RICKS CABARET INTERNATIONAL INC
Form 10-Q
February 16, 2010

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

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2009

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-13992

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

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

10959 Cutten Road
Houston, Texas 77066
(Address of principal executive offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes T No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o N/A

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. Large accelerated filer £ Accelerated filer £ Non-accelerated filer £ Smaller reporting company T

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No T

As of February 5, 2010, 9,382,395 shares of the Registrant’s Common Stock were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

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

ASSETS

	DECEMBER 31, 2009 (UNAUDITED)	SEPTEMBER 30, 2009
CURRENT ASSETS:		
Cash and cash equivalents	$ 9,471,397	$ 12,850,250
Accounts receivable		
Trade, net	678,133	776,721
Other, net	248,039	136,761
Marketable securities	977,069	-
Inventories	1,151,644	1,231,353
Prepaid expenses and other current assets	690,339	846,430
Assets of discontinued operations	198,630	210,032
Total current assets	13,415,251	16,051,547
PROPERTY AND EQUIPMENT:		
Buildings, land and leasehold improvements	47,391,262	46,577,101
Furniture and equipment	15,812,202	12,289,630
	63,203,464	58,866,731
Accumulated depreciation	(11,312,115)	(10,566,656)
Total property and equipment, net	51,891,349	48,300,075
OTHER ASSETS:		
Goodwill and indefinite lived intangibles	80,349,501	78,330,914
Definite lived intangibles, net	1,274,914	1,161,433
Other	1,381,536	1,232,330
Total other assets	83,005,951	80,724,677
Total assets	$ 148,312,551	$ 145,076,299

See accompanying notes to consolidated financial statements.

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

LIABILITIES AND STOCKHOLDERS' EQUITY

	DECEMBER 31, 2009 (UNAUDITED)	SEPTEMBER 30, 2009
CURRENT LIABILITIES:		
Accounts payable – trade	$ 990,525	$ 787,982
Accrued liabilities	2,931,834	2,413,988
Texas patron tax liability	1,761,915	1,162,960
Current portion of derivative liabilities, at fair value	1,035,720	885,600
Current portion of long-term debt	6,265,945	5,855,727
Liabilities of discontinued operations	51,760	51,799
Total current liabilities	13,037,699	11,158,056
Deferred tax liability	18,643,403	18,581,344
Other long-term liabilities	661,208	641,800
Derivative liabilities at fair value, less current portion	2,105,987	2,455,992
Long-term debt, less current portion	33,415,054	31,956,856
Total liabilities	67,863,351	64,794,048
COMMITMENTS AND CONTINGENCIES		
TEMPORARY EQUITY – Common stock, subject to put rights (293,000 and 317,000 shares, respectively)	6,314,000	6,871,000
PERMANENT STOCKHOLDERS' EQUITY:		
Preferred stock, $.10 par, 1,000,000 shares authorized; none issued and outstanding	-	-
Common stock, $.01 par, 15,000,000 shares authorized; 8,879,566 shares issued	88,796	88,796
Additional paid-in capital	54,504,966	54,530,319
Accumulated other comprehensive loss	(31,886)	-
Retained earnings	16,255,435	15,472,747
Total Rick's permanent stockholders' equity	70,817,311	70,091,862
Noncontrolling interests	3,317,889	3,319,389
Total permanent stockholders' equity	74,135,200	73,411,251
Total liabilities and stockholders' equity	$ 148,312,551	$ 145,076,299

See accompanying notes to consolidated financial statements.

