

RICKS CABARET INTERNATIONAL INC  
Form 10-Q  
February 11, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended December 31, 2012

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

Commission File Number: 001-13992

**RICK’S CABARET INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

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

**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

As of January 31, 2013, 9,527,344 shares of the Registrant's Common Stock were outstanding.

## NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements, which are other than statements of historical facts. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission (“SEC”). Important factors that in our view could cause material adverse effects on our financial condition and results of operations include, but are not limited to, the risks and uncertainties related to our future operational and financial results, competitive factors, the timing of the openings of other clubs, the availability of acceptable financing to fund corporate expansion efforts, our dependence on key personnel, the ability to manage operations and the future operational strength of management, and the laws governing the operation of adult entertainment businesses. We undertake no obligation to revise or publicly release the results of any revision to any forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, the “Company,” “we,” “our,” and similar terms include Rick’s Cabaret International, Inc. and its subsidiaries, unless the context indicates otherwise.

RICK'S CABARET INTERNATIONAL, INC.

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**PART I FINANCIAL INFORMATION**

## Item 1. Financial Statements.

## RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

ASSETS

| <u>(in thousands, except per share data)</u>   | December 31,<br>2012<br>(UNAUDITED) | September 30,<br>2012 |
|--|-------------------------------------|-----------------------|
| Assets   |                                     |                       |
| Current assets:                                |                                     |                       |
| Cash and cash equivalents                      | \$ 6,871                            | \$ 5,520              |
| Accounts receivable:                           |                                     |                       |
| Trade, net                                     | 1,707                               | 1,743                 |
| Other, net                                     | 311                                 | 296                   |
| Marketable securities                          | 575                                 | 1,059                 |
| Inventories                                    | 1,399                               | 1,260                 |
| Deferred tax asset                             | 3,991                               | 3,635                 |
| Prepaid expenses and other current assets      | 584                                 | 1,123                 |
| Assets of discontinued operations              | 64                                  | 72                    |
| Total current assets                           | 15,502                              | 14,708                |
| Property and equipment, net                    | 90,907                              | 79,940                |
| Other assets:                                  |                                     |                       |
| Goodwill and indefinite lived intangibles, net | 93,598                              | 94,029                |
| Definite lived intangibles, net                | 1,056                               | 1,177                 |
| Other  | 3,144                               | 2,539                 |
| Total other assets                             | 97,798                              | 97,745                |
| Total assets                                   | \$ 204,207                          | \$ 192,393            |

See accompanying notes to consolidated financial statements.



## RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

## LIABILITIES AND STOCKHOLDERS' EQUITY

| <u>(in thousands, except per share data)</u>   | December 31,<br>2012 | September 30,<br>2012 |
|--|----------------------|-----------------------|
|  | (UNAUDITED)          |                       |
| Liabilities and Stockholders' Equity   |                      |                       |
| Current liabilities:   |                      |                       |
| Accounts payable   | \$ 1,609             | \$ 1,865              |
| Accrued liabilities  | 6,251                | 4,298                 |
| Texas patron tax liability   | 10,739               | 9,849                 |
| Current portion of derivative liabilities  | 75                   | 75                    |
| Current portion of long-term debt  | 6,361                | 6,603                 |
| Liabilities of discontinued operations   | 147                  | 163                   |
| Total current liabilities  | 25,182               | 22,853                |
| Deferred tax liability   | 23,815               | 23,963                |
| Other long-term liabilities  | 844                  | 833                   |
| Long-term debt   | 64,090               | 56,925                |
| Total liabilities  | 113,931              | 104,574               |
| Commitments and contingencies  |                      |                       |
| Temporary equity - Common stock, subject to put rights 5 and 9 shares, respectively                            | 92                   | 207                   |
| PERMANENT STOCKHOLDERS' EQUITY:  |                      |                       |
| Preferred stock, \$.10 par, 1,000 shares authorized; none issued and outstanding                               | -                    | -                     |
| Common stock, \$.01 par, 20,000 shares authorized; 9,537 and 9,584 shares issued and outstanding, respectively | 95                   | 96                    |
| Additional paid-in capital   | 61,130               | 61,212                |
| Accumulated other comprehensive income   | 70                   | 59                    |
| Retained earnings  | 25,584               | 22,939                |
| Total Rick's permanent stockholders' equity  | 86,879               | 84,306                |
| Noncontrolling interests   | 3,305                | 3,306                 |
| Total permanent stockholders' equity   | 90,184               | 87,612                |
| Total liabilities and stockholders' equity   | \$ 204,207           | \$ 192,393            |

See accompanying notes to consolidated financial statements.





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

| <u>(in thousands, except per share data)</u>                         | Three Months Ended          |          |
|--|-----------------------------|----------|
|  | 2012                        | 2011     |
|  | December 31,<br>(UNAUDITED) |          |
| Revenues:  |                             |          |
| Sales of alcoholic beverages   | \$ 10,406                   | \$ 8,916 |
| Sales of food and merchandise  | 2,578                       | 1,997    |
| Service revenues   | 12,655                      | 9,886    |
| Other  | 1,502                       | 1,220    |
| Total revenues   | 27,141                      | 22,019   |
| Operating expenses:  |                             |          |
| Cost of goods sold   | 3,386                       | 2,932    |
| Salaries and wages   | 6,038                       | 4,925    |
| Stock-based compensation   | 282                         | 8        |
| Other general and administrative:                                    |                             |          |
| Taxes and permits  | 4,221                       | 3,447    |
| Charge card fees   | 374                         | 308      |
| Rent   | 570                         | 703      |
| Legal and professional   | 641                         | 700      |
| Advertising and marketing  | 1,109                       | 995      |
| Depreciation and amortization  | 1,320                       | 1,120    |
| Insurance  | 499                         | 292      |
| Utilities  | 489                         | 404      |
| Other  | 2,278                       | 1,818    |
| Total operating expenses   | 21,207                      | 17,652   |
| Income from operations   | 5,934                       | 4,367    |
| Other income (expense):  |                             |          |
| Interest income and other  | 8                           | 2        |
| Interest expense   | (1,643 )                    | (973 )   |
| Gain on change in fair value of derivative instruments               | (1 )                        | 98       |
| Income from continuing operations before income taxes                | 4,298                       | 3,494    |
| Income taxes   | 1,584                       | 1,208    |
| Income from continuing operations                                    | 2,714                       | 2,286    |
| Loss from discontinued operations, net of income taxes               | (14 )                       | (48 )    |
| Net income   | 2,700                       | 2,238    |
| Less: net income attributable to noncontrolling interests            | (53 )                       | (53 )    |
| Net income attributable to Rick's Cabaret International, Inc.        | \$ 2,647                    | \$ 2,185 |
| Basic earnings (loss) per share attributable to Rick's shareholders: |                             |          |
| Income from continuing operations                                    | \$ 0.28                     | \$ 0.23  |
| Loss from discontinued operations                                    | (0.00 )                     | (0.00 )  |

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|  |         |         |
|--|---------|---------|
| Net income   | \$ 0.28 | \$ 0.23 |
| Diluted earnings (loss) per share attributable to Rick's shareholders: |         |         |
| Income from continuing operations                                      | \$ 0.28 | \$ 0.23 |
| Loss from discontinued operations                                      | (0.00 ) | (0.00 ) |
| Net income   | \$ 0.28 | \$ 0.23 |
| Weighted average number of common shares outstanding:                  |         |         |
| Basic  | 9,575   | 9,685   |
| Diluted  | 9,833   | 9,687   |

See accompanying notes to consolidated financial statements.

