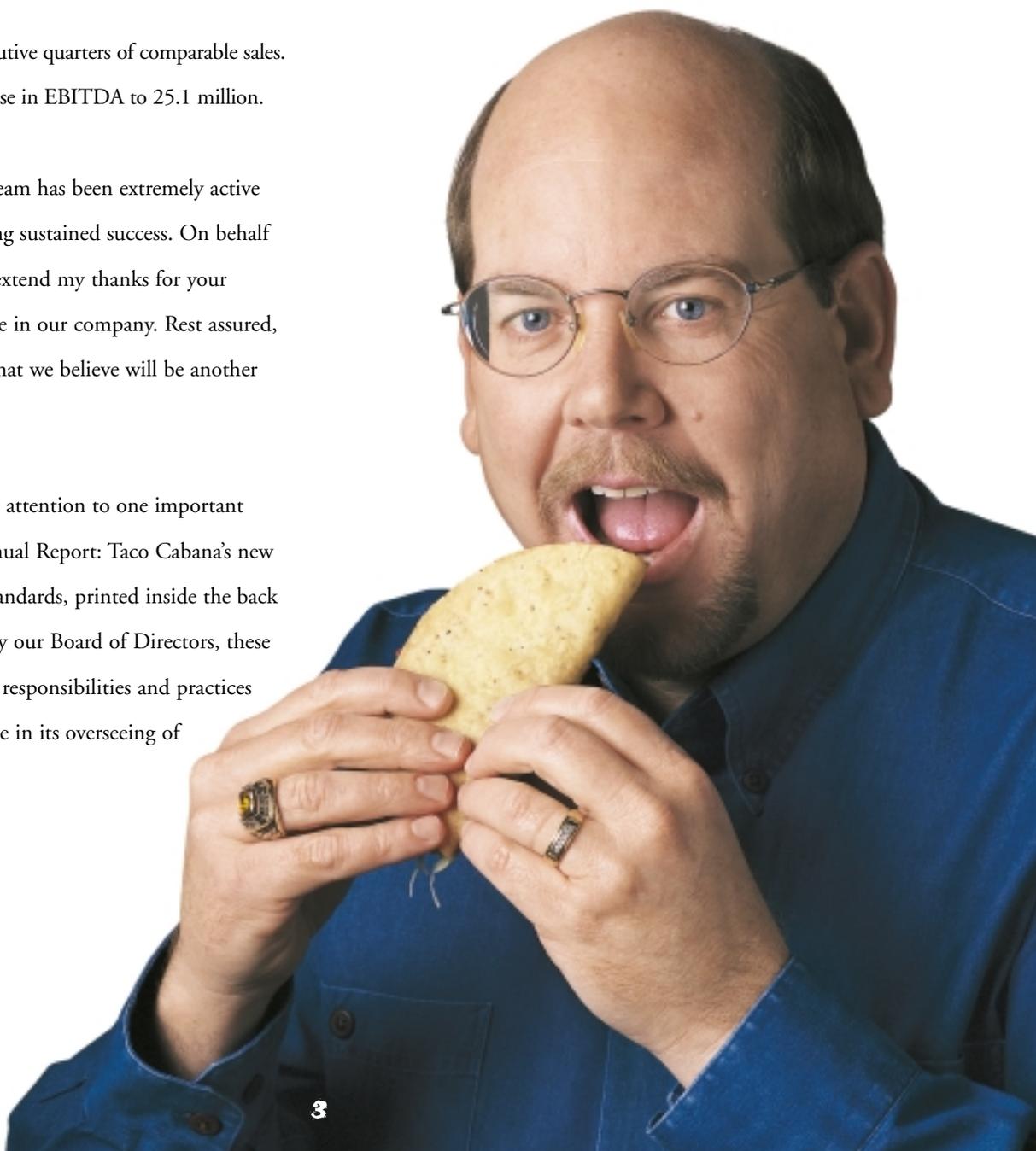
management's short and long-term direction for the company. We believe they signal a strong commitment toward representing the best interest of our shareholders.

Sincerely,



Stephen Clark

President and Chief Executive Officer





HOT INGREDIENTS

FAST, AUTHENTIC TEX-MEX: IT'S STILL OUR BREAD AND BUTTER.

When San Antonio restaurateur Felix Stehling opened a single 24-hour taco stand in 1978, little did he know he was launching what would become a publicly traded company with more than \$159 million in sales. 119 locations spanning five states. And more than 3,500 passionate employees.

Taco Cabana still serves up great Tex-Mex around the clock. But as our business has evolved, we've carved a hot new niche in the quick-service food market. And our customers love it. They get fast, authentic Tex-Mex in a setting that says, "Hey. Come on in, relax, have some fun."