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RICK'S CABARET INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended December 31,	
	2009	2008
	(UNAUDITED)	
Revenues:		
Sales of alcoholic beverages	$8,049,465	$6,633,571
Sales of food and merchandise	1,590,011	1,420,066
Service revenues	9,292,249	8,139,890
Internet revenues	145,005	176,763
Media revenues	256,757	183,636
Other	671,099	579,769
Total revenues	20,004,586	17,133,695
Operating expenses:		
Cost of goods sold	2,456,107	2,229,474
Salaries and wages	4,310,305	4,220,886
Stock-based compensation	44,037	20,044
Other general and administrative:		
Taxes and permits	2,835,564	2,319,300
Charge card fees	346,188	338,541
Rent	993,133	917,962
Legal and professional	649,609	504,049
Advertising and marketing	2,938,173	1,172,371
Depreciation and amortization	842,358	844,352
Insurance	261,851	239,237
Utilities	405,869	428,918
Other	1,535,644	1,422,340
Total operating expenses	17,618,838	14,657,474
Income from operations	2,385,748	2,476,221
Other income (expense):		
Interest income	3,673	5,734
Interest expense	(1,028,583)	(833,471)
Gain on change in fair value of derivative instruments	44,275	-
Income from continuing operations before income taxes	1,405,113	1,648,484
Income taxes	513,548	576,746
Income from continuing operations	891,565	1,071,738
Loss from discontinued operations, net of income taxes of $19,899 and $111,680	(35,377)	(207,406)
Net income	856,188	864,332
Less: net income attributable to noncontrolling interests	(73,500)	(73,500)
Net income attributable to Rick’s Cabaret International, Inc.	$782,688	$790,832

Basic earnings (loss) per share attributable to Rick’s shareholders:		
Income from continuing operations	$0.09	$0.11
Loss from discontinued operations	(0.00)	(0.02)
Net income	$0.08	$0.08
Diluted earnings (loss) per share attributable to Rick’s shareholders:		
Income from continuing operations	$0.09	$0.10
Loss from discontinued operations	(0.00)	(0.02)
Net income	$0.08	$0.08
Weighted average number of common shares outstanding:		
Basic	9,370,175	9,366,033
Diluted	9,385,209	9,599,954

See accompanying notes to consolidated financial statements.

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RICK'S CABARET INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE THREE MONTHS ENDED DECEMBER 31,	
	2009	2008
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$856,188	$864,332
Loss from discontinued operations	35,377	207,406
Income from continuing operations	891,565	1,071,738
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	842,358	844,354
Deferred taxes	62,984	220,085
Amortization of note discount	44,931	-
Gain on change in fair value of derivative instruments	(44,275)	-
Beneficial conversion	5,694	5,695
Deferred rents	19,408	25,958
Stock compensation expense	44,037	20,044
Other	-	13,347
Changes in operating assets and liabilities:		
Accounts receivable	(12,690)	(116,888)
Inventories	95,598	(334,194)
Prepaid expenses and other assets	(11,067)	(307,575)
Accounts payable and accrued liabilities	1,319,344	(2,057,573)
Cash provided by (used in) operating activities of continuing operations	3,257,887	(615,009)
Cash provided by (used in) operating activities of discontinued operations	(24,014)	72,016
Net cash provided by (used in) operating activities	3,233,873	(542,993)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(1,392,113)	(610,360)
Purchase of marketable securities	(1,008,955)	-
Acquisition of businesses, net of cash acquired	(2,672,174)	(48,351)
Payments from notes receivable	2,214	2,374
Cash used in investing activities of continuing operations	(5,071,028)	(656,337)
Cash used in investing activities of discontinued operations	-	(2,598)
Net cash used in investing activities	(5,071,028)	(658,935)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of put options and payments on derivative instrument	(529,115)	-
Payments on long-term debt	(684,698)	(1,078,377)
Purchase of treasury stock	(252,885)	(236,518)
Distribution to minority interests	(75,000)	(75,000)
Cash used in financing activities of continuing operations	(1,541,698)	(1,389,895)
NET DECREASE IN CASH	(3,378,853)	(2,591,823)
CASH AT BEGINNING OF PERIOD	12,850,250	5,504,066
CASH AT END OF PERIOD	$9,471,397	$2,912,243

CASH PAID DURING PERIOD FOR:		
Interest	$745,671	$755,763
Income taxes	$245,042	$1,655,000

See accompanying notes to consolidated financial statements.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009
(UNAUDITED)

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-Q of Regulation S-X. 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, 2009 included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. The interim unaudited financial statements should be read in conjunction with those financial statements included in the Form 10-K. 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, 2009 are not necessarily indicative of the results that may be expected for the year ending September 30, 2010.

In previous filings, we have recognized our Rick’s Cabaret in Austin, Texas as a discontinued operation. That club was held for sale during a portion of 2009, but we have recently decided to renovate and reopen the club and relaunch it with a new concept in March 2010. Accordingly, the Austin club is recognized in continuing operations in the accompanying consolidated financial statements.