**RICK'S CABARET INTERNATIONAL, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| (in thousands, except per share data)                    | Three Months<br>Ended<br>December 31,<br>2012    2011<br>(UNAUDITED) |         |
|--|--|---------|
| Net income to common stockholders                        | \$2,647  | \$2,185 |
| Other comprehensive income:                              |  |         |
| Unrealized holding gain on securities available for sale | 11   | 15      |
| Comprehensive income to common stockholders              | \$2,658  | \$2,200 |

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## RICK'S CABARET INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands, except per share data)

ENDED DECEMBER 31,  
2012            2011  
(UNAUDITED)

## CASH FLOWS FROM OPERATING ACTIVITIES:

|   |          |          |
|---|----------|----------|
| Net income  | \$ 2,700 | \$ 2,238 |
| Loss from discontinued operations   | 14       | 48       |
| Income from continuing operations   | 2,714    | 2,286    |
| Adjustments to reconcile net income to cash provided by operating activities: |          |          |
| Depreciation and amortization   | 1,320    | 1,120    |
| Deferred taxes  | (109 )   | 1,129    |
| Amortization of note discount   | 45       | 36       |
| (Gain) loss on change in fair value of derivative instruments                 | 1        | (98 )    |
| Deferred rents  | 10       | 12       |
| Stock compensation expense  | 282      | 8        |
| Changes in operating assets and liabilities:                                  |          |          |
| Accounts receivable   | 15       | 246      |
| Inventories   | (139 )   | (107 )   |
| Prepaid expenses and other assets   | (86 )    | (10 )    |
| Accounts payable and accrued liabilities                                      | 2,195    | 603      |
| Cash provided by operating activities of continuing operations                | 6,248    | 5,225    |
| Cash provided by (used in) operating activities of discontinued operations    | (24 )    | (10 )    |
| Net cash provided by operating activities                                     | 6,224    | 5,215    |

## CASH FLOWS FROM INVESTING ACTIVITIES:

|  |          |          |
|--|----------|----------|
| Additions to property and equipment                        | (2,438 ) | (1,177 ) |
| Proceeds from sale of marketable securities                | 500      | -        |
| Acquisition of businesses, net of cash acquired            | -        | (380 )   |
| Cash used in investing activities of continuing operations | (1,938 ) | (1,557 ) |

## CASH FLOWS FROM FINANCING ACTIVITIES:

|   |          |          |
|---|----------|----------|
| Purchase of put options and payments on derivative instrument | (74 )    | (554 )   |
| Payments on long-term debt                                    | (2,402 ) | (1,394 ) |
| Purchase of treasury stock                                    | (405 )   | (417 )   |
| Distribution to minority interests                            | (54 )    | (54 )    |
| Cash used in financing activities of continuing operations    | (2,935 ) | (2,419 ) |

## NET INCREASE IN CASH AND CASH EQUIVALENTS

|  |          |           |
|--|----------|-----------|
| NET INCREASE IN CASH AND CASH EQUIVALENTS        | 1,351    | 1,239     |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 5,520    | 9,698     |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD       | \$ 6,871 | \$ 10,937 |

## CASH PAID DURING PERIOD FOR:

|              |          |        |
|--------------|----------|--------|
| Interest     | \$ 1,565 | \$ 861 |
| Income taxes | \$ -     | \$ -   |

See accompanying notes to consolidated financial statements.

Non-cash transactions:

During the quarter ended December 31, 2012, the Company incurred \$9.3 million in debt in connection with the acquisition of real estate.

During the quarters ended December 31, 2012 and 2011, the Company recognized unrealized holding gains on marketable securities held for sale of approximately \$11,000 and \$15,000, respectively.

During the quarter ended December 31, 2012, the Company purchased and retired 50,733 common treasury shares. The cost of these shares was \$405,459.

During the quarter ended December 31, 2011, the Company purchased and retired 60,240 common treasury shares. The cost of these shares was \$417,063.

**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(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, 2012 included in the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission. The interim unaudited consolidated financial statements should be read in conjunction with those consolidated financial statements included in the Form 10-K. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting solely of normal recurring adjustments, have been made. Operating results for the three months ended December 31, 2012 are not necessarily indicative of the results that may be expected for the year ending September 30, 2013.

**2. RECENT ACCOUNTING STANDARDS AND PRONOUNCEMENTS**

In June 2011 new guidance was issued regarding the disclosure of the components of comprehensive income. This guidance gives the entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In either option, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for interim and annual periods beginning after December 15, 2011 and is required to be adopted retrospectively. The Company has adopted this guidance beginning with this Form 10-Q for the quarter ending December 31, 2012.

In July 2012 new guidance was issued regarding the impairment testing related to indefinite-lived intangible assets. This guidance permits an entity to make a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible

asset is less than its carrying amount, it will not be required to perform the quantitative impairment for that asset. This guidance is effective for interim and annual periods beginning after September 15, 2012. The Company has early-adopted this guidance beginning with the Form 10-K for the year ended September 30, 2012. The implementation of this guidance did not have a material impact on the Company's consolidated financial statements.

### **3. SIGNIFICANT ACCOUNTING POLICIES**

Following are certain significant accounting principles and disclosures.

#### Discontinued Operations

In March 2011, the Company made the decision to sell its Las Vegas location and, in April 2011, sharply reduced its operations in order to eliminate losses as it sought a buyer for the club. The Company believes that it has done everything possible to make this location viable since its acquisition in 2008 and now believes it is in its shareholders' best interests not to continue these efforts. The club was shuttered and the landlord took over the property in June 2011. Therefore, this club is recognized as a discontinued operation in the accompanying consolidated financial statements.

The Company has sold a controlling portion of the membership interest in the entity that previously operated its Rick's Cabaret in Austin, Texas. Accordingly, the Company has deconsolidated the subsidiary and carries it as an equity-method investment. The club is recognized as a discontinued operation in the accompanying consolidated financial statements.

The Company closed its Divas Latinas club in Houston during September 2010. This club is recognized in discontinued operations.

#### Fair Value Accounting

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





**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(UNAUDITED)**

**3. SIGNIFICANT ACCOUNTING POLICIES - continued**

SFAS No. 157 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.

The Company classifies its marketable securities as available-for-sale, which are reported at fair value. Unrealized holding gains and losses, net of the related income tax effect, if any, on available-for-sale securities are excluded from income and are reported as accumulated other comprehensive income in stockholders' equity. Realized gains and losses from securities classified as available for-sale are included in income. The Company measures the fair value of its marketable securities based on quoted prices for identical securities in active markets, or Level 1 inputs. As of December 31, 2012, available-for-sale securities consisted of the following:

| (in thousands)           | Cost   | Gross<br>Unrealized | Fair   |
|--------------------------|--------|---------------------|--------|
| Available for Sale       | Basis  | Gains               | Value  |
| Tax-Advantaged Bond Fund | \$ 500 | \$ 75               | \$ 575 |

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In accordance with ASC Topic 320, *Investments — Debt and Equity Securities*, the Company reviews its marketable securities to determine whether a decline in fair value of a security below the cost basis is other than temporary. Should the decline be considered other than temporary, the Company writes down the cost basis of the security and include the loss in current earnings as opposed to an unrealized holding loss. No losses for other than temporary impairments in the Company's marketable securities portfolio were recognized during the quarter ended December 31, 2012.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

| (in thousands)        | Carrying |         |         |         |
|-----------------------|----------|---------|---------|---------|
| December 31, 2012     | Amount   | Level 1 | Level 2 | Level 3 |
| Marketable securities | \$ 575   | \$ 575  | \$ -    | \$ -    |
| Derivative liability  | \$ 75    | \$ -    | \$ 75   | \$ -    |

| (in thousands)        | Carrying |          |         |         |
|-----------------------|----------|----------|---------|---------|
| September 30, 2012    | Amount   | Level 1  | Level 2 | Level 3 |
| Marketable securities | \$ 1,059 | \$ 1,059 | \$ -    | \$ -    |
| Derivative liability  | \$ 75    | \$ -     | \$ 75   | \$ -    |

**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(UNAUDITED)**

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

*Employee and Director Stock Option Plans*

In 1995, the Company adopted the 1995 Stock Option Plan (the "1995 Plan") for employees and directors. In August 1999, the Company adopted the 1999 Stock Option Plan (the "1999 Plan") and in 2010, the Company's Board of Directors approved the 2010 Stock Option Plan (the "2010 Plan") (collectively, "the Plans"). The 2010 Plan was approved by the shareholders of the Company at the 2011 Annual Meeting of Shareholders. The options granted under the Plans may be either incentive stock options, or non-qualified options. The Plans are 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 Plans.

