

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

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

FORM 10-Q

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

For the quarterly period ended June 30, 2010

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
(State or other jurisdiction of
incorporation or organization)

76-0458229
(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 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 No

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes

No x

As of August 2, 2010, 10,200,270 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

	JUNE 30, 2010 (UNAUDITED)	SEPTEMBER 30, 2009
CURRENT ASSETS:		
Cash and cash equivalents	\$ 18,418,886	\$ 12,850,250
Accounts receivable		
Trade, net	899,427	776,721
Other, net	303,336	136,761
Marketable securities	766,695	-
Inventories	1,341,134	1,231,353
Prepaid expenses and other current assets	2,623,878	846,430
Assets of discontinued operations	174,562	210,032
Total current assets	24,527,918	16,051,547
PROPERTY AND EQUIPMENT:		
Buildings, land and leasehold improvements	53,465,661	46,577,101
Furniture and equipment	17,368,227	12,289,630
	70,833,888	58,866,731
Accumulated depreciation	(12,965,667)	(10,566,656)
Total property and equipment, net	57,868,221	48,300,075
OTHER ASSETS:		
Goodwill and indefinite lived intangibles	80,983,686	78,330,914
Definite lived intangibles, net	1,263,544	1,161,433
Other	1,358,205	1,232,330
Total other assets	83,605,435	80,724,677
Total assets	\$ 166,001,574	\$ 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

	JUNE 30, 2010 (UNAUDITED)	SEPTEMBER 30, 2009
CURRENT LIABILITIES:		
Accounts payable – trade	\$ 744,703	\$ 787,982
Accrued liabilities	2,978,992	2,413,988
Patron tax liability	3,241,635	1,162,960
Current portion of derivative liabilities, at fair value	1,231,937	885,600
Current portion of long-term debt	6,066,232	5,855,727
Liabilities of discontinued operations	43,116	51,799
Total current liabilities	14,306,615	11,158,056
Deferred tax liability	21,551,799	18,581,344
Other long-term liabilities	700,025	641,800
Long-term debt, less current portion	37,151,397	31,956,856
Derivative liabilities at fair value, long-term portion	1,553,348	2,455,992
Total liabilities	75,263,184	64,794,048
COMMITMENTS AND CONTINGENCIES		
TEMPORARY EQUITY – Common stock, subject to put rights (228,000 and 317,000 shares)	5,011,000	6,871,000
PERMANENT STOCKHOLDERS' EQUITY:		
Preferred stock, \$.10 par, 1,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$.01 par, 20,000,000 shares authorized; 9,808,821 and 8,879,566 shares issued	98,088	88,796
Additional paid-in capital	62,499,582	54,530,319
Accumulated other comprehensive loss	(242,260)	-
Retained earnings	20,056,811	15,472,747
Total Rick's permanent stockholders' equity	82,412,221	70,091,862
Noncontrolling interests	3,315,169	3,319,389
Total permanent stockholders' equity	85,727,390	73,411,251
Total liabilities and stockholders' equity	\$ 166,001,574	\$ 145,076,299

See accompanying notes to consolidated financial statements.

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

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2010 (UNAUDITED)	2009	2010 (UNAUDITED)	2009 (UNAUDITED)
Revenues:				
Sales of alcoholic beverages	\$8,067,620	\$8,083,038	\$25,146,015	\$21,682,582
Sales of food and merchandise	1,701,003	1,655,346	5,073,341	4,641,341
Service revenues	9,003,094	10,175,446	28,520,656	27,110,704
Internet revenues	143,642	151,989	432,809	493,384
Media revenues	203,235	238,064	770,718	707,030
Other	808,218	722,549	2,427,684	1,930,181
Total revenues	19,926,812	21,026,432	62,371,223	56,565,222
Operating expenses:				
Cost of goods sold	2,457,149	2,290,450	7,553,160	6,732,036
Salaries and wages	4,488,552	4,093,317	13,210,281	12,309,771
Stock compensation	44,037	20,044	132,111	60,132
Other general and administrative:				
Taxes and permits	2,981,475	2,443,994	9,151,410	7,158,717
Charge card fees	368,251	421,714	1,084,124	1,208,115
Rent	971,822	922,879	3,022,933	2,792,064
Legal and professional	866,504	565,802	2,275,577	1,880,364
Advertising and marketing	1,264,924	3,378,418	5,710,028	6,246,951
Insurance	276,472	331,718	797,603	838,082
Utilities	396,778	379,031	1,213,525	1,182,342
Impairment of nightclub assets	-	-	-	823,090
Depreciation and amortization	991,541	853,140	2,715,959	2,556,104
Other	1,540,506	1,479,728	4,716,914	4,192,051
Total operating expenses	16,648,011	17,180,235	51,583,625	47,979,819
Operating income	3,278,801	3,846,197	10,787,598	8,585,403
Other income (expense):				
Interest income	5,122	1,113	14,375	8,507
Interest expense	(996,207)	(811,686)	(3,042,749)	(2,453,989)
Interest expense - loan origination costs	(286,719)	-	(348,257)	-
Other	-	-	(2,675)	(8,565)
Gain (loss) on change in fair value of derivative instruments	(407,049)	(121,904)	22,433	(121,904)
Income from continuing operations before income taxes	1,593,948	2,913,720	7,430,725	6,009,452
Income taxes	661,641	1,024,758	2,594,267	2,112,107
Income from continuing operations	932,307	1,888,962	4,836,458	3,897,345
Loss from discontinued operations, net of income taxes	(15,826)	(30,969)	(45,614)	(262,049)
Net income	916,481	1,857,993	4,790,844	3,635,296

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Less: net income attributable to noncontrolling interests	(59,780)	(73,500)	(206,780)	(220,500)
Net income attributable to Rick's Cabaret International, Inc.	\$856,701	\$1,784,493	\$4,584,064	\$3,414,796
Basic earnings (loss) per share attributable to Rick's shareholders:				
Income from continuing operations	\$0.09	\$0.20	\$0.49	\$0.40
Loss from discontinued operations	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.03)
Net income	\$0.09	\$0.19	\$0.48	\$0.37
Diluted earnings (loss) per share attributable to Rick's shareholders:				
Income from continuing operations	\$0.09	\$0.19	\$0.48	\$0.39
Loss from discontinued operations	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.03)
Net income	\$0.09	\$0.19	\$0.48	\$0.36
Weighted average number of common shares outstanding:				
Basic	9,905,134	9,185,758	9,545,546	9,288,536
Diluted	9,957,838	9,409,562	9,875,520	9,499,015

Comprehensive income for the three months ended June 30, 2010 and 2009 was \$501,403 and \$1,784,493, and for the nine months was \$4,341,804 and \$3,401,449, respectively. This includes the changes in available-for-sale securities and net income.