2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS

On July 1, 2009, the Financial Accounting Standards Board (“FASB”) issued FASB Statement of Financial Accounting Standards (“SFAS”) No. 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, which is included in FASB Accounting Standards Codification (“ASC”) 105, Generally Accepted Accounting Principles. This new guidance approved the FASB ASC as the single source of authoritative nongovernmental GAAP. The FASB ASC is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included in the FASB ASC will be considered non-authoritative. The ASC is a restructuring of GAAP designed to simplify access to all authoritative literature by providing a topically organized structure. The adoption of FASB ASC did not impact the Company’s financial condition or results of operations. Technical references to GAAP included in these notes to the Consolidated Financial Statements are provided under the new FASB ASC structure.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (ASC 855), which establishes general standards of accounting for, and requires disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company adopted the provisions of ASC 855 as of June 30, 2009. The adoption of these provisions did not have a significant impact on the Company’s consolidated financial statements.

In December 2006, the FASB issued SFAS No. 157 (ASC 820), Fair Value Measurements. ASC 820 clarifies the definition of fair value, describes methods used to appropriately measure fair value, and expands fair value disclosure requirements, but does not change existing guidance as to whether or not an instrument is carried at fair value. For financial assets and liabilities, ASC 820 is effective for fiscal years beginning after November 15, 2007, which required the Company to adopt these provisions in fiscal 2009. For nonfinancial assets and liabilities, ASC 820 is effective for fiscal years beginning after November 15, 2008, which required the Company to adopt these provisions in fiscal 2010.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS – continued

ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 – Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's derivative liabilities have been measured principally utilizing Level 2 inputs and the marketable securities have been measured using Level 1 inputs.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (ASC 825). The fair value option permits entities to choose to measure eligible financial instruments at fair value at specified election dates. The entity will report unrealized gains and losses on the items on which it has elected the fair value option in earnings. The adoption of ASC 825 did not have a material impact on the Company's financial position or results of operations.

In December 2007, the FASB issued Statement No. 141R, Business Combinations (ASC 805), and Statement No. 160, Non-controlling Interests in Consolidated Financial Statements, an amendment of ARB No. 51, (ASC 810). ASC 805 modifies the accounting and disclosure requirements for business combinations and broadens the scope of the previous standard to apply to all transactions in which one entity obtains control over another business. ASC 810 establishes new accounting and reporting standards for non-controlling interests in subsidiaries. The Company was required to apply the provisions of the new standards in the first quarter of fiscal 2010. Early adoption was not permitted for these new standards. The adoption of these standards did not have a material impact on the accompanying consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133 (ASC 815). ASC 815 amends SFAS No. 133 and requires entities to enhance their disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Adoption of this standard did not have a material impact on the Company's financial statements.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

3. SIGNIFICANT ACCOUNTING POLICIES

Following are certain accounting principles and disclosures which are new in this quarter.

Marketable Securities

Marketable securities at December 31, 2009 consist of common stock. ASC 320, Investments in Debt and Equity Securities, requires certain investments be recorded at fair value or amortized cost. The appropriate classification of the investments in marketable equity is determined at the time of purchase and re-evaluated at each balance sheet date. As of December 31, 2009, the Company's marketable securities were classified as available-for-sale, which are carried at fair value, with unrealized gains and losses reported as other comprehensive income within the stockholders' equity section of the accompanying consolidated balance sheets. The cost of marketable equity securities sold is determined on a specific identification basis. The fair value of marketable equity securities is based on quoted market prices. There have been no realized gains or losses related to marketable securities for the quarters ended December 31, 2009 or 2008. Marketable securities held at December 31, 2009 have a cost basis of approximately $1,009,000.

Discontinued Operations

In previous filings, the Company has recognized the Rick's Cabaret in Austin, Texas as a discontinued operation. That club was held for sale during a portion of 2009, but management recently decided to renovate and reopen the club in March 2010. Accordingly, the Austin club is recognized in continuing operations in the accompanying consolidated financial statements.

4. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION

Employee and Director Stock Option Plans

In August 1999, the Company adopted the 1999 Stock Option Plan ("the Plan"). The options granted under the Plan may be either incentive stock options or non-qualified options. The Plan is administered by the Board of Directors or by a compensation committee of the Board of Directors. The Board of Directors has the exclusive power to select individuals to receive grants, to establish the terms of the options granted to each participant, provided that all options granted shall be granted at an exercise price equal to at least 85% of the fair market value of the common stock covered by the option on the grant date and to make all determinations necessary or advisable under the Plan. The options are subject to termination of employment and generally expire five years from the date of grant. Employee options generally vest in installments over two years. As of December 31, 2009, 378,000 shares of common stock were available for future grants under the Plan.

The compensation costs recognized for the three months ended December 31, 2009 and 2008 were $44,037 and $20,044, respectively. There were no stock option exercises for the three months ended December 31, 2009. There were no stock option grants for the three month periods ended December 31, 2009 and 2008.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

4. STOCK OPTIONS AND STOCK-BASED EMPLOYEE COMPENSATION - continued

Below is the summary of common stock options outstanding as of December 31, 2009:

Employee and Director Stock Option Plan:	Options Authorized	Options Outstanding	Options Vested	Available for Grant
1999 Stock Option Plan	1,500,000	120,000	60,000	378,000

Stock Option Activity

The following is a summary of all stock option transactions for the three months ended December 31, 2009:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding as of September 30, 2009	120,000	$7.53		
Granted	-	-		
Cancelled or expired	-	-		
Exercised	-	-		
Outstanding as of December 31, 2009	120,000	$7.53	1.57	$151,400
Options exercisable as of December 31, 2009	60,000	$6.32	1.56	$151,400

5. GOODWILL AND OTHER INTANGIBLES

Following are the changes in the carrying amounts of goodwill and licenses for the three months ended December 31, 2009 and 2008:

	2009		2008	
	Licenses	Goodwill	Licenses	Goodwill
Beginning balance	$ 41,259,794	$ 37,071,120	$ 39,298,343	$ 37,159,351
Change in tax basis of assets	-	14,813	-	-
Intangibles acquired	2,003,774	-	-	48,351
Ending balance	$ 43,263,568	$ 37,085,933	$ 39,298,343	$ 37,207,702

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

6. SEGMENT INFORMATION

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

	FOR THE THREE MONTHS ENDED DECEMBER 31,	
	2009	2008
REVENUES		
Club operations	$19,602,824	$16,773,297
Media	256,757	183,636
Internet websites	145,005	176,762
	$20,004,586	$17,133,695
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		
Club operations	$2,561,304	$2,707,465
Media	(64,884)	(216,276)
Internet websites	21,285	52,581
Corporate expenses	(1,112,592)	(895,286)
	$1,405,113	$1,648,484

General corporate expenses include corporate salaries, health insurance and social security taxes for officers, legal, accounting and information technology employees, corporate taxes and insurance, legal and accounting fees, depreciation, interest expense and other corporate costs such as automobile and travel costs. Management considers these to be non-allocable costs for segment purposes. Interest expense included in corporate expenses was $376,125 and $133,318 for the 2009 and 2008 quarters, respectively.

7. LONG-TERM DEBT

During November 2008, $600,000 of related party debt matured and was paid in cash by the Company.

8. COMMON STOCK

During the quarter ended December 31, 2008, the Company purchased 48,200 shares of Company common stock for its treasury at an aggregate cost of $236,518. These shares have been retired.

During the quarter ended December 31, 2009, the Company purchased 33,000 shares of Company common stock for its treasury at an aggregate cost of $252,885. These shares have been retired.

9. EARNINGS PER SHARE (EPS)

The Company computes earnings per share in accordance with FASB ASC 260, Earnings Per Share. ASC 260 provides for the calculation of basic and diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of the Company.

Potential common stock shares consist of shares that may arise from outstanding dilutive common stock warrants and options (the number of which is computed using the "treasury stock method") and from outstanding convertible debentures (the number of which is computed using the "if converted method").

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

9. EARNINGS PER SHARE (EPS) - continued

Diluted EPS considers the potential dilution that could occur if the Company's outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in the Company's earnings (as adjusted for interest expense, that would no longer occur if the debentures were converted).