The compensation costs recognized for the three months ended December 31, 2012 and 2011 were \$281,745 and \$8,254, respectively. There were no stock option grants or exercises for the three month periods ended December 31, 2012 and 2011.

**Stock Option Activity**

The following is a summary of all stock option transactions for the three months ended December 31, 2012:

| (in thousands, except for per share and year information) | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual | Aggregate Intrinsic Value |
|---|--------|---------------------------------|--|---------------------------|
|---|--------|---------------------------------|--|---------------------------|

|   |     |         | Term<br>(years) |       |
|---|-----|---------|-----------------|-------|
| Outstanding as of September 30, 2012        | 785 | \$ 8.36 |                 |       |
| Granted                                     | -   | -       |                 |       |
| Cancelled or expired                        | -   | -       |                 |       |
| Exercised                                   | -   | -       |                 |       |
| Outstanding as of December 31, 2012         | 785 | \$ 8.36 | 1.54            | \$ 27 |
| Options exercisable as of December 31, 2012 | 30  | \$ 7.15 | 0.67            | \$ 27 |

## 5. GOODWILL AND OTHER INTANGIBLES

Following are the changes in the carrying amounts of goodwill and licenses for the three months ended December 31, 2012 and 2011:

| (in thousands)       | 2012     |          | 2011     |          |
|----------------------|----------|----------|----------|----------|
|                      | Licenses | Goodwill | Licenses | Goodwill |
| Beginning balance    | \$50,608 | \$43,421 | \$42,092 | \$23,550 |
| Intangibles acquired | -        | -        | 380      | -        |
| Other                | -        | (431 )   | (3 )     |          |
| Ending balance       | \$50,608 | \$42,990 | \$42,469 | \$23,550 |

## 6. COMMON STOCK

During the quarter ended December 31, 2012, the Company purchased 50,733 shares of Company common stock for its treasury at an aggregate cost of \$405,459. These shares have been retired.

During the quarter ended December 31, 2011, the Company purchased 60,240 shares of Company common stock for its treasury at an aggregate cost of \$417,063. These shares have been retired.

**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****DECEMBER 31, 2012****(UNAUDITED)****7. EARNINGS PER SHARE (EPS)**

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

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

(in thousands, except per share data)

|   | FOR THE QUARTER ENDED<br>DECEMBER 31, |            |
|---|---------------------------------------|------------|
|   | 2012                                  | 2011       |
| Basic earnings per share:   |                                       |            |
| Income from continuing operations attributable to Rick's shareholders | \$ 2,661                              | \$ 2,233   |
| Loss from discontinued operations, net of income taxes                | (14 )                                 | (48 )      |
| Net income attributable to Rick's shareholders                        | \$ 2,647                              | \$ 2,185   |
| Average number of common shares outstanding                           | 9,575                                 | 9,685      |
| Basic earnings per share:   |                                       |            |
| Income from continuing operations attributable to Rick's shareholders | \$ 0.28                               | \$ 0.23    |
| Discontinued operations   | \$ (0.00 )                            | \$ (0.00 ) |
| Net income attributable to Rick's shareholders                        | \$ 0.28                               | \$ 0.23    |
| Diluted earnings per share:   |                                       |            |
| Income from continuing operations attributable to Rick's shareholders | \$ 2,661                              | \$ 2,233   |
| Adjustment. to net earnings from assumed conversion of debentures (2) | 65                                    | -          |
| Adjusted income from continuing operations                            | 2,726                                 | 2,233      |
| Discontinued operations   | (14 )                                 | (48 )      |

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|   |            |            |
|---|------------|------------|
| Adjusted net income attributable to Rick's shareholders                       | \$ 2,712   | \$ 2,185   |
| Average number of common shares outstanding:                                  |            |            |
| Common shares outstanding   | 9,575      | 9,685      |
| Potential dilutive shares resulting from exercise of warrants and options (1) | 4          | 2          |
| Potential dilutive shares resulting from conversion of debentures (2)         | 254        | -          |
| Total average number of common shares outstanding used for dilution           | 9,833      | 9,687      |
| Diluted earnings per share:   |            |            |
| Income from continuing operations attributable to Rick's shareholders         | \$ 0.28    | \$ 0.23    |
| Discontinued operations   | \$ (0.00 ) | \$ (0.00 ) |
| Net income attributable to Rick's shareholders                                | \$ 0.28    | \$ 0.23    |

(1) All outstanding warrants and options were considered for the EPS computation. Potential dilutive options and warrants of 864,081 for the three months ended December 31, 2012 have been excluded from earnings per share due to being anti-dilutive.

(2) Convertible debentures (principal and accrued interest) outstanding at December 31, 2012 and 2011 totaling \$2,598,771 and \$6,283,919, respectively, were convertible into common stock at a price of \$10.00 and \$10.25 per share in 2012 and 2011.

\*EPS may not foot due to rounding.

**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(UNAUDITED)**

**8. ACQUISITIONS**

**2012**

The Company's wholly owned subsidiary, RCI Dining Services (Tarrant County), Inc., a Texas Corporation ("RCI Tarrant County"), entered into an Agreement for Purchase and Sale of Membership Units with Fred McDonald ("Seller") for the purchase of 100% of the membership units of 12291 CBW, LLC ("12291 CBW"). 12291 CBW owned and operated an adult entertainment cabaret known as "The New West" located at 12291 Camp Bowie West, Aledo, Texas. The Agreement for Purchase and Sale of Membership Units closed October 5, 2011, whereby RCI Tarrant County acquired the membership units of 12291 CBW for the purchase price of \$380,000. The Company now operates the BYOB club as "Temptations". The Company also paid \$55,000 at closing for certain costs related to the access to the club. The entire \$380,000 has been allocated to license.

**2013**

In connection with the acquisition of the Foster Clubs, as explained in Note M in the Company's Form 10-K for the year ended September 30, 2012, the Company's wholly owned subsidiary, Jaguars Holdings, Inc. ("JHI"), entered into a Commercial Contract (the "Real Estate Agreement"), which agreement provided for JHI to purchase the real estate where the Foster Clubs are located. The transactions contemplated by the Real Estate Agreement closed on October 16, 2012. The purchase price of the real estate was \$10.1 million (discounted to \$9.6 million as explained below) and was paid with \$350,000 in cash, \$9.1 million in mortgage notes, including the assumption of approximately \$4.2 million in notes, and an agreement to make a one-time payment of \$650,000 in twelve years that bears no interest. The note bears interest at the rate of 9.5%, is payable in 143 equal monthly installments and is secured by the real estate properties. The Company has recorded a debt discount of \$431,252 related to the one-time payment of \$650,000. The Company reduced previously recognized goodwill.