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE NINE MONTHS ENDED JUNE 30,	
	2010	2009
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$4,584,064	\$3,414,796
Loss from discontinued operations, net of income taxes	45,614	262,049
Income from continuing operations	4,629,678	3,676,845
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	2,715,959	2,556,104
Write-off of prepaid loan origination costs	274,425	-
Impairment of nightclub assets	-	823,090
Deferred taxes	1,972,395	585,589
Amortization of note discount	136,807	-
Beneficial conversion	17,084	17,083
Noncontrolling interests	206,780	220,500
Deferred rents	58,225	77,876
Gain on change in fair value of derivative instruments	(22,433)	121,904
Stock compensation expense	132,111	60,132
Other	-	13,347
Changes in operating assets and liabilities:		
Accounts receivable	(291,495)	(103,584)
Inventories	(109,781)	278,933
Prepaid expenses and other assets	(325,534)	(1,104,180)
Accounts payable and accrued liabilities	2,807,807	(1,153,467)
Cash provided by operating activities of continuing operations	12,202,028	6,070,172
Cash provided by (used in) operating activities of discontinued operations	(18,827)	49,770
Net cash provided by operating activities	12,183,201	6,119,942
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of marketable securities	(1,008,955)	-
Additions to property and equipment	(7,163,021)	(1,318,794)
Acquisition of businesses, net of cash acquired	(3,141,410)	(48,351)
Payments from notes receivable	2,214	6,018
Cash used in investing activities of continuing operations	(11,311,172)	(1,361,127)
Cash provided by investing activities of discontinued operations	-	1,158
Net cash used in investing activities	(11,311,172)	(1,359,969)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term debt	9,258,192	-
Payments related to put options	(1,568,650)	(762,285)
Exercise of stock options	14,000	-
Payments on long-term debt	(1,905,220)	(2,156,374)
Purchase of treasury stock	(890,715)	(1,218,033)
Distribution to noncontrolling interests	(211,000)	(225,000)
Cash provided by (used in) financing activities of continuing operations	4,696,607	(4,361,692)

NET INCREASE IN CASH	5,568,636	398,281
CASH AT BEGINNING OF PERIOD	12,850,250	5,504,066
CASH AT END OF PERIOD	\$18,418,886	\$5,902,347
CASH PAID DURING PERIOD FOR:		
Interest	\$2,935,996	\$2,232,195
Income taxes	\$990,760	\$2,709,984

See accompanying notes to consolidated financial statements.

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Non-cash transactions:

In June 2010, the Company issued detachable warrants in conjunction with debt to acquire 179,512 common shares of the Company. The warrants were valued at \$434,571 and this amount is classified as a discount on the related debt with the offset to additional paid-in capital and amortized over the life of the debt.

During the nine months ended June 30, 2010, the Company retired certain debt and accrued interest aggregating \$7,463,074 in exchange for 895,255 shares of the Company's common stock.

During the nine months ended June 30, 2010, the Company retired 92,500 shares of treasury stock at a cost aggregating \$890,715.

In June 2009, the Company retired its treasury stock amounting to \$2,511,813 by a charge to additional paid-in capital.

In April 2009, the Company acquired 15,218 of its shares subject to put options with notes payable totaling \$350,000.

In April 2009, the Company transferred \$5,175,000 from temporary equity and recorded the fair value of the resulting derivative financial instrument of \$3,751,192. The difference was recognized as additional paid-in capital.

In March 2009, the Company sold 100% of the common stock of Texas S&I which owned and operated the Encounters nightclub for \$40,000, including a note for \$35,000.

See accompanying notes to consolidated financial statements.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated 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 consolidated 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 and nine months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending September 30, 2010.

2. SIGNIFICANT ACCOUNTING POLICIES

Fair Value of Financial Instruments

We calculate the fair value of our assets and liabilities which qualify as financial instruments and include this additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short maturity of these instruments. The carrying value of short and long-term debt also approximates fair value since these instruments bear market rates of interest. None of these instruments are held for trading purposes.

3. 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 ("GAAP"), 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 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

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

3. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS – continued

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.

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 consolidated financial statements.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

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 June 30, 2010, 378,000 shares of common stock were available for future grants under the Plan.

The compensation cost recognized for the nine months ended June 30, 2010 and 2009 was \$132,111 and \$60,132, respectively. There were 5,000 and no stock options exercised for the nine months ended June 30, 2010 and 2009, respectively. There were no stock options granted for the nine month periods ended June 30, 2010 and 2009.

Stock Option Activity

Below is the summary of common stock options outstanding as of June 30, 2010:

Employee and Director Stock Option Plan:	Options Authorized	Options Outstanding	Options Vested	Available for Grant
1999 Stock Option Plan	1,500,000	115,000	55,000	378,000

The following is a summary of all stock option transactions for the nine months ended June 30, 2010:

	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	(5,000)	(2.80)		
Outstanding as of June 30, 2010	115,000	\$7.74	1.11	\$99,150
Options exercisable as of June 30, 2010	55,000	\$6.64	1.14	\$99,150

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

5. GOODWILL AND OTHER INTANGIBLES

Following are the changes in the carrying amounts of goodwill and licenses for the nine months ended June 30, 2010 and 2009:

	2010		2009	
	Licenses	Goodwill	Licenses	Goodwill
Beginning balance	\$ 41,259,794	\$ 37,071,120	\$ 39,298,343	\$ 37,159,351
Other	-	39,813	-	-
Intangibles acquired	1,999,901	613,058	-	48,351
Ending balance	\$ 43,259,695	\$ 37,723,991	\$ 39,298,343	\$ 37,207,702

6. LONG-TERM DEBT

During November 2008, \$600,000 of related party debt matured and was paid in cash by the Company. The Company also made additional payments of \$1,556,374 on other long-term debt during the nine months ended June 30, 2009.

On August 6, 2009, the Company completed the sale of an aggregate of \$7,200,000 in 10% Convertible Debentures (the "2009 Debentures") to certain accredited investors (the "Holders"). On April 16, 2010, the Company sent a Notice of Redemption to all of the Holders, thereby exercising its right to redeem all of the 2009 Debentures, including the entire outstanding principal amount of all the 2009 Debentures and any accrued but unpaid interest thereon. Upon receipt of such Notice of Redemption, all of the Holders exercised their right to convert the principal amount plus all accrued but unpaid interest thereon of the 2009 Debentures at the conversion price of \$8.75 per share in lieu of receiving a cash payment (pursuant to the terms of the 2009 Debentures), effective as of May 3, 2010. Accordingly, on May 4, 2010, the Company issued an aggregate of 842,972 shares of its common stock to these Holders, in conversion of an aggregate of \$7,200,000 of outstanding principal and an aggregate of \$176,000 of outstanding interest on such 2009 Debentures. As a result of this conversion, the Company made no cash payments to the Holders in connection with the Notice of Redemption. Concurrent with the retirement of the debt, the Company was required to write off, as interest expense, the unamortized portion of its related loan origination costs, amounting to \$274,425.

On June 25, 2010, the Company completed the sale of an aggregate of approximately \$9.2 million in 10% Convertible Debentures (the "2010 Debentures") to certain accredited investors (the "Holders"). The 2010 Debentures bear interest at the rate of 10% per annum and mature on June 25, 2013. The 2010 Debentures are payable with one initial payment of interest only due December 26, 2010, and, thereafter in ten equal quarterly principal payments, plus accrued interest thereon. At the option of the Holders, the principal amount of the 2010 Debentures and the accrued but unpaid interest thereon may be converted into shares of the Company's common stock at \$10.25 per share. The 2010 Debentures are redeemable by the Company at any time if the closing price of its common stock for 20 consecutive trading days is at least \$13.47 per share.