Net earnings applicable to common stock and the weighted – average number of shares used for basic and diluted earnings per share computations are summarized in the table that follows:

	FOR THE QUARTER ENDED DECEMBER 31, 2009	2008
Basic earnings per share:		
Income from continuing operations attributable to Rick's shareholders	$818,065	$998,238
Loss from discontinued operations, net of income taxes	(35,377)	(207,406)
Net income attributable to Rick's shareholders	$782,688	$790,832
Average number of common shares outstanding	9,370,175	9,366,033
Basic earnings per share - income from continuing operations	$0.09	$0.11
Basic earnings per share - discontinued operations	$(0.00)	$(0.02)
Basic earnings per share - net income attributable to Rick's shareholders	$0.08	$0.08
Diluted earnings per share:		
Average number of common shares outstanding:		
Common shares outstanding	9,370,175	9,366,033
Potential dilutive shares resulting from exercise of warrants and options (1)	15,034	233,921
Potential dilutive shares resulting from conversion of debentures (2)	-	-
Total average number of common shares outstanding used for dilution	9,385,209	9,599,954
Diluted earnings per share - income from continuing operations atrributable to Rick's shareholders	$0.09	$0.10
Diluted earnings per share - discontinued operations	$(0.00)	$(0.02)
Diluted earnings per share - net income attributable to Rick's shareholders	$0.08	$0.08

(1) All outstanding warrants and options were considered for the EPS computation.
(2) Convertible debentures (principal and accrued interest) outstanding at December 31, 2009 and 2008 totaling $7,902,176 and $960,582, respectively, were convertible into common stock at a price from $8.75 to $12.00 per share in 2009 and $12.00 to $25.32 per share in 2008. Potential dilutive shares of 888,491 and 89,527 for the three months ended December 31, 2009 and 2008, respectively, have been excluded from earnings per share due to being anti-dilutive.

*EPS may not foot due to rounding.

10. ACQUISITIONS AND DISPOSITIONS

On December 18, 2009, our wholly owned subsidiary, RCI Entertainment (3105 I-35), Inc. ("RCI"), entered into and closed a Stock Purchase Agreement (the "RCI Purchase Agreement") with Spiridon Karamalegos ("Karamalegos"), the

Joy Club of Austin, Inc. ("JOY") and North IH-35 Investments, Inc. ("NIII"), whereby RCI acquired 51% of the outstanding stock of JOY and 49% of the outstanding stock of NIII. JOY is the owner and operator of the adult nightclub business known as "Joy of Austin" which leases and occupies the real property and improvements located at 3105 South IH-35, Round Rock, Texas 78664 (the "Property"). NIII is the owner of the Property and leases the Property to JOY. Contemporaneously with entry into the RCI Purchase Agreement, RCI and Karamalegos entered into an Assignment and Assumption Agreement (the "Assignment Agreement"), whereby Karamalegos assigned to RCI his right to acquire the remaining 49% of the outstanding stock of JOY and the remaining 51% of the outstanding stock of NIII, which right Karamalegos obtained pursuant to a Purchase Agreement entered into between Karamalegos, Evangelos Polycrates ("Polycrates"), JOY and NIII (the "Polycrates Purchase Agreement"). Pursuant to the RCI Purchase Agreement and the Assignment Agreement, RCI acquired and owns 100% of the outstanding stock of JOY and 100% of the outstanding stock of NIII.

RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

10. ACQUISITIONS AND DISPOSITIONS - continued

Pursuant to the terms of the RCI Purchase Agreement and the Assignment Agreement, RCI paid aggregate consideration of $4,550,000, plus assumption of a promissory note with First State Bank-Taylor (the “Purchase Price”), for the acquisition of JOY and NIII. The Purchase Price was payable as follows:

(i) $1,820,000 by wire transfer to Karamalegos;

(ii) $880,000 by wire transfer to Polycrates;

(iii) $530,000 evidenced by a five (5) year secured promissory note to Karamalegos, bearing interest at the rate of 4.75% per annum and payable in sixty (60) equal monthly installments of principal and interest of $9,941 (the “Karamalegos Note”). The Karamalegos Note is secured by a third lien in favor of Karamalegos against the Property and improvements located thereon and a second lien on all of the shares of JOY and NIII;