The following information summarizes the allocation of fair values assigned to the assets at the purchase date.

|                    |          |
|--------------------|----------|
| Buildings and land | \$10,066 |
| Goodwill           | (431 )   |
| Net assets         | \$9,635  |

On December 6, 2012, the Company's wholly owned subsidiary, RCI Holdings, Inc. ("RCI Holdings"), entered into a Purchase and Sale Agreement (the "Real Estate Agreement") with Regent 39 Corp. ("Regent"). Regent owns the building located at 50 West 33<sup>rd</sup> Street, New York, New York where an adult cabaret owned by the Company's subsidiary, RCI Entertainment (New York), Inc. ("RCI New York"), is located. Regent currently leases the entire building to RCI New York under a lease agreement with a term that ends in 2023. The Real Estate Agreement provides for RCI Holdings to acquire the building from Regent for aggregate consideration of \$23,000,000. Pursuant to the agreement, RCI Holdings paid \$500,000 cash in escrow on December 6, 2012 (included in other assets in the accompanying Consolidated Balance Sheet) and will pay an additional \$250,000 cash in escrow by March 6, 2013. The Real Estate Agreement is scheduled to close by June 4, 2013, at which time the escrow funds will be released to Regent, and RCI Holdings will pay Regent the balance of the purchase price, under the terms and conditions of the Real Estate Agreement. Also at closing, Regent will assign to RCI Holdings the lease agreement under which RCI New York leases the building.

## 9. INCOME TAXES

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

| (in thousands)  | 2012    | 2011    |
|---|---------|---------|
| Computed expected tax expense   | \$1,461 | \$1,223 |
| State income taxes  | 36      | 35      |
| Stock option disqualifying dispositions and other permanent differences | 87      | (50 )   |
| Total income tax expense  | \$1,584 | \$1,208 |

Included in the Company's deferred tax liabilities at December 31, 2012 is approximately \$16.3 million 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.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. During the quarters ended December 31, 2012 and 2011, the Company recognized no interest and penalties for unrecognized tax benefits. The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states. The last three years remain open to tax examination.





**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(UNAUDITED)**

**10. COMMITMENTS AND CONTINGENCIES**

**Legal Matters**

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 the Company is 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 gave notice of its right to collect the tax pending the outcome of its appeal but took no affirmative action to enforce that right. 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 but on August 26, 2011, the Texas Supreme Court reversed the judgment of the Court of Appeals, ruling that the SOB Fee does not violate the First Amendment to the U.S. Constitution, and remanded the case to the District Court to determine whether the fee violates the Texas Constitution.

TEA appealed the Texas Supreme Court's decision to the U.S. Supreme Court (regarding the constitutionality of the fee under the First Amendment of the U.S. Constitution), but the U.S. Supreme Court denied the appeal on January 23, 2012. Subsequently, the case was remanded to the District Court for consideration of the remaining issues raised by TEA. On June 28, 2012, the District Court in Travis County held a hearing on TEA's Texas Constitutional claims and on July 9 entered an order finding that the tax was a constitutional Occupations Tax. The Court denied the remainder of TEA's constitutional claims. TEA is now in the process of appealing this new decision to the Texas Third Court of Appeals.

The Company has not made any payments of these taxes since the first quarter of 2009 and plans not to make any such payments while the case is pending in the courts. However, the Company will continue to accrue and expense the potential tax liability on its financial statements, so any ultimate negative ruling will not have any effect on its

consolidated income statement and will only affect the consolidated balance sheet. If the final decision of the courts is ultimately in the Company's favor, as it believes it will be, then the Company will record a one-time gain of the entire amount previously expensed.

Since the inception of the tax, the Company has paid more than \$2 million to the State of Texas under protest for all four quarters of 2008 and the first quarter of 2009, expensing it in the 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 all subsequent quarters, as a result of the Third Court's 2009 decision, the Company has accrued the tax, but not paid the State. Accordingly, as of December 31, 2012, the Company has approximately \$10.7 million in accrued liabilities for this tax. Patron tax expense amounted to approximately \$890,000 and \$712,000 for the quarters ended December 31, 2012 and 2011, respectively.

**RICK'S CABARET INTERNATIONAL, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2012**

**(UNAUDITED)**

**10. Commitments and Contingencies - continued**

The Company's Texas clubs have filed a separate lawsuit against the State in which the Company raises additional challenges to the statute imposing the fee or tax, demanding repayment of the taxes the Company has paid under this statute. The courts have not yet addressed these additional claims. If the Company is successful in the remaining litigation, the amount the Company has paid under protest should be repaid or applied to any future, constitutional admission tax or other Texas state tax liabilities.

The Company's subsidiary that operated the club in Las Vegas has recently been audited by the Department of Taxation of the State of Nevada for sales and other taxes. The audit period was from the date of opening in September 2008 through July 31, 2010. As a result of the audit, the Department of Taxation contends that the Company's Las Vegas subsidiary owes approximately \$2.1 million, including penalties and interest, for Las Vegas Live Entertainment Taxes. The Company does not believe it is subject to the Live Entertainment Tax and is protesting the audit results. Accordingly, the Company has not accrued the contingent liability in the accompanying consolidated financial statements. It is unknown at this time whether the resolution of this uncertainty will have a material effect on the Company's operations.

The Company has been a defendant in a federal court, pending since March 30, 2009, in the Southern District of New York relating to claims under the Fair Labor Standards Act and New York's wage and hour laws. Discovery is now complete. The Company denies any liability in this matter and is vigorously defending the allegations.

In September 2011, the Company's subsidiary, RCI Entertainment Las Vegas, Inc. ("RCI Las Vegas") and Rick's Cabaret International were sued by the lessor of its club in Las Vegas for breach of contract and other issues relating to RCI Las Vegas' lease. RCI Las Vegas has no assets and, therefore, is not able to pay the "deficiency", if any is ultimately found in a court of law. If the plaintiff should attempt to claim that the "deficiency" is a liability of the parent company, the Company believes it has the legal basis upon which to refute this claim as the parent company is not liable for the debts of its subsidiaries. Therefore, the Company does not believe that this contingency will ultimately result in a liability and, therefore, no accrual has been made in the accompanying consolidated financial statements.

## 11. SUBSEQUENT EVENTS

On January 24, 2013, the Company sold to an investor (i) a 10% Convertible Debenture with a principal amount of \$3,000,000 (the “Debenture”), under the terms and conditions set forth in the Debenture, and (ii) a warrant to purchase a total of 60,000 shares of the Company’s common stock (the “Warrant”), under the terms and conditions set forth in the Warrant. The Debenture has a term of two years, is convertible into shares of our common stock at a conversion price of \$10.00 per share (subject to adjustment), and has an annual interest rate of 10%, with one initial payment of interest only due July 24, 2013, and thereafter, the principal amount is payable in six equal quarterly principal payments of \$500,000 plus accrued and unpaid interest. Six months after the issue date of the Debenture, the Company has the right to redeem the Debenture if its common stock has a closing price of \$13.00 (subject to adjustment) for 20 consecutive trading days. The Warrant has an exercise price of \$10.00 per share (subject to adjustment) and expires on January 24, 2015. In the event there is an effective registration statement registering the shares of common stock underlying the Warrant, the Company has the right to require exercise of the Warrant if its common stock has a closing price of \$13.00 (subject to adjustment) for 20 consecutive trading days. The Company sold the Debenture and Warrant to the investor in a private transaction and received consideration of \$3,000,000. Brean Capital, LLC acted as exclusive placement agent for the transaction and received a placement fee of 6% of the gross proceeds raised.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion should be read in conjunction with our consolidated financial statements and related notes thereto included in this quarterly report and the audited consolidated financial statements and related notes included in our Form 10-K as of September 30, 2012.

