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RICKS CABARET INTERNATIONAL INC
Form 10QSB
February 14, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

- Quarterly report pursuant to Section 13 Or 15(d) of the Securities Exchange Act of 1934; For the quarterly period ended: December 31, 2004
- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-26958

RICK'S CABARET INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Texas 76-0458229
(State or other jurisdiction IRS Employer
of incorporation or organization) Identification No.)

10959 Cutten Road
Houston, Texas 77066
(Address of principal executive offices, including zip code)

(281) 397-6730
(Registrant's telephone number, including area code)

APPLICABLE ONLY TO CORPORATE ISSUERS

On February 4, 2004, there were 3,700,148 shares of common stock, \$.01 par value, outstanding.

Transitional Small Business Disclosure Format (check one): Yes No

RICK'S CABARET INTERNATIONAL, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

ASSETS

	12/31/04 (UNAUDITED)	9/30/04 (AUDITED)
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,438,214	\$ 278,185
Accounts receivable		
Trade	71,641	72,909
Other, net	200,471	203,343
Marketable securities	77,859	122,350
Inventories	249,453	261,486
Prepaid expenses and other current assets	1,029,146	1,010,416
	5,066,784	1,948,689
	5,066,784	1,948,689
PROPERTY AND EQUIPMENT		
Buildings, land and leasehold improvements	9,942,236	9,421,119
Furniture and equipment	2,254,818	2,210,054
	12,197,054	11,631,173
	12,197,054	11,631,173
Accumulated depreciation	(2,935,786)	(2,798,155)
	9,261,268	8,833,018
	9,261,268	8,833,018
OTHER ASSETS		
Goodwill	1,982,848	1,982,848
Other	448,401	435,204

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Total other assets	2,431,249	2,418,052
Total assets	\$16,759,301	\$13,199,759

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

	12/31/04 (UNAUDITED)	9/30/04 (AUDITED)
CURRENT LIABILITIES		
Accounts payable - trade	\$ 232,793	\$ 317,278
Accrued liabilities	505,562	650,348
Current portion of long-term debt	571,841	516,845
Total current liabilities	1,310,196	1,484,471
Deferred gain on sale of subsidiary	163,739	163,739
Long-term debt less current portion	7,150,020	3,364,765
Total liabilities	8,623,955	5,012,975
COMMITMENTS AND CONTINGENCIES		
	---	---
MINORITY INTERESTS	40,345	40,808
STOCKHOLDERS' EQUITY		
Preferred stock, \$.10 par, 1,000,000 shares authorized; none outstanding	---	---
Common stock, \$.01 par, 15,000,000 shares authorized; 4,608,678 shares issued	46,087	46,087
Additional paid-in capital	11,273,149	11,273,149
Accumulated other comprehensive income	64,512	109,002
Accumulated deficit	(1,994,967)	(1,988,482)
Less 908,530 shares of common stock held in treasury, at cost	(1,293,780)	(1,293,780)
Total stockholders' equity	8,095,001	8,145,976
Total liabilities and stockholders' equity	\$16,759,301	\$13,199,759

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	(UNAUDITED)	(UNAUDITED)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (6,485)	\$ 239,256
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation	137,631	125,658
Minority interests	(463)	(9,526)
Changes in operating assets and liabilities	(325,562)	(186,554)
	-----	-----
Cash provided by (used in) operating activities	(194,879)	168,834
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(139,421)	(51,618)
Decrease in notes receivable	80,538	3,036
	-----	-----
Cash used in investing activities	(58,883)	(48,582)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	3,802,000	---
Payments on long-term debt	(388,209)	(75,156)
	-----	-----
Cash provided by (used in) financing activities	3,413,791	(75,156)
	-----	-----
NET INCREASE IN CASH	3,160,029	45,096
CASH AT BEGINNING OF PERIOD	278,185	604,865
	-----	-----
CASH AT END OF PERIOD	\$ 3,438,214	\$ 649,961
	=====	=====
CASH PAID DURING PERIOD FOR:		
Interest	\$ 86,500	\$ 86,165
	=====	=====

Non-cash transaction:

During the quarter ended December 31, 2004, the Company purchased a 9,000 square feet office building for \$516,499, payable with \$90,039 cash at closing and a fifteen year promissory note, bearing interest rate at 7%, in the amount of \$426,460.

RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2004

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB of Regulation S-B. They do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. However, except as disclosed herein, there has been no material change in the information disclosed in the notes to the financial statements for the year ended September 30, 2004 included in the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in

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conjunction with those financial statements included in the Form 10-KSB. In the opinion of Management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the three months ended December 31, 2004 are not necessarily indicative of the results that may be expected for the year ending September 30, 2005.

2. STOCK OPTIONS

The Company accounts for its stock options under the recognition and measurement principles of Accounting Principles Board ("APB") opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standard ("SFAS") No. 123, Accounting for Stock Based Compensation, to stock-based employee compensation. The following presents pro forma net income (loss) and per share data as if a fair value accounting method had been used to account for stock-based compensation:

	THREE MONTHS ENDED DECEMBER 31,	
	2004	2003
	(Unaudited)	(Unaudited)
Net income (loss), as reported	\$ (6,485)	\$ 239,256
Less total stock-based employee compensation expense determined under the fair value based method for all awards	(128,393)	(11,943)
	-----	-----
Pro forma net income (loss)	\$ (134,878)	\$ 227,313
	=====	=====
Earnings per share:		
Basic and diluted - as reported	\$ 0.00	\$ 0.06
	=====	=====
Basic and diluted - pro forma	\$ (0.04)	\$ 0.06
	=====	=====

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2004

3. RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current year presentation.

4. COMPREHENSIVE INCOME

The Company reports comprehensive income in accordance with the provisions of SFAS No. 130, Reporting Comprehensive Income. Comprehensive income consists of net income (loss) and gains (losses) on available-for-sale marketable securities.

5. SEGMENT INFORMATION

Below is the financial information related to the Company's segments:

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	THREE MONTHS ENDED DECEMBER 31,	
	2004	2003
	(Unaudited)	(Unaudited)
REVENUES		
Club operations	\$ 3,481,626	\$ 3,651,288
Internet websites	187,231	200,745
	-----	-----
	\$ 3,668,857	\$ 3,852,033
	=====	=====
NET INCOME (LOSS)		
Club operations	\$ 549,688	\$ 577,227
Internet websites	31,186	3,881
Corporate expenses	(587,359)	(341,852)
	-----	-----
	\$ (6,485)	\$ 239,256
	-----	-----

6. REVENUE RECOGNITION

The Company recognizes revenue from the sale of alcoholic beverages, food and merchandise and services at the point-of-sale upon receipt of cash, check, or credit card charge. This includes daily, annual and lifetime VIP memberships.

Under Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, membership revenue should be deferred and recognized over the estimated membership usage period. Management estimates that the weighted average useful lives for memberships are 12 and 24 months for annual and lifetime memberships, respectively. The Company does not track membership usage by type of

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 DECEMBER 31, 2004

membership, however it believes these lives are appropriate and conservative, based on management's knowledge of its client base and membership usage at the clubs.

If the Company had deferred membership revenue and recognized it based on the lives above, the impact on revenue and net income recognized would have been an increase of \$6,002 and \$6,357 for the three months ended December 31, 2004 and 2003, respectively. This would have also resulted in a deferred revenue balance of \$6,309 and \$53,193 for the three months ended December 31, 2004 and 2003, respectively. Management does not believe the impact of this difference in accounting treatment is material to the Company's annual and quarterly financial statements. However, the Company began to record revenues in such manner effective January 1, 2004, and hence as of December 31, 2004 deferred revenues of \$23,298 has been recorded related to such memberships.

The Company recognizes Internet revenue from monthly subscriptions to its online entertainment sites when notification of a new subscription is received from the third party hosting company or from the credit card company, usually two to three days after the transaction has occurred. The Company recognizes Internet

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auction revenue when payment is received from the credit card company as revenues are not deemed estimable nor collection deemed probable prior to that point.