(iv) $1,320,000 evidenced by a five (5) year secured promissory note to Polycrates, bearing interest at the rate of 4.75% per annum and payable in sixty (60) equal monthly installments of principal and interest of $24,759 (the “Polycrates Note”). The Polycrates Note is individually guaranteed by Karamalegos for the first thirty (30) months and is secured by a second lien in favor of Polycrates against the Property and improvements located thereon and a first lien on all of the shares of JOY and NIII; and

(v) The assumption of a Promissory Note dated September 10, 2004, in the original principal amount of $850,000, executed by NIII and payable to First State Bank-Taylor, which Promissory Note had a current balance of $652,489 as of the date of acquisition, and is secured by the Property and improvements located thereon. The note bears interest at the rate of 7.25%, payable in monthly installments of principal and interest of $7,761. The interest rate is subject to adjustment on September 10, 2014 to the rate of prime plus 2.5%. The note is due and payable on or before September 10, 2019.

Also pursuant to the agreements described above, Karamalegos entered into a four (4) year Non-Competition Agreement with RCI, and Polycrates entered into a three (3) year Non-Competition Agreement with RCI.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

10. ACQUISITIONS AND DISPOSITIONS - continued

The following information summarizes the allocation of fair values assigned to the assets and liabilities at the acquisition date.

Net current assets	$43,715
Property and equipment and other assets	2,955,000
Non-compete agreement	200,000
Goodwill	701,321
SOB licenses	2,003,774
Deferred tax liability	(701,321)
Net assets acquired	$5,202,489

The Company incurred approximately $43,000 in legal costs associated with the acquisition, which are included in legal and professional expense in the accompanying consolidated statement of income.

Goodwill in the acquisition represents the offset to the deferred tax liability recorded as a result of the difference in the basis of the net assets for tax and financial purposes. The goodwill is not deductible for income tax purposes. The results of operations of this entity are included in the Company's consolidated results of operations since December 18, 2009. This acquisition was made to further the Company's growth objective of acquiring nightclubs that will quickly contribute to the Company's earnings per share. Proforma
results of operations have not been provided, as the amounts were not deemed material to the consolidated financial statements.

11. INCOME TAXES

Income tax expense on continuing operations for the periods presented differs from the "expected" federal income tax expense computed by applying the U.S. federal statutory rate of 34% to earnings before income taxes for the three months ended December 31, as a result of the following:

		2009		2008
Computed expected tax expense	$	477,738	$	560,485
State income taxes		38,321		37,393
Permanent differences		21,373		205
Other		(23,884)		(21,337)
Total income tax expense (including tax credit applicable to discontinued operations)	$	513,548	$	576,746

Included in the Company's deferred tax liabilities at December 31, 2009 is approximately $14,800,000 representing the tax effect of indefinite lived intangible assets from club acquisitions which are not deductible for tax purposes. These deferred tax liabilities will remain in the Company's balance sheet until the related clubs are sold.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2009

12. COMMITMENTS AND CONTINGENCIES

Beginning January 1, 2008, the Company's Texas clubs became subject to a new state law requiring each club to collect and pay a $5 surcharge for every club visitor. A lawsuit was filed by the Texas Entertainment Association ("TEA"), an organization to which we are a member, alleging the fee amounts to be an unconstitutional tax. On March 28, 2008, a State District Court Judge in Travis County, Texas ruled that the new state law violates the First Amendment to the United States Constitution and is therefore invalid. The judge's order enjoined the State from collecting or assessing the tax. The State appealed the Court's ruling. In Texas, when cities or the State give notice of appeal, it supersedes and suspends the judgment, including the injunction. Therefore, the judgment of the District Court cannot be enforced until the appeals are completed. Given the suspension of the judgment, the State has opted to collect the tax pending the outcome of its appeal. On June 5, 2009, the Court of Appeals for the Third District (Austin) affirmed the District Court's judgment that the Sexually Oriented Business ("S.O.B.") Fee violated the First Amendment to the U.S. Constitution. The Attorney General of Texas has asked the Texas Supreme Court to review the case. On August 26, 2009, the Texas Supreme Court ordered both sides to submit briefs on the merits, while not yet deciding whether to grant the State's Petition for review. The State's brief was filed on September 25, 2009 and the Texas Entertainment Association's brief was filed on October 15, 2009. On February 12, 2009, the Supreme Court of Texas granted review of the Petition by the Attorney General of Texas. Oral argument of the matter will be held on March 25, 2010.