We call our competitive edge "The Cabana Experience.™" It's kicked-back casual, with just the right mix of value-priced meals served up in a festive atmosphere that appeals to families and singles, children and adults alike.

The Cabana Experience is where robust ingredients, sensational Tex-Mex cooking, and our unique patio-style restaurant design converge with a team of dedicated, talented employees and creative, outside-the-box marketing strategies.

Put it all together, and it's what keeps our customers coming back for more.

IT'S BEEN A TEX-MEXCITING YEAR.

If the competition's getting heated up over Taco Cabana's system-wide success, we're not surprised. Here's a snapshot of the events, programs, and innovations that helped make 1999 our best year ever.

- We opened 10 new prototype locations last year, bringing the system-wide restaurant total to 109 company-owned and 10 franchised locations. Among our 10 new restaurants were three in Oklahoma, where Taco Cabana was an instant hit. In fact, the very first Oklahoma City Taco Cabana set an opening week record with over \$91,000 in weekly sales.
- Taco Cabana's system-wide reimagining campaign continued as we retrofitted 30 more locations with interior upgrades.
- We introduced a sizzling new menu item: The Personal Size Quesadita. It's a take-anywhere taste treat featuring melted cheese, fajita chicken or beef, and other Tex-Mex flavor sensations grilled between two fresh flour tortillas. This snappy little menu addition is without question the most successful product introduction in Taco Cabana's history.

- The Local Store Marketing (LSM) initiative introduced in 1998 and fully developed in '99 proved to be another winning concept for Taco Cabana. After researching the wants and needs of team members and hundreds of customers at every Taco Cabana restaurant, we held a series of two-day marketing “boot-camps” that trained field operations teams how to meet marketing needs on a local basis. The result? Targeted Neighborhood Marketing Plans with tool kits that empower local management teams to tailor promotions and community involvement programs according to their own unique customer base.

- Our Human Resources department implemented a new performance system that helped every management employee set quantifiable performance goals. Inspired by Taco Cabana’s visible momentum over the past eight quarters, team members have enthusiastically raised the performance bar in all areas, from sales projections to customer satisfaction scores.

- We developed our first computer-based training system, creating a learning environment that focuses on the development of all team members.



- Taco Cabana continued to support Reading is Fundamental, Inc. (RIF), the largest and most successful literacy program in the U.S. Through financial contributions and volunteer involvement, Taco Cabana helped bring books and reading activities to school children in more than 1,600 Texas locations. In preparation of our entrance into the Phoenix market, Taco Cabana also adopted 10 elementary schools in Phoenix, enabling us to extend RIF to 10,254 Arizona children. In addition, we adopted five elementary schools in Oklahoma, connecting 3,000 more children to RIF literacy programs.

- Taco Cabana joined in the United Way campaign in 1999 with a significant employee pledge and a sizable Corporate Gift. Plus, management team members volunteered their time and helped with administrative tasks and other responsibilities requested by United Way. We will continue our support of this worthy organization in 2000 and beyond.

- We also introduced Taco Cabana’s splashy new website in 1999, instantly linking customers, investors, potential employees, and suppliers to press releases, current financial data, and lots more. Log on at www.tacocabana.com to hear the latest spots in our popular radio campaign featuring actor/comic Cheech Marin at his irreverent best.



WE'RE GROWING LIKE NOBODY'S BUSINESS.

 Our 2000-and-beyond story is about market expansion, growth-oriented strategies, and new product roll-outs designed to take Taco Cabana to even higher levels of profitability and success. Here's a sampling of the plans already in the works for fiscal year 2000.

- Taco Cabana will launch 15 new locations in 2000, most of which will be in markets outside of Texas. Taco Cabana will enter the Arizona market with five to six new state-of-the-art restaurants and expand our operations in Oklahoma with four to six new locations. Each will leverage streamlined productivity, operating cost-reductions, and guest enhancement opportunities inherent in the Prototype II design. Prototype II captures the open, relaxed ambiance of Taco Cabana's outdoor dining experience. Updated interior dining features include accent columns, patio umbrellas and furniture, and indoor plantings designed to mirror Taco Cabana's trademark exterior landscaping.
- We will extend our reimagining initiative to 13 additional restaurants, completing a three-year image

HOT PLANS



enhancement plan. The scope of work incorporates prototype image elements including equipment upgrades and operational improvements.