7. LONG-TERM DEBT

On November 15 and 17, 2004, the Company borrowed \$590,000 and \$1,042,000, respectively, from a financial institution at an annual interest rate of 10% over a 10 year term. The monthly payment of principal and interest are \$5,694 and \$10,056, respectively. On November 30, 2004, the Company borrowed \$900,000 from an unrelated individual at an 11% annual interest rate over a 10 year term. The monthly payment of principal and interest is \$9,290. On December 30, 2004, the Company borrowed \$1,270,000 from a financial institution at an annual interest rate of 10% over a 10 year term. The monthly payment of principal and interest is \$12,256. The money received from this financing will be used for the acquisition and renovation of the New York club.

8. SUBSEQUENT EVENTS

On January 18, 2005, the Company completed the acquisition of Peregrine Enterprises, Inc., which operated the Paradise Club in Midtown Manhattan, New York (50 West 33rd Street). The Company provided a total consideration of \$7.625 million for the assets and stock of the former Paradise Club, which had operated on the site for more than a decade. The transaction consisted of \$2.5 million in cash and \$5.125 million in a promissory note bearing simple interest at the rate of 4.0% per annum, part of which is convertible to restricted shares of Rick's Cabaret common stock at prices ranging from \$4.00 to \$7.50 per share.

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Item 2. Management's Discussion and Analysis or Plan of Operations.

The following discussion should be read in conjunction with our audited consolidated financial statements and related notes thereto included in this quarterly report.

FORWARD LOOKING STATEMENT AND INFORMATION

The Company is including the following cautionary statement in this Form 10-QSB to make applicable and take advantage of the safe harbor provision of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by, or on behalf of, the Company. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Certain statements in this Form 10-QSB are forward-looking statements. Words such as "expects," "believes," "anticipates," "may," and "estimates" and similar expressions are intended to identify forward-looking statements. Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties are set forth below. The Company's expectations, beliefs and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties, but there can be no assurance that management's expectation, beliefs or projections will result, be achieved, or be accomplished. In addition to other factors and matters discussed elsewhere herein, the following are important factors that, in the view of the Company, could cause material adverse affects on the Company's financial condition and results of operations: the risks and uncertainties relating to our Internet operations, the impact and implementation of the sexually oriented business ordinances in the jurisdictions where our

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facilities operate, competitive factors, the timing of the openings of other clubs, the availability of acceptable financing to fund corporate expansion efforts, and the dependence on key personnel. The Company has no obligation to update or revise these forward-looking statements to reflect the occurrence of future events or circumstances.

GENERAL

We presently conduct our business in two different areas of operation:

1. We own and operate upscale adult nightclubs serving primarily businessmen and professionals. Our nightclubs offer live adult entertainment, restaurant and bar operations. We own and operate seven adult nightclubs under the name "Rick's Cabaret" and "XTC" in Houston, Austin and San Antonio, Texas, and Minneapolis, Minnesota. We also own and operate a sports bar called "Hammers" and an upscale venue that caters especially to urban professionals, businessmen and professional athletes called "Club Onyx" in Houston. No sexual contact is permitted at any of our locations.
2. We have extensive internet activities.
 - a) We currently own three adult Internet membership Web sites at www.couplestouch.com, www.M4Mcouples.com, and www.xxxpassword.com. We

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acquire www.xxxpassword.com site content from wholesalers.

- b) We operate an online auction site www.naughtybids.com. This site

provides our customers with the opportunity to purchase adult products and services in an auction format. We earn revenues by charging fees for each transaction conducted on the automated site.