In connection with the sale of the 2010 Debentures in June 2010, the Company also issued an aggregate of 179,512 warrants (the "Warrants") to the Holders, on a pro-rata basis. The Company issued each Holder a number of Warrants

equal to 20% of the number of shares of common stock into which each Holder's 2010 Debenture is convertible. The Warrants have an exercise price of \$10.25 and expire on

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010

6. LONG-TERM DEBT - continued

June 25, 2013. The Warrants provide that the Company has the right to require exercise of the Warrants if the closing price of the Company's common stock for 20 consecutive trading days is at least \$14.35.

The fair value of the warrants were estimated to be \$434,571 in accordance with FASB ASC 820, Fair Value Measurements and Disclosures, using a Black-Scholes option-pricing model using the following weighted average assumptions:

Volatility	68%
Expected life	1.5 years
Expected dividend yield	-
Risk free rate	1.18%

The cost of the warrants has been recognized as a discount on the related debt and will be amortized over the life of the debt.

The proceeds from the sale of the 2010 Debentures and Warrants in June 2010 are intended to be utilized to make future acquisitions, and may be utilized for working capital and general corporate purposes.

An adviser to the Company received compensation in the amount of \$460,000, which was capitalized as loan origination cost and will be amortized over the life of the debt, in connection with advising the Company regarding the June 2010 sale of the 2010 Debentures and Warrants. The 2010 Debentures and Warrants were sold under the exemption from registration provided by Section 4(2) of the Securities Act of 1933 and the rules and regulations promulgated thereunder, including Regulation D. All of the offers and sales of the 2010 Debentures and Warrants were made exclusively to "accredited investors" (as such term is defined in Rule 501(a) of Regulation D) in offers and sales not involving a public offering. The Holders purchased the securities for their own account and not with a view towards or for resale. There was no general solicitation or advertising conducted in connection with the sales of the securities.

7. COMMON STOCK

See Note 6 above regarding the Company's redemption of the 2009 Debentures in May 2010.

During the nine months ended June 30, 2010, the Company purchased 92,500 shares of Company common stock for at an aggregate cost of \$890,715 in connection with the Company's payments related to its put options. These shares were retired.

During the nine months ended June 30, 2009, the Company purchased 269,549 shares of Company common stock for its treasury at an aggregate cost of \$1,218,033. These and all other treasury shares were cancelled during the three months ended June 30, 2009 in the amount of \$2,511,813.

8. 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.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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8. EARNINGS PER SHARE (“EPS”) - continued

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”).

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 JUNE 30,		FOR THE NINE MONTHS ENDED JUNE 30,	
	2010	2009	2010	2009
Basic earnings per share:				
Income from continuing operations attributable to Rick's shareholders	\$ 872,527	\$ 1,815,462	\$ 4,629,678	\$ 3,676,845
Loss from discontinued operations, net of income taxes	(15,826)	(30,969)	(45,614)	(262,049)
Net income attributable to Rick's shareholders	\$ 856,701	\$ 1,784,493	\$ 4,584,064	\$ 3,414,796
Average number of common shares outstanding	9,905,134	9,185,758	9,545,546	9,288,536
Basic earnings per share - income from continuing operations	\$ 0.09	\$ 0.20	\$ 0.49	\$ 0.40
Basic earnings per share - discontinued operations	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.03)
Basic earnings per share - net income attributable to Rick's shareholders	\$ 0.09	\$ 0.19	\$ 0.48	\$ 0.37
Diluted earnings per share:				
Income from continuing operations attributable to Rick's shareholders	\$ 872,527	\$ 1,815,462	\$ 4,629,678	\$ 3,676,845
Adjustment to net earnings from assumed conversion of debentures (1)	-	-	117,000	-
Adjusted income from continuing operations	872,527	1,815,462	4,746,678	3,676,845
Discontinued operations	(15,826)	(30,969)	(45,614)	(262,049)
Adjusted net income attributable to Rick's shareholders	\$ 856,701	\$ 1,784,493	\$ 4,701,064	\$ 3,414,796
Average number of common shares outstanding:				
Common shares outstanding	9,905,134	9,185,758	9,545,054	9,288,536
Potential dilutive shares resulting from exercise of warrants and options(2)	52,704	223,804	45,614	210,479
Potential dilutive shares resulting from conversion of debentures (3)	-	-	284,360	-
	9,957,838	9,409,562	9,875,520	9,499,015

Total average number of common shares
outstanding used for dilution

Diluted earnings per share - income from continuing operations attributable to Rick's shareholders	\$ 0.09	\$ 0.19	\$ 0.48	\$ 0.39
Diluted earnings per share - discontinued operations	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.03)
Diluted earnings per share - net income attributable to Rick's shareholders	\$ 0.09	\$ 0.19	\$ 0.48	\$ 0.36

(1) Represents interest expense on dilutive convertible debentures, that would not occur if they were assumed converted.

(2) All outstanding warrants and options were considered for the EPS computation.

(3) Convertible debentures (principal and accrued interest) outstanding at June 30, 2010 and 2009 totaling \$9,454,783 and \$691,165, respectively, were convertible into common stock at a price from \$10.25 to \$12.00 per share in 2010 and \$12.00 per

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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8. EARNINGS PER SHARE (“EPS”) – continued

share in 2009, and resulted in additional dilutive common shares (based on average balances outstanding) in 2010. Potential dilutive shares of 69,552 and 36,629 for the three months and nine months ended June 30, 2010, respectively, have been excluded from earnings per share due to being anti-dilutive. Potential dilutive shares of 57,597 for the three months and nine months ended June 30, 2009 have been excluded from earnings per share due to being anti-dilutive.

* EPS may not foot due to rounding.

9. ACQUISITIONS AND DISPOSITIONS

Joy of Austin

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.

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

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9. ACQUISITIONS AND DISPOSITIONS - continued

(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.

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.

Fort Worth Gentlemen's Club

On June 1, 2010, our wholly owned subsidiary RCI Entertainment (3315 North Freeway FW), Inc. (the "Purchaser") completed the acquisition of certain assets (the "Purchased Assets") of Restaurant Associates, Inc., a Texas corporation (the "Seller") pursuant to an Asset Purchase Agreement (the "Purchase Agreement") between Purchaser, Seller, Voldar, LLC, a Texas limited liability company ("Voldar"), Sherri Mofid ("Mofid"), John Faltynski ("Faltynski") and James Noryian ("Noryian"). The Purchase Agreement was executed and closed on June 1, 2010. Seller owned and operated an adult entertainment cabaret known as "Fort Worth Gentleman's Club" (the "Club"), located at 3315 North Freeway, Fort Worth, Texas 76106 (the "Real Property").

At closing, Purchaser paid Seller \$2,155,520 cash by wire-transfer for the Purchased Assets. Purchaser also entered into two lease agreements, a lease agreement for the Real Property with Voldar (the "Voldar Lease") and a lease

agreement for unimproved property adjacent to the Real Property (the “Adjacent Property”) with Mofid (the “Mofid Lease”). Each lease agreement has a term of five years with one five year option to extend at the discretion of Purchaser. Each lease agreement also grants Purchaser an option

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9. ACQUISITIONS AND DISPOSITIONS - continued

to purchase the respective properties from Voldar and Mofid. Purchaser may exercise the options to purchase any time after the twelfth month but before the expiration of the lease agreements (including their optional extensions). The option to purchase the Real Property and the option to purchase the Adjacent Property must be exercised contemporaneously. The purchase price upon exercise of the option to purchase the Real Property will range from \$4,500,000 to \$5,175,000 during the five-year term. The purchase price upon exercise of the option to purchase the Adjacent Property will range from \$500,000 to \$575,000 during the five-year term.