- We're preparing to roll-out Taco Cabana's Local Store Marketing plan system-wide, hand-in-hand with a team member incentive plan. Dubbed "Sparkle and Smile," it's aimed at improving cleanliness and hospitality. This exciting incentive program offers every operational employee the chance to win substantial cash prizes and rewards. The payoffs will be huge, in more ways than one.
- Several Tex-Mexceptional menu-additions will hit targeted stores in 2000. The new "Cabana Bowl" is a full meal in a taco-shell bowl heaped with steaming rice, beans, fajita meat, and topped off with fresh guacamole.

**TACO CABANA
OFFICER TEAM**



Bottom Row (left to right): Dennis Greenia, Doug Gammon, Stephen Clark, Becky Rainey, David Lloyd.

Top Row (left to right): James Jenkins, Brad Smith, Mark Phillips, Greg Bushnell, Ramon Torres, Brian Callahan, Tom Turkett.

We'll also introduce an entire line-up of shredded beef products, with palate-pleasing flavors geared especially for Phoenix and other new markets outside of Texas. And we're extending the popular Personal Sized Quesadita into a full line of new Breakfast Quesaditas destined to become a hot best seller.

- We're exploring the revenue generating and new-customer-exposure merits of expanded catering services.
- We're developing strategies to leverage secondary marketing opportunities in the 10-and-under age group. The new "Cabana Kids" program kicks off in April, 2000 with bigger meals and better toys. We're also researching ways to enhance local community involvement with children via programs such as the Homework Club and the PTA Club, with additional programs under development.

BETTER TEX-MEX. BETTER VALUE. BETTER CHECK US OUT.

Thanks to our team members' enthusiastic dedication, Taco Cabana will continue its emergence as a strong, growing, dynamic company, worthy of investor confidence. All the elements for success are in place: Streamlined operations, a comprehensive marketing program, a solid plan for expansion, value pricing, and sensational Tex-Mex food served up in a unique, fun, festive atmosphere.

In other words, we're fired up about the future. So, if you're hungry for an appetizing new investment opportunity, come taste the Cabana Experience for yourself.

Taco Cabana. We're hot.

2000 IMPERATIVES

- Drive positive Comparable Sales in all markets through the aggressive execution of local, market-wide, and system-wide marketing programs.
- Continue to validate our "Growth Model" outside Texas with the successful development of the Phoenix market.
- Improve Guest Satisfaction with an enhanced Cabana Experience focusing on service, cleanliness, and friendliness.
- Create a caring environment where all Taco Cabana employees can learn, grow, and contribute.
- Increase Shareholder Value by exceeding 20% EPS growth and achieving expected returns on Invested Capital.



BOARD OF DIRECTORS

Stephen Clark
President and Chief Executive Officer

William J. Nimmo
Partner: Halpern, Denny & Company
Boston, Massachusetts

Rod Sands
Managing Director: S. V. Capital Management
San Antonio, Texas

Cecil Schenker
Partner: Akin, Gump,
Strauss, Hauer & Feld, LLP
San Antonio, Texas

Richard Sherman
Investments
Louisville, Kentucky

Lionel Sosa
CEO: Garcia LKS Advertising
San Antonio, Texas

OFFICERS

Stephen Clark
President and Chief Executive Officer

Doug Gammon
Senior Vice President, Human Resources and
People Development

Dennis Greenia
Senior Vice President, Marketing

David Lloyd
Senior Vice President, Chief Financial Officer,
Secretary, and Treasurer

Greg Bushnell
Vice President, Development

Brian Callahan
Vice President and Chief Information Officer

Mark Phillips
Vice President, Operations

James Jenkins
Vice President, Controller

Becky Rainey
Vice President, General Counsel

Brad Smith
Vice President, Real Estate

Ramon Torres
Vice President, Operations

Tom Turkett
Vice President, Purchasing

STOCK EXCHANGE

The common Stock of the Company is listed for trading on the NASDAQ National Market System under the trade symbol "TACO."

REGISTRAR AND STOCK TRANSFER AGENT

Harris Trust and Savings Bank
1601 Elm Street, Suite 2320
Dallas, Texas 75201

INDEPENDENT ACCOUNTANTS

Deloitte & Touche, LLP
700 N. St. Mary's, Suite 1100
San Antonio, Texas 78205

FORM 10-K

A copy of the Company's annual report to the Securities and Exchange Commission (Form 10-K), as well as quarterly reports, will be furnished without charge to any stockholder upon written request. Please submit all written requests to:

Investor Relations
Taco Cabana, Inc.
8918 Tesoro Drive, Suite 200
San Antonio, Texas 78217
(210) 804-0990

CORPORATE GOVERNANCE STANDARDS ADOPTED BY THE BOARD OF DIRECTORS, FEBRUARY 2000

The Board will always act in the best interest of all shareholders.