Our nightclub revenues are derived from the sale of liquor, beer, wine, food, merchandise, cover charges, membership fees, independent contractors' fees, commissions from vending and ATM machines, valet parking, and other products and service. Our internet revenues are derived from subscriptions to adult content internet websites, traffic/referral revenues, and commissions earned on the sale of products and services through Internet auction sites, and other activities. Our fiscal year end is September 30.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2004 AS COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2003

For the three months ended December 31, 2004, the Company had consolidated total revenues of \$3,668,857 compared to consolidated total revenues of \$3,852,033 for the three months ended December 31, 2003, a decrease of \$183,176. The decrease in total revenues was primarily due to the sale of our subsidiary in the amount of \$136,162, decrease in overall revenues generated by the Company's club businesses in the amount of \$33,500, and a decrease of \$13,514 by the Company's internet business. The decrease in overall revenues of the Company's club businesses was due to the impact of a presidential election month in November, which resulted in a 13.74% decrease in total revenues for the month, and a new competitive club opening and severe weather in Minneapolis. Total revenues for same-location-same-period of club operations decreased to \$3,329,426 for the three months ended December 31, 2004 from \$3,512,125 for same period ended December 31, 2003, or by 5.20%. Management has developed and implemented a strategy to regain the market share in the Minneapolis location.

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The cost of goods sold for the three months ended December 31, 2004 was 12.85% of total revenues compared to 13.21% for the three months ended December 31, 2003. The decrease was due primarily to the reduction in costs of maintaining our internet operations and an addition of XTC club, which has low cost of goods sold. The cost of goods sold for the club operations for the three months ended December 31, 2004 was 13.33% of total revenues compared to 13.39% for the three months ended December 31, 2003. We continue our efforts to achieve reductions in cost of goods sold of the club operations through improved inventory management. We continue a program to improve margins from liquor and food sales and food service efficiency. The cost of goods sold from our internet operations for the three months ended December 31, 2004 was 4.16% compared to 10.09% for the three months ended December 31, 2003. The cost of goods sold for same-location-same-period of club operations for the three months ended December 31, 2004 was 13.85%, compared to 13.30% for the same period ended December 31, 2003.

Payroll and related costs for the three months ended December 31, 2004 were \$1,343,538 compared to \$1,287,987 for the three months ended December 31, 2003. The increase was primarily due to the increase in payroll in opening a new club and corporate activities. Payroll for same-location-same-

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period of club operations decreased to \$995,549 for the three months ended December 31, 2004 from \$1,055,377 for the same period ended December 31, 2003. Management has implemented labor cost reduction methods and currently believes that its labor and management staff levels are appropriate.

Other general and administrative expenses for the three months ended December 31, 2004 were \$1,775,216 compared to \$1,747,685 for the three months ended December 31, 2003. The increase was due primarily to an increase in direct operating expenses, utilities, accounting, and depreciation from opening new locations and legal, financing, and traveling costs due to the acquisition of New York club. The total cost related to the acquisition of the New York club is estimated to be \$90,000.

Interest expense for the three months ended December 31, 2004 was \$93,767 compared to \$86,165 for the three months ended December 31, 2003. The increase was primarily due to the increase in the Company's long-term debts as a result of acquiring the New York club. As of December 31, 2004, the balance of long term debt was \$7,721,861 compared to \$3,951,179 a year earlier.

Net income for the three months ended December 31, 2004 was a deficit of \$6,485 compared to a net income of \$239,256 for the three months ended December 31, 2003. The decrease in net income was primarily due to the decrease in the Company's club business and an increase of certain expenses related to the acquisition of the New York club. Net income for same-location-same-period of club operations decreased to \$534,595 for the three months ended December 31, 2004 from \$597,963 for same period ended December 31, 2003, or by 10.60%.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2004, the Company had a working capital of \$3,756,588 compared to a working capital of \$464,218 at September 30, 2004. The increase in working capital was primarily due to an increase in cash from new long-term debts, and other current assets offset by decreases in accounts payable, accrued liabilities and marketable securities. The value of available-for-sale marketable securities decreased by \$44,491, primarily due to market price fluctuation.

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Net cash used by operating activities in the three months ended December 31, 2004 was \$194,879 compared to net cash provided of \$168,834 for the three months ended December 31, 2003. The decrease in cash provided by operating activities was primarily due to a decrease in net income, accounts payable, and accrued expenses and an increase in other current assets.

The Company used \$58,883 and \$48,582 of cash in investing activities and provided \$3,413,791 and used \$75,156 of cash in financing activities during the three months ended December 31, 2004 and 2003, respectively.