**GENERAL**

Rick's Cabaret International, Inc. was incorporated in the State of Texas in 1994. Through our subsidiaries, as of December 31, 2012, we own and/or operate a total of thirty-four adult nightclubs that offer live adult entertainment, restaurant and bar operations. We also own a sexually oriented business license at one other location which will be opened in January 2013. The Company also has one non adult-oriented nightclub/restaurants opened in January 2013 and two more scheduled to be opened later in 2013. The Company has one reportable segment, nightclubs. Our website address is [www.Ricks.com](http://www.Ricks.com) . We also have an investors' website – [www.ricksinvestor.com](http://www.ricksinvestor.com) .

**SCHEDULE OF CLUBS**

| Name of Nightclub                    | Date<br>Acquired/Opened |
|--------------------------------------|-------------------------|
| Club Onyx, Houston, TX               | 1995                    |
| Rick's Cabaret, Minneapolis, MN      | 1998                    |
| XTC Cabaret, Austin, TX              | 1998                    |
| XTC Cabaret, San Antonio, TX         | 1998                    |
| Rick's Cabaret, Houston, TX          | 2000                    |
| XTC Cabaret North, Houston, TX       | 2004                    |
| Rick's Cabaret, New York City, NY    | 2005                    |
| Club Onyx, Charlotte, NC             | 2005                    |
| Rick's Cabaret, San Antonio, TX      | 2006                    |
| XTC Cabaret South, South Houston, TX | 2006                    |
| Rick's Cabaret, Fort Worth, TX       | 2007                    |
| Tootsie's Cabaret, Miami Gardens, FL | 2008                    |
| XTC Cabaret, Dallas, TX              | 2008                    |
| Club Onyx, Dallas, TX                | 2008                    |
| Club Onyx, Philadelphia, PA          | 2008                    |
| Rick's Cabaret, North Austin, TX     | 2009                    |
| Cabaret North, Fort Worth, TX        | 2009                    |
| Cabaret East, Fort Worth, TX         | 2010                    |
| XTC Cabaret, Fort Worth, TX          | 2010                    |

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|                                    |      |
|------------------------------------|------|
| Rick's Cabaret DFW, Fort Worth, TX | 2011 |
| Downtown Cabaret, Minneapolis, MN  | 2011 |
| Rick's Cabaret, Indianapolis, IN   | 2011 |
| Temptations, Aledo, TX             | 2011 |
| Silver City Cabaret, Dallas, TX    | 2012 |
| Jaguars Club, Odessa, TX           | 2012 |
| Jaguars Club, Phoenix, AZ          | 2012 |
| Jaguars Club, Lubbock, TX          | 2012 |
| Jaguars Club, Longview, TX         | 2012 |
| Jaguars Club, Tye, TX              | 2012 |
| Jaguars Club, Edinburg, TX         | 2012 |
| Jaguars Club, El Paso, TX          | 2012 |
| Jaguars Club, Harlingen, TX        | 2012 |
| Rick's Cabaret, Lubbock, TX        | 2012 |
| Jaguar's Club, Beaumont, TX        | 2012 |
| Rick's Cabaret, Odessa, TX (1)     | 2012 |
| Vee Lounge, Fort Worth, TX (2)     | 2013 |
| Bombshells, Dallas, TX (1)         | 2013 |
| Ricky Bobby, Fort Worth, TX (1)    | 2013 |

(1) To be opened in 2013.

(2) Opened in January 2013

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.

## **CRITICAL ACCOUNTING POLICIES**

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles of the United States of America ("GAAP"). GAAP consists of a set of standards issued by the FASB and other authoritative bodies in the form of FASB Statements, Interpretations, FASB Staff Positions, Emerging Issues Task Force consensuses and American Institute of Certified Public Accountants Statements of Position, among others. The Company has updated references to GAAP in this Form 10-Q to reflect the guidance in the ASC. The preparation of these consolidated financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates, including investment impairment. These estimates are based on management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

### 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. The Company's 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. The Company recognizes 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. The Company recognizes allowances for doubtful accounts or notes when, based on management judgment, circumstances indicate that accounts or notes receivable will not be collected.

### 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 29 to 40 years. Furniture, equipment and leasehold improvements have estimated useful lives between five and 40 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. Definite lived intangible assets are amortized on a straight-line basis over their estimated lives. Fully amortized assets are written-off against accumulated amortization.

### Impairment of Long-Lived Assets

The Company reviews 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. The Company’s annual evaluation was performed as of September 30, 2012, 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 net asset impairment at September 30, 2012.

### Fair Value of Financial Instruments

The Company calculates the fair value of its 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

The Company accounts 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, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock*. Under certain circumstances that would require the Company 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 the Company's 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, 2010 when the Company 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

The Company recognizes 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.

The Company recognizes 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. The Company recognizes 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 the Company's annual Expo convention are recognized upon the

completion of the convention in August.

### Sales and Liquor Taxes

The Company recognizes sales and liquor taxes paid as revenues and an equal expense in accordance with FASB ASC 605, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement*. Total sales and liquor taxes aggregated \$1.6 million and \$1.4 million for the three months ended December 31, 2012 and 2011, 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. Advertising and marketing expenses are expensed as incurred and are included in operating expenses in the accompanying consolidated statements of income.

### Income Taxes

Deferred income taxes are determined using the liability method in accordance with FASB ASC 740, *Accounting for 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, the Company issues 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 the Company at a fixed price per share. The Company 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 the Company. The Company has accounted for these shares in accordance with the guidance established by FASB ASC 480, *Distinguishing Liabilities From Equity*, as a reclassification of the value of the shares from permanent to temporary equity. As the shares become due, the Company transfers the value of the shares back to permanent equity, less any amount paid to the holder. Also see “Derivative Financial Instruments” above.

### Earnings (Loss) Per Common Share

The Company computes earnings (loss) 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 the earnings of the Company.

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 the Company’s outstanding common stock options, warrants and convertible debentures were converted into common stock that then shared in the Company’s earnings (loss) (as adjusted for interest expense, that would no longer occur if the debentures were converted).

### Stock Options

The Company has adopted the fair value recognition provisions of FASB ASC 718, *Compensation—Stock Compensation*.

The compensation cost recognized for the three months ended December 31, 2012 and 2011 was \$281,745 and \$8,254, respectively. There were no stock options exercises for the three months ended December 31, 2012 and 2011.

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2012 AS COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2011**

For the three months ended December 31, 2012, we had consolidated total revenues of \$27.1 million compared to consolidated total revenues of \$22.0 million for the three months ended December 31, 2011, an increase of \$5.1 million or 23.3%. The increase in total revenues was primarily attributable to sales at clubs purchased in 2011 and 2012 of approximately \$4.8 million.