Board members will be active, objective, and constructive participants at board meetings.

The Board will assist management in representing Taco Cabana to the outside world.

The Board will be advised and consulted on all key organizational changes.

The Board will evaluate the performance of the CEO, at least annually, during a session that is not attended by the CEO. A Board member will then provide feedback to the CEO.

The Board will annually assess and discuss its effectiveness as a Board and identify opportunities for improvement.

An annual board meeting schedule will be published prior to the beginning of the fiscal year. Board members will be expected to attend at least 75% of the board meetings.

The Board should receive all agendas and board meeting materials at least one week prior to scheduled board meetings.

Each board meeting will include a review and discussion of the latest financial results of the Company, including, but not limited to, income statements, balance sheets, and cash flow results and projections.

Each board meeting will include a percentage of time for in-depth strategic business presentation and discussion.

In tracking and evaluating company performance, management and the Board will develop and track a list of peer companies for quarterly financial comparison of results at each board meeting.

Every year, at least two months prior to the end of the fiscal year, the Board will review and approve a long-term strategic plan and a one-year operating plan for the Company.

All capital expansion plans and acquisitions will be presented, in advance to the Board by management, complete with full financial analysis, return expectations and all assumptions utilized in the analysis.

Incentive compensation plans linking pay directly and objectively to measured financial goals, or other measured operating results, will be presented by the CEO and approved by the Board prior to the beginning of each new fiscal year for employees at the director level and above.

Succession planning, training programs and management development programs for employees at the director level and above, will be reported annually by the CEO to the Board.

The Board will consider the correlation between executive pay and company performance at least annually.

All directors will stand for election every year. Directors may not stand for re-election after age 70.

The Audit and Compensation Committees will consist of a majority of independent directors. For this purpose "independent" means no present or former employment by the Company, with no business or personal ties to the Company, other than share ownership and director fees.

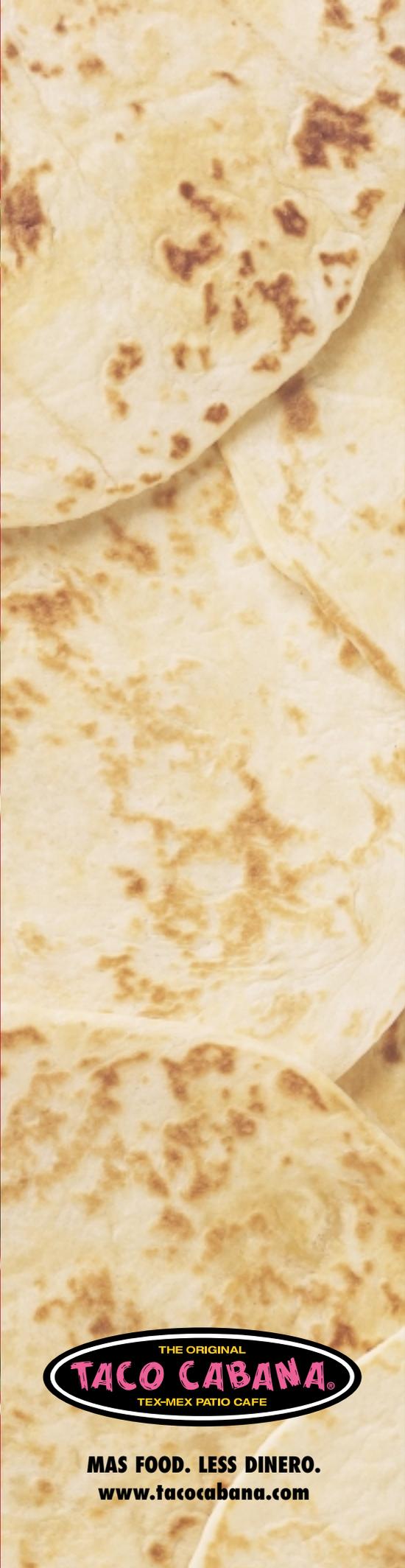
All directors' fees will be paid in stock. All directors are required to accumulate and maintain 15,000 Taco Cabana shares before selling or disposing of any shares.

All senior vice presidents and above must buy and hold outright (excluding options and restricted stock) Taco Cabana stock valued at a level equal to their annual salary.

By express language in the shareholder-approved incentive plan, stock options may not be re-priced. The exercise price for options will not be lowered, even if the current market price of the stock is below the exercise price.

These Corporate Governance Standards have been developed and approved by the Board, and are reviewed by the Board at least annually.





MAS FOOD. LESS DINERO.
www.tacocabana.com