The Company's need for capital historically was a result of construction or acquisition of new clubs, renovation of older clubs, and investments in technology. The Company has utilized capital to repurchase its common stock as part of the Company's share repurchase program.

On September 16, 2003, the Company was authorized by its board of directors to repurchase up to \$500,000 worth of the Company's common stock. No shares have been purchased under this plan.

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On November 15 and 17, 2004, the Company borrowed \$590,000 and \$1,042,000, respectively, from a financial institution at an annual interest rate of 10% over a 10 year term. The monthly payment of principal and interest are \$5,694 and \$10,056, respectively. On November 30, 2004, the Company borrowed \$900,000 from an unrelated individual at an 11% annual interest rate over a 10 year term. The monthly payment of principal and interest is \$9,290. On December 30, 2004, the Company borrowed \$1,270,000 from a financial institution at an annual interest rate of 10% over a 10 year term. The monthly payment of principal and interest is \$12,256. The money received from this financing is used for the acquisition and renovation of New York club.

In the opinion of management, working capital is not a true indicator of the financial status. Typically, businesses in the industry carry current liabilities in excess of current assets because the business receives substantially immediate payment for sales, with nominal receivables, while accounts payable and other current liabilities normally carry longer payment terms. Vendors and purveyors often remain flexible with payment terms providing businesses with opportunities to adjust to short-term business down turns. The Company considers the primary indicators of financial status to be the long-term trend of revenue growth and mix of sales revenues, overall cash flow, profitability from operations and the level of long-term debt.

We have not established lines of credit or financing other than our existing debt. There can be no assurance that we will be able to obtain additional financing on reasonable terms in the future, if at all, should the need arise.

In the event the sexually oriented business industry is required in all states to convert the entertainers who perform at our locations, from being independent contractors to employee status, we have prepared alternative plans that we believe will protect our profitability. We believe that the industry standard of treating the entertainers as independent contractors provides sufficient safe harbor protection to preclude payroll tax assessment for prior years.

The sexually oriented business industry is highly competitive with respect to price, service and location, as well as the professionalism of the entertainment. Although we believe that we are well-positioned to compete successfully in the future, there can be no assurance that we will be able to maintain our high level of name recognition and prestige within the marketplace.

SEASONALITY

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Our nightclub operations are significantly affected by seasonal factors. Historically, we have experienced reduced revenues from April through September with the strongest operating results occurring during October through March. Our experience to date indicates that there does not appear to be a seasonal fluctuation in our Internet activities.

GROWTH STRATEGY

The Company believes that its club operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Upon careful market research, we may open new clubs. As is the case with the acquisition of the New York club, we may acquire existing clubs in locations that are consistent with our growth and income targets, and which

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appear receptive to the upscale club formula we have developed. We may form joint ventures or partnerships to reduce start-up and operating costs, with our Company contributing assets in the form of our brand name and management expertise. We may also develop new club concepts that are consistent with our management and marketing skills. We may also acquire real estate in connection with club operations, although some clubs may be in leased premises.

We also expect to continue to grow our Internet profit centers and plan to focus in the future on high-margin activities that leverage our marketing skills while requiring a low level of start-up expense and ongoing operating costs.

Item 3. Controls and Procedures.

As of the end of the period of this report, the Company's principal executive and principal financial officers carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic reports to the Securities and Exchange Commission. There have been no significant changes in the Company's internal controls or in other factors, which could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

PART II OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

Exhibit 31.1 - Certification of Chief Executive Officer and Chief Financial Officer of Rick's Cabaret International, Inc. required by Rule 13a - 14(1) or Rule 15d - 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 -- Certification of Chief Executive Officer and Chief Financial Officer of Rick's Cabaret International, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and Section 1350 of 18 U.S.C. 63.

(b) Reports on Form 8-K

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None.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

RICK'S CABARET INTERNATIONAL, INC.

Date: February 14, 2005

By: /s/ Eric S. Langan

Eric S. Langan
Chief Executive Officer and
Chief Financial Officer

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