The Company has paid the tax for the first five calendar quarters under protest and expensed the tax in the accompanying financial statements, except for two locations in Dallas where the taxes have not been paid, but the Company is accruing and expensing the liability. For the quarter ended December 31, 2009, as a result of the Third Court's decision, the Company accrued the fee, but did not pay the State. As of December 31, 2009, the Company has approximately $1.76 million in accrued liabilities for this tax. The Company has paid more than $2 million to the State of Texas since the inception of the tax. The Company's Texas clubs have filed a separate lawsuit against the State to demand repayment of the taxes. If the State's appeal ultimately fails, the Company's current amount paid under protest would be repaid or applied to future admission tax and other Texas state tax liabilities.

13. SUBSEQUENT EVENTS

We have evaluated subsequent events for potential recognition and/or disclosure through February 16, 2010, the date the consolidated financial statements were issued.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results 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-Q 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-Q 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. Our expectations, beliefs and projections are expressed in good faith and are believed by us to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in our 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 our view, could cause material adverse effects on our 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 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. We have no obligation to update or revise these forward-looking statements to reflect the occurrence of future events or circumstances.

GENERAL

We operate in three businesses in the adult entertainment industry:

1. We own and/or operate upscale adult nightclubs serving primarily businessmen and professionals. Our nightclubs offer live adult entertainment and restaurant and bar operations. Through our subsidiaries, we currently own and/or operate a total of eighteen adult nightclubs that offer live adult entertainment and restaurant and bar operations. Seven of our clubs operate under the name "Rick's Cabaret"; four operate under the name “Club Onyx”, upscale venues that welcome all customers but cater especially to urban professionals, businessmen and professional athletes; five clubs operate under the name "XTC Cabaret"; one club that operates as “Tootsie's”, and one club that operates as “Cabaret North”. In addition to the above clubs, we intend to reopen, under a new concept, the former Rick's Cabaret in Austin, Texas which has been closed for several months. Our nightclubs are in Houston, Austin, San Antonio, Dallas and Fort Worth, Texas; Charlotte, North Carolina; Minneapolis, Minnesota; New York, New York; Miami Gardens, Florida; Philadelphia, Pennsylvania and Las Vegas, Nevada. In addition to the above clubs, we intend to reopen, under a new concept, the former Rick's Cabaret in Austin, Texas, which has been closed for several months. No sexual contact is permitted at any of our locations.

2. We have extensive Internet activities.

a) We currently own two adult Internet membership Web sites at www.CoupleTouch.com and www.xxxpassword.com. We acquire 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.

3. In April 2008, we acquired a media division, including the leading trade magazine serving the multi-billion dollar adult nightclubs industry. As part of the transaction we also acquired two industry trade shows, two other industry trade publications and more than 25 industry websites.

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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 services. 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. Media revenues include sale of advertising content and revenues from an annual Expo convention. Our fiscal year end is September 30.

For several years, we have greatly reduced our usage of promotional pricing for membership fees for our adult entertainment web sites. This reduced our revenues from these web sites.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts in the financial statements and accompanying notes. Estimates and assumptions are based on historical experience, forecasted future events and various other assumptions that we believe to be reasonable under the circumstances. Estimates and assumptions may vary under different assumptions or conditions. We evaluate our estimates and assumptions on an ongoing basis. We believe the accounting policies below are critical in the portrayal of our financial condition and results of operations.

On July 1, 2009, the FASB issued Statement of Financial Accounting Standards No. 168, FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, which is included in FASB ASC 105, Generally Accepted Accounting Principles. This new guidance approved the FASB ASC as the single source of authoritative nongovernmental GAAP. The FASB ASC is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included in the FASB ASC will be considered non-authoritative. The ASC is a restructuring of GAAP designed to simplify access to all authoritative literature by providing a topically organized structure. The adoption of FASB ASC did not impact our financial condition or results of operations. Technical references to GAAP included in these notes to the consolidated financial statements are provided under the new FASB ASC structure.