Also pursuant to the agreements described above, Mofid and Voldar entered into a five-year Non-Competition Agreement with RCI.

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

Net current assets	\$41,833
Property and equipment and other assets	1,300,629
Non-compete agreement	200,000
Goodwill	613,058
Net assets acquired	\$2,155,520

The Company incurred approximately \$23,000 in legal costs associated with the acquisition, which are included in legal and professional expense in the accompanying consolidated statement of income.

The results of operations of this entity are included in the Company's consolidated results of operations since June 1, 2010. 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.

10. 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 and nine months ended June 30, as a result of the following:

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2010	2009	2010	2009
Computed expected tax expense	\$541,942	\$990,665	\$2,526,447	\$2,043,214
State income taxes	12,489	47,780	89,130	114,962
Gain/loss on change in fair value of derivative instruments and other permanent differences	107,210	(13,687)	(21,310)	(46,069)
Total income tax expense	\$661,641	\$1,024,758	\$2,594,267	\$2,112,107

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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10. INCOME TAXES - continued

Included in the Company's deferred tax liabilities at June 30, 2010 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.

11. DISCONTINUED OPERATIONS

The accompanying consolidated financial statements reflect the following as discontinued operations as of and for the periods ended June 30, 2010 and 2009:

The Company sold one of its nightclubs, Encounters in San Antonio, on March 1, 2009 for \$40,000, including \$5,000 in cash and a \$35,000 note payable monthly for one year. The Company recognized an impairment of \$221,563 for this club during the quarter ended December 31, 2008. The actual loss at date of sale was \$226,175.

The Company closed its Divas Latinas club in Houston during September 2009. This club is also recognized in discontinued operations.

In certain previous filings, the Company had recognized its Rick's Cabaret in Austin, Texas as a discontinued operation. That club was held for sale during a portion of 2009, but the Company decided to renovate and reopen the club and relaunch it with a new concept in April 2010. After the club was not immediately successful, the Company closed the club again in July 2010. The Company is currently negotiating a venture under an entirely new concept. The Company anticipates that the new venture will be reopened in September 2010. Accordingly, the Austin club is recognized in continuing operations in the accompanying consolidated financial statements.

Following is summarized information regarding these discontinued operations:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Loss from discontinued operations	\$(24,347)	\$(47,645)	\$(70,176)	\$(176,977)
Loss on sale of discontinued operations	-	-	-	(226,175)
Income tax - discontinued operations	8,521	16,676	24,562	141,103
Total loss from discontinued operations, net of tax	\$(15,826)	\$(30,969)	\$(45,614)	\$(262,049)

Major classes of assets and liabilities included as assets and liabilities of discontinued operations as of:

	June 30, 2010	September 30, 2009
Current assets	\$ 56,392	\$ 59,524
Property and equipment	115,721	146,859
Other assets	2,449	3,649
Current liabilities	(10,409)	(19,092)
Long-term liabilities	(32,707)	(32,707)

Net assets (liabilities)	\$	131,446	\$	158,233
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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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12. SEGMENT INFORMATION

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

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Business segment sales:				
Night clubs	\$ 19,579,935	\$ 20,636,379	\$ 61,167,696	\$ 55,364,808
Media	203,235	238,064	770,718	707,030
Internet websites	143,642	151,989	432,809	493,384
	\$ 19,926,812	\$ 21,026,432	\$ 62,371,223	\$ 56,565,222
Business segment operating income:				
Night clubs	\$ 4,285,623	\$ 4,626,028	\$ 13,664,169	\$ 11,302,329
Media	(102,123)	(100,827)	(257,870)	(373,426)
Internet websites	17,741	46,838	60,416	140,028
General corporate	(922,440)	(725,842)	(2,679,117)	(2,483,528)
	\$ 3,278,801	\$ 3,846,197	\$ 10,787,598	\$ 8,585,403
Business segment capital expenditures:				
Night clubs	\$ 5,645,005	\$ 408,634	\$ 10,760,694	\$ 1,290,716
Other	--	1,449	133,163	5,049
General corporate	934,364	22,553	1,092,359	36,166
	\$ 6,579,369	\$ 432,636	\$ 11,986,216	\$ 1,331,931
Business segment depreciation and amortization:				
Night clubs	\$ 754,939	\$ 658,450	\$ 2,061,364	\$ 1,971,949
Media	5,000	5,000	15,000	15,000
Internet websites	1,027	3,416	7,097	10,422
General corporate	230,575	186,274	632,498	558,733
	\$ 991,541	\$ 853,140	\$ 2,715,959	\$ 2,556,104

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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13. 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, 2010, the Supreme Court of Texas granted review of the Petition by the Attorney General of Texas. Oral argument of the matter was heard 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 consolidated 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 subsequent quarters, as a result of the Third Court's decision, the Company accrued the fee, but did not pay the State. As of June 30, 2010, the Company has approximately \$3,242,000 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.

For all the above legal matters, no contingent reserves for liabilities have been recorded in the accompanying consolidated balance sheets as such potential losses are not deemed probable or estimable.

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RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES
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14. SUBSEQUENT EVENTS

On July 16, 2010, the Company's wholly owned subsidiary RCI Entertainment (Fort Worth), Inc. ("RCI Fort Worth or Purchaser") completed the acquisition of certain assets (the "Purchased Assets") of Golden Productions JGC Fort Worth, LLC, a Texas limited liability company ("Golden Productions") and VCG Holding Corp., a Colorado corporation ("VCGH") pursuant to an Asset Purchase Agreement (the "Purchase Agreement") between Purchaser, Golden Productions and VCGH. The Purchase Agreement was executed and closed on July 16, 2010. Golden Productions owned and operated an adult entertainment cabaret known as "Jaguar's Gold Club Fort Worth" (the "Club"), located at 12325 Calloway Cemetery Road, Fort Worth, Texas, 76040 (the "Premises"). VCGH owned the improvements on the Premises, including the building and fixtures (the "Improvements").

At closing, RCI Fort Worth paid aggregate consideration to Golden Production and/or VCGH for the Purchased Assets of (1) \$1,000,000 cash by wire-transfer and (2) 467,497 shares of common stock of VCGH, which were held by the Company. RCI Fort Worth also entered into a ground lease agreement for the land where the Premises is located with Bryan S. Foster, the current owner of the land (the "Lease Agreement"). The Lease Agreement has a term of five years with four options to extend the lease for five years, at the discretion of RCI Fort Worth. The initial monthly rental rate during its term is \$20,000 per month. The Lease Agreement also grants RCI Fort Worth or its assigns an option to purchase the land from Mr. Foster, which option may be exercised any time after the 12th anniversary date of the Lease Agreement and before the expiration of the Lease Agreement (including its option term) at a purchase price of fair market value, but in no event less than \$3,000,000.

Also at closing, RCI Fort Worth entered a Non-Competition Agreement with Mr. Foster. The term of the Non-Competition Agreement ends on September 17, 2012.