Following is a comparison of our consolidated income statements for the quarters ended December 31, 2012 and 2011 with percentages compared to total revenue:

| (in thousands)  | 2012     | %      | 2011    | %      |
|---|----------|--------|---------|--------|
| Sales of alcoholic beverages                                  | \$10,406 | 38.3 % | \$8,916 | 40.5 % |
| Sales of food and merchandise                                 | 2,578    | 9.5 %  | 1,997   | 9.1 %  |
| Service Revenues  | 12,655   | 46.6 % | 9,886   | 44.9 % |
| Other   | 1,502    | 5.5 %  | 1,220   | 5.5 %  |
| Total Revenues  | 27,141   | 100.0% | 22,019  | 100.0% |
| Cost of Goods Sold  | 3,386    | 12.5 % | 2,932   | 13.3 % |
| Salaries & Wages  | 6,038    | 22.2 % | 4,925   | 22.4 % |
| Stock-based Compensation                                      | 282      | 1.0 %  | 8       | 0.0 %  |
| Taxes and permits   | 4,221    | 15.6 % | 3,447   | 15.7 % |
| Charge card fees  | 374      | 1.4 %  | 308     | 1.4 %  |
| Rent  | 570      | 2.1 %  | 703     | 3.2 %  |
| Legal & professional  | 641      | 2.4 %  | 700     | 3.2 %  |
| Advertising and marketing                                     | 1,109    | 4.1 %  | 995     | 4.5 %  |
| Depreciation and amortization                                 | 1,320    | 4.9 %  | 1,120   | 5.1 %  |
| Insurance   | 499      | 1.8 %  | 292     | 1.3 %  |
| Utilities   | 489      | 1.8 %  | 404     | 1.8 %  |
| Other   | 2,278    | 8.4 %  | 1,818   | 8.3 %  |
| Total operating expenses                                      | 21,207   | 78.1 % | 17,652  | 80.2 % |
| Income from continuing operations                             | 5,934    | 21.9 % | 4,367   | 19.8 % |
| Interest income   | 8        | 0.0 %  | 2       | 0.0 %  |
| Interest expense  | (1,643 ) | -6.1 % | (973 )  | -4.4 % |
| Gain (loss) on change in fair value of derivative instruments | (1 )     | 0.0 %  | 98      | 0.4 %  |
| Income from continuing operations before income taxes         | \$4,298  | 15.8 % | \$3,494 | 15.9 % |

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

Service revenues include cover charges, fees paid by entertainers, room rentals, memberships and fees charged for credit card processing. Other revenues include ATM commissions earned, video games and other vending and certain promotion fees charged to our entertainers. We recognize 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. The cost of goods sold for the club operations for the three months ended

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December 31, 2012 was 12.4% compared to 13.2% for the three months ended December 31, 2011. The cost of goods sold for same-location-same-period of club operations for the three months ended December 31, 2012 was 13.1%, compared to 13.3% for the same period ended December 31, 2011.

The increase in payroll and related costs, stated as "Salaries & Wages" above, was primarily due to the addition of the new clubs during 2012. Payroll for same-location-same-period of club operations increased to \$4.2 million for the three months ended December 31, 2012 from \$4.1 million for the same period ended December 31, 2011. Management currently believes that its labor and management staff levels are appropriate.

The decrease in rent expense is due to certain refunds of overpaid rent from a landlord in prior years.

The decrease in legal and professional expense is principally due to a continuing labor lawsuit in New York which was more active in 2011 and other more active lawsuits in 2011.

The increase in depreciation and amortization is due to the acquisitions of new clubs.

The increase in insurance expense is due to an increase from acquisitions and an increase in premium rates.

The increase in the percentage of other expenses is due to growth from new clubs.

The increase in interest expense was attributable to the new debt in 2012 from acquisition debt, net of the continuing amortization of our long-term debt.

Income taxes, as a percentage of income before taxes was 36.9% and 34.6% for the quarters ended December 31, 2012 and 2011, respectively. The increase is due to a change in permanent differences in 2012, principally the stock-based compensation.

Operating income (exclusive of corporate overhead) for same-location-same-period of club operations increased to \$6.1 million for the three months ended December 31, 2012 from \$5.4 million for same period ended December 31, 2011, or by 12.5%.

### **Non-GAAP Financial Measures**

In addition to our financial information presented in accordance with GAAP, management uses certain “non-GAAP financial measures” within the meaning of the SEC Regulation G, to clarify and enhance understanding of past performance and prospects for the future. Generally, a non-GAAP financial measure is a numerical measure of a company’s operating performance, financial position or cash flows that excludes or includes amounts that are included in or excluded from the most directly comparable measure calculated and presented in accordance with GAAP. We monitor non-GAAP financial measures because it describes the operating performance of the company and helps management and investors gauge our ability to generate cash flow, excluding some recurring charges that are included in the most directly comparable measures calculated and presented in accordance with GAAP. Relative to each of the non-GAAP financial measures, we further set forth our rationale as follows:

*Non-GAAP Operating Income and Non-GAAP Operating Margin.* We exclude from non-GAAP operating income and non-GAAP operating margin amortization of intangibles, gains and losses from asset sales, stock-based compensation charges, litigation and other one-time legal settlements and acquisition costs. We believe that excluding these items assists investors in evaluating period-over-period changes in our operating income and operating margin without the impact of items that are not a result of our day-to-day business and operations.

*Non-GAAP Net Income and Non-GAAP Net Income per Basic Share and per Diluted Share.* We exclude from non-GAAP net income and non-GAAP net income per diluted share and per basic share amortization of intangibles, income tax expense, impairment charges, gains and losses from asset sales, stock-based compensation, litigation and other one-time legal settlements and acquisition costs, and include the Non-GAAP provision for income taxes, because we believe that excluding such measures helps management and investors better understand our operating activities.

*Adjusted EBITDA .* We exclude from Adjusted EBITDA depreciation expense, amortization of intangibles, income tax, interest expense, interest income, gains and losses from asset sales, acquisition costs, litigation and other one-time legal settlements and impairment charges because we believe that adjusting for such items helps management and



investors better understand operating activities. Adjusted EBITDA provides a core operational performance measurement that compares results without the need to adjust for Federal, state and local taxes which have considerable variation between domestic jurisdictions. Also, we exclude interest cost in our calculation of adjusted EBITDA. The results are, therefore, without consideration of financing alternatives of capital employed. We use adjusted EBITDA as one guideline to assess our unleveraged performance return on our investments. Adjusted EBITDA is also the target benchmark for our acquisitions of nightclubs.

Our adjusted EBITDA does not include interest expense, litigation and other one time legal settlements, income taxes, depreciation, amortization and impairment charges. Because we have borrowed money in order to finance our operations, interest expense is a necessary element of our costs and our ability to generate revenues. Because we use capital assets, depreciation, amortization and impairment charges are also necessary elements of our costs. Also, the payment of income taxes is a necessary element of our operations. Therefore, any measures that exclude these elements have material limitations. To compensate for these limitations, we believe that it is appropriate to consider both net earnings (loss) determined under GAAP, as well as adjusted EBITDA, non-GAAP net income and non-GAAP operating income, to evaluate our performance. Also, we separately analyze any significant fluctuations in interest expense, depreciation, amortization, impairment charges and income taxes.

The following tables present our non-GAAP measures for the quarters ended December 31, 2012 and 2011 (in thousands, except per share amounts):

| (in thousands)  | 2012    | 2011    |
|---|---------|---------|
| Reconciliation of GAAP operating income to Adjusted EBITDA  |         |         |
| GAAP operating income   | \$5,934 | \$4,367 |
| Litigation and other one-time legal settlements   | -       | -       |
| Acquisition costs   | 55      | 40      |
| Depreciation and amortization   | 1,320   | 1,120   |
| Adjusted EBITDA   | \$7,309 | \$5,527 |
| Reconciliation of GAAP net income (loss) to non-GAAP net income                                     |         |         |
| GAAP net income (loss)  | \$2,647 | \$2,185 |
| Amortization of intangibles   | 131     | 120     |
| (Gain) loss on change in fair value of derivative instruments                                       | 1       | (98 )   |
| Stock-based compensation  | 282     | 8       |
| Income tax expense  | 1,584   | 1,208   |
| Acquisition costs   | 55      | 40      |
| Loss from discontinued operations, net of income taxes  | 14      | 48      |
| Non-GAAP provision for income taxes   | (1,631) | (1,229) |
| Non-GAAP net income   | \$3,083 | \$2,282 |
| Reconciliation of GAAP diluted net income (loss) per share to non-GAAP diluted net income per share |         |         |
| Fully diluted shares  | 9,833   | 9,687   |
| GAAP net income (loss)  | \$0.28  | \$0.23  |
| Amortization of intangibles   | 0.01    | 0.01    |
| (Gain) loss on change in fair value of derivative instruments                                       | 0.00    | (0.01 ) |
| Stock-based compensation  | 0.03    | 0.00    |
| Income tax expense  | 0.16    | 0.12    |
| Acquisition costs   | 0.01    | 0.00    |
| Loss from discontinued operations, net of income taxes  | 0.00    | 0.00    |
| Non-GAAP provision for income taxes   | (0.17 ) | (0.13 ) |
| Non-GAAP diluted net income per share   | \$0.32  | \$0.24  |
| Reconciliation of GAAP operating income to non-GAAP operating income                                |         |         |
| GAAP operating income   | \$5,934 | \$4,367 |
| Amortization of intangibles   | 131     | 120     |
| Stock-based compensation  | 282     | 8       |
| Acquisition costs   | 55      | 40      |