Accounts and Notes Receivable

Trade accounts receivable for the nightclub operation is primarily comprised of credit card charges, which are generally converted to cash in two to five days after a purchase is made. The media division’s accounts receivable is primarily comprised of receivables for advertising sales and Expo registration. Our accounts receivable, other is comprised of employee advances and other miscellaneous receivables. The long-term portion of notes receivable are included in other assets in the accompanying consolidated balance sheets. We recognize interest income on notes receivable based on the terms of the agreement and based upon management’s evaluation that the notes receivable and interest income will be collected. We recognize allowances for doubtful accounts or notes when, based on management judgment, circumstances indicate that accounts or notes receivable will not be collected.

Marketable Securities

Marketable securities at December 31, 2009 consist of common stock. ASC 320, Investments in Debt and Equity Securities, requires certain investments be recorded at fair value or amortized cost. The appropriate classification of the investments in marketable equity is determined at the time of purchase and re-evaluated at each balance sheet date. As of December 31, 2009, the Company’s marketable securities were classified as available-for-sale, which are carried at fair value, with unrealized gains and losses reported as other comprehensive income within the stockholders’ equity section of the accompanying consolidated balance sheets. The cost of marketable equity securities sold is determined on a specific identification basis. The fair value of marketable equity securities is based on quoted market prices. There have been no realized gains or losses related to marketable securities for the quarters ended December 31, 2009 or 2008. Marketable securities held at December 31, 2009 have a cost basis of approximately $1,009,000.

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Inventories

Inventories include alcoholic beverages, food, and Company merchandise. Inventories are carried at the lower of cost, average cost, which approximates actual cost determined on a first-in, first-out (“FIFO”) basis, or market.

Property and Equipment

Property and equipment are stated at cost. Provisions for depreciation and amortization are made using straight-line rates over the estimated useful lives of the related assets and the shorter of useful lives or terms of the applicable leases for leasehold improvements. Buildings have estimated useful lives ranging from 31 to 40 years. Furniture, equipment and leasehold improvements have estimated useful lives between five and ten years. Expenditures for major renewals and betterments that extend the useful lives are capitalized. Expenditures for normal maintenance and repairs are expensed as incurred. The cost of assets sold or abandoned and the related accumulated depreciation are eliminated from the accounts and any gains or losses are charged or credited in the accompanying consolidated statement of income of the respective period.

Goodwill and Intangible Assets

FASB ASC 350, Goodwill and Other Intangibles Assets addresses the accounting for goodwill and other intangible assets. Under FASB ASC 350, goodwill and intangible assets with indefinite lives are no longer amortized, but reviewed on an annual basis for impairment. All of our goodwill and intangible assets relate to the nightclub segment, except for $567,000 related to the media segment. Definite lived intangible assets are amortized on a straight-line basis over their estimated lives. Fully amortized assets are written-off against accumulated amortization. Our annual evaluation was performed as of September 30, 2009, based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the current business model. We determined that there is no goodwill impairment at September 30, 2009, except for the impairment taken in the second quarter of fiscal 2009 relating to the discontinued operation in Austin.

Impairment of Long-Lived Assets

We review property and equipment and intangible assets with definite lives for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of its carrying amounts to future undiscounted cash flows the assets are expected to generate. If property and equipment and intangible assets with definite lives are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the asset exceeds its fair value. Assets are grouped at the lowest level for which there are identifiable cash flows, principally at the club level, when assessing impairment. Cash flows for our club assets are identified at the individual club level.

Certain of our recent acquisitions, specifically Las Vegas, Philadelphia and the Media Group, have been underperforming, principally due to the recent general economic downturn, especially in Las Vegas, but also due to certain specific operational issues, such as the change of concept in Philadelphia and the cab fare marketing issues in Las Vegas. Our assumptions for the projected cash flows for these units include a gradual recovery for the economy and gradual improvement in the cab fare issue in Las Vegas. With these assumptions, the cash flows from these units are adequate to show no need for impairment at this time. We will continue to monitor these units in the future in case our assumptions do not prove to be appropriate.