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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. 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 effects 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 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 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 21 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; six clubs operate under the name "XTC Cabaret"; one club that operates as "Tootsie's", one club that operates as "Cabaret North" and one club, acquired in July 2010, that operates as "Jaguars". 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 reopened in April 2010, under a new concept, the former Rick's Cabaret in Austin, Texas, which had been closed for several months. When the club was not immediately successful, we closed the club again in July 2010. We are currently negotiating an agreement under an entirely new concept. We anticipate that the new venture will be reopened in September 2010. No sexual contact is permitted at any of our locations.

2. We have 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.

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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 nightclub industry. As part of the transaction we also acquired two industry trade shows, two other industry trade publications and more than 25 industry websites.

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 websites.

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 consolidated 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.

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Marketable Securities

Marketable securities at June 30, 2010 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 June 30, 2010, 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 periods ended June 30, 2010 or 2009. Marketable securities held at June 30, 2010 have a cost basis of approximately \$1,009,000.

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.

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While there has been some improvement in operations at the Las Vegas club and in our media segment, those units and Club Onyx in Philadelphia are still not profitable. If these operations do not improve in the next quarter, these assets may need to be impaired as of September 30, 2010.

Fair Value of Financial Instruments

We calculate the fair value of our assets and liabilities which qualify as financial instruments and includes this additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of these financial instruments. The estimated fair value of accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the relatively short maturity of these instruments. The carrying value of short and long-term debt also approximates fair value since these instruments bear market rates of interest. None of these instruments are held for trading purposes.

Derivative Financial Instruments

We account for financial instruments that are indexed to and potentially settled in its own stock, including stock put options, in accordance with the provisions of FASB ASC 815, Derivatives and Hedging. Under certain circumstances that would require us to settle these equity items in cash, and without regard to probability, FASB ASC 815 would require the classification of all or part of the item as a liability and the adjustment of that reclassified amount to fair value at each reporting date, with such adjustments reflected in our consolidated statements of income. The first instrument to meet the requirements of FASB ASC 815 for derivative accounting occurred in the quarter ended June 30, 2009 when we renegotiated the payback terms of certain put options and agreed to pledge as collateral to certain holders a second lien on certain property.

Revenue Recognition

We recognize revenue from the sale of alcoholic beverages, food and merchandise, other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

We recognize internet revenue from monthly subscriptions to its online entertainment sites when notification of a new or existing subscription and its related fee are received from the third party hosting company or from the credit card company, usually two to three days after the transaction has occurred. The monthly fee is not refundable. We recognize Internet auction revenue when payment is received from the credit card as revenues are not deemed estimable nor collection deemed probable prior to that point.

Revenues from the sale of magazines and advertising content are recognized when the issue is published and shipped. Revenues and external expenses related to our annual Expo convention are recognized upon the completion of the convention in August.

Sales and Liquor Taxes

We recognize sales and liquor taxes paid as revenues and an equal expense in accordance with FASB ASC 605, Revenue Recognition. Total sales and liquor taxes aggregated \$4,108,000 and \$3,414,000 for the nine months ended June 30, 2010 and 2009, respectively.

Advertising and Marketing

Advertising and marketing expenses are primarily comprised of costs related to public advertisements and giveaways, which are used for promotional purposes. This category also includes fees paid for transportation in certain cities,

especially Las Vegas. Advertising and marketing expenses are expensed as incurred and are included in operating expenses in the accompanying consolidated statements of income.

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Income Taxes

Deferred income taxes are determined using the liability method in accordance with FASB ASC 740, Income Taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In addition, a valuation allowance is established to reduce any deferred tax asset for which it is determined that it is more likely than not that some portion of the deferred tax asset will not be realized.

FASB ASC 740 creates a single model to address accounting for uncertainty in tax positions by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FASB ASC 740 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. There are no unrecognized tax benefits to disclose in the notes to the consolidated financial statements.

Put Options

In certain situations, we issue restricted common shares as partial consideration for acquisitions of certain businesses or assets. Pursuant to the terms and conditions of the governing acquisition agreements, the holder of such shares has the right, but not the obligation, to put a fixed number of the shares on a monthly basis back to us at a fixed price per share. We may elect during any given month to either buy the monthly shares or, if management elects not to do so, the holder can sell the monthly shares in the open market, and any deficiency between the amount which the holder receives from the sale of the monthly shares and the value of shares will be paid by us. We have accounted for these shares in accordance with the guidance established by FASB ASC 480 as a reclassification of the value of the shares from permanent to temporary equity. As the shares become due, we transfer the value of the shares back to permanent equity, less any amount paid to the holder. Also see “Derivative Financial Instruments” above.

Earnings Per Common Share (“EPS”)

We compute earnings per share in accordance with FASB ASC 260, Earnings Per Share. FASB 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 our earnings.

Potential common stock shares consist of shares that may arise from outstanding dilutive common stock options and warrants (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”). Diluted EPS considers the potential dilution that could occur if our outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in our earnings (as adjusted for interest expense, that would no longer occur if the debentures were converted).

Stock Options

We utilize the fair value recognition provisions of FASB ASC 718, Compensation—Stock Compensation to account for stock options issued.

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The stock option compensation costs recognized for the quarters ended June 30, 2010 and 2009 were \$44,037 and \$20,044, respectively, and were \$132,111 and \$60,132, respectively, for the nine months then ended. There were 5,000 and no stock options exercised for the nine months ended June 30, 2010 and 2009, respectively. There were no stock options grants for the quarters ended June 30, 2010 and 2009.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2010 AS COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2009

For the three months ended June 30, 2010, we had consolidated total revenues of \$19,926,812 compared to consolidated total revenues of \$21,026,432 for the three months ended June 30, 2009, a decrease of \$1,099,620 or 5.2%. The decrease in total revenues was primarily attributable to a 13.5% decrease in same store sales for the quarter, principally due to a \$2.5 million decrease in revenues at our Las Vegas club for the quarter, a 58% decrease, offset by new club acquisitions in Fort Worth and Austin, Texas.

Income taxes, as a percentage of income before taxes were 41.5% and 35.2% for the quarters ended June 30, 2010 and 2009, respectively. The increase in 2010 is due to the significant loss on change in fair value of derivative instruments which is not deductible for tax purposes.

The decrease in net income was primarily due to the decrease in revenues explained above. Income before income taxes (exclusive of corporate overhead) for same-location-same-period of club continuing operations decreased to \$4,396,209 for the three months ended June 30, 2010 from \$4,827,865 for same period ended June 30, 2009, or by 8.9%.

Following is a comparison of the Company's income statement for the quarters ended June 30, 2010 and 2009 with percentages compared to total revenue:

	2010	%		2009	%	
Sales of alcoholic beverages	\$8,067,620	40.5	%	\$8,083,038	38.4	%
Sales of food and merchandise	1,701,003	8.5	%	1,655,346	7.9	%
Service revenues	9,003,094	45.2	%	10,175,446	48.4	%
Internet revenues	143,642	0.7	%	151,989	0.7	%
Media	203,235	1.0	%	238,064	1.1	%
Other	808,218	4.1	%	722,549	3.4	%
Total revenues	19,926,812	100.0	%	21,026,432	100.0	%
Cost of goods sold	2,457,149	12.3	%	2,290,450	10.9	%
Salaries & wages	4,488,552	22.5	%	4,093,317	19.5	%
Stock compensation	44,037	0.2	%	20,044	0.1	%
Taxes and permits	2,981,475	15.0	%	2,443,994	11.6	%
Credit card fees	368,251	1.8	%	421,714	2.0	%
Rent	971,822	4.9	%	922,879	4.4	%
Legal & professional	866,504	4.3	%	565,802	2.7	%
Advertising and marketing	1,264,924	6.3	%	3,378,418	16.1	%
Depreciation and amortization	991,541	5.0	%	853,140	4.1	%
Insurance	276,472	1.4	%	331,718	1.6	%
Utilities	396,778	2.0	%	379,031	1.8	%
Other	1,540,506	7.7	%	1,479,728	7.0	%

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Total operating expenses	16,648,011	83.5	%	17,180,235	81.7	%
Income from continuing operations	3,278,801	16.5	%	3,846,197	18.3	%
Interest income	5,122	0.0	%	1,113	0.0	%
Interest expense	(996,207)	-5.0	%	(811,686)	-3.9	%
Interest expense – amortization of loan origination costs	(286,719)	-1.4	%	-	0.0	%
Loss on change in fair value of derivative instruments	(407,049)	-2.0	%	(121,904)	-0.6	%
Income from continuing operations before income taxes	\$1,593,948	8.0	%	\$2,913,720	13.9	%

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Following is an explanation of significant variances in the above amounts.

Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers. The Company recognizes revenue from other revenues and services at the point-of-sale upon receipt of cash, check, or credit card charge.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding, media postage and internet traffic purchases and webmaster payouts. The cost of goods sold for the club operations for the three months ended June 30, 2010 was 12.3% compared to 10.9% for the three months ended June 30, 2009. This was due to the decrease in 2010 from 2009 in service revenues, which has no related cost. The cost of goods sold from our internet operations for the three months ended June 30, 2010 was 1.8% compared to 0.3% for the three months ended June 30, 2009. The cost of goods sold from our media operations for the three months ended June 30, 2010 was 20.9%, compared to 32.0% for the previous year quarter. The cost of goods sold for same-location-same-period of club continuing operations for the three months ended June 30, 2010 was 11.6%, compared to 10.7% for the same period ended June 30, 2009.

The increase in payroll and related costs, stated as "Salaries & Wages" above, was primarily due to the addition of the new clubs. The increase in percentage to total revenues is principally due to the increase in the minimum wage. Payroll for same-location-same-period of club continuing operations increased to \$3,338,514 for the three months ended June 30, 2010 from \$3,285,701 for the same period ended June 30, 2009. Management currently believes that its labor and management staff levels are appropriate.

Taxes and permits consists principally of payroll taxes, property taxes, sales and alcohol taxes, licenses and permits and the patron tax in our nightclubs in Texas. The increase in percentage to total revenues in 2010 is principally due to the two new clubs in Texas which are subject to the patron tax.

Rent expense increased principally due to the new club in Fort Worth acquired on September 30, 2009.

The increase in legal and professional expense is principally due to the labor lawsuit in New York.

The decrease in the percentage of advertising and marketing to total revenue in 2010 is principally due to the improvement in the marketing costs in Las Vegas.

The increase in depreciation and amortization is due to the new clubs acquired during the year.

The increase in interest expense was attributable to our obtaining new debt during August 2009 to finance the purchase of new clubs and related real estate. That debt was retired in May 2010 and we raised new debt capital in June 2010. Concurrent with the retirement of the debt, the Company was required to write off, as interest expense, the unamortized portion of its related loan origination costs, amounting to \$274,425. As of June 30, 2010, the balance of long-term debt was \$43,217,629 compared to \$31,768,115 a year earlier.

Loss on change in fair value of derivative instruments represents the calculated loss on the derivative principally caused by the decrease in our common stock price during the 2010 quarter.

The Company has taken the following steps to remedy losses in certain clubs:

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Rick's Cabaret Las Vegas lost approximately \$200,000 before income taxes for the quarter ended June 30, 2010, compared to a loss of approximately \$300,000 in the 2009 quarter even with the significant decrease in sales, due to a decrease in marketing costs. We have worked diligently to reduce marketing costs in Las Vegas, resulting in improved performance.

The Rick's Cabaret in Philadelphia was losing money since inception. We have converted the location to Club Onyx Philadelphia in January 2009 and the club began to be profitable until the economic recession in Philadelphia began to reduce revenues. We have changed management recently in this club and have begun to show better revenues. We have also negotiated a \$14,000 decrease in rent, beginning April 1.

The accompanying consolidated financial statements reflect the following as discontinued operations as of and for the period ended June 30, 2010:

The Company sold one of its nightclubs, Encounters in San Antonio, on March 1, 2009 for \$40,000, including \$5,000 in cash and a \$35,000 note payable monthly for one year. The Company recognized an impairment of \$221,563 for this club during the quarter ended December 31, 2008. The actual loss at date of sale was \$226,175.

We closed our Divas Latinas club in Houston during September 2009. This club is also recognized in discontinued operations.

In previous filings, we 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 decided to renovate and reopen the club and we relaunched it with a new concept in April 2010. When the club was not immediately successful, we closed the club again in July 2010. We are currently negotiating an agreement under an entirely new concept. We anticipate that the new venture will be reopened in September 2010. Accordingly, the Austin club is recognized in continuing operations in the accompanying consolidated financial statements.

Following is summarized information regarding these discontinued operations:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Loss from discontinued operations	\$(24,347)	\$(47,645)	\$(70,176)	\$(176,977)
Loss on sale of discontinued operations	-	-	-	(226,175)
Income tax - discontinued operations	8,521	16,676	24,562	141,103
Total loss from discontinued operations, net of tax	\$(15,826)	\$(30,969)	\$(45,614)	\$(262,049)

Major classes of assets and liabilities included as assets and liabilities of discontinued operations as of:

	June 30, 2010	September 30, 2009
Current assets	\$ 56,392	\$ 59,524
Property and equipment	115,721	146,859
Other assets	2,449	3,649
Current liabilities	(10,409)	(19,092)
Long-term liabilities	(32,707)	(32,707)
Net assets (liabilities)	\$ 131,446	\$ 158,233

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RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED JUNE 30, 2010 AS COMPARED TO THE NINE MONTHS ENDED JUNE 30, 2009

For the nine months ended June 30, 2010, we had consolidated total revenues of \$62,371,223 compared to consolidated total revenues of \$56,565,222 for the nine months ended June 30, 2009, an increase of \$5,806,001 or 10.3%. The increase in total revenues was primarily attributable to an increase in same store sales plus new club acquisitions in Fort Worth and Austin, Texas. Total revenues for same-location-same-period of club continuing operations increased to approximately \$56,632,517 for the nine months ended June 30, 2010 from approximately \$54,402,343 for same period ended June 30, 2009, a 4.1% increase.

Income taxes, as a percentage of income before taxes were 34.9% and 35.1% for the nine months ended June 30, 2010 and 2009, respectively.

The increase in net income was primarily due to the increase in revenues explained above and a decrease in marketing costs in Las Vegas and in Dallas/Fort Worth. Income before income taxes (exclusive of corporate overhead) for same-location-same-period of club continuing operations increased to \$14,448,751 for the nine months ended June 30, 2010 from \$12,276,160 for same period ended June 30, 2009, or by 17.7%.