|                           |         |         |
|---------------------------|---------|---------|
| Non-GAAP operating income | \$6,402 | \$4,535 |
|---------------------------|---------|---------|

Reconciliation of GAAP operating margin to non-GAAP operating margin

|                             |      |   |      |   |
|-----------------------------|------|---|------|---|
| GAAP operating income       | 21.9 | % | 19.8 | % |
| Amortization of intangibles | 0.5  | % | 0.5  | % |
| Stock-based compensation    | 1.0  | % | 0.0  | % |
| Acquisition costs           | 0.2  | % | 0.2  | % |
| Non-GAAP operating margin   | 23.6 | % | 20.5 | % |

The accompanying consolidated financial statements reflect the following as discontinued operations as of and for the three months ended December 31, 2012 and 2011.

In March 2011, the Company made the decision to sell its Las Vegas location and, in April 2011, sharply reduced its operations in order to eliminate losses as it seeks a buyer for the property. The Company believes that it has done everything possible to make this location viable since its acquisition in 2008 and now believes it is in its shareholders' best interests not to continue these efforts. The club was shuttered and the landlord took over the property in June 2011. Therefore, this club is recognized as a discontinued operation in the accompanying consolidated financial statements.

The Company has sold a portion of the membership interest in the entity that previously operated its Rick's Cabaret in Austin, Texas. Accordingly, the Company has deconsolidated the subsidiary and carries it as an equity-method investment. The club is recognized as a discontinued operation in the accompanying consolidated financial statements.

We closed our Divas Latinas club in Houston during September 2010. This club is recognized in discontinued operations.

Following is summarized information regarding the discontinued operations:

| (in thousands)                                      | Quarter<br>Ended<br>December<br>31, |        |
|---|-------------------------------------|--------|
|   | 2012                                | 2011   |
| Loss from discontinued operations                   | \$(22)                              | \$(74) |
| Income tax - discontinued operations                | 8                                   | 26     |
| Total loss from discontinued operations, net of tax | \$(14)                              | \$(48) |

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

| (in thousands)           | December<br>31,<br>2012 | September<br>30,<br>2012 |
|--------------------------|-------------------------|--------------------------|
| Current assets           | \$ 31                   | \$ 30                    |
| Property and equipment   | 31                      | 40                       |
| Other assets             | 2                       | 2                        |
| Current liabilities      | (114 )                  | (130 )                   |
| Long-term liabilities    | (33 )                   | (33 )                    |
| Net assets (liabilities) | \$ (83 )                | \$ (91 )                 |

## LIQUIDITY AND CAPITAL RESOURCES

We believe our ability to generate cash from operating activities is one of our fundamental financial strengths. Refer to the heading "Cash Flows from Operating Activities" below. The near-term outlook for our business remains strong, and we expect to generate substantial cash flows from operations in 2013. As a result of our expected cash flows from operations, we have significant flexibility to meet our financial commitments. The Company has not recently raised capital through the issuance of equity securities. Instead, we use debt financing to lower our overall cost of capital and increase our return on shareowners' equity. Refer to the heading "Cash Flows from Financing Activities" below. We have a history of borrowing funds in private transactions and from sellers in acquisition transactions and continue to have the ability to borrow funds at reasonable interest rates in that manner. We have historically utilized these cash flows to invest in property and equipment and adult nightclubs. Refer to the heading "Cash Flows from Investing Activities" below.

As of December 31, 2012, excluding the patron tax liability, we had working capital of \$1.1 million compared to working capital of \$1.7 million as of September 30, 2012. The decrease is principally due to the real estate purchases

we made during 2012, utilizing \$3.8 million in cash and an increase in current debt. Because of the large volume of cash we handle, stringent cash controls have been implemented. At December 31, 2012, our cash and cash equivalents were \$6.9 million compared to \$5.5 million at September 30, 2012.

Our depreciation for the quarter ended December 31, 2012 was \$1.2 million compared to \$1.0 million for the quarter ended December 31, 2011. Our amortization for the quarter ended December 31, 2012 was \$131,000 compared to \$105,000 for the quarter ended December 31, 2011.

### *Sources and Use of Funds*

Cash flows from operating activities are generally the result of net income adjusted for depreciation and amortization expenses, deferred taxes, (increases) decreases in accounts receivable, inventories and prepaid expenses and increases (decreases) in accounts payable and accrued liabilities. See a summary of these activities below.

Cash flows used in investing activities generally reflect payments relating to acquisitions of businesses, property and equipment and marketable securities. See a summary of these activities below.

Cash flows from financing activities generally reflect proceeds from issuance of shares and long-term debt, and payments on debt and put options and purchase of treasury stock. See a summary of these activities below.

**Cash Flows from Operating Activities**

Following are our summarized cash flows from operating activities:

|  | Three Months<br>Ended<br>December 31, |         |
|--|---------------------------------------|---------|
|  | 2012                                  | 2011    |
| Income from continuing operations          | \$2,714                               | \$2,286 |
| Depreciation and amortization              | 1,320                                 | 1,120   |
| Deferred taxes                             | (109 )                                | 1,129   |
| Stock compensation expense                 | 282                                   | 8       |
| Change in operating assets and liabilities | 1,985                                 | 732     |
| Other                                      | 32                                    | (60 )   |
|  | \$6,224                               | \$5,215 |

**Cash Flows from Investing Activities**

Following are our summarized cash flows from investing activities:

|   | Three Months<br>Ended<br>December 31, |           |
|---|---------------------------------------|-----------|
|   | 2012                                  | 2011      |
| Sale of marketable securities                 | \$500                                 | \$-       |
| Additions to property and equipment           | (2,438)                               | (1,177)   |
| Additions of businesses, net of cash acquired | -                                     | (380 )    |
|   | \$(1,938)                             | \$(1,557) |

Following is a reconciliation of our additions to property and equipment for the quarters ended December 31, 2012 and 2011:

(in thousands)

Three Months  
ended  
December 31,

|  | 2012     | 2011    |
|--|----------|---------|
| Acquisition of real estate   | \$11,483 | \$-     |
| Capital expenditures funded by debt                                | (9,711)  | -       |
| New capital expenditure in new clubs                               | 290      | 711     |
| Maintenance capital expenditures                                   | 376      | 466     |
| Total capital expenditures in consolidated statement of cash flows | \$2,438  | \$1,177 |

### Cash Flows from Financing Activities

Following are our summarized cash flows from financing activities:

|  | Three Months<br>Ended<br>December 31, |           |
|--|---------------------------------------|-----------|
|  | 2012                                  | 2011      |
| Purchase of put options and payments on derivative | \$(74 )                               | \$(554 )  |
| Payments on long-term debt                         | (2,402)                               | (1,394)   |
| Purchase of treasury stock                         | (405 )                                | (417 )    |
| Distribution of minority interests                 | (54 )                                 | (54 )     |
|  | \$(2,935)                             | \$(2,419) |

The following table presents a summary of our cash flows from operating, investing, and financing activities:

|                                 | Three Months<br>Ended<br>December 31, |         |
|---------------------------------|---------------------------------------|---------|
|                                 | 2012                                  | 2011    |
| Operating activities            | \$6,224                               | \$5,215 |
| Investing activities            | (1,938)                               | (1,557) |
| Financing activities            | (2,935)                               | (2,419) |
| Net increase (decrease) in cash | \$1,351                               | \$1,239 |

### 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.

The maximum obligation that could be owed if our stock were valued at zero is \$204,500 at December 31, 2012. 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 or Derivative Liability and Stockholders' Equity and will have no income statement effect. The only income statement effect from these put options is the "mark to market" valuation quarterly of the derivative liability.