Following is a comparison of the Company's income statement for the nine months ended June 30, 2010 and 2009 with percentages compared to total revenue:

	2010	%		2009	%	
Sales of alcoholic beverages	\$25,146,015	40.3	%	\$21,682,582	38.3	%
Sales of food and merchandise	5,073,341	8.1	%	4,641,341	8.2	%
Service revenues	28,520,656	45.7	%	27,110,704	47.9	%
Internet revenues	432,809	0.7	%	493,384	0.9	%
Media	770,718	1.4	%	707,030	1.2	%
Other	2,427,684	3.9	%	1,930,181	3.4	%
Total revenues	62,371,223	100.0	%	56,565,222	100.0	%
Cost of goods sold	7,553,160	12.1	%	6,732,036	11.9	%
Salaries & wages	13,210,281	21.2	%	12,309,771	21.8	%
Stock compensation	132,111	0.2	%	60,132	0.1	%
Taxes and permits	9,151,410	14.7	%	7,158,717	12.7	%
Credit card fees	1,084,124	1.7	%	1,208,115	2.1	%
Rent	3,022,933	4.8	%	2,792,064	4.9	%
Legal & professional	1,971,399	3.2	%	1,880,364	3.3	%
Advertising and marketing	5,710,028	9.2	%	6,246,951	11.0	%
Depreciation and amortization	2,715,959	4.4	%	2,556,104	4.5	%
Insurance	797,603	1.3	%	838,082	1.5	%
Utilities	1,213,525	1.9	%	1,182,342	2.1	%
Impairment of nightclub assets	-	0.0	%	823,090	1.5	%
Costs related to VCG Holdings acquisition	304,178	0.5	%	-	0.0	%
Other	4,716,914	7.6	%	4,192,051	7.4	%
Total operating expenses	51,583,625	82.6	%	47,979,819	84.8	%
Income from continuing operations	10,787,598	17.3	%	8,585,403	15.2	%

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Interest income and other	11,700	0.0	%	(58)	0.0	%
Interest expense	(3,042,749)	-4.9	%	(2,453,989)	-4.3	%
Interest expense – amortization of loan origination costs	(348,257)	-0.6	%	-	0.0	%
Gain (loss) on change in fair value of derivative instruments	22,433	0.0	%	(121,904)	-0.2	%
Income from continuing operations before income taxes	\$7,430,725	11.9	%	\$6,009,452	10.6	%

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Following is an explanation of significant variances in the above amounts.

Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers.

Cost of goods sold includes cost of alcoholic and non-alcoholic beverages, food, cigars and cigarettes, merchandise, media printing/binding, media postage and internet traffic purchases and webmaster payouts. The cost of goods sold for the club continuing operations for the nine months ended June 30, 2010 was 12.0% compared to 11.7% for the nine months ended June 30, 2009. The cost of goods sold from our internet operations for the nine months ended June 30, 2010 was 2.3% compared to 1.2% for the nine months ended June 30, 2009. The cost of goods sold from our media operations for the nine months ended June 30, 2010 was 26.3% compared to 36.2% for the 2009 period. The cost of goods sold for same-location-same-period of continuing club operations for the nine months ended June 30, 2010 was 11.4%, compared to 11.7% for the same period ended June 30, 2009.

The increase in payroll and related costs, stated as "Salaries & Wages" above, was primarily due to the addition of the new clubs. The decrease in percentage to total revenues is principally due to the large increase in sales which was accomplished with similar staffing. Payroll for same-location-same-period of club operations increased to \$9,940,107 for the nine months ended June 30, 2010 from \$9,710,806 for the same period ended June 30, 2009. Management currently believes that its labor and management staff levels are appropriate.

Taxes and permits consists principally of payroll taxes, property taxes, sales and alcohol taxes, licenses and permits and the patron tax in our nightclubs in Texas. The increase in percentage to total revenues in 2010 is principally due to the two new clubs in Texas which are subject to the patron tax.

Rent expense increased principally due to the new club in Fort Worth.

The decrease in advertising and marketing is principally due to Las Vegas and its marketing campaign, offset by significant marketing costs in Dallas/Fort Worth for several clubs, including the new club, Cabaret North.

Maintenance capital expenditures amounted to approximately \$1,750,000 for the nine months ended June 30, 2010. We anticipate that depreciation will exceed maintenance capital expenditures for the year ending September 30, 2010 by approximately \$1.5 million.

We incurred certain one-time costs related to negotiating the unsuccessful acquisition of VCG Holdings. These costs amounted to \$304,178 for the nine months ended June 30, 2010. Without these costs, our fully diluted earnings per share would have increased by \$0.03.

The increase in interest expense was attributable to our obtaining new debt during August 2009 to finance the purchase of new clubs and related real estate. That debt was retired in May 2010 and we raised new debt capital in June 2010. Concurrent with the retirement of the debt, the Company was required to write off, as interest expense, the unamortized portion of its related loan origination costs, amounting to \$274,425. As of June 30, 2010, the balance of long-term debt was \$43,217,629 compared to \$31,768,115 a year earlier.

Gain (loss) on change in fair value of derivative instruments represents the calculated gain (loss) on the derivative principally caused by any increase or decrease in our common stock price during the periods.

The Company has taken the following steps to remedy losses in certain clubs:

The Rick's Cabaret in Austin lost \$1.4 million before income taxes during the nine months ended June 30, 2009. That club was held for sale during a portion of 2009, but we decided to renovate and reopen the club and we relaunched it with a new concept in April 2010. When the club was not immediately successful, we closed the club again in July 2010. We are currently negotiating an agreement under an entirely new concept. We anticipate that the new venture will be reopened in September 2010.

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The Rick's Cabaret in Philadelphia was losing money since inception. We have converted the location to Club Onyx Philadelphia in January 2009 and the club began to be profitable until the economic recession in Philadelphia began to reduce revenues. We have changed management recently in this club and have begun to show better revenues. We have also negotiated a \$14,000 decrease in rent, beginning April 1.

Club Onyx Dallas did not have a liquor license during the quarter ended December 2008 until December 5, 2008 and lost \$127,000 before income taxes for the nine months ended June 30, 2009. This location was substantially profitable for the nine months ended June 30, 2010.

Rick's Cabaret Las Vegas lost approximately \$1.6 million before income taxes for the nine months ended June 30, 2009. The club lost approximately \$543,000 for the nine months ended June 30, 2010. We have made expense reductions and modifications to our marketing campaign in this location and continue to see improvement in operations. We will continue to monitor expense levels and the marketing costs.

LIQUIDITY AND CAPITAL RESOURCES

Working Capital and Cash Flows

At June 30, 2010, we had working capital of approximately \$10,221,000 compared to approximately \$4,893,000 at September 30, 2009. The increase is principally due to the new debt issued in June 2010, which is principally long-term debt at June 30, 2010.

Net cash provided by operating activities in the nine months ended June 30, 2010 was \$12,183,201 compared to \$6,119,942 for the nine months ended June 30, 2009. The increase in cash provided by operating activities was primarily due to the nonpayment of patron taxes during the nine months ended June 30, 2010 and the payment of income taxes and accounts payable during the nine months ended June 30, 2009.

We used \$11,311,172 of cash in investing activities during the nine months ended June 30, 2010 compared to \$1,359,969 during the nine months ended June 30, 2009. The increase was principally due to the acquisition of a new clubs in December 2009 and June 2010 along with related real estate. Cash of \$4,696,607 was provided by financing activities during the nine months ended June 30, 2010 compared to \$4,361,692 cash used during the nine months ended June 30, 2009. The principal difference in the two periods was the proceeds from long-term debt of approximately \$9.3 million.

We require capital principally for construction or acquisition of new clubs, renovation of older clubs and investments in technology. We may also utilize capital to repurchase our common stock as part of our share repurchase program.

Put Options

As part of certain of our acquisition transactions, we have entered into Lock-Up/Leak-Out Agreements with the sellers pursuant to which, on or after a contractual period after the closing date, the seller shall have the right, but not the obligation, to have us purchase from seller a certain number of our shares of common stock issued in the transactions in an amount and at a rate of not more than a contractual number of the shares per month (the "Monthly Shares") calculated at a price per share equal to a contractual value per share ("Value of the Rick's Shares"). At our election during any given month, we may either buy the Monthly Shares or, if we elect not to buy the Monthly Shares from the seller, then the seller shall sell the Monthly Shares in the open market. Any deficiency between the amount which the seller receives from the sale of the Monthly Shares and the value of the shares shall be paid by us within three (3) business days of the date of sale of the Monthly Shares during that particular month. Our obligation to purchase the Monthly Shares from the Seller shall terminate and cease at such time as the seller has received a contractual amount

from the sale of the Rick's Shares and any deficiency. Under the terms of the Lock-Up/Leak-Out Agreements, the seller may not sell more than a contractual number of our shares per 30-day period, regardless of whether the seller "Puts" the shares to us or sells them in the open market or otherwise.

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During April and May 2009, we completed renegotiation of terms of certain of our long term debt and a significant portion of outstanding put options. The maximum obligation that could be owed if our stock were valued at zero is \$8,892,000 at June 30, 2010. We consider this type of financing transaction to be similar to interest-free debt. If we are required to buy back any of these put options, the buy-back transaction will be purely a balance sheet transaction, affecting only Temporary Equity and Stockholders' Equity and will have no income statement effect. Following is a schedule of the annual obligation (after the renegotiation) we would have if our stock price remains in the future at the closing market price on August 2, 2010 of \$7.70 per share, of which there can be no assurance:

For the Year Ending September 30:	
2010	\$ 737,700
2011	3,000,000
2012	2,059,177
2013	138,323
Total	\$ 5,935,200

Each \$1.00 per share movement of our stock price has an aggregate effect of \$384,000 on the total obligation.

Other Liquidity and Capital Resources

We have not established lines of credit or financing other than the above mentioned notes payable and 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.

On September 29, 2008, our Board of Directors authorized us to repurchase up to \$5,000,000 worth of our common stock. During the nine months ended June 30, 2010, no shares were purchased under this program. During the nine months ended June 30, 2009, we purchased 162,041 shares of common stock in the open market at prices ranging from \$2.64 to \$5.95 per share.

We believe that the adult entertainment industry standard of treating entertainers as independent contractors provides us with safe harbor protection to preclude payroll tax assessment for prior years. We have prepared plans that we believe will protect our profitability in the event that sexually oriented business industry is required in all states to convert dancers who are now independent contractors into employees.

The sexually oriented business industry is highly competitive with respect to price, service and location, as well as the professionalism of the entertainment. Although management believes 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.

IMPACT OF INFLATION

We have not experienced a material overall impact from inflation in our operations during the past several years. To the extent permitted by competition, we have managed to recover increased costs through price increases and may continue to do so. However, there can be no assurance that we will be able to do so in the future.

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SEASONALITY

Our nightclub operations are 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

We believe that our nightclub operations can continue to grow organically and through careful entry into markets and demographic segments with high growth potential. Our growth strategy is: (a) to open new clubs after careful market research, (b) to acquire existing clubs in locations that are consistent with our growth and income targets and which appear receptive to the upscale club formula we have developed, as is the case with the acquisitions of the clubs in Austin, Dallas and Fort Worth, Texas, Miami Gardens, Florida, Philadelphia, Pennsylvania, and Las Vegas, Nevada, (c) to form joint ventures or partnerships to reduce start-up and operating costs, with us contributing equity in the form of our brand name and management expertise, (d) to develop new club concepts that are consistent with our management and marketing skills, (e) to acquire real estate in connection with club operations, although some clubs may be in leased premises, and/or (f) to enter into licensing agreements in strategic locations.

We continue to evaluate opportunities to acquire new nightclubs and anticipate acquiring new locations that fit our business model as we have done in the past.

We also expect to continue to grow our Internet profit centers. We plan to focus on high-margin Internet activities that leverage our marketing skills while requiring a low level of start-up cost and ongoing operating costs and refine and tune our Internet sites for better positioning in organic search rankings amongst the major search providers. We will restructure affiliate programs to provide higher incentives to our current affiliates to better promote our Internet sites, while actively seeking new affiliates to send traffic to our Internet sites.

The acquisition of additional clubs and/or internet operations for amounts in excess of our cash balances will require us to obtain additional debt or issuance of our common stock, or both. 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. An inability to obtain such additional financing could have an adverse effect on our growth strategy.

Item 4T. Controls and Procedures.

Disclosure Controls and Procedures. Management maintains "disclosure controls and procedures," as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

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Our management evaluated, with the participation of our principal executive and principal financial officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of June 30, 2010. Based on this evaluation, our principal executive and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2010.

There were no changes in our internal control over financial reporting during our quarter ended June 30, 2010, that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

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, 2010, the Supreme Court of Texas granted review of the Petition by the Attorney General of Texas. Oral argument of the matter was heard 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 consolidated 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 subsequent quarters, as a result of the Third Court's decision, the Company accrued the fee, but did not pay the State. As of June 30, 2010, the Company has approximately \$3,242,000 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.

For all the above legal matters, no contingent reserves for liabilities have been recorded in the accompanying consolidated balance sheets as such potential losses are not deemed probable or estimable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the three months ended June 30, 2010, we purchased no shares of common stock in the open market. During the three months ended June 30, 2010, we purchased 34,500 shares of common stock from put option holders at prices ranging from \$8.17 to \$12.05 per share. Following is a summary of our purchases by month:

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Period:	(a)	(b)	(c)	(d)
Month Ending	Total Number of Shares (or Units) Purchased	Average Price Paid per Share	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs
April 30, 2010	-	-	-	
May 31, 2010	18,500	\$11.24	-	
June 30, 2010	16,000	\$8.66	-	
Total for the three months ended June 30, 2010	34,500	\$10.05	-	\$ 4,171,425

Item 6. Exhibits.

Exhibit 31.1 – Certification of Chief Executive 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 31.2 – Certification of 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 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.

Exhibit 32.2 -- Certification of 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.

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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: August 16, 2010

By:/s/ Eric S. Langan
Eric S. Langan
Chief Executive Officer and President

Date: August 16, 2010

By:/s/ Phillip K. Marshall
Phillip K. Marshall
Chief Financial Officer and Principal Accounting Officer