Each \$1.00 per share movement of our stock price has an aggregate effect of \$8,500 on the total obligation.

### Other Liquidity and Capital Resources

We have not established lines of credit or financing other than the notes payable explained in Note 8 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 million worth of our common stock. During the three months ended December 31, 2012, we purchased 50,733 shares of common stock in the open market at prices ranging from \$7.84 to \$8.26. During the three months ended December 31, 2011, we purchased 60,240 shares of common stock in the open market at prices ranging from \$6.32 to \$7.79.



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.

### **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.

### **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 market analysis, (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, (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, and/or (e) to acquire real estate in connection with club operations, although some clubs may be in leased premises.

During fiscal 2008, we acquired a media division for a total cost of \$1.1 million. This acquisition was funded primarily through issuance of our restricted common stock valued at \$369,754, and \$700,000 in cash. This media operation had total revenues of approximately \$1.2 million, \$1.4 million and \$1.4 million for fiscal years 2012, 2011 and 2010, respectively and net losses of approximately \$67,000, \$156,000 and \$242,000.

During fiscal 2008, we acquired five existing nightclub operations and 49% of an existing nightclub operation for a total cost of \$69.8 million, including real property of \$14.8 million. These acquisitions were funded primarily through indebtedness of \$21 million, including real property debt of \$8 million, issuance of our restricted common stock valued at \$13 million, \$701,711 in debt forgiveness, and \$35.4 million in cash. These nightclub operations (exclusive of the Las Vegas club closed in 2011 and the Austin club in which we sold 60% in 2011) had total revenues of approximately \$35.5 million, \$34.9 million and \$32.6 million for fiscal years 2012, 2011 and 2010, respectively, and pretax income of approximately \$11.8 million, \$11.0 million and \$9.4 million.

During fiscal 2009, we acquired one nightclub operation for cash of approximately \$2.4 million. The closing occurred on September 30, 2009. This acquisition was funded with cash of \$2.3 million. This nightclub operation had total revenues of approximately \$3.8 million, \$3.6 million and \$3.8 million in 2012, 2011 and 2010, respectively and net income (loss) before taxes of approximately \$ 505,000, \$266,000 and \$(26,000) for 2012, 2011 and 2010, respectively.

During fiscal 2010, we acquired three existing nightclub operations for a total cost of approximately \$9.2 million, including real property of approximately \$4.6 million. These acquisitions were funded primarily with cash of approximately \$5.9 million, real property debt of approximately \$2.5 million, and a seller's common stock which we owned, valued at approximately \$795,000. These nightclub operations had total revenues of approximately \$8.6 million, \$7.3 million and \$2.8 million and net income before taxes of approximately \$932,000, \$609,000 and \$176,000 for fiscal years 2012, 2011 and 2010, respectively.

During fiscal 2011, we acquired three existing nightclub operations and opened another for a total cost of approximately \$11.3 million, including real property of approximately \$6.4 million. These acquisitions were funded with cash. These nightclub operations had total revenues of approximately \$5.6 million for fiscal year 2012, and net income before taxes of approximately \$500,000.

During fiscal 2012, we acquired eleven existing nightclub operations and two other licensed locations under development for a total cost of approximately \$35.4 million, including real property of approximately \$7.6 million. These acquisitions were funded primarily with cash of approximately \$4.9 million, debt of \$22 million and real property debt of approximately \$9.0 million. These nightclub operations had total revenues of approximately \$4.3 million and net income before taxes of approximately \$620,000 for fiscal year 2012. These amounts do not include the acquisition of approximately \$10.1 million of real estate relating to the Jaguars acquisition which was closed on October 16, 2012.

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. The acquisition of additional clubs 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 3. Quantitative and Qualitative Disclosures About Market Risk.**

As of December 31, 2012, there were no material changes to the information provided in Item 7A of the Company's Annual Report on Form 10-K for fiscal year ended September 30, 2012.

#### **Item 4. Controls and Procedures.**

##### *Evaluation of Disclosure Controls and Procedures*

Under the supervision and with the participation of the Company's senior management, including the Company's chief executive officer and chief financial officer, the Company conducted an evaluation of the effectiveness of the design and operation of the Company's 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 the end of the period covered by this quarterly report (the "Evaluation Date"). Based on this evaluation, the Company's chief executive officer and chief financial officer concluded as of the Evaluation Date that the Company's disclosure controls and procedures were effective such that the information relating to the Company, including consolidated subsidiaries, required to be disclosed in the Company's Securities and Exchange Commission ("SEC") reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including the Company's chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

##### *Changes in Internal Control Over Financial Reporting*

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2012 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II—OTHER INFORMATION**

#### **Item 1. Legal Proceedings.**

See the "Legal Matters" section within Note 10 of Notes to Consolidated Financial Statements within this Quarterly Report on Form 10-Q for the requirements of this Item, which section is incorporated herein by reference.

#### **Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended September 30, 2012, as such factors could materially affect the Company's business, financial condition or future results. In the three months ended December 31, 2012, there were no material changes to the risk factors disclosed in the Company's 2012 Annual Report on Form 10-K. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company deems to be immaterial, also may have a material adverse impact on the Company's business, financial condition or results of operations.

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

During the three months ended December 31, 2012, we purchased 45,733 shares of common stock in the open market at prices ranging from \$7.84 to \$8.26 per share. During the three months ended December 31, 2012, we purchased 5,000 shares of common stock from put option holders at a price of \$8.23 per share. Following is a summary of our purchases by month:

| 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 |
| October 31, 2012  | 5,000                                       | \$ 8.23                      | -   | 1,073,827   |
| November 30, 2012 | 11,999                                      | \$ 7.94                      | 11,999  | 978,568   |
| December 31, 2012 | 33,734                                      | \$ 7.98                      | 33,734  | 709,518   |
| Total             | 50,733                                      | \$ 7.99                      | 45,733  | 709,518   |

**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.

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

101.INS

XBRL Instance Document.

101.SCH

XBRL Taxonomy Extension Schema Document.

101.CAL

XBRL Taxonomy Extension Calculation Linkbase Document.

101.DEF

XBRL Taxonomy Extension Definition Linkbase Document.

101.LAB

XBRL Taxonomy Extension Label Linkbase Document.

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document





**SIGNATURES**

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

**RICK'S CABARET  
INTERNATIONAL,  
INC.**

Date: February 11, 2013 By: /s/ Eric S. Langan  
Eric S. Langan  
Chief Executive  
Officer and President

Date: February 11, 2013 By: /s/ Phillip K. Marshall  
Phillip K. Marshall  
Chief Financial Officer  
and Principal Accounting  